REPUBLIC OF SOUTH AFRICA

IN THE COMPETITION APPEAL COURT OF SOUTH AFRICA

HELD IN CAPE TOWN

Reportable

CASE NO: 131/CAC/Jun14

In the matter between:-

SASOL CHEMICAL INDUSTRIES LIMITED Appellant

And

THE COMPETITION COMMISSION Respondent

JUDGMENT: 17 June 2015

DAVIS JP

Introduction

[1] This case concerns the meaning and the scope of s 8(a) of the Competition Act 89 of 1998 ('the Act') which provides that a dominant firm may not 'charge an excessive price to the detriment of consumers. Section 1 (1) defines an "excessive price" as a price for a good or service which (aa) bears no reasonable relation to the economic value of that good or service; and (bb) is higher than the value referred to in sub paragraph (aa).'

[2] While economists define excessive prices as those which are significantly and persistently above the competitive level, the translation of this seemingly simple statement into law and consequently the enforcement of s 8(a) of the Act in immensely complex. David Lewis (*Thieves at the Dinner Table* (2012) at 177 notes that excessive pricing in competition law is fraught with complexity and controversy:

> 'Pricing power derives from market power. However, the mere possession of market power is not contrary to competition law. Indeed some important source of market power is innovation and other, pro-competitive conduct. The rents derived from the possession of market power will, in most circumstances, sooner or later attract new entrants, the more so if the dominant incumbent takes 'excessive' advantage of its privileged position. And so the effort to acquire market and, therefore, pricing power and the attention it attracts from rivals are an important driver of the competitive process.'

A similar sentiment is articulated by O'Donoghue and Padilla The Law and Economics of Article 102 TFEU (2nd ed) at 737:

> 'The use of Article 102 TFEU to curb excessive prices has been criticised on several different levels. A first basic objection is that no generally accepted criterion exists in the decisional practice and case law to determine when price are "excessive." Further, even if a criterion, or series of criteria, could be agreed upon as a benchmark, determining an excessive price in practice is extremely complex and subject to a number of difficulties. A second criticism is that prices above marginal cost are common and necessary in many industries where high profits are necessary to

> recover large up-front capital and other fixed costs. Third, any policy on excessive prices is likely to yield incorrect predictions in many instances and the costs of such errors is likely to be higher than the costs of allowing certain excessive prices to escape censure. Fourth little or no guidance is offered in the decisional practise and case law on what might constitute objective justification for a price that exceeds the relevant criterion for determining an excessive price. Finally, devising effective remedies in excessive pricing cases raises difficult issues.'

This case compels this court to engage with all of this complexity and controversy which is inherent in the doctrine of excessive pricing.

The Factual Matrix

[3] The case involves an appeal by appellant against the decision of the Competition Tribunal ('Tribunal') that it contravened s 8 (a) of the Act by charging excessive prices for propylene and polypropylene (PP) from 2004 to 2007. The production of purified propylene is dependent on the production of purified feedstock propylene. Polypropylene is produced from purified propylene. Appellant is the only significant producer of purified propylene in South Africa.

[4] In August 2010 respondent ('the Commission') referred three complaints against appellant and Safripol (Pty) Ltd to the Tribunal submitting that both companies had contravened the Act. One of the complaints was a price fixing

complaint. This was settled in 2010. The two remaining complaints concern forms of excessive pricing which are the subject matter of this appeal.

[5] In essence, the Commission contends that appellant charged excessive prices for PP within the period 2004 to 2007. During this period appellant was dominant in the market for the supply of PP to domestic customers in South Africa, having a market share between 64% and 80% over the complaint period. According to the founding affidavit deposed to by Mr Lesofe on behalf of the Commission:

> ‘Up until 2008, appellant had the capacity to produce approximately 228 000 tonnes of PP per year. As from January 2008, Sasol’s capacity has expanded to approximately 528 000 tonnes per year.
>
> Safripol (Pty) Ltd has the capacity to produce approximately 120 000 tonnes of PP per year.
>
> Both appellant and Safripol sell PP in South Africa, primarily to plastic product manufacturers. However, appellant and Safripol together produce more polypropolene than is required by customers in South Africa. Domestic demand for PP has remained constant since 2004 at approximately 220 000 tonnes per year.
>
> Consequently, appellant (and to a lesser extent Safripol) export significant quantities of polypropylene both to other regions of Africa and to various destinations overseas. Sasol’s largest export markets are West Africa and China. Appellant’s export sales are made on a costs and freight (“CFR”), or costs, insurance and freight basis…

> According to the Commission appellant charges domestic customers of PP different prices for different grades, and offers customer various discounts, but derives all of its domestic prices for PP from an import parity price ("IPP") calculation it performs on a weekly basis. In other words, its prices to South African consumers of PP are IPP-based. The Commission contends that these prices are up to 32% higher than Sasol's export prices.'

[6] According to the Commission, the economic value of PP sold to domestic customers in South Africa was the price at which it concluded its export sales. This price is excessive because it bore no reasonable relation to the economic value of PP, being 32 % higher than export prices to China and 20% higher than Hong Kong CFR prices. The Commission contends that the difference was unreasonable and detrimental to downstream consumers.

[7] In addition, the Commission submitted that appellant charged excessive prices to Safripol for purified propylene during the period 2004 – 2007. Again it was contended that appellant was dominant in the market for the supply of propylene to domestic customers in South Africa, having a market share over the complaint period of more than 90% of the market. The Commission contends that the economic value of propylene can be derived by taking appellant's PP export prices, that is the price that the Commission considered to be the competitive PP price, and then deducting a standard margin. According to the Commission, this calculation showed that the price for propylene charged to Safripol was 55% above the economic value.

[8] The economic value of propylene could also be measured by predictions made by appellant in 2003 for the price of propylene. Appellant had predicted the price of purified propylene in determining the profitability of opening a new PP plant (which opened in 2008) and which was part of the so-called project Turbo. Appellant's actual purified propylene prices turned out to be 326% higher than the calculation used in determining the profitability of Project Turbo. Accordingly, appellant's prices bore no reasonable relation to the economic value and were detrimental to downstream consumers. I turn to deal in more detail with the relevant products.

Propylene

[9] Feedstock propylene is a by-product of liquid fuels produced in an oil refinery. It is a raw and impure propylene gas which has different potential alternative uses, two of which are relevant to the present dispute. The first is to return the feedstock propylene to the fuel pool where it is then used in the production of fuel. The second is to purify the propylene for use in the production of PP. The latter is a thermoplastic polymer which is a raw material used in the production of a wide range of plastic products. Appellant buys the propylene feedstock that it uses to produce purified propylene and PP from a fellow subsidiary, Sasol Synfuels (Pty) Limited (Synfuels) at a low price. Feedstock propylene is produced in many oil refineries that employ fuel upgrading processes and by Synfuels in its synthetic fuels production. In both cases, it is a by-product of petrol or fuels production. Its value is calculated from

its value in alternative uses which involves the costs of the conversion and the price of that product.

[10] Synfuels produces liquid fuels from coal. Feedstock propylene is a bi-product of this process. As a result of a unique process for the production of liquid fuels from coal, Synfuels suffers a disadvantage when compared to conventional oil refineries in the use of its feedstock propylene. Conventional oil refineries can employ feedstock propylene more productively and profitably than Synfuels in the production of fuel, given their different processes to achieve this end. Conventional oil refineries use an alkylation process whereas Synfuels uses a Cat-Poly process. The alkylation process makes more productive and profitable use of the feedstock propylene than the Cat-Poly process, with the result that feedstock propylene is less valuable in the production of fuels for Synfuels than it is for the conventional oil refineries.

[11] Mr McDougall, chief business analyst at the Sasol Group described the position as follows:

> ‘The important difference between Sasol Synfuels and the conventional refinery is the value of the feedstock propylene thus derived. This emerges from the difference in the petrochemical processes. This difference to a conventional refinery is due to the absence of isobutane in the synthetic fuel process, and the substantial volumes of propylene.
>
> In the case of Sasol Synfuels, the propylene feedstock stream does not become part of the petrol pool as an input into high-value component such as alkylate. Instead, it

becomes a part of the petrol pool as a result of being a core input into a Cat-Poly process. As noted above, this plant configuration was the outcome of economic choices taken at the time of the design of the synthetic fuels plant in the 1970's, in light of the petrol specifications applicable in South Africa at the time.

The value of using the propylene feedstock in the fuel-making process is determined by the net revenues obtained by doing so: this is the sales value of the petrol (at the Sasol Synfuels 'gate') less the not inconsiderable costs of the various stages set out in paragraph 5.9 above. Since the factory gate price of petrol and diesel are very similar on a volumetric basis and since the costs of processing the propylene into transport fuels and of hydrogenating the Cat-Poly product to reduce olefin levels are essentially the same for petrol as for diesel, the focus for present purposes will be on petrol. Since LPG is not derived from propylene, its value does not influence the costs associated with converting propylene to transport fuels.

This means that the floor price is the propylene in the propylene feedstock in the Sasol Synfuels' process is the price of petrol less the significant fuel-making costs (net of the costs of 'cleaning' the feedstock propylene stream). This is the heart of SP's 'special advantage': Sasol Synfuels has a fuel production process in terms of which the opportunity value to it of the propylene sold to SP is significantly less than petrol, compared to the conventional refinery in which the opportunity value of feedstock propylene produced is significantly more than petrol.

Put simply, SP is able to purchase propylene feedstock (in chemical sales) at a value which is significantly less than that which would be available from a conventional refinery. Also, because the parties are related, Sasol Synfuels does not seek a

> premium above FAV, which an independent party could and would do. In practical terms, SP's Monomers business pays Sasol Synfuels an amount for propylene each month, which reflects the fuel prices during the month in question less a contractually defined value for fuel-making costs, since these are the two elements of the FAV calculation set out above. Unlike the price of petrol, the fuel making element of the calculation does not vary on a month by month basis, since the elements are set by the initial contract and the escalation clauses defined.'

[12] In summary, as appellant pointed out, because feedstock propylene is a bi-product of the production of fuel it does not have its own costs of production. It is costed at an opportunity cost that equals to a value its owner can derive from it. The opportunity cost of feedstock propylene in the hands of an oil refinery is equal to its fuel alternative value ('FAV'); that is the value the refinery can derive from the feedstock by using it in the production of fuel. Because of the relative disadvantage of Synfuels production process, the FAV of its feedstock propylene is significantly lower than that of conventional oil refineries. Feedstock propylene in the hands of Synfuels is worth less than in the case of a conventional oil refinery because it cannot use its feedstock propylene as productively and profitably as can the conventional oil refinery.

[13] To minimise this disadvantage and to render the use of feedstock propylene more profitable, Sasol established a plant for the purification of feedstock propylene and for the production of PP. These facilities were housed in appellant during the relevant period. Synfuels supplied feedstock propylene to SCI and the latter produced purified propylene in its so called Monomers Division which sold it to it both

to its Polymers Division and Safripol. Both appellant, Polymers and Safripol used the purified propylene to manufacture PP which was then sold to buyers both domestically and overseas.

[14] In short, Synfuels sold its feedstock propylene to appellant at its own low FAV. It was calculated to be extremely low for the reasons already set out above.

[15] The Commission contended, notwithstanding its low costs and the abundance of supply, over demand, that appellant's domestic prices for polypropylene were relatively high by international standards. The returns made were described by the Commission as "extraordinary". According to the Commission appellant's nett domestic price of propylene in the complaint period was at least 12 – 18 % higher than the domestic prices in Europe. Over the complaint period it enjoyed an average return on capital of approximately 162% per year and accordingly appellant recovered the full capital invested in the business "8 times over".

[16] Over the complaint period the Commission contended that, on the basis of an integrated price, the propylene and PP businesses considered together, generated an average return of 62.8% per year. Thus appellant recovered the full capital investment in these businesses 3 times over.

[17] Accordingly, the Commission contended that, when appellant's feedstock cost advantage is compared to the Western Europe refinery grade propylene costs, the differences in domestic prices of PP (excluding appellant's special rebates) between

appellant and Western Europe producers was between 41 to 47% over the complaint period. In the Commission's view, the reason for this difference was simple: appellant did not pass on any of its costs advantage to customers, notwithstanding that its supply exceeds demand in South Africa. The Commission contended that the appellant prices its PP with reference to the costs of importing PP, which is the customer's next best alternative. In its view, these are the highest prices a monopolist could charge in a domestic market and substantially higher than the prices at which appellant sells the same PP which it exports. In short, the domestic price of PP was on average 23% higher than its deep sea export prices.

[18] This summary of the dispute provides the background for an analysis of the Tribunal's decision.

The Tribunal's decision

[19] The decision of the Tribunal, unfortunately, has proved extremely difficult to understand. Accordingly, I shall confine myself to the core findings and eschew an attempt to parse its reasoning. After examining the history of State support for Sasol, the Tribunal concluded that appellant's special feedstock costs advantage had to be taken into account at some stage in the enquiry as to the application of s 8 (a) of the Act. In its view, 'there is no justification for the elimination of the low costs of feedstock propylene from the evaluation'. Rejecting the evidence of Dr Jorge Padilla on behalf of appellant, the Commission contended that it was not legally justified to exclude appellant's special costs advantage from the enquiry.

[20] This conclusion led the Tribunal to an analysis, in terms of s 8 (a) of the Act, of establishing the price under scrutiny, comparing it to the actual costs of appellant and then deciding if these costs reflected economic value.

[21] Correctly, it noted that the major differences between the approach taken by the Commission and appellant's experts related to:

1. The treatment of feedstock propylene costs,
2. the valuation of SCI's capital assets;
3. the level of capital reward/return on capital;
4. the allocation of group costs; and
5. the allocation of fixed costs between domestic and export sales.

