

Unclassified**English - Or. English****20 November 2018****DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE****Cancels & replaces the same document of 9 November 2018****Global Forum on Competition****COMPETITION LAW AND STATE-OWNED ENTERPRISES - Contribution
from South Africa****- Session V -****30 November 2018**

This contribution is submitted by South Africa under Session V of the Global Forum on Competition to be held on 29-30 November 2018.

More documentation related to this discussion can be found at: oe.cd/csoes.

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Competition Law and State-Owned Enterprises

- Contribution from South Africa -

Background

1. The following note sets out the Competition Commission of South Africa's ("the Commission") response to the call by the Organisation of Economic Cooperation and Development ("OECD") for written submissions to inform the roundtable discussion on investigations into conduct by State-Owned Enterprises ("SOEs") to be held on the 29-30th November 2018.
2. The Roundtable will look at investigations into anticompetitive mergers, agreements and conduct by SOEs. The purpose of this exercise is to examine the type of conduct SOEs are engaged in, the analytical questions that arose in the identified cases, the rationale for doing so, and the way in which their status affected those investigations. In engaging in this exercise, the Roundtable aims to identify the main challenges of enforcing competition law against SOEs and look for ways to address them. The request has highlighted that the submission should focus on cases, practical challenges, and any developments within a jurisdiction. The focus should be on any enforcement challenges that may have arisen from the nature of these enterprises as well as from the types of markets in which they operate.

1. Introduction

3. The term State-Owned Enterprise ("SOE") encompasses a wide range of institutions. In 2013, the Presidential Review Committee on SOEs indicated that South Africa has over 700 SOEs,¹ from constitutional organisations like the SA Human Rights Commission, to government entities (museums, research institutions, regulators), to commercially run companies. This report focuses on commercially run companies.
4. The Commission has received a number of complaints relating to SOEs. In fact, the majority (67%) of the abuse of dominance cases successfully prosecuted in South Africa to date have related to conduct by SOEs or former SOEs.² The focus of this submission is on describing where intervention by the Commission has resulted in good outcomes, where

¹ Presidential Review Committee on State-Owned Entities, Main Report.

² Since 1998, the Competition Tribunal has considered a total of 25 unilateral conduct cases. One case, related to excessive pricing of antiretroviral medication, was settled prior to reaching the Tribunal. Of the 25 cases brought before the Tribunal, 8 were consent orders; 10 contested cases were brought by the Commission and 7 cases were self-referred by private parties. In the 10 contested cases brought by the Commission, the Competition Tribunal found that the Act had been contravened in 8 cases, 2 of which were overturned by the Competition Appeal Court. Of the 6 cases in which the finding of a contravention thus stood, 4 were against current state-owned companies (SAA and Telkom) and the other two (Patensie and Senwes) were against firms in agricultural markets where state-sanctioned anti-competitive conduct was the norm under the Apartheid regime.

outcomes have been less than favourable, and where the failure to intervene has prevented effective competition.

5. In line with the OECD's request, the Commission will briefly outline the current state of South African competition regulation within the larger SOE framework before expanding on several cases. The cases that have been selected provide examples of outcomes which can be categorised as either "good", "bad", or "ugly". Instances where intervention by the Commission has resulted in good outcomes is referred to as "the good". Instances where outcomes have been less than favourable are referred to as "the bad" and instances where failure to intervene has prevented effective competition, are referred to as "the ugly". In the conclusion, we highlight practical challenges to enforcement against SOEs.

2. Competition regulation and SOEs in South Africa

6. When the Competition Act ("the Act") first came into effect in 1998, section 3(1)(d) excluded its application to "*acts subject to or authorised by public regulation*". This meant that the competition authorities did not have jurisdiction over regulated entities. In 2000 the Act was amended to repeal this provision and introduce a new section which makes provision for concurrent jurisdiction with regulated entities on competition matters.

7. The Act mandates that the manner in which the concurrent jurisdiction is exercised must be managed in terms of negotiated agreements to coordinate and harmonize the actions of the regulatory authority and the competition authorities. It is on this basis that the Commission has concluded a number of memorandums of agreements ("MOAs") with industry regulators. The main purpose of the MOAs is to clarify how the concurrent jurisdiction will operate where competition concerns overlap with regulatory responsibilities.³

8. Further, the Commission can only consider complaints where an SOE can be shown to participate in a market as a competitor. This stems from *AEC Electronics (Pty) Ltd v The Department of Minerals and Energy*,⁴ in which the Competition Tribunal ("the Tribunal") held that the objective of the Act's prohibited practice regime is the prevention of certain anti-competitive practices by firms that *participate in markets* and not the review of the exercise of state power by state functionaries.⁵ This restricts the scope that the Commission has to intervene in markets where SOEs benefit from market-distorting decisions made by government or regulatory bodies.