[22] The Tribunal observed that the difference in the experts' approaches to feedstock was clearly the most significant dispute between the parties. Central to the resolution of the case was how the costs of feedstock propylene ought to be valued. It was agreed that the feedstock propylene price should be scrutinised to determine whether the price to be applied in the analysis reflected an arm's length price, being a normal price under conditions of competition, given that the price of feedstock propylene between Synfuels and appellant was between related firms. The Tribunal found as follows:

> ‘The appropriate test in s 8(a) analysis is the price charged relative to the economic value of the good or service in question. As highlighted in *Mittal*, the actual costs of the dominant firm are important evidence of economic value provided that they reflect normal costs in long run competitive conditions. It is thus necessary to consider whether SCI’s actual costs properly reflect economic value, i.e. whether the price actually paid by SCI for feedstock propylene reflects the price that would have been paid under competitive market conditions.
>
> To determine the above we have specifically had regard to and placed weight on what Sasol’s own internal and public documents say about the price charged by Synfuels to SCI for feedstock propylene.
>
> The evidence has shown that over the complaint period and most of the relevant cycle the price for feedstock propylene was determine under formulae in supply agreements that were expressly stated to reflect the FAV of the feedstock propylene to Synfuels. This pricing principle is the principle that would apply to sales to all customers under competitive conditions because it is costs-reflective.’

[23] By way of an examination of Sasol own internal documents and communications, the Tribunal thus concluded that there was substantial evidence that Synfuels had recognised that the FAV was the market price of feedstock propylene over a sustained period.

[24] Turning to the measurement of appellant’s capital asset base, the Tribunal noted that the valuation of appellant’s capital assets were relevant to the

determination of two items of cost; that is the costs of depreciation, being the annual costs of the capital assets used in the business determined by spreading the total costs of the assets over the use for life and the return to investors, being the return to investors for their investment in the relevant firm.

[25] The Commission had argued that the appropriate asset base was the depreciated historical assets values of appellant's capital assets. By contrast appellant's expert, Mr Harman made an adjustment from historical costs to replacement costs to account for the impact of inflation over time and contended that this was the preferable approach. An adjustment from historical costs to replacement cost reduced the mark ups for purified propylene by approximately 2.8% (tier 1 prices) and 3.2% (tier 2 prices) and reduced the mark up for PP by approximately 8-11 %. The Tribunal accepted that the replacement costs was an appropriate proxy for economic costs in an inflationary environment. It therefore employed Mr Harman's calculation, save that it rejected arguments for an additional reduction in the price-cost mark ups by using insurance values as an appropriate and reliable value of replacement costs.

[26] There was also a considerable dispute concerning the appropriate return on capital. Here the Tribunal was confronted with two questions: the appropriate risk premium above the risk free rate and whether this becnhmark is a pre-tax or after tax measure.

[27] It appears from the Tribunal's determination that it accepted Mr Harman's calculation, that the determination of a normal return on capital must be based on the computation of the weighted average cost of the capital (WACC) of appellant rather than Professor Wainer who contended, on behalf of the Commission, that the normal return on equity is a risk free rate plus an equity risk premium of roughly 4-7% or Dr Roberts's equity premium of 3-5%. However, it rejected Mr Harman's proposed use of an inception WACC and the further addition of a hurdle rate. It accepted Mr Harman's approach that after tax return was the appropriate calculation.

[28] Mr Harman's proposed adjustment to group costs to Dr Roberts' price costs mark ups had the effect of reducing the mark ups of propylene by 5.1% (tier 1) and 5.6% (tier 2). In particular, Mr Harman canvassed three cost items, being corporate development costs, Sasol's management fee costs and insurance costs. By contrast, the Commission contended that the corporate development costs were not necessarily incurred for the benefit of the purified propylene business. After analysing the evidence, the Tribunal came to the view that it was not necessary to make any adjustments to the price cost mark ups for group costs.

[29] Finally, the Tribunal turned to the question of the allocation of fixed costs between domestic and export sales. The Commission's experts had allocated common costs of the domestic and export businesses in proportion to the volumes of each business, there assuming that the fixed costs were incurred equally across these products. This approach was accepted by the Tribunal which held that the volume based approach was the most appropriate.

[30] On this basis, the Tribunal found that the mark ups of purified propylene prices over actual costs during the complaint period were in the range of between 39.9% to 41.5% for tier 2 sales to Safripol and in the range of 25.1% and 26.5% for tier 1 sales for Safripol.

[31] The Tribunal then turned to other measures used in the assessment of the economic value of purified propylene; in particular, the prices charged by the dominant firm for the same product in other markets, including export markets and prices charged by other firms in other geographical markets. The Tribunal adopted the view that an enquiry based upon export prices for purified propylene was less reliable than the price-costs test in order to determine the economic value for purified propylene. To the argument that recourse could be had to purified propylene prices charged by other firms in other geographical markets, the Tribunal concluded that there were no good comparator in other geographical markets in relation to purified propylene for the period under review.

[32] Turning to polypropylene during the complaint period, the Tribunal concluded that appellant's domestic prices were 41% to 47% higher for respectively homopolymer and raffia grade compared to the Western European discounted prices computed on the basis of feedstock costs comparable to appellant. Comparing the average export netback price for deep sea exports to appellant's local prices, the Tribunal concluded that the local prices for PP over the relevant cycle were, on average, 23% higher than average deep sea export prices.

[33] Applying these findings to the wording of s 8(a), the Tribunal rejected the evidence of Dr Padilla that long run competitive equilibrium meant conditions of free entry and free exit from notional competitors in the relevant market in which the firm under scrutiny is dominant. In the Tribunal's view this assumption was fundamentally flawed because; 'it disregards the fact that the very basis of the complaint is that in that market there is never going to be more than one firm and therefore never going to be effective competition. Markets in which excessive pricing is likely to occur are precisely those markets where there never will be entry and exit by new entrants.'

[34] In summary, the Tribunal rejected the argument that appellant should be treated as if it had never received State support and therefore that its 'special advantage" should not be taken into account. Accordingly, it held that, when regard was had to the price-cost test for PP, there was no reasonable relationship between the price charged by appellant to the local plastic convertors for PP during the complaint period and the economic value of the product. Similarly, after examining the price-cost test results for purified propylene, the nature of the product, its importance as an intermediate input in industrial development, the market characteristics and other circumstances read within the prism of the objects of the Act, both the tier 1 and 2 prices charged to Safripol during the period bore no reasonable relation to the economic value of purified propylene.

[35] It followed that, if a lowered purified propylene price was charged to Safripol, the latter would be able to lower its PP price and offer cheaper PP to the plastic convertors, expand its PP productive capacity, offer more products to convertors and

provide more technical service and product development support and assistance to customers.

[36] In the view of the Tribunal, consumer detriment had been demonstrated in relation to appellant's pricing for purified propylene. Similarly, the Tribunal cited evidence from consumers of plastic products to the effect that the high price of PP acted to their disadvantage, particularly in that local convertors must compete with imports of finished plastic products.

[37] Given the nature of the contravention, the Tribunal ordered appellant to pay administrative penalties of R 205.2 m and R 328.8 m for the two contraventions of s 8 (a) of the Act; that is in relation to purified propylene and PP respectively which were sold during the complaint period.

Appellant's case

[38] Mr Trengove who appeared together with Mr Wilson, Mr Gotz, Mr Burger and Mr Marriott, on behalf of appellant, sought to attack the foundation of the Tribunal's reasoning and thus the Commission's case that the propylene and PP prices were excessive because appellant had failed to pass its unique feedstock cost advantage on to its customers. Mr Trengove's core argument was that the Tribunal's reasoning was incompatible with this Court's judgment in *Mittal, supra*. His argument ran thus: In *Mittal,* this court sought to engage with the question as to how it can be objectively

determined whether a particular price 'has no reasonable relation to the economic value of the products supplied' and may hence be regarded as excessive. In doing so, the Court examined the decision in *United Brands Company v Commission* [1978] ECR 207 and, particularly, the finding of the European Court of Justice that a mere comparison of prices at which the seller actually sold the relevant product to different buyers in the same market was an insufficient basis to conclude that the higher price was "excessive", even where the price was 50% higher than the lower price. (paras 261 - 268 of *United Brands*)

[39] Pursuant to this, the Court in *Mittal* said the following at para 40:

> 'What the legislature must be taken to have intended by 'economic value' is the notional price of the good or service under assumed conditions of long-run competitive equilibrium. This requires the assumption that, in the long run, firms could enter the industry in the event of a higher than normal rate of return on capital, or could leave the industry to avoid a lower than normal rate of return. It does not imply perfect competition in the short-run, but rather competition that would be effective enough in the long run to eliminate what economies refer to as 'pure profit' – that is a reward of any factor of production in excess of the long-run competitive norm which is relevant to that industry of production.'

[40] Mr Trengove noted that, at para 43 of the *Mittal* judgment, the Court held that economic value 'is a notional objective competitive, market standard, and not one derived from circumstances peculiar to the particular firm. Thus where the firm's prices are no higher than economic value, no contravention of s 8(a) can arise.

[41] If the firm's prices are higher than economic value so determined, the test of reasonableness in respect of the difference remains to be applied. Significantly for Mr Trengove's argument the court held as follows at para 43:

> 'The test of reasonableness applies to the excess of price over economic value, and thus only to the element of 'pure profit' (over and above 'normal profit') implicit in that price. It is at this stage of the enquiry that circumstances peculiar to the particular dominant firm would rationally come into the reckoning. It would seem sound, when considering whether the higher price bears a reasonable relation to economic value or not, to take into account the benefits flowing to the firm the subsidised loan, long-term low rental, or other special advantage which may serve to reduce its own long-run average costs below the notional norm.'

[42] In seeking to tease out the implications of the Mittal case, Mr Trengove referred to the evidence of appellant's expert, Dr Padilla. In his testimony, Dr Padilla referred to paragraph 40 of *Mittal* and noted that this passage did not equate economic value to costs and certainly not to the costs of a dominant firm. For Dr Padilla, the challenge was to determine normal profit in terms of a level that would be consistent with the long run competitive norm. Dr Padilla noted that competition eliminates rents that are not firm specific:

> 'Firm specific cost advantages are not transferred to consumers by the competitive process. Firm specific rents associated to firm specific advantages are compatible with the long run competitive norm. The CAC's definition of economic value makes perfect sense as a matter of economics …

. And it makes sense because free entry … because it talks about free entry and free exit. And by talking about free entry, the court is telling us this price that we regard as the economic value is a price that serves the interest of consumers. Interest of consumers are protected, because if the dominant company tries to raise prices, entry will discipline that firm, it will bring prices to a level that is optimal for consumers.

But at the same time the court is imposing the free exist condition and he's telling us, but we are not crazy. We don't want to go to the point of extracting all costs advantages so that firms are losing money. The free exit condition tells us we can transfer rents to consumers, but there is a limit. And the limit is that it will go beyond a certain level then these firms will exit the market.'

[43] Turning to the question of how long term competitive equilibrium is to be calculated, Dr Padilla contrasted the approach of the Commission to that of appellant:

'The Commission's approach relies on two assumptions. The first assumption is that the entrants are clones of Sasol. The free entry process and free exit process in the Commission's case is what I term later a world of clones. The second assumption is that entry and exit doesn't happen in South Africa. It happens in a market that is many, many, many times larger than South Africa. I will explain later that it has to be a market of galactic proportions. And then, you know, it makes sense, the clone wars in a galactic market.

My approach is completely different, I'm focussing on entrants that are efficient, but that they're efficient, having access to the technology that is available in the market, not the technology that Sasol has, which is unique, which is peculiar, but this time

> peculiar, not in the sense of unusual, but in the sense of the Oxford dictionary that it belongs to and comes from the Latin term, peculiars, private property. It is the private property, that's why it is peculiar. My entrants don't have that peculiar technology. My entrants have the technology that is available in the market, their standard refineries.'

[44] On the basis of this evidence, Mr Trengove submitted that the notional competitive market price is based on the costs of the notional competitor. Accordingly, in an excessive pricing case, the actual costs of a dominant firm may constitute useful evidence of the costs of the notional competitor, but the actual costs of a dominant firm are not the benchmark. The benchmark remains the costs of the notional competitor. The dominant firm's actual costs may only be used if, and to the extent, that these costs reflect those of a notional competitor. On this basis, Mr Trengove argued that appellant's peculiarly low feedstock costs had to be disregarded in the determination of economic value of propylene and PP which, ultimately, stood to be based on the costs of feedstock propylene in a competitive market.

[45] Mr Trengove contrasted this approach to the evidence of Dr Roberts, on behalf of the Commission, particularly the latter's approach to the decision in Mittal in general and to paragraph 43 thereof in particular. Under cross examination, he put it to Dr Roberts that a long term competitive norm is the benchmark by which costs are to be determined. Costs that did not conform to this standard, that is costs which are special to a particular firm are to be disregarded. By contrast, Dr Roberts suggested

that, in a hypothetical enquiry test for the long term competitive result, notional competitors had to be postulated as having the same cost structure as the dominant firm. The following exchange is illustrative:

> 'ADV TRENGOVE: You say that the notional competitor, one should postulate, should have the same costs as the dominant firm?
>
> DR ROBERTS: Apart from if they are peculiar.
>
> ADV TRENGOVE: Well what renders a costs peculiar if you simply replicate it and attribute it to every competitor in the notional market?
>
> DR ROBERTS: Well I think there are a number of things that one, which are not necessarily affected in the decision, but whether it's due to risk taking or innovation. This what patents protect. So if you are engaged in peculiar things that were particular to the firm in terms of risks that is made, then those will clearly be things that one would take into account as being peculiar to that firm, which would be different from just being located close to or having the abundant feedstock, I mean locate in a place which allows access to that feedstock.
>
> ADV TRENGOVE: So you understand the costs that ought to be disregarded, not merely as all of the costs that are peculiar to the firm, you only exclude certain categories of peculiarity?
>
> DR ROBERTS: It's a definition of peculiarity, which distinguishes between, I believe, the costs of SCI in terms of the feedstock costs, abundant low costs feedstock and other things that could be peculiar.'

[46] Mr Trengove placed emphasis on Dr Roberts' acknowledgement that economic value must be determined not only on the basis of firm specific costs but

also by taking account of the firm specific history of the firm under investigation. According to Mr Trengove, Dr Roberts pursued a conclusion that would yield a specific economic value contrary to the holding in *Mittal*:

> 'DR ROBERTS: I said things that … sorry, maybe we can dominate to say, the things that would be regarded as peculiar would be things such as particular innovation, risk taking, behaviour. Things which are … and again this potentially a disagreement with the CAC, because they talk about subsidised loans or lower market rentals, so I find it difficult to understand the context in where that comes from. But I'm suggesting that if there particular innovation or risk taking by the firm, then this would be something that they would have a return on.
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> ADV TRENGOVE: But those … the court's language there was quite clear. It was language sued in the context of Arcelor Mittal, which had a history of state support.
>
> DR ROBERTS: Well to be very blunt, this is why I find it unusual, because subsidised loans didn't come into that case. What came into that case was lower costs iron ore and they make no mention of that here. So I agree with you, it's … you would expect it to be in relation to the case, but it actually doesn't mention the main thing that was peculiar in the sense or special to Arcelor Mittal, which was the 25 years of costs based iron ore.
>
> ADV TRENGOVE: It spoke of cost saving to the firm resulting from a subsidised loan or lower than market rental, or indeed any other special advantage. That doesn't mean only advantages, deserving advantages as you suggest, it means any advantage, current or historical?
>
> DR ROBERTS: On that interpretation, then I disagree with the CAC decision. So if you were to ask me I agree with all of it, then on that interpretation I definitely disagree with the CAC decision.'

[47] In Mr Trengove's view by following the approach of Dr Roberts, the Tribunal had, in effect, repudiated the fundamentals of the *Mittal* holding. In this connection he referred to paragraph 95 of the Tribunal's determination:

> 'The Court (in *Mittal*) did not disregard this specific example of costs advantages. The context however was a particular approach of determining in the first instance on a notional level what competitor's costs would be in a notional competitive market. The Court was concerned with a far broader and holistic approach. Furthermore, we must have regard to all relevant factors because ultimately one is trying to determine whether in a particular case the price charged in a particular environment and in particular circumstances was excessive.'

From this, the Tribunal came to the following key conclusion:

> 'Where the dominant firm's position in a particular market is not the result of any innovation or risk-taking on its part but rather due to current or past exclusive or special rights, one therefore would want to have regard to those facts. Thus, part of the s 8(a) enquiry should be an explanation for why the dominant firm is able to charge a price above the economic value of the good or service in question – in particular, if this ability is the result of its own efforts (for example, risk taking or innovation), so that the high prices should be regarded as an appropriate reward for the firm's competitive efforts, or if it is simply the result of the firm taking advantage of its entrenched dominance, in which case its actions, to the extent that they harm consumers/customers, may be an abuse as contemplated in s 8(a).'

[48] In Mr Trengove's view, this finding meant that economic value is no longer to be regarded an objective market standard applied across the board to all dominant firms. It is a subjective standard in the sense that it is based on a subjective value judgment of the specific firm in the sense that it is predicated on the peculiar history and costs of a single firm and applies only thereto.

[49] It was on this basis that the Tribunal rejected Dr Padilla's approach in that it held if 'one excludes SCI's special costs advantage from the first stage of enquiry, regardless of its origin, one will never take that advantage into account'. In other words, on Dr Padilla's interpretation one must engage in a notional exercise and, if the result of that produces no difference between the notional economic value and the actual price, then the enquiry stops. This leads to an artificial result and is a misreading of the *Mittal* judgment when applied in its broader context.

[50] Mr Trengove vigorously attacked this finding, contending that it represented a flagrant violation of the doctrine of precedent, in that it was so obviously a misreading of the *Mittal* judgment. In his view, the Court's interpretation of s 8(a) in *Mittal* gives effect to its purpose; that is it made the benchmark against which the dominant firm's price stands to be judged the notional price that would have prevailed in a competitive market. It posits competition and then asks how the dominant firm's price compares with the price that would have prevailed in a competitive market. It compensates for the lack of competition in the market by assessing the dominant firm's price against the price that would have prevailed in a competitive market. In Mr Trengove's view, the purpose of s 8(a) and therefore the prohibition of excessive pricing does not seek

to achieve anything more than to compensate for the lack of competition in the market. On the basis of what he referred to as the vague subjective and firm specific rule adopted by the Tribunal, it would be impossible for any dominant firm to determine where a permissible price ends and an impermissible price begins.

[51] The importance of the debate about feedstock was highlighted by Mr Trengove's submission that, even if the Court accepted all the Tribunal's findings and figures, save to adjust appellant's feedstock cost to a competitive market value, the premium of appellant's prices over economic value declined to 7.2% for propylene and 0.8% for PP. There would then be little left of the case against appellant as these prices would manifestly be reasonable in relation to economic value.

Respondent's case

[52] Mr Wesley, who appeared with Ms Lekoane on behalf of the Commission, (the heads on behalf of respondent having been prepared by Mr Subel, Mr Wesley and Mr Lekoane) contended that the only sensible approach to the determination and the consequence of a long term competitive equilibrium was to consider the notional competitive market as one where pure profit has been competed away and where price reflects costs. If the notional competitive standard was considered to be one where pure profit was competed away, what was left to be considered was a market, where there existed competition between efficient firms which were identical to the dominant firm. Given the scale of the economy in propylene and PP, this would imply that a long run competitive equilibrium had to be considered in a somewhat larger market that the South African market.

[53] Mr Wesley also submitted that to consider outcomes under a notional long run competitive equilibrium in order to derive economic value requires an assumption that the rival firms have the same or lower costs of feedstock as appellant because Synfuels had abundant feedstock propylene, and, absent exerting its monopoly power, should supply the notional competitors at its FAV. The feedstock is not "special" to appellant, apart from appellant not being subjected to the full exertion of monopoly power by Synfuels which should not fall within the meaning of a "a special cost advantage".

[54] Mr Wesley submitted that the only cost advantages which should be taken into account in favour of a dominant firm in an excessive pricing enquiry are those that are the product of risk and innovation by the firm. It is only where there has been such risk or innovation that a firm might be entitled to charge high prices as a consequent reward. But a large difference between the price of actual costs might still not be reasonable. In his view, the effect of appellant's case in general and the evidence of Dr Padilla in particular was that there would be a profound distortion of the approach to an abuse by way of excessive pricing. Dr Padilla assumed that any firm's lower costs was a product of efficiency of the firm. He did not consider that a cost advantage might not be the product of a firm's own efforts but simply the result of previous state largesse, precisely the situation when an abuse by way of excessive pricing might well occur.

The differences regarding the dispute with regard to the interpretation of *Mittal*

[55] To return to the facts: It appears that Synfuels sold propylene feedstock to appellant under three sets of agreements. In 1994 there was an agreement for a stream of propylene known as the condensate 3 stream. In 1999 another agreement was concluded for additional feedstock known as the condensate 2 stream and in 2003 a 1 tier agreement was reached which governed the supply of all feedstock by Synfuels to appellant.

[56] The actual price that appellant paid during the entire complaint period was the price set out in terms of this latter agreement. As noted earlier, the Tribunal used appellant's actual costs of feedstock propylene, that is the price in terms of the 2003 agreement in its price – cost tests for both propylene and PP. It did so on the basis that 'under conditions of competition, Synfuels would sell its feedstock to all customers in the South African market at its uniquely low FAV because it is cost reflective.'

[57] Mr Trengove submitted that a firm with a unique cost advantage would have no incentive to reduce its price down to its own costs as it could effectively compete at its competitor's costs or capture the entire market at a price only marginally lower. The appellant's unique costs advantage meant that its costs were lower than those of its competitors and it would not have to compete down to its own cost. It could reduce its price just below its competitor costs but no further. Accordingly, the Tribunal's findings that 'under conditions of competition FAV is the price which Synfuels would sell its feedstock to all customers in the South African market because it is cost - reflective', would hold true only in circumstances where all firms are able to supply

feedstock propylene to appellant at Synfuels' FAV. This could only happen if the upstream market for the supply of feedstock propylene was populated by a multitude of clones of Synfuels and would all share its uniquely low FAV. By contrast, appellant argued that in a hypothetical market populated by Synfuels and notional typical suppliers of feedstock (that is conventional refineries) the price would tend towards the marginal refinery's alkylation FAV. By contrast, Synfuels was the only supplier of propylene feedstock, had no competition, and buyers would thus compete the price up to their breakeven level.

[58] For all these reasons, Mr Trengove submitted that the Tribunal had failed to appreciate that the FAV concerned was the alkylation value of the feedstock. The opportunity costs of ordinary refineries served as a floor price for feedstock propylene. But, if Synfuels was to behave rationally, it would only need to price at a level just below the opportunity costs of the ordinary producer to capture the entire market. In turn, this meant that any conclusion that appellant's actual feedstock costs reflected a competitive market price was wrong.

[59] Mr Trengove also referred to documentary evidence which had been made available to the Tribunal, in particular the three agreements to which I have made reference. They reflected that Synfuels had, from time to time, negotiated for the sale of feedstock to third parties. In all of these negotiations, it had consistently demanded more than its FAV and was never prepared to sell to third parties at a price equal to its own FAV. Thus, in the 1994 agreement, which was part of a basket of agreements between Sasol and AECI which established the Polyfin JV, Synfuels undertook to

supply feedstock to Polyfin for which Sasol would receive FAV together with a share of the joint venture. In Project Mango, Synfuels demanded its 1994 feedstock price plus $45 to correct for errors in the 1994 agreement and a premium of $60. In Project 2003, Synfuels offered to supply feedstock to the JV but at a premium above its FAV of 50% of the difference between its price and the next lowest price.

[60] According to Mr Trengove, by rejecting this evidence, the Tribunal had failed to appreciate that the significance of this evidence lay in the fact that it supported the economic theory upon which appellant had based its case. Synfuels might surrender its unique feedstock costs advantage to its fellow subsidiary, being appellant, but it did not have an incentive to do so in relation to third parties. This conclusion reflected how a producer with a unique feedstock costs advantage would act in a competitive market.

[61] In summary, appellant's case was that its actual feedstock costs were not those which have been incurred by a notional producer in a competitive market. It enjoyed a special cost advantage which meant that its costs had to be adjusted upwards in accordance with the principles of the decision in *Mittal*. Mr Trengove noted that the Commission, which bore the onus of proof, had never established the nature of this adjustment and had made no attempt to do so, save to attack the appellant's recourse to the refinery floor price.

[62] Mr Trengove submitted that the erroneous treatment of appellant's feedstock cost advantage not only inflated the margin above "economic value" but also

contaminated other features of its decision. In particular, it was only by using appellants very low cost of feedstock propylene in its calculations of economic value that the Tribunal was able to obtain its results for its price-cost test for propylene. It was only by artificially decreasing appellant's price for propylene as an input cost that it had obtained the results it did for PP and its price-cost test. Further, the Tribunal justified its dismissal of the relevance of the propylene price comparators in other geographical markets solely on the basis that the foreign producers did not enjoy appellant's feedstock costs advantage. Only by artificially decreasing PP prices in Western Europe to account for this cost advantage, could the Tribunal have concluded that appellant's PP prices was substantially above the foreign prices.

[63] By contrast, Mr Wesley submitted that the feedstock prices contained in the supply agreements were actually higher than Synfuels' actual FAV. The prices under both the 1999 and 2003 agreements did not reflect the FAV because they did not correctly measure the price of fuel that otherwise would have been made from the feedstock nor the costs to make and supply fuel from feedstock propylene.

[64] The Commission disagreed with the Tribunal's finding where it had not accepted the Commission's downward adjustment to take account of FAV in its profit cost analysis.

[65] In summary, the Commission contended that the prices under the 2003 agreement were some 9% higher than Synfuels' actual FAV during the complaint period. For this reason, the Commission submitted that any analysis of economic

value based on SCI's costs should include a downward adjustment to those costs to reflect actual FAV.

[66] The Commission contended further that the price for feedstock propylene in the 1994 agreement, which also purports to be at Synfuels's FAV, is 15% lower than the price under the 2003 agreement over the period FY02-FY08. Initially in his witness statement Mr MacDougall attributed this difference to missing depreciation costs. To make an allowance for this in its initial calculations the Commission, added an amount of R 100 per ton (inflated yearly) to the 1994 prices when performing its analyses of economic value based on actual FAV during the complaint period (the "1994 + R100" estimates).

[67] During his evidence, Mr MacDougall indicated that the difference between the 1994 prices and the 2003 prices were that various costs were included or included in the different agreements, or measured differently. In the view of the Commission it was notable that, he made no mention of the depreciation costs that he had relied in his witness statement, as explaining the difference.

[68] Using Mr MacDougall's new evidence, as well as evidence emerging from documents discovered by appellant, the Commission claimed to have performed a direct analysis of whether the 2003 prices reflected actual FAV, having regard to the different costs and measurements of costs used in calculating those prices.

[69] The Commission contended that this analysis supported its initial conclusion that the prices charged by Synfuels under the 2003 agreement did not reflect actual FAV. In fact, on the Commission's revised analyses, actual FAV was below the "1994 + R 100" estimate it had initially used.

[70] This Court does not need to engage in this particular debate unless it is satisfied that the price-cost analysis based on the FAV is in itself not justifiable in terms of s 8 (a) of the Act. It is to this question that I must now turn.

The proper application of s 8(a)

[71] As Mr Wesley correctly noted there are two fundamental debates between the parties in this appeal in relation to the application of s 8 (a), read together with definition of excessive price as defined in s 1(1) (ix) of the Act. The first relates to the proper interpretation of the phrase 'economic value' and the second to the manner in which the reasonableness of the relation being price and economic value is to be assessed.

[72] I deal first with the question of the resolution of the debate with regard to economic value.

[73] Under cross examination, it was put to Dr Roberts that the Commission must succeed in the feedstock debate in order to win its case. Although he equivocated

(as unfortunately was the case under much of his cross examination), Dr Roberts did concede that the basic question of the feedstock cost was 'by far and away the biggest' dispute between the parties.