9. The extent to which the Competition Act or general principles of competition are referenced in the respective legislation governing SOEs varies. For the electricity utility

³ The Commission has so far concluded memorandums of understandings with the following South African regulators: National Liquor Authority (2008), National Consumer Commission (2011), National Gambling Board (2011), Council for Medical Schemes (2012), Auditor General of South Africa (2014), North West Gambling Board (2014), ITAC (2015), Ports Regulator of South Africa (2015), Department of Agriculture, Forestry and Fisheries (2016), Construction Industry Development Board (2016), Broad Based Black Economic Empowerment Commission (2016), and the South African Bureau of Standards (2017).

⁴ *AEC Electronics (Pty) Ltd v Department of Minerals and Energy* 48/CR/Jun09.

⁵ *AEC Electronics* case at paragraph 18.

Eskom and state-owned airline South African Airways, competition does not seem to form part of the relevant legislation whereas legislation affecting the rail and port utility, Transnet, and telecommunication infrastructure utility, Broadband Infraco, have references to both the promotion of competition and to the Competition Act.

3. Competition enforcement and SOEs: Case studies

10. The cases presented below cover a range of outcomes. The first is an example of where competition enforcement against an SOE resulted in a good outcome (Telkom), the second reflects a failure to regulate *for* competition despite known benefits of doing so (Eskom), the third reflects continued bad conduct by an SOE despite intervention (SAA), and the final case study is one where intervention did not occur and the effects have been particularly ugly (Transnet).

3.1. The Good

3.1.1. Telkom⁶

11. Telkom is a vertically integrated provider of telecommunications services in South Africa in which the South African government holds a majority share. Telkom is regulated by the Independent Communications Authority of South Africa (“ICASA”).

12. Following sector reforms implemented by the first democratic government in 1995/6, Telkom was granted a five year period of exclusivity on public switched telecommunication services (“PSTS”) and facilities provision. In return Telkom was required to fulfil certain universal service obligations. Telkom was the *de jure* monopoly provider of PSTS and facilities services until 2002 and the *de facto* monopoly provider until 2005.

13. In 2002 the Commission received a complaint against Telkom from the South African Vans Association (“SAVA”) and 20 other internet service providers (“ISPs”) alleging that it was abusing its dominance to exclude (existing and potential) competitors in the downstream market for internet services. The Commission conducted an investigation into the allegations and on 24 February 2004, referred the case to the Tribunal. The Commission found that Telkom had:

- Refused to supply access to essential facilities (its infrastructure) to independent VANS providers;
- Induced Telkom customers not to deal with the independent VANS providers;
- Charged their customers excessive prices for access services; and
- Discriminated in favour of its own customers by giving them a discount on distance-related charges which it did not advance to customers of the independent VANS providers.

14. Telkom challenged this referral in the High Court on various grounds, including the jurisdiction of the Tribunal to hear the case. Telkom argued that the relevant jurisdiction to investigate the complaint lay with ICASA, the regulator, and not the competition

⁶ Competition Commission v. Telkom SA Ltd, Case No. Case 11/CR/Feb04 and *Competition Commission v Telkom SA SOC Ltd (016865) [2013] ZACT 62 (18 July 2013)*

authorities. Following legal proceedings lasting several years, the Supreme Court of Appeal (“the SCA”) eventually rejected Telkom’s argument and referred the matter back to the Tribunal to be heard,⁷ finding that the competition authorities had the required jurisdiction and were the appropriate authorities to deal with the complaint.

15. The Tribunal found that Telkom had abused its dominance by refusing to grant competitors access to an essential facility (in contravention of section 8(b) of the Act) and that it had induced customers not to deal with competitors (contravening 8(d)(i) of the Act). The Tribunal imposed an administrative penalty of \$51 600 000⁸ on Telkom for this conduct.⁹

16. Around the same time, the Commission had been investigating a second complaint against Telkom alleging similar conduct. Between 2005 and 2007, complaints were received from a number of competitors.¹⁰ The Commission found that Telkom had again abused its dominance, contravening sections 8 (a), (b), (c) and (d) (iii) of the Act.¹¹ The Commission negotiated a settlement with Telkom which included an admission of guilt, a further penalty and, most importantly, structural and behavioural remedies to prevent Telkom from pursuing similar conduct in future.