[74] Mr Trengove asked Dr Roberts if he calculated the costs of propylene, made his comparisons and then arrived at the conclusion that the propylene price was excessive in that it exceeded the economic value at a margin of between 36 to 71 %. This set of figures had emerged from the supplementary economic expert report filed by Dr Roberts in which the following appeared:

> 'Adjusting the costs to reflect the FAV based on Sasol Synfuels' actual opportunity cost and applying bond +3% return, I find that prices charged to Safripol for purified propylene (Tiers 1 and 2) are on average 36% and 53% (Sasol calculated FAV, condensate 3 contract + R 100), 45% and 64% (discount OOC fuel sales) and 52% and 71% (coastal sales) higher than total cost of production, for FY2002 to FY2008.'

[75] Dr Roberts conceded that this 'excess' depended 'vitally on the feedstock debate.' The following exchange clarified this issue:

> 'ADV TRENGOVE: It is only when one takes account of the feedstock advantage, in other words, postulates the low costs as the cost on which the economic value has to be determined that it jumps from 10% to 33%.
>
> DR ROBERTS: That's correct.
>
> ADV TRENGOVE: And then the range from 33 to 59 is a range which depends on the particular alternative value one attributes to the feedstock.

DR ROBERTS: Agreed.'

With regard to PP the following exchange is instructive:

'ADV TRENGOVE: This is an outcome reached by again doing the calculation of cost from the ground up. Correct? You call it an integrated approach.

DR ROBERTS: Yes, that's right, ja.

ADV TRENGOVE: You don't assume you don't make any assumption about the costs of propylene as an input cost.

DR ROBERTS: No.

ADV TRENGOVE: This is again a calculation right from feedstock cost through to price.

DR ROBERTS: Yes.

ADV TRENGOVE: And substantially it is the same excess, which you say exist in the propylene price, which is being replicated in the polypropylene price.

DR ROBERTS: I agree entirely, ja.

ADV TRENGOVE: And again vitally dependent on the feedstock assumption.

DR ROBERTS: Agreed.'

[76] Dr Roberts then developed his explanation by pointing out that the excessive pricing assessment which was conducted by the Commission was the excessive pricing by a dominant firm; that is appellant and not Synfuels. Accordingly, what was required was to examine the dominant firm's costs in terms of the competitive norm 'so, this would be where the firm is efficient or inefficient, for example, in terms of its average costs. So, you got to look at well are the cost of the firm, do they correspond to the

competitive norm? We are talking about the costs of its production processes and you got an exercise there that you have to do and that is where we believe he has an onus to say that SCI is efficient.'

[77] By contrast, Dr Padilla based his report on two readings of the *Mittal* judgment. In the first instance, his results were based upon that which he referred to as the Mittal 1 test that the notion of economic value was the notional price of a good or service under assumed conditions of long term competitive equilibrium. This equilibrium arises when there is free entry and free exit. In the present case, the Mittal 1 test would relate to a situation where the seller of feedstock propylene had low opportunity costs and bargaining power and the buyers of feedstock propylene did not have any bargaining power because of the fact that they were in a long term competitive equilibrium. According to Dr Padilla, under the Mittal 1 test, the relevant market price for feedstock propylene would be one in which downstream propylene producers would just breakeven in economic terms. It assumed that Synfuels was in a position of bargaining power because it was the only supplier of feedstock propylene in South Africa, possessed of the advantage of the Fischer-Tropsch process; that is the process by which oil is produced from coal.

[78] Central to the debate about a price cost test, was the so called Mittal 2 reading. The Mittal 2 test envisaged that economic value be assessed using the dominant firm's economic costs of production. But on Dr Padilla's reading, the Court in *Mittal* made it clear that the dominant firm's own costs will only provide a measure of economic value if they correspond to the economic norm. Accordingly, he argued

that adjustments to the dominant firm's costs may need to be made to arrive at an estimate of its costs, and thus economic value, in the notional competitive norm.

[79] In adopting a price-cost comparison approach, Dr Padilla testified that price-cost margins should be adjusted for firm specific costs to avoid penalising efficiency.

[80] Central to the debate then between Dr Roberts and Dr Padilla, as interrogated through the cross examination, of Dr Roberts was Dr Padilla's postulate that the determination of the cost of feedstock would be equivalent to the FAV of the conventional South African refineries.

[81] In support of its contention that its actual feed cost were not that which would have been incurred by a notional producer in a competitive market and that it had a special cost advantage, appellant sought to adjust its cost calculation in accordance with its reading of the Mittal case by reference to a quantification of the South African refinery floor price.

[82] This calculation was provided by Dr Koster who sought to calculate the 'so-called refinery floor price' which was not designed to allow the refinery any margin over the propylene – in – alkylate valuation or additional costs associated with operating a depropaniser which the oil refiner will need to install to separate refinery grade propylene from the fluidize catalytic cracking gas stream. According to Dr Koster:

> ‘The annual difference between the refinery grade propylene prices and the propylene-in-alkylate value was calculated for each of the years between 1998 and 2007. The low points from this calculation were then averaged, with the assumption being that the low points represent market clearing conditions, with no margin over costs. This average was found to be US$45/ton. This value was taken to be the minimum mark-up a refinery operator is prepared to accept to divert propylene away from the alkylation unit.’

[83] Dr Koster compared the transfer price that appellant paid to Synfuels for the feedstock propylene to the refinery floor prices calculated the found that over the period of July 1997 to December 2008 the propylene – in – alkylate value exceeded the transfer price by 24.5%. On this approach, appellant’s business enjoyed a price advantage of 24.5% held at the marginal and arguably the next ton of propylene that would be produced in South Africa.

Evaluation

[84] The key question thus arises: is it permissible to ignore appellant’s lower costs, which it enjoys as a result of its relationship with Synfuels which produces an excess of propylene as a result of its specific technology and construct a price which increases the costs of appellant based on a postulate of a competitive economy in which the cost of feedstock would be significantly higher than is the case where there is of the alleged special advantage enjoyed by appellant.

[85] In summary Dr Padilla contends as follows: Synfuels produces large quantities of propylene feedstock and has low opportunity costs measured by the FAV. Appellant benefits from the low costs feedstock due to its vertical integration with Synfuels and Synfuels' unique technology. Dr Padilla contends that Synfuels, like any other commercial enterprise, would not transfer all of the benefit of its low costs in an unrelated chemical business. Hence, the market price of propylene feedstock would not therefore be equal to FAV. This is demonstrated by what is referred to as Project Mango.

[86] Briefly the background to this project was that in 1996 Polifin Limited and Dow, which was then rated as one of the world's leading polymer companies, began discussions on establishing a new PPJV, a project known as Project Mango. The envisaged co-operation aimed at expanding PP production at Secunda by a further 200 000 tons per year over and above 80 000 per year expansion envisaged in what was referred to as a PP phase 2 expansion project. Of relevance to the present analysis is that the Mango JV would have required additional feedstock propylene. Polifin therefore approached Sasol for feedstock supply. As Sasol was planning to use its feedstock propylene in an alternative chemicals project (oxo-alcohol), it offered a feedstock propylene price to Polifin which was set so that Sasol would be no worse off with Project Mango than with the so-called oxo alcohol project.

[87] This first offer was at US $ 376 per ton Polifin convinced Sasol that a contract with Polifin would be less risky while the oxo-alcohol project would carry some risk.

This price was decreased to $ 330 per ton but at this price Project Mango was considered not to be viable.

[88] According to various Polyfin board minutes, it appears that Synfuels position was that the price would at least have to be the Condensate 3 price plus US $ 45 per ton, plus US $ 60 per ton opportunity value determined for the proposed oxo– alcohol project.

[89] Dr Padilla considered that this constituted evidence that the market price for propylene feedstock would not be equal to the FAV of Synfuels. Taking the present case where there was only one seller of propylene feedstock with lower opportunity costs, being Synfuels, and that there was a long run competitive equilibrium assumed at both propylene and PP levels, Dr Padilla contended that the correct approach was to adjust actual costs upwards. His preferred approach was to adjust the propylene feedstock propylene price to the South African refinery floor price.

[90] This calculation stood in sharp contrast to the Commission's approach that the transfer price should be adjusted downward to what it took to be Synfuels' opportunity costs for supplying propylene feedstock to appellant. In his first report, Dr Roberts had contended that the feedstock costs were equivalent to that which was contained in the 1994 feedstock agreement which formed part of a basket of agreements by which Sasol AECI established their Polyfin JV. In terms of these agreements Synfuels undertook to supply feedstock to Polifin under this feedstock agreement for which Sasol received FAV, together with a share of the JV. This approach was then

altered and Dr Roberts argued that these costs was lower than those obtained from applying the 1994 agreement because, during the complaint period, Sasol Oil had discounted all exported fuels at lower prices.

[91] Dr Padilla attacked this approach on the basis that it was inconsistent with long run competitive equilibrium. As he stated: 'the only way in which competition between Synfuels and the hypothetical companies could bring the price of feedstock to the costs, the fuel alternative value for Synfuels, is if you pass a free entry, free exit model for the clones in the market that is far bigger than the South African market.' He further contended that to base the entire costing on the 1994 agreement would be to ignore the context of the negotiations between the parties which culminated in the agreement and, in particular, the allocation of shares in Polifin between Sasol and AECI. He further contended that the Commission was asking this court to accept that the 1994 agreement could be projected forwards to 2004 to 2007 without any adjustment.

[92] The comparison between the Commission's approach as advocated by Dr Roberts and the approach of the appellant as set out by Dr Padilla was that Dr Padilla adopts as the costs of the feedstock propylene an amount of R 5465 per ton. Appellant's actual costs, that is the price it paid to Synfuels for the feedstock was in the amount of R 4453 per ton. By contrast, the Commission invoked three prices, the FAV based on the 1994 agreement, of R 4076 per ton, the FAV based on OOC discounts of R 3881 per ton and the FAV based on coastal sales of R 3701 per ton.

[93] Given that the Tribunal did not accept all of Dr Roberts' testimony, it is best to focus the evaluation on its finding which was based, it said, 'under conditions of competition, FAV is the price at which Synfuels would sell its feedstock to all customers in the South African market because it is cost reflective'. On this basis, it used appellant's actual costs of feedstock propylene, that is the price set out in terms of the 2003 1 Tier agreement in its price cost test which it applied for both for propylene and indeed for PP.

[94] There is certainly evidence elicited under cross examination by Dr Roberts that supports this approach. The importance of this evidence necessitates reproduction of the full exchange:

> 'ADV TRENGOVE: Now, the floor of these producers, firstly, if one were to take the other refineries, not SCI, they would, their floor, their minimum price of each of them would be its fuel alternative value.
>
> DR ROBERTS: I agree, ja.
>
> ADV TRENGOVE: None of them would reduce their price below their fuel alternative value.
>
> DR ROBERTS: No, their real fuel alternative, yes.
>
> ADV TRENGOVE: Indeed, but whether they compete down to that level or not depends on whether they … it depends on their output and the dynamic in the market. If they can dispose of their output without lowering their price to the floor, they will do so.
>
> DR ROBERTS: Yes that follows.

ADV TRENGOVE: Synfuels will compete in that same market and it will also lower its price as far as may be necessary to dispose of its output, as all the others would. Correct?

DR ROBERTS: If it is selling as effectively a monopoly, yes it wouldn't…

ADV TRENGOVE: Well, it's not a monopolist. It's a competitor for as long as the … it has competition for as long as the floor, for as long as the price is above the floor of the SA refineries. Correct?

DR ROBERTS: It just says input. This would be, as long as there is excess capacity in terms of the other refineries, but if they are capacity constrained, then actually they are irrelevant.

ADV TRENGOVE: But for as long as the price is above the SA refineries price, it would compete and it would be in competition with the other refineries.

DR ROBERTS: No, no, if the other refineries, and this is where capacity, they comes back in, if the other refineries have hot very minimal capacities, they could choose to sell their refinery floor prices and Synfuels could charge much higher prices. I mean, Synfuels is a monopolist.

ADV TRENGOVE: Well, capacity constraints will allow anybody to charge any price, if the capacity is sufficiently constrained, but it allows, assume for the moment, sufficient capacity.

DR ROBERTS: So, all the other refineries have got excess capacity, then they would set the price, ja. They would be the ceiling to Synfuels market power.

ADV TRENGOVE: Synfuels would also reduce its price sufficiently to dispose of its output, but there is one difference and that is…

DR ROBERTS: Well, that's not true. I mean, that's not true. If it is exerting market power, it will only reduce its price according to the demand of the buyers, not dispose of all its output, absolutely not…

ADV TRENGOVE: What I'm saying is it will reduce its price only insofar as may be necessary to dispose of all its output.

DR ROBERTS: No, if it is necessary to dispose of all its output, then it is different. If it is saying here are the refineries, they've got a price and we are competing down to that price, they are not going to keep on pushing the price down until they've disposed of its output. Then they would have to go and provide prices that allow the buyers to increase their sales to meet… so that the buyers, because Synfuels essentially has got to derive demand. It derives demand from the buyers.

If it is going to dispose of all of its output, then it is going to have to reduce its price below the other refineries in order to allow to its buyers to increase their supply, their production and meet other markets. So, it would reduce its price presumably as a monopoly, just until it hits the ceiling that's provided by the refineries.

ADV TRENGOVE: Yes, the point is as soon as that price reaches what we've called the SA refinery floor price, do you understand what I mean by that term?

DR ROBERTS: Yes.

ADV TRENGOVE: As soon as the price, the descending price hits that level, then below that level SCI is the only seller.

DR ROBERTS: Ja.

ADV TRENGOVE: Which would mean that it would have no incentive to compete, to lower its price down to its own floor.

DR ROBERTS: We are in agreement on that. I mean, it wouldn't necessarily sell all of its output, but I that's … I think we agree.'

[95] By contrast, the Commission insisted that FAV must determine the cost of feedstock propylene. In support, it referred to the evidence of Dr Koster, on behalf of

appellant, which was to the effect that US prices were below FAV (being alkylation values) in 2006 and at FAV in 2008. This set of figures accorded in the Commission's view of the way in which the market works; that is in a competitive market prices are competed down towards cost. If the market for the supply of the input becomes competitive (with many firms with similar cost structures), the market price of the input will fall towards cost because the sellers have no bargaining power.

[96] In support of these arguments the Commission referred to Sasol's own contemporaneous internal documents which reflected that FAV was a market price including the 1995 transfer pricing policy and the 2001 transfer pricing policy. These prices were reflected in Sasol's annual financial statements which were representations intended to be true and reliable made inter alia to shareholders investing public to JSE and the SEC in the United States.

[97] Mr Wesley submitted that, in defining the economic value of feedstock propylene at appellant's breakeven price, which is the highest price that Synfuels could charge, by definition this would lead to the conclusion that appellant's prices were not excessive because they were not higher than its costs. This would move the excessive pricing upstream while preventing scrutiny of the upstream producer, being Synfuels, because it is not actually charging that feedstock price in that the price being employed would be a constructive price.

[98] It is now possible to return to the relevant jurisprudence. In the *Mittal, supra* case this Court sought to give content to the definition of excessive price as contained

in s 1 (1) (ix); that is a price for a good or service which (aa) bears no reasonable relation to the economic value of that good or service; and (bb) is higher than the value referred to in subparagraph (aa). As noted in the introduction to this judgment, this definition needs to be read together with s 8 (a) which provides that it is prohibited for a dominant firm to charge an excessive price to the detriment of consumers.

[99] The analysis with which this judgment has been concerned has turned on the question of an excessive price, as that term has been interpreted. The interpretation seized upon by the Tribunal in much of its determination was informed by a reading of but a few paragraphs of the *Mittal*, judgment. In dealing with this question at para 43 this Court said:

> 'Thus economic value is a notional objective competitive market standard, not one derived from circumstances peculiar to the particular firm. If the firms prices are no higher than economic value, no contravention of s 8 (a) can arise. If however, the firm's price is in fact higher than economic value so determined, the test of reasonableness in respect of the difference remains to be applied… the test of reasonableness applies to the excess of price over economic value and thus only to the element of 'pure profit' (over and above normal profit) implicit in that price.'

The court went on to say: 'The criterion of economic value … recognises only the costs that would be recovered in long run competitive equilibrium.' It also said in para 42 that at the stage of reasonableness, account could be taken of benefits flowing to the firm ‘from the subsidised loan, long term low rental or other special advantage which may serve to reduce its own long run average cost below the notional norm.’

[100] Unfortunately, both during the evidence that was led and in the determination by the Tribunal, only these paragraphs from the judgment of this Court were canvassed in any detail. What renders the Tribunal determination even more confusing is that, after a lengthy exposition of the law and application to the facts, all based on these paragraphs, the Tribunal belatedly refers to later passages of the judgment. This piecemeal reading is regrettable.

[101] I shall return presently to the role of an expert in these matters but, at this stage, suffice it to say that Dr Roberts, who was called to give expert evidence on economic questions, showed an unfortunate keenness to provide the Tribunal with the benefit of his legal expertise and his own reading of the judgment, notwithstanding that he has no legal expertise. The Tribunal should guard against the unfortunate tendency in its future hearings.

[102] This unsatisfactory, partial reading of the *Mittal* judgment only compounded the difficulties experienced by this Court on appeal. A full reading of the *Mittal* judgment shows that the Court engaged fully with the effect of the *United Brands* decision, *supra* which so heavily influenced the formulation of s 8 (a) of the Act. Of particular relevance is the following passage at paras 49-50:

‘A ‘fairly robust approach’ may thus have to be adopted particularly when account is taken that ‘long run normal’ profit and the conceptual basis upon which this term is predicated are notional. Within the context of adjudication, which deals with probabilities, these concepts cannot be employed with scientific precision. For example, where the actual price is shown, as in the *British Leyland* case, to exceed the normal price for roughly similar products to a degree which is, on the face of it, utterly exorbitant, then the need to quantify economic value more precisely before concluding that the actual price bears no reasonable relation to it may fall away.

In this way a *prima facie* case would have been made out, leaving it to a firm in appellant’s position to adduce evidence to the contrary. If it is to avoid the case against it becoming conclusive. Likewise, where the dominant firm raises the normal price for its product substantially without any corresponding rise in costs, this may indicate *prima facie* that the new price is higher than economic value without the need to quantify the latter more precisely. Where input costs vary considerably in cycles, the dominant firm’s actual costs may fall sharply without it carrying out a corresponding reduction in its price. Likewise, if the firm usually prices to import parity, it may neglect for a time to bring its price into correspondence with that (ultimately constraining) maximum, relying in the short term on customer ignorance or inertia in order to charge more. In consequence, the firm’s own accounting profits may show a considerable increase during a certain period or periods, over and above the levels which it usually achieves. If there is no reason to suppose that the firm’s own usual levels of accounting profits would have resulted in a return on capital that is less than the notional competitive norm, (ie enough to sustain it in business in the long run), then it would appear *prima facie* that the firm must have earned ‘pure’ profit as a result of its pricing during the period or periods when the spike occurred. Thus an adverse finding on a narrower basis that that originally alleged may potentially be secured, without any concession that the firm's prices ordinarily charged when input costs etc were higher were themselves legitimate.'

[103] Given the influence of European law, the decision in *Scandlines Sverige AJ v Helsingborg* (unreported decision of the European Commission Case No: COMP/A 36.568/D3) is also of relevance to the explication of the phrase "excessive value".

[104] The following passages at paras 102-103 of that decision are of particularly interesting:

'It is important to note that the decisive test in United Brands focuses on the price charged, and its relation to the economic value of the product. While a comparison of prices and costs, which reveals the profit margin, of a particular company may serve as a first step in the analysis (if at all possible to calculate), this in itself cannot be conclusive as regards the existence of an abuse under Article 82.

In this decision, the Commission will follow the methodology set out by the Court in paragraph 252 of the United Brands judgment. The Commission will therefore assess the costs actually incurred by HHAB in providing the products/services in question (the costs of production) and make a comparison with the prices actually charged (section II.B.2.1). The Commission will then assess whether the prices are unfair when compared to prices charged to other users or by other posts (section II.B.2.2), or whether the prices are unfair in themselves (section II.B.2.3).'

[105] The costs which were incurred for the feedstock propylene reflected the price charged by Synfuels which became known as the transfer price. This was the price at which Synfuels sold feedstock to appellant. This was the price at which appellant acquired the feedstock. Dr Padilla, obviously aware that at this level of costs, appellant ran the risk of being found guilty of s 8 (a) as a result of possible significant differences between price and costs sought to construct a cost based basis on the notional idea of a long run competitive equilibrium at which various suppliers could provide feedstock but only Synfuels would have the advantage of a low cost structure which it had to pass on to appellant. By contrast, Dr Roberts sought to reduce the costs below that which Synfuels charged appellant in order to strengthen the case which the Commission sought to bring before this Court.

[106] This almost surrealistic commitment to either a high cost, being the refineries price of feedstock, or a low cost based on reductions from the transfer price were luminously illustrated in certain passages of the evidence. For example under cross examination Professor Wainer, the accounting expert who testified on behalf of the Commission, was pressed by Mr Trengove with regard to the appropriate costing of feedstock:

> ‘ADV TRENGOVE: What do you say about feedstock?
>
> PROF WAINER: I said I don’t express a view as to whether it is… was sold at below or above market value. I simply made the point that that these runs contrary to the disclosures in the financial statements.
>
> ADV TRENGOVE: And the same could be said of Dr Roberts’ adjustment of feedstock costs?

PROF WAINER: Yes.

ADV TRENGOVE: You also said that if SCI were…

PROF WAINER: Can I put this judgment away?

ADV TRENGOVE: For the time being, yes.

PROF WAINER: Hopefully forever.

ADV TRENGOVE: Well I don't make any promises. You also say that if SCI were earning the returns indicated by Mr Harman's calculations.

PROF WAINER: Yes.

ADV TRENGOVE: Then it should close its business.

PROF WAINER: Yes.

ADV TRENGOVE: But that is because you equate economic cost with accounting costs, is that not so?

PROF WAINER: No. If you were to measure the returns in this fashion, forget about whether it's accounting or economic, I'm talking about in a financial context, in other words, if this was a representation of reality, then if that's the reality when you must close shop, because you're generating returns so far below your WACC or below any reasonable rate of return.

ADV TRENGOVE: <u>But nobody has suggested that it reflects a reality at all</u>.

PROF WAINER: But that's the implications I've simply pointed out. I'm not <u>saying that they suggested it was reality</u>. What I'm pointing out to the extent that it may be useful, is what a peculiar result is achieved, that if you were to rely on this as being any representation of something of value, then the necessary inference is that they should close shop.' (my emphasis)

[107] But it was not only under cross examination that the dichotomy between 'a reality' and a costing based on a particular form of economic modelling was reflected. Mr Behrens who testified on behalf of appellant was cross examined on a similar topic. The following passage of evidence is equally illustrative.

> 'MR BEHRENS: In a competition case you need the expert analysis of Mr Harman. However, what I can say that in the business we know that by just, call it making a profit on the accounts is not necessarily sufficient to say that it is economically profitable.
>
> ADV WESLEY: No, but the extent to which you make money over operating cost or cash cost, the reward you need, what is the proper measure of cost, do you use the replacement costs of the asset, you will recall we have spent days on this with the expert evidence. You recall all of that?
>
> MR BEHRENS: Yes.
>
> ADV WESLEY: Yes and so, your statement that currently Sasol polymers is not economically profitable in that sense would be a matter of expert opinion, because you would have to have the similar debates about what costs are you looking at, what is the regard you are looking at, how do you measure all of these things. You accept that?
>
> MR BEHRENS: What I am leading to in my answer is that within this connect, yes, within this case, but within running the business we would always bear in mind the aspects that I am mentioning. Those are real aspects like what is the working capital that is tied up in that company. So, even if it might be making a profit, if it is tying up a lot of working capital, management will star looking at the company and to say well even then it might be the right thing to shut the business, because it is not rewarding the assets and the money that it is holding up or that it requires to operate.'

[108] The uncontested fact reveals that the actual price paid by appellant during the entire complaint period was the price as reflected in the 2003 One Tier agreement. Mr Behrens said the following about the price contained in that agreement:

> 'In the case of SP's Monomers business, however, Synfuels and SP belong to the same group of companies. This has resulted in supply agreements in which Monomers (and previously Polifin) has obtained feedstock effectively at Synfuels' (comparatively low) FAV. Even if a notional propylene manufacturer in South Africa could buy propylene feedstock from Synfuels, the latter would not supply an independent manufacturer on the advantageous terms that SP enjoys. It is naturally a speculative exercise to say what price Synfuels would obtain from an independent purchaser in this hypothetical scenario, but it is certain that Synfuels would not allow the purchaser to reap all the benefit of the low FAV of Synfuels' propylene feedstock. The price would certainly be higher than Synfuels' FAV and probably higher than an oil refiner's FAV, since Synfuels (like feedstock suppliers globally) would seek a price which would ensure that the propylene purifier could obtain no more than a market related margin in on-selling polymer-grade propylene to its customers.'

[109] That a price advantaged a company within the group is, as Mr Behrens suggests, unsurprising. But the price was pitched at a level which would pass transfer pricing legislation. This is evident in that the relevant financial statements were drafted to pass tax muster, which means that they were required to comply with an 'arm's length standard'. Accordingly, there appears to be an insufficient basis to intervene in the complex problem of pricing. A measure of deference is called for in

these enquiries not only because of the importance of freedom of pricing but also to obviate converting courts into price regulations.

[110] Two further observations need to be made. As the European Commission noted in *Scandlines Sverige, supra* at para 232:

> 'The economic value of the product/service cannot simple be determined by adding to the approximate costs incurred in the provision of this product/service … a profit margin which would be a pre-determined percentage of the product costs. [Rather, the] economic value must be determined with regards to the particular circumstances of the case and take into account also non-costs factors such as the demand for the product/service.'

[111] In the *Mittal* case, this Court was concerned to deal with the pricing policy adopted by *Mittal*. In this case, the Tribunal had, in essence, taken the view that, once a firm is super dominant, a price that cannot be found to be 'based on cognisable competition considerations is excessive, in that it will not have been determined by the free interaction of demand and supply in a competitive market. Faced with a Tribunal decision that totally ignored all the detailed evidence led before it, this Court in *Mittal* sought to provide a framework to evaluate this evidence and thereby determine whether the price so charged was excessive; hence the importance of para 40 and 43 of the judgment. In the present case, the key question turned on a different issue: the refusal to pass on a cost advantage which turned not on the pricing policy of appellant alone but also on Synfuels, which was not a party to these proceedings. In this case therefore, if the cost of an essential component of the

production of product/s, whose prices are under scrutiny, can be justified on rational grounds, that should be the yardstick employed in the primary inquiry with which the Court is engaged. The complexity of price assessment dictates that some deference is required

[112] It is possible to illustrate the implications of this finding with the following hypothetical. Chemical X is very volatile. It is neither imported nor exported. In Korea, United States, China, Europe, the conventional feedstock import for producing X is extracted from deep mines at a costs of R 100. There are additional production costs of R 20, resulting in total costs per unit of R 120. These markets are highly competitive and the price of X is approximately R 125. In South Africa, by contrast, the feedstock lies just below the surface and the cost of this feedstock is low, being only R 10. All the land where the feedstock resides is owned by A Co. A Co's costs of producing X is only R 30. A Co sells X in South Africa at a price of R 100 which is well below the price of other countries, where the production costs are R 120 in without taking into account the competitive costs of capital. A Co would argue that the price is not excessive in relation to some international price benchmark which is higher. A Co says that R 100 is fair because it prices lower than the prices of other countries. But it is excessive in relation to A Co's costs. When it is recalled that s 8(a) is concerned to deal with a dominant firm (during the complaint period, appellant's national market share for the production and supply for purified propylene measured by capacity was in excess of 90%) then, in effect, the monopolist's costs become relevant. Suppose it is possible to import X into South Africa at transport costs of R 10. The import 'landing costs' in South Africa would now be R 130.