17. These remedies included the implementation of functional separation between Telkom’s retail and wholesale divisions along with the implementation of a transparent transfer pricing programme to ensure non-discriminatory service provision by Telkom to its retail business and rival ISPs. The settlement was confirmed by the Tribunal in July 2013.¹²

18. The decisions against Telkom provided the Commission with the appropriate case law to have certainty around jurisdictional questions when investigating firms are subject to oversight by other regulatory bodies. It also provides an example of where effective behavioural and structural remedies unlocked competition throughout the value chain in an otherwise highly concentrated market, dominated by a single SOE. By separating Telkom’s wholesale and retail divisions and operating them as distinct business units, the settlement improved the terms upon which independent service providers could access a non-replicable and essential facility owned by an SOE.

3.2. The Bad

3.2.1. Eskom

19. Eskom is a state-owned power utility, responsible for generating 96% of the country’s electricity requirements. Eskom is subject to regulation by the National Energy Regulator of South Africa (NERSA), which regulates electricity in terms of the Electricity Regulation Act, 2006. Eskom faces (limited) competition in generation from Independent

⁷ *Competition Commission v Telkom* (623/2008) [\[2009\] ZASCA 155](#) (27 November 2009).

⁸ Using a 2012 USD/ZAR exchange rate of 8.6965.

⁹ Tribunal Case number 11/CR/Feb04.

¹⁰ Commission case numbers: 2005Jun1670, 2005Dec2023, 2007Apr2868, 2007Jun2990 and 2007Dec3434.

¹¹ Section 8(a) prohibits excessive pricing, section 8(b) deals with essential facilities, section 8(c) prohibits general exclusionary acts such as engaging in a margin squeeze, and section 8(d)(iii) prohibits tying and bundling.

¹² Tribunal case number: 016865.

Power Producers (IPPs) and some municipalities, who collectively generate less than 4% of South Africa's electricity requirements.

20. As well as enjoying a near monopoly in generation, Eskom is vertically integrated throughout the value-chain, from generation to distribution, and owns the transmission network. Eskom accounts for about 60% of distribution; the rest is distributed by municipalities. Its sole ownership of the transmission network is protected by regulation.

21. Whilst the transmission network has characteristics of a natural monopoly, electricity generation can be (and is in several countries) subject to competition. As the system operator, and designated "Single Purchaser", IPPs are mandated to sell all generated electricity to Eskom. Eskom transmits both its own and its competitors' electricity, making Eskom both player and referee in the market. As a result, and despite government's decision in 2003 that power generation capacity would be divided between Eskom (70%) and IPPs (30%), little progress has been made in this regard.¹³

22. The lack of competition in this market has contributed to South Africa's continued electricity shortages, black-outs, and escalating electricity prices. Despite a number of IPPs lining up to build and supply additional electricity, few of these investments have been implemented. IPPs have been denied access to the transmission grid as Eskom either outright refuses to purchase electricity generated or is able to set the purchase price such that IPPs could not justify their investments.

23. In 2016 and 2017 the Commission received complaints relating to Eskom's outright refusal to sign purchasing agreements with IPPs.¹⁴ The Complainants alleged that this exclusionary conduct by Eskom results in the foreclosure of competing producers of electricity in the market for the production of electricity. Moreover, the Complainants alleged that the refusal to sign the Power Purchase Agreements ("PPAs") means that the IPPs are denied access to the national electricity grid. This, the complainants allege, amounts to a refusal to grant access to an essential facility when it is economically feasible to do so.

24. Before the Commission was able to finalise its investigation, intervention by the Minister of Public Enterprises and the Minister of Energy resulted in the purchase agreements being signed. Therefore, the Commission did not intervene as the conduct which formed the basis of the complaints ceased. The delay in signing the purchase agreements did, however, already have negative effects for IPPs and may have unduly delayed South Africa's transition to a cleaner energy mix. The conduct of the Eskom also clearly shows that it is able to undermine competition and that its (legislative) dominance in transmission may undermine entry and competition upstream.

25. Short of intervention by the Commission and government, IPPs have limited recourse. An Independent Systems and Market Operator (ISMO) Bill was released more than six years ago with the intention to promote competition, particularly at the generation level. The ISMO Bill proposed the establishment of an independent state-owned entity that would become the sole purchaser of electricity from both Eskom and IPPs and would assume responsibility for system operation though the Bill was unclear about whether Eskom or the ISMO would own the transmission grid. The Bill envisaged that ISMO's pricing would be done in a transparent manner and that access to the grid would be regulated in the interest of more competitive prices to consumers. The Commission was

¹³ http://www.energy.gov.za/files/esources/electricity/electricity_independant.html.

¹⁴ Case Numbers: 2016OCT0544 and 2017FEB0037.

broadly in favour of this proposal, with the caveat that further information would be required to assess efficacy and cost savings at each level. The ISMO Bill has not progressed beyond the comments stage.

3.2.2. Airlines: South African Airways¹⁵

26. South African Airways (“SAA”) is South Africa’s national airline and is wholly owned by the government. It has been the subject of numerous complaints to the Commission, covering abuse of dominance, cartel behaviour as well as being the focus of concerns around state-aid distorting competition in the airline industry.

27. In October 2000, a complaint against SAA was lodged with the Commission by a competing domestic airline, Nationwide. The Commission’s investigation concluded that SAA had abused its dominance by concluding agreements with travel agencies resulting in the exclusion of competitors. The Tribunal found these agreements contravened section 8(d)(i) of the Act which prohibits inducement. SAA was fined an administrative penalty of approximately \$6.1 million.¹⁶

28. Two further complaints were subsequently received by the Commission focusing on similar conduct, namely the incentive schemes offered by SAA to travel agents.¹⁷ Following its investigation, the Commission entered into a settlement with SAA whereby SAA agreed to pay the Commission an administrative penalty of approximately \$2 million¹⁸ but with no admission of liability. The settlement also included a behavioural remedy designed to prevent SAA from pursuing similar conduct in future. This settlement was confirmed by the Tribunal in December 2006.

29. Despite the settlement, rival airlines (Comair and Nationwide) chose to continue the case at the Tribunal, as a finding of contravention is a prerequisite for the institution of a claim for civil damages. The Tribunal again ruled against SAA, finding that it had contravened Section 8(d)(i) of the Act and foreclosed competitors, extending its market power in the travel agent segment.

30. In addition to the above, SAA entered into a settlement agreement with the Commission in February 2012 concerning two cartel conduct complaints:

- The Air Cargo Complaint¹⁹ – It was found that SAA was involved in a contravention of section 4(1)(b)(i) of the Act when it engaged in discussions and confirmed information related to fuel surcharge rates with competitors. SAA agreed to pay an administrative penalty of approximately \$2.2 million²⁰; and

¹⁵ *The Competition Commission v. South African Airways*, Case no. 18/CR/Mar01 and *Nationwide Airlines and others v. South African Airways*, Case 80/CR/Sept06.

¹⁶ Using a 2010 USD/ZAR exchange rate of 7.3324.

¹⁷ *Nationwide Airlines (Pty) Ltd v South African Airways (Pty) Ltd* case 80/CR/Sep06.

¹⁸ Using a 2010 USD/ZAR exchange rate of 7.3324.

¹⁹ *Competition Commission vs. SAA Cargo & Others* Commission case number: 2006Mar2215 Tribunal case number 42/CR/Ju110.

²⁰ Using a 2012 USD/ZAR exchange rate of 8.6965.

- The Far East Complaint²¹ – It was found that SAA was involved in a contravention of section 4(1)(b)(i) of the Act when it, along with other “Far East Respondents”, on a number of occasions in the years 2004, 2005 and February 2006 participated in discussions related to market fare levels and coordinated increases on certain market fares for flights out of South Africa to Hong Kong. Further, the Commission’s evidence revealed that during the period under investigation SAA may also have fixed certain other trading conditions including those pertaining to seasonality of fares. SAA in this instance agreed to pay an administrative penalty of approximately \$3 million.²²

31. Despite numerous interventions from competition authorities, SAA continues to engage in anti-competitive practices.²³ Financial penalties do not seem to deter anticompetitive behaviour of SAA as the SOE continues to be the subject of a number of complaints.

32. In addition to these complaints, SAA has also received a number of government bailouts which have formed the basis of a complaint by the main opposition party, the Democratic Alliance (“DA”).²⁴ In the complaint, the DA alleged that SAA and SA Express are harming the local airline industry at the expense of taxpayers and consumers.²⁵ Moreover, SAA and SA Express operate with impunity from external pressures as they are able to rely on bailouts that they receive from the state when they cannot meet their financial obligations.