Suppose the opportunity costs of importers selling into South Africa, that is taking into account the fact that importers could sell in their own countries, is R 135. Suppose that A Co now argues that the price of R 100 is not excessive because it is less than the price of substitutes which is R 135. The argument is that R 135 is a competitive price, that is the price of the next best substitute. But A Co still earns profits which approximate those of a monopolist. The monopoly price is defined by the price where the monopolist maximises the profits, that is where it is unprofitable to raise the price by even more. A Co lacks the incentive to raise the price above R 100 because the price of R 100 maximises profits. It supplies the whole market therefore at R100. To use the cost of substitutes in the way X suggest would be to declare that no firm would ever be seen as pricing excessively; that is there is always some next best substitute, just one that is far less economic or practical.

[113] This scenario, sketched by way of a hypothetical, is not far removed from the well-known American case of *The United States v Aluminium Company of America* 148 F. 2d 416 (2d Cir . 1945), where Judge Learned Hand was required to analyse a situation where Alcoa priced above its costs but below the landed costs of imports which were higher because of the transportation cost and the imposition of a tariff. Judge Hand said:

> 'It is entirely consistent with the evidence that it was the threat of greater foreign imports which kept Alcoa's price where they were, and prevented it from exploiting it advantage as sole domestic producer; indeed it is hard to resist the conclusion that potential imports did put a "ceiling" upon those prices. Nevertheless within the limits

> afforded by the tariff and the costs of transportation, Alcoa is free to raise its prices as it chose since it was free from domestic competition save as it drew other metals into the markets as substitutes.'

[114] Assume a slightly different scenario. A Co sells at a price of R 134 barely below the constraint implied by the potential imports at R 135. The argument is that this is a competitive price for it is R 1 lower than any other competitive price by way of an import. The invitation by A is in effect for a court to fall for the so called cellophane fallacy (*United States v EI Dupont Devemours and Company* 351 US 377 (1956). Richard Posner Antitrust Law (2001) at 150-151 captures the fallacy thus:

> 'If a firm has monopoly power, it is probably already pricing at a point reflecting the use of its monopoly power, and just below the level that will cause a critical mass of buyers to shift to substitutes. At that point, by definition, alternative products and their sellers will keep the monopolist's price at its current price and no higher. So one would expect an increase in a profit maximising monopolist's price to cause buyers to shift to an alternative product. Therefore cross-elasticity of demand for a product calculated on the basis of current price tells you only the outer limits of the power of a putative monopolist.'

[115] In the light of this analysis, the ultimate determination of whether appellant has contravened s 8(a) must be predicated on a feedstock price which represents the price which Synfuels sold feedstock to appellant. That price can be justified as the actual cost pursuant to an agreement that is subject to independent regulatory scrutiny. There is no basis to adopt a hypothetical price, divorced from the reality

conceded by appellant, which application would gut any possibility of prosecuting on excessive pricing case.

[116] The balance of the illustration and the hypothetical remains to be determined: that is whether, given the returns enjoyed by the appellant, the price for the products in the defined markets in South Africa, constituted a price which is excessive in terms of economic value. Before we arrive at this conclusion however, the remaining costing issues require attention.

Evaluation of capital assets

[117] An evaluation of appellant's capital assets is relevant to the ultimate determination of the costs incurred in the production of the relevant products for the following reasons.

1. There is a dispute concerning the costs of depreciation; that is the annual cost of the capital assets employed in appellant's business
2. There is a dispute concerning the return to investors; that is the reward to investors for their investment in appellant.

On behalf of the Commission, Dr Roberts valued the capital assets at their book value; that is he assessed the historical costs of the assets less depreciation at the beginning of the complaint period. The Tribunal preferred the approach of appellant's expert, Mr Harman, who employed a replacement cost value. This approach required a revaluation of appellant's capital assets by updating the historical costs for inflation by an industry inflation index which is designed to keep track with inflationary increases in plant costs. On the basis of this approach, the depreciated book value is inflated in order to determine the value of second hand assets at current prices at the beginning of the complaint period. In his evidence Mr Harman provided a simple example to illustrate the obvious attraction of his approach;

> 'MR HARMAN: So just give you an example of that, let's say that I purchased an asset some time ago for R 100.00, it has been depreciated to today, so that it's worth R 50.00. Now let's say that there had been 100% inflation over the period, all that I'm doing is I'm taking that 50 and inflation that number up by inflation.
>
> PROF HOLDEN: Inflation of what?
>
> MR HARMAN: The inflation of the asset by an HIS CERA index.
>
> PROF HOLDEN: And how did you get that?
>
> MR HARMAN: The inflation index?
>
> PROF HOLDEN: Yes.
>
> MR HARMAN: The inflation index comes from CMAL, or it may have come from SCI, I can't remember the ultimate source, but it is an asset index that is used widely in the chemical industry to trace how chemical plants and maybe other plants increase over time. So it's an industrial index, not a CPI index, correct.
>
> ADV TRENGOVE: An industrial index designed for the very purpose of keeping track with the increases in plant costs?
>
> MR HARMAN: Correct and so my use of this has been confirmed by CMAI as being a sensible way to increase assets, but I haven't left it there. So that is my base and I've tried to select an inflation profile that gives me a low value.'

[118] By contrast, the Commission contended that appellant's assets were in the early part of their life and so the reward on them was higher than would be the case if the calculation was done on an average return over their use for life. The Commission's approach employed a reward on capital invested at historical costs which took into account that, if the assets were significantly depreciated, there would be a relatively lower return. Further, the Commission considered that Mr Harman had approached the matter on an incorrect premise; that is that appellant's assets would need to be replaced. In the view of the Commission, this would not make sense in this market and industry and did not recognise the outcome under effective competition between established rivals. Rivalry between existing companies would mean rewarding capital invested for incremental expansions as well as maintaining the plant. The main assets in this industry generally had very long lives.

[119] The problem for the Commission was that their own expert, Professor Wainer, conceded that the historical costs basis for depreciation provides only for the replacement of assets at the end of its life at the amount of the original historical cost. This calculation makes no provision for the effect of inflation, because it values assets at the price at which they were originally purchased. Manifestly, the logic employed by Mr Harman within the context of an inflationary environment is a more logical and coherent approach to the problem of depreciation. This approach was captured in *Scandlines Sverige AV, supra* at para 223 – 224 where the European Commission made the following point:

> ‘However a company that sets its prices on basis of depreciated historical costs may – depending on how the production costs of the relevant assets have developed over the years – will find itself in the position that its return does not (ie. No longer) allow it to finance future capital expenditures for the replacement of existing assets.’

[120] The Tribunal however rejected Mr Harman’s contention for an additional reduction in this regard, by using insurance values as the appropriate value of replacement costs:

> ‘The insurance values of a firm’s assets may for any number of reasons would be either over or understated. If one is going to value assets by reference to an insurance value one needs to interrogate the insurance value methodology because insurance standards and economic standard may all differ. This was not done.’

[121] In this regard, the Tribunal did not appear to base its adverse finding on any significant argument raised by the Commission. Indeed, in the expert minute of 10 May 2013, the only objection taken to insurance values was it was ‘inappropriate – as form of replacement costs”. No further justification was offered. In his supplementary report of 30 July 2012 Mr Harman justified the use of insurance values as follows:

> ‘I consider that this is a reasonable assumption because: i) the insurance values are accepted by Sasol’s insurers; ii) insurance values do not include all of the assets associated with SCI’s facilities (i.e. they exclude many of the commercial assets, such as buildings, workshops, IT equipment and infrastructure); and iii) insurance values

> are lower than CMAI estimates based on a Greenfield basis. For the financial year 2001 to financial year 2009 period, I have used an insurance value of R573m on a net replacement cost basis.'

[122] There was no answer from the Commission to this compelling argument nor any reasoning employed by the Tribunal which would justify a rejection of Mr Harman's approach.

Capital Reward

[123] It was common cause that the cost of equity capital must factor in a return on the capital employed. Two disputes arose in this connection:

1. How to determine the equity risk premium.
2. Whether the benchmark is a pre-tax or after tax measure.

[124] Mr Harman based his determination of the normal return on capital on a computation of the weighted average costs of capital ('WACC') of appellant and, within the determination of the WACC, employed the capital asset pricing model (CAPM) for the determination of the cost of equity. In his first report together with his third report, Mr Harman noted that his calculations were based on 'the analytical framework of the WACC which assumes that companies are financed by a mix of debt and equity capital. Both forms of finance have different costs associated with them and the WACC reflects the average return that an entity must achieve to satisfy the demands of both equity and debt holders'.

[125] Mr Harman calculated the costs of debt by employing the interest rate paid on South African government debt and adding a premium to reflect the additional risk that debt holders face when lending to Sasol rather than to the South African government, a point which hardly requires justification. In his calculation of the costs of equity use Mr Harman employed the CAPM which is widely used by South African companies for the valuation of their equity investments as well as by South African regulators and regulators globally.

[126] Although there is a debate relating to how CAPM can be calculated, Mr Harman followed standard practice, providing a range of estimates for an average WACC which estimates reflect the inherent uncertainty in calculating the cost of capital. In validating these results he compared them to a number of external sources.

[127] By contrast, Professor Weiner testified that the normal return on equity was a risk free rate together with an equity risk premium of between 4-7%, Dr Roberts adopted a risk free rate together with 3% as his basis for evaluation. For reasons which I propose to set out later in this judgment, both the evidence of Professor Weiner and Dr Roberts in this regard leaves much to be desired. These calculations were no more than a 'thumb suck'. Unfortunately, this Court was thus disadvantaged by not benefitting from evidence on this point from the Commission that was adequately reasoned.

[128] The Tribunal was therefore clearly correct in dismissing this evidence. However, for reasons that are hardly justified and, to the extent that there was any justification little sense can be divined therefrom, the Tribunal rejected Mr Harman's proposed use of an inception of WACC. Having accepted his method and thus logical approach adopted by Mr Harman, the Tribunal should have accepted appellant's case which was based on the use of an average inception WACC over the complaint period. That is not to say that the use of the WACC and hence the CAPM is beyond any critical reproach. See for example Richard Rolls 1977 Journal of Financial Economics 129 and Richard Dayala 2012 (31) Business Valuation Review 23. By contrast see the Interpretations Committee of the International Accounting Standards Board's Guidelines on the Application of IFRS 13 Fair Value Measurement December 2012. But no justifiable evidence to counter Mr Harman's testimony was offered by the Commission.

[129] In his evidence, which was neither contested nor adequately rejected by way of a set of plausible reasons offered by the Tribunal, Mr Harman testified that, to preserve an investment incentive, a company must be rewarded for the risk expected ex ante. Therefore setting an ex ante cost of capital, that is the costs of capital used in assessing the project at its inception, is a necessary component of a coherent analysis. In his expert report Mr Harman explains this as follows:

> 'I have carried out a number of profitability tests. It can be argued that, in assessment of realised rates of return, the relevant costs of capital should be the costs of capital that was used in assessing the project at its inception. In this case, the relevant costs

of capital would be SCI's estimated "project inception" WACC in 1990. However, I have considered the following project inception costs of capital:

- the cost of capital for financial year 2000 as an indicator of the project inception WACC, which I compare to profitability over the period 2001 to 2008; and
- the cost of capital for financial year 2003 as an indicator of the project inception WACC, which I compare to profitability over the Complaint Period.

As the risk-free rate in South Africa dropped significantly over the period 1990 to 2001, my estimates of the project inception WACC are lower than the WACC in 1990. As such, my estimate of the WACC at project inception will be conservative.'

[130] There was also no plausible reason for rejecting the use of a hurdle rate which clearly was necessary because appellant sought to price its projects on an ex ante basis. The hurdle rate allows for an estimation of specific risks as contrasted to an ex post facto outcome that does not account for these risks.

[131] The second dispute concerned a before or after tax return. Regrettably, the evidence of the Commission again reflected a level of analysis which could not possibly be plausibly advanced by an expert in the field. In the assessment of a marginal investment, a firm would take account of the marginal effective tax rate, which is a measure of the burden of tax on the investment for a profit maximising firm. This rate determines the scale of a project: a higher marginal effective tax rate means small size projects and fewer investments. The marginal effective tax rate is well known as an important determination for foreign direct investment and shows

manifestly that, when examining returns, it is the after tax return upon which an investor relies in order to assess the possibility of a new investment.

Group Costs

[132] Regrettably there is little reasoning in the approach adopted by the Tribunal with regard to this issue. Three sets of costs were involved, corporate development costs, management fee costs and insurance costs. In seeking to divine the reasoning by which the Tribunal considered that no adjustment for group costs was to be made, the only plausible reason that I could find is contained in the following two paragraphs of the Tribunal's determination.

> 'The evidence suggests that the corporate development costs, which represents approximately 65% of the group costs allocated to propylene, were actually for the Fischer Tropsch technology and the associated research. We have found no direct link between the supposed value of this research to purified propylene and the costs allocated to purified propylene. There was also no evidence that the costs allocated to propylene were incurred for propylene.
>
> Furthermore, Behrens gave evidence that the group costs were allocated to Sasol Polymers on an operating margin basis. However, this would give rise to a bias as more costs would be allocated to the businesses that have high operating margins rather than the businesses that realise the most value from the research.'

[133] Mr Harman had prepared a report which was based on appellant's discovered information and which revealed that in 2009 PP was allocated R 101.3 million of total group costs and propylene R 56.3 million. According to Mr Harman, over 80% of these amounts were made up of three costs items: corporate development costs, Sasol management fee costs and insurance costs. Mr Harman had taken these 2009 and the allocations and deflated them for inflation. He argued, on this basis, that the cost allocation method that he had employed was reasonable and reflected, in broad terms, the group costs that would have been allocated to propylene and PP during the complaint period after adjusting for the impact for inflation. The submissions made by the appellant that the group costs allocation applied by Mr Harman reflects a reasonable estimation of the group costs incurred for the benefit of propylene and PP during the complaint period and should be upheld.

Allocation of common costs

[134] The Tribunal adopted a volume based approach which had been proposed by the Commission with regard to the allocation of common costs for propylene. The appellant accepted this allocation methodology for, in its view, it had a trivial effect on the results. With regards to PP however, the appellant rejected the approach adopted by both Dr Roberts and Professor Weiner that a volume based allocation to costs between export and domestic PP sales was appropriate. These witnesses assumed that the fixed costs were incurred equally across all products, an assumption favoured by the Tribunal, on the basis that the allocation, having been

made related to the same product. Further it considered that the costs of production were the same of that product irrespective of the location of the sale.

[135] Mr Harman offered a most plausible rebuttal of this approach which is reflected in his evidence as follows:

> 'If costs are allocated on a volume basis, [PP] exports have a price-cost mark up of minus 12.5% and domestic sales have a price-cost mark up of 2.4%. Over both markets the average price-cost mark up is minus 5.6%. This suggests that exports are loss-making, whereas domestic sales recover economic costs. However, the negative price-cost mark up in the export market suggests that Sasol Polypropylene would be better off ceasing production for export markets. Ceasing export sales would leave Sasol Polypropylene with only domestic sales but its fixed costs would remain unchanged. This would leave a price-costs mark up of minus 15.9%. Eliminating the apparently loss-making exports thus leads to a reduction in average profitability from minus 5.6% to minus 15.9%. This counter-intuitive result reflects the fact that exports only appeared loss making because the volume base allocation over allocates common costs to exports.'

[136] Although Mr Harman conceded that there was no one correct method of allocating costs to a single product with different prices and different investment economics, he indicated a strong preference for an allocation in which common costs were allocated to the export business up to the point where it recovered economic costs. The remainder would then be allocated to the domestic business. This approach recognises the marginal nature of export sales by allocating proportional

economic costs to the export business which breaks even in economic terms. The remaining fixed costs are then paid by the domestic business. Any greater allocation of common costs to the export business would suggest that appellant's export at a loss which it did not do.

[137] I accept the approach adopted by the appellant was the most rational approach provided towards the question of allocated costs.

Aggregate of separate calculations for Tier 1 and Tier 2 prices

[138] The supply agreement concluded between appellant and Safripol during the complaint period (following an amendment of 26 June 1999 was that Safripol would pay appellant a Tier 1 price for the first 55 000 tons propylene purchased by Safripol. The Tier 1 price was "calculated on a monthly basis i.e divided by 12". Thereafter the Tier 2 price would apply. In his evidence Mr Behrens explained the structure as follows:

> 'The increased price charged by SP to Safripol for volumes above 55 000 tons was directly related to higher costs associated with the production of the additional volumes, including a higher feedstock price from Synfuels (as just explained), higher capital costs incurred by SP in constructing PPU3 as compared with PPU1 and higher operating costs due to the dilute nature of the relevant condensate stream.

> It is important to note that the increased price paid by Safripol for volumes above 55 000 tons was also applicable to SP's PP business for its additional volumes arising from the new investment (PPU3).'

[139] Safripol's monthly bill therefore comprised a portion of its supplies for the month at the Tier 1 price and the balance at the Tier 2 price. Each monthly bill reflected an amount equal to the weighted average of the two prices. Appellant contends that the propylene prices which should be considered for the purposes of assessing whether or not its prices were excessive is the weighted average of appellant's propylene prices for propylene sold to Safripol.

[140] By contrast, the Tribunal found that the Tier 1 and the Tier 2 prices should be considered separately and hence it would be inappropriate to consider a weighted average. The Tribunal found that the evidence suggested that Safripol's decisions to buy were made on the Tier 2 prices independently of the Tier 1 prices. Safripol bought all of the contractually fixed volumes of purified propylene at the lower Tier 1 price but did not purchase all of the volume it could at the higher Tier 2 price.

[141] The Tribunal noted that appellant contended that the price differentiation between the two Tiers reflected higher costs associated with the production of the additional purified propylene volumes, including a higher feedstock price from Synfuels, higher purification and operating costs due to the diluted nature of the relevant condensate stream and necessary investments. However for the Tribunal, these allegations did not accord with the way in which the propylene pricing was

negotiated with Polifin nor did it accord with the interpretation provided by Mr MacDougal who explained it simply as a 'take it or leave it' offer.

[142] I agree with Mr Trengove when he contended that Safripol paid the weighted average of the Tier 1 and Tier 2 prices every month during the complaint period. Accordingly, the "real" price paid by Safripol every month was the weighted average of the two prices. It appeared to be a rather artificial construct to separate them on expost facto basis. Significantly, when the costs of Tier 1 and tier 2 were examined, the Commission did not separately deal with the costs of Tier 1 and Tier 2 but compared Tier 2 prices to average costs, which approval was followed by the Tribunal in its calculations.

[143] To the extent that it was suggested that there was no evidence to show that there was difference in costs associated with the production of Tier 1 and Tier 2 propylene, as I have indicated Mr Behrens provided an explanation. No further evidence on either side was forthcoming.

[144] However the following cross examination of Dr Roberts is also instructive:

> 'ADV TRENGOVE: So, is although they had this formula with two components, the monthly bill would always be a bill in effect a weighted average of the two prices.
>
> DR ROBERTS: Ja, the bill would be on an average price. The decision by the firm, of course, is completely different, because the buyer is looking at two separate prices, but I accept that that's the way in which the bill will be sent.'

[145] In attempting to fend off this concession by Dr Roberts, Mr Wesley contended that while Safripol does buy all of the propylene volumes at the lower Tier 1 price, it does not buy all the volume it could have at the Tier 2 price, because it buys further product from Sapref. I fail to understand how this additional purchase trumps the argument that a calculation which sets out the average price should not be the yardstick for the overall assessment.

[146] The Tribunal found it would be inappropriate to consider the weighted average mark up of propylene / PP over the costs of the complaint period. It simply stated that 'each year should be attributed equal weight' but, as unfortunately was the case in much of this determination, it never properly explained why this attribution should apply in this case.

[147] By contrast, Mr Harman gave credible evidence which is summarised in his third report as follows:

> 'When Dr Roberts summarises his multi-year analysis into a single percentage, his average is based on the average mark up in each year (i.e is a simple average). I calculate a percentage based on the total costs and revenues over the period (I.e a weighted average). This difference in arithmetic approach creates a difference of approximately 2% between our results for both propylene and polypropylene. I consider that my approach avoids a calculation bias.'

Mr Harman expanded on this evidence as follows:

> 'My approach avoids an upwards bias Dr. Roberts' approach. Consider a product with a constant unit price of 100 for two years but unit costs of 80 in Year 1 and 120 in Year 2. The product gains 20 (100 minus 80) in Year 1 but under-recovers 20 (100 minus 120) in Year 2. My approach would find a zero percentage mark up (i.e sum of total revenue (100+100=200) divided by total cost (80+120=200) minus 1) Dr Roberts' approach, would find a positive mark up of 4%. In Year 1, the mark up would be 25% (100/80-1) and in Year 2, it would be minus 17% (100/120-1). The average of 25% and (17%) equals 4%. My approach is consistent with IRR approach, which considers total revenues and total costs over time rather than revenues and costs for each individual year in isolation.'

[148] Given that this case is about a complaint period and the establishment of excessive pricing over this particular period, and not in specific years of the complaint period, to employ a simple average as was applied by the Commission would have a computational upward price whereby prices that exactly equal average economic value should be found to exceed this value. Mr Harman's evidence should have been favoured and accordingly a weighted average should have been adopted by the Tribunal.

[149] To recapitulate this Court has found that the feedstock propylene costs should be held to be equal to the price charged by Sasol Synfuels in terms of the 2003 agreement. It has also found that the approach adopted by the appellant to the evaluation of appellant's capital assets, the appropriate rate of return on capital, the allocation of group costs and the allocation of common costs should be followed.

[150] The Court then found itself in a difficulty. No calculation had been made by either of the parties of the price – cost mark up on the basis of these findings. Accordingly, in a series of requests to the parties on 17, 20 and 23 April 2015 this Court sought assistance with regard to these calculations. For completeness I should add that in its second letter of 20 April 2015, the Court clarified its request, requesting that the parties conduct the calculation on the following basis:

1. The Tier 1 and Tier 2 Propylene prices are treated separately; and
2. On an averaging of Tier 1 and Tier 2 purified propylene prices.

[151] On 23 April 2015 a further request was generated which confirmed that the following assumption should also apply:

1. The capital assets should be valued at their depreciated insurance values.
2. The inception WACC including a hurdle rate should be used to determine the capital reward charge.
3. Common costs should be allocated using the volume formula for propylene and the economic method for PP.
4. The analysis should be performed over two periods from FY 2001 to FY 2008 inclusive and from FY 2002 to FY 2008 inclusive.
5. The tax effect should be included.

Propylene

[152] Appellant produced the following table with regard to propylene.

Sasol Propylene, price / cost mark ups

Period of analysis	Tier 1	Tier 2	Average
FY2001 to FY2008	7.1%	19.6%	12.1%
FY2002 to FY2008	8.8%	22.3%	14.3%

Sasol Polypropylene

[153] In respect of polypropylene appellant presented a price – costs mark up under two scenarios which were as follows:

- Poly-A, which is the price / cost comparison where the price of purified propylene is taken as the value actually paid by Sasol Polypropylene (i.e. purified propylene is purchased at the amount that is contained in the financial statements); and
- Poly-D2 (i.e. the integrated approach), which is the price / costs comparison where the price of propylene is set equal to the estimated economic costs of propylene, assuming feedstock propylene is set equal to the actual costs of feedstock propylene as contained in the financial statements of Sasol Propylene.

[154] Appellant's calculation was set out in the following table:

Sasol Propylene, price / cost mark ups

Period of analysis	Poly-A	Poly D
FY2001 to FY2008	-28.9%	-28.2%
FY2002 to FY2008	-27.2%	-24.4%

[155] On 5 May 2015 this court received the following letter from the Commission's attorneys:

> 'We refer to the Court's letters of 17, 20 and 23 April 2015 and SCI's response of 24 April 2015 and the memorandum from FTI attached to that response.
>
> The Commission agrees with the figures contained in the FRI memorandum (although the Commission does not understand the Court to have requested the calculation of "Poly A", which is not on an integrated basis) and wishes only to draw to the Court's attention two further assumptions made by FTI in the calculation.
>
> Firstly, as FTI records at the end of paragraph 1.3 of its memorandum, the prices FTI has used in its calculation of the polypropylene price/cost markup include sales made under the Customer Export Incentive Programme (CEIP), which are at lower prices than domestic sales, and which the Commission contends ought to be have been excluded from the calculation (as set out in paragraphs 241 - 247 of the Commission's

heads of argument). If these sales are excluded then the markups for polypropylene contained in the FTI memorandum should be increased by approximately 2%.

Secondly, FTI also records at the end of paragraphs 1.3 of its memorandum that it has used a weighted average in its calculations. By this it means that it has averaged prices across the years and also the costs across the years before calculating the markup, rather than giving an equal weight to the percentage markup in each year as the Commission contends ought to be done (as set out in paragraphs 220 – 225 of the Commission's heads of arguments). Using the Commission's method increases the markups reflected in the FTI memorandum by less than 1% though and the difference in the two approaches is therefore not material to the calculations requested by the Court.

[156] The Commission also noted that:

'It observed that on the basis of that the impact would be different if a different permutation of the disputed amendments was accepted by the Court. Mr Harman's slide presentation the effect of using appellants approach is to decrease the average mark-up by between 1.9% and 2.4%.'

[157] Mention was made in the letter from the Commission's attorneys of the Customer Export Incentive Program (CEIP). This now requires some attention. Appellant offered a rebate to customers on the price of PP if the latter manufactured a product using polypropylene for a product to be exported. The discount was offered on the basis that appellant would otherwise be obliged to export the PP itself. The

Commission contended that it was not appropriate to include these prices in the calculation of prices that were the subject matter of the complaint. The complaint only concerned appellant's domestic prices. Furthermore, the Commission did not allege that the CEIP prices, which are significantly lower than the domestic prices, were excessive. The Tribunal held that, if these prices were excluded, the costs should be similarly excluded, which the Commission had not done.

[158] Leaving aside the merit of the arguments and assuming that these sales were excluded, the mark up for PP should be increased by approximately 2%. Assuming further that the Commission was correct that appellant should not have taken average prices across the years together with the costs before calculating the mark up, but rather given equal weight to the percentage mark up in each year, as the Commission contended ought to be done, this would have increased the mark up by less than 1%. Furthermore, on the assumption of a different permutation of the amendments, as urged upon this Court by the Commission, this would have increased the average mark up by between 1.9 to 2.4%.

[159] On the basis of all of these assumptions, it would mean that the price-costs mark up on average would be in the region of 16% for FY 2001 to FY 2008 insofar as propylene is concerned and from FY 2002 to FY 2008 to slightly less than 19%. Commensurate increases would also have to be made insofar as the separate Tier 1 and Tier 2 calculations are concerned. Manifestly, on these calculations the changes to the PP price-cost mark up should not vex any court with respect to an excessive pricing dispute.

[160] As this court has taken the average of Tier 1 and Tier 2 prices, for the reasons already advanced in this judgment, on the basis of the calculations provided by both of the parties, irrespective of whether one takes FY 2001 to FY 2008 or FY 2002 to FY 2008 the price-cost mark up would be with the range of between 12% - 14%.

Reasonableness

[161] Given this finding, it is possible to turn to the second leg of the enquiry, namely the question of reasonableness; that is whether appellant's prices are reasonably related to economic value.

[162] As noted, s 8 (a) of the Act is clear: a price is excessive only if it is higher than economic value and bears no reasonable relation thereto. Section 8 (a) does not apply to prohibit any price in excess of economic value. This conclusion must follow from the wording that is employed: the price is excessive if it is both higher than economic value and bears no reasonable relation thereto. This formulation, as has been noted on a number of occasions in this judgment, was derived from the decision of the European Court of Justice in *United Brands Company v EC Commission, supra* at para 248-250. The relevant article of the EU Treaty, with which excessive pricing is concerned is Article 102. In the German version this article contains the following wording 'Unangenessene Preisen'; that is prices that are out of line or disproportionate. Accordingly, a proportionality enquiry appears to be indicated to determine the reasonableness component of the test for excessive pricing.

[163] In its decision, the Tribunal was cognisant of an observation of this Court in *Mittal* that a reasonable assessment involved a value judgment and that there was no single inflexibly clear threshold which could be applied to determine whether a price was excessive in each and every case.

[164] The Tribunal in its determination found that the following features of the relevant market were important:

1. Appellant was a dominant firm for the manufacture and supply of purified propylene. It was also a dominant firm in the production of sale of PP in South Africa.

2. The barriers to entry in these markets are high. Access to purified propylene and polypropylene markets would require reliable and significant supply feedstock propylene. There was no supply in South African other than by way of Synfuels.

3. Appellant enjoyed a cost advantage as the producer of purified propylene and PP due to the nature of the feedstock propylene as a by-product of Synfuels' fuel operations.

4. Synfuels had an abundance of feedstock propylene as a bi product and poor alternative uses therefore

5. Appellant had not been able to demonstrate that its market position in purified propylene and PP with the result of innovation or risk taking on its part.

6. Sasol had enjoyed very significant state support for its business for a protracted period of time. It had leveraged this support to create positions of dominance in the domestic market for both purified propylene and PP.

7. High input prices for both purified propylene and PP held significant implications for the South African economy since they had marked negative effects on the relevant downstream industries.

[165] The Tribunal then held: 'In the case of purified propylene the price-cost test is the only reliable indicator of the economic value of the purified propylene sold by SCI during the complaint period.' As it had found that the final price cost test for purified propylene showed that prices over actual costs were in the range of between 39.9% to 51.5% for Tier 2 sale to Safripol and in the range of 25.1 to 26.5 for Tier 1 sales to Safripol, the Tribunal was satisfied that this was both excessive and unreasonable in relation to economic value. With regard to PP it found that during the complaint period the price over actual costs was in the range of between 17.6% and 25.4 %, on a very conservative basis and between 26.9% to 36.5% on a more realistic basis. Furthermore, a comparison of appellant's domestic polypropylene prices to the prices in Western European indicated that appellant's domestic prices were 41% and 47%

higher respectively for the homopolymer and raffia grade in the relevant period compared to the Western European discounted prices computed on the basis of feedstock cost comparable to appellant. On this basis it found that there was no reasonable relationship between the price charged by appellant to the local plastic convertors for PP and the economic value thereof.

[166] Certain conclusions with respect to this leg of the overall inquiry which were reached by the Tribunal unfortunately do not take the matter particularly far. The fact that appellant was dominant will always be the case when dealing with an excessive pricing dispute in terms of s 8 (a). To the argument that propylene and PP are characterised by high barriers to the entry, in particular because entry requires access to a significant supply of feedstock propylene, Dr Padilla showed that there was in fact an excess of feedstock propylene supply in the market during the complaint period. The Tribunal appeared to have agreed that there was an abundance of feedstock propylene in the market.

[167] Mr Trengove also observed correctly that appellant sold propylene to Safripol and there was no reason to think that it would not have given serious consideration to supplying a new entry into the market, as might have been the case with Project Mango. Further, with regard to the question as to whether the prices caused harm to consumers, this was itself a separate enquiry to that dealing with reasonableness as, again, is evident from the wording of s 8 (a).

[168] Throughout his argument Mr Wesley pressed the point concerning the difference between the prices charged by international producers as compared to appellant. In particular, Mr Wesley referred to the fact that the net prices for PP in Europe were between 12% to 18% lower than appellant's domestic prices.

[169] Mr Wesley pointed out that Dr Padilla's calculation in this regard included the CEIP rebate, which, in his view, should not have been included. If this rebate was excluded, appellant's prices were between 15.4 and 20.5% higher than Western European prices in the complaint period for homopolymer and raffia grade respectively. Mr Wesley noted that it was not in dispute that European firms were not low cost producers.

[170] This argument is one which, as this court pointed out in *Mittal,* serves as a measure to test economic value. See para 51 of the *Mittal* judgment. Nonetheless, this would not prevent the Commission from employing this comparator to justify its conclusion with respect to the finding that there was no reasonable relationship between the price charged by appellants to the local plastic convertors for PP during the complaint period and the economic value of the PP. But as already noted, appellant's price-cost figures are not in favour of the Commissions' case with respect to economic value.

[171] A great deal was made by the Commission and by the Tribunal with regard to the origins of appellant's dominance, in particular the history of state support and the fact that appellant's dominant position in the relevant market was not the result of any

innovation or risk taking on its part. This Court in *Mittal* considered that these factors should be examined at the reasonableness stage of the enquiry, because it was here that it was appropriate to take into account how the firm's cost affected the reasonableness of its price in relation to the value of the good and whether the high price of the good represented a reward for risk and innovation.

[172] Unfortunately the Tribunal's emphasis on innovation and risk taking resulted in it in making an observation which is manifestly incorrect, for if followed, it would destroy any possibility of instituting a successful excessive pricing case in the important area of intellectual property. This observation is the following:

> 'Due regard must be paid to the fact that a dominant firm's price for the product or service may justifiably be higher than its economic value. An example would be the pricing of a patented product where the patent holder has the right to the economic exploitation of the innovation for a limited period. Accordingly, a patent holder may charge a price which bears no relation to the economic value of the product for the duration of the specific patent. This, however, is not a relevant factor here.'

[173] As Sutherland and Kemp <u>Competition Law of South Africa</u> (loose-leaf at 7-50 (4)) correctly observe:

> 'While patent holder innovation research expenditure may have a bearing on economic value of its product and the reasonableness of its price this is not, as the Tribunal seems to suggest, a license for patent holders to engage in excessive pricing. Such an approach has no basis on the wording of s 8 (a).'

[174] In this case however, even if this court was inclined to consider that a price costs ratio of 14% is excessive, this on its own cannot suffice to justify a holding that the price bears no reasonable relation to the economic value of the good or service. Of course, it must be remembered that a return of 14% is in addition to the return on capital which has been factored into the costs and hence into the calculation of economic value. Thus, the figure of 14% is in addition to a competitive return which is the reason why it must be regarded as excessive in relation to economic value. But returns above economic value are not *per se* unreasonable. In this case, when appellant manufactured purified propylene in its Monomers division, it sold the propylene to its Polymers division and to Safripol at the same prices. Its PP prices were only approximately 16% above the cheapest PP in the world. Half of this difference was as a result of government policy which maintained a tariff protection on imported PP throughout the complaint period, a fact which was confirmed by Dr Roberts under cross examination.

[175] A review of the European jurisprudence indicates that the prices charged have to be substantially higher than the defined economic value before an adverse finding will be made. See for example, *British Leyland Plc. v Commission* 1987 (1) CMCR 185; *Napp Pharmaceutical Holdings Ltd v Director of Fair Trading* [2002] 4 All ER 376. A price which is significantly less than 20% of the figure employed to determine economic value falls short of justifying judicial interference in this complex area. Ancient support can be found for this finding. The TALMUD (Baba Bathra 90a) ruled that if the profit gained was more than 16.67% it was regarded as excessive.

[176] For all of these reasons therefore the evidence as it is presented to the Tribunal cannot justify the finding that the price of propylene bore no reasonable relation to the economic value of the good.

[177] On the basis of this finding, it is unnecessary to engage in the question as to whether there was detriment to consumers nor is the Court required to deal with the question of administrative penalties.

Economic experts

[178] Throughout this judgment I have raised questions of expert evidence and specifically the role of an expert in these proceedings. This important question is not only a feature of this case but, unfortunately, has raised itself in numerous appeal records which have been presented to this Court over the past fifteen years. Regrettably this Court must now draw attention to the inability of the Tribunal to exercise discipline over proceedings in order to in order to ensure that economic experts provide evidence on economic questions, leaving points of legal interpretation to the Tribunal and to this Court, after submissions by the extremely qualified lawyers who represent the parties have been presented.

[179] There are further issues with regard to the expert evidence which is led before the Tribunal. For the guidance of experts who present evidence before the Tribunal in future cases as well as the Tribunal itself, I propose to deal with this question. I readily accept that there are areas of economics where there is an

overwhelming consensus over the uncompetitive character of certain business practices in a particular context. But as Richard Posner "*The Law and Economics of the Economic Expert Witness*" 1999 (13) The Journal of Economic Perspectives 91 at 96 has written:

> 'Where the use of economic experts is more problematic is in the areas of economics where there is no professional consensus. This used to be and to some extent still is the situation with regard to antitrust economics. A perfectly respected economist may be an antitrust "hawk", another equally respected economic economist an antitrust dove. Each might have a long list of reputable academic publications fully consistent with systematically pro-plaintiff or pro-defendant testimony, and so a judge or jury would have little basis for choosing between them.'

Closer to the reasons which have prompted this excursus, Barbier de la Serre and Sibony have observed that there are numerous cases 'in which the conclusions of the experts reports were not irrelevant but were questioned and/or judge unfounded (eg when the other party submitted an expert report that contradicted the findings of the other report, the report did not put forwards the 'slightest evidence' supporting its conclusion, the experts' conclusions were based on complex premises which in view of their number and complexity did not permit sufficiently defined conclusions, the experts qualifications did not correspond to the factual issues at stake and the report was based on incomplete knowledge where the facts were simply 'unreliable'. ('Expert evidence before the EC Courts' (2008) 45 Common Market Law Review 941 at 968; See also *Impala v Commission* [2006] ECR II – 2289 at para 345.

[180] This concern about the impartiality of expertise and its implications for complex cases such as the present were captured by Lord Woolf in his Interim Access to Justice Report (Interim Report to the Lord Chancellor on the Civil Justice System) in England and in Wales (1995). See Chapter 23 at para 5:

> 'Most of the problems with expert evidence arise because the expert is initially recruited as part of the team which investigates and advances a party's contentions and then has to change roles and seek to provide the independent expert evidence which the court is entitled to expect. As Lord Wilberforce in The Ikarian Reefer (1993) 2 Lloyds Reports 68) stated: 'It is necessary that expert evidence presented to the court should be and should be seen to be the independent product of the expert uninfluenced as to form or content by the exigencies of litigation.' In many cases the expert, instead of playing the role identified by Lord Wilberforce has become … 'a very effective weapon in the party's arsenal of tactics.'

[181] This approach finds support in the leading South African authority, Zeffertt and Paizes The South African Law of Evidence (2nd ed) at 330 who cite favourably from The Ikarian Reefer, which judgment they consider reflects adequately the duties and responsibilities of expert witnesses:

> '1. Expert evidence presented to the Court should be, and should be seen to be, the independent product of the expert uninfluenced as to form or content by the exigencies of litigation (*Whitehouse v Jordan* [1981] W.I.R. 246 at p. 256. per Lord Wilberforce).

2. An expert witness should provide independent assistance to the court by way of objective unbiased opinion in relation to matters within his expertise (see *Polivitte Ltd v Commercial Union Assurance Co. Plc*., [1987] Lloyd's Rep. 379 at p. 386 per Mr Justice Garland and *Re J.* [1990] F.C.R. 193 per Mr Justice Cazalet). An expert witness in the High Court should never assume the role of an advocate.

3. An expert witness should state the facts or assumption upon which his opinion is based. He should not omit to consider material facts which could detract from his concluded opinion (*Re J* sup.).

4. An expert witness should make it clear when a particular quotation or issue falls outside his expertise.

5. If an expert's opinion is not properly researched because he considers that insufficient data is available, then this must be stated with an indication that the opinion is no more than a provisional one. (*Re J* sup.), In cases where an expert witness who has prepared a report could not assert that the report contained the truth, the whole truth and nothing but the truth without some qualification, that qualification should be stated in the report (*Derby & Co. Ltd. and Others v Weldon and Others*, *The Times*, Nov. 9, 1990 per Lord Justice Staughton)…'

[182] It is these guidelines which should be followed in future hearings before the Tribunal. Suffice to say that in this case, once the issue of feedstock costs had been resolved, the appellant placed before the Tribunal impressive and cogent evidence which, sadly was not properly gainsaid by the Commission, to the extent that it would have been justified to conclude, on the probabilities, that the Commission's case

should have been upheld. To the contrary, figures cited without any clear and reasoned justification do not constitute expert evidence. Further, an expert in a defined area is not necessarily an expert in another defined area. The Tribunal must in future guard against expert overreaching.

[183] These observations are made partly to counter the predictable reaction to a decision of this Court in this complex area of excessive pricing, namely that excessive cases can never succeed before South African courts. This would be a completely unjustified conclusion. Had this court been confronted with evidence to properly contest Mr Harman's testimony in particular and thus had the Court enjoyed the benefit of expert evidence, as set out above, with regard to the evaluation of capital assets, the level of the capital reward / return on capital, the allocation of group and common cost, this evidence may this well have shed a different light on this case.

[184] As indicated earlier, some measure of latitude has to be given to firms with regard to pricing. If not, a court will become a price regulator; hence the importance of sustained expert evidence. Furthermore, to the extent that the policy issues are important, particularly within the context of the South African economy the observation made by Sutherland et al should also be considered:

> 'The Tribunal distinguished between firms that have gained their dominance through state support and those that have achieved dominance through innovation and risk-taking. Given the passage of time and firm-specific developments since the receipt of such support, it may be difficult for a dominant firm accurately to determine the source of its dominance, or the extent to which any subsequent innovation and risk-taking

> may weigh against that support. And yet, as outlined above, this distinction may fundamentally alter the economic value of the relevant good and thus the firm's obligations under the Act. An appeal has been lodged in the *Sasol* case.' (at 7 – 50 (4))

Safripol

[185] The second appellant, Safripol noted an appeal against the behavioural remedies granted by the Tribunal in paragraphs 455 to 509 of its decision. Safripol seeks an order setting aside the behavioural remedies granted by the Tribunal and replacing them with a set of behavioural remedies which it proposes to the Court. Safripol does not however appeal against the remainder of the Tribunal's decision. Indeed, Safripol supported the Tribunal's finding that first appellant has engaged in excessive pricing. Given the approach adopt by this Court to the appeal of appellant, there is no need to deal with the arguments put forward by Safripol regarding the Tribunal's order.

Conclusion

[186] In the result, the appeal is upheld. The decision of the Competition Tribunal is set aside and replaced with the following order:

> The complaint referral is dismissed.

DAVIS JP

MOLEMELA and VICTOR AJJA concurred