33. The DA argued that if loans are granted on more favourable terms to SAA relative to its rivals, the operating costs of SAA in the market would be lower than that of its competitors. As a result, Mango, SAA’s low cost subsidiary, would also benefit from the bailout and be able to maintain low pricing whilst rivals are forced to react to market conditions. The net effect of this would serve to entrench SAA’s dominant position in the market.

34. The combination of a dominant SOE consistently operating in an anti-competitive manner and significant state-aid in the form of financial bailouts (which may contribute to the disregard for financial penalties), has meant competition in this market has not been on a level playing field. This is evidenced by a number of rivals exiting the market, such as Nationwide, 1time, Comair, and Blue Crane. And while difficult to ascribe these exits solely to the behaviour of the SOE, these conditions are likely to have played a role in reducing competition.

²¹ Competition Commission vs./ Singapore Airlines Commission case number: 2008Jan3474, Tribunal case number 45/CR/Apr12

²² Using a 2012 USD/ZAR exchange rate of 8.6965

²³ See, for example: Competition Commission Case number 2016Jun0299, It was alleged that SAA has been and is continuing to sub-lease planes to its subsidiary Mango Airlines at discounted rates. This conduct has allowed Mango to offer flights at rates that are below operational costs to the detriment of other airlines in the industry.

²⁴ Case Number 2013Jan0007.

²⁵ SA Express was a division of Transnet. On 18 April 2007, the Cabinet approved the transfer of SA Express from Transnet to the State. SA Express has since become one of the fastest growing regional airlines in Africa.

3.3. The Ugly

3.3.1. *Transnet Limited*²⁶

35. In 2007, the National Energy Regulator of South Africa (“NERSA”) granted Petroline RSA Proprietary Limited (“Petroline”), a private energy company, a license to build petroleum pipeline from Mozambique to South Africa (Maputo-to-Gauteng). This pipeline would have been in direct competition with the existing coast-to-inland liquid fuels transmission pipeline owned by state owned enterprise, Transnet Limited (“Transnet”), which runs from Durban to Gauteng. In the same year, Transnet was also granted a license to build a new multi-product pipeline (“NMPP”) from Durban to Gauteng.

36. In 2011 the Commission received a complaint from Petroline regarding the conduct of the National Treasury and NERSA. Petroline alleged that its pipeline project was rendered unviable by the fact that Transnet received a subsidy from the National Treasury and an allegedly unusual and highly favourable tariff decision from NERSA. In Petroline’s view, the two events rendered tariffs on the NMPP too low for Petroline to be able to operate the alternative pipeline profitably. More formally, Petroline alleged that Transnet is dominant in the liquid fuel pipeline market and has contravened sections 8(c), 8(d)(iv), and 9(1) of the Act.²⁷

37. Petroline would have been the first competitor in the South African liquid fuels pipeline sector. It had invested approximately \$12.3 million by the time it abandoned its project in 2011.²⁸ The events leading to Petroline’s exit are related to the National Treasury’s decision to grant a subsidy to Transnet and NERSA’s decision to alter the methodology it uses to calculate pipeline tariffs, which; combined, allowed NERSA to set a tariff for the NMPP well below where it ought to have been set given the enormous costs of the NMPP.

38. These two events collectively had a major impact on Transnet’s coast-to-inland tariff. It subsidised the Transnet coast-to-inland tariff by sharing the responsibility to pay for it with customers who will not directly utilize the pipeline. Petroline would have had to compete against this subsidized tariff. This is a clear case in which the SOE was favoured over the potential entrant resulting in the NMPP being priced below cost, directly contributing to Petroline’s exit.

39. In line with the decision in *AEC Electronics*, the competition authorities did not have the jurisdiction to enforce competition law in this instance. Lacking any rival or competition incentives, the NMPP was subject to numerous delays and significant cost overruns. It was only completed in 2017, despite Transnet’s indications that it would be completed in 2012.²⁹ The final cost more than doubled, from \$1.03bn to \$2.47bn.³⁰

²⁶ Case Number 2011May0059.

²⁷ Section 8(c) prohibits general exclusionary acts where the anticompetitive effect outweigh pro-competitive gains, section 8(d)(iv) prohibits predatory pricing and section 9(1) prohibits price discrimination.

²⁸ Using a 2011 USD/ZAR exchange rate of 8.1285

²⁹ <https://www.fin24.com/Companies/Industrial/durbanjoburg-fuel-pipeline-opens-after-years-of-delays-spiralling-costs-20171006>

³⁰ Using a 2017 USD/ZAR exchange rate of 12.3026

40. This case provides an example where the inability to enforce competition principles in a market has directly resulted in the exit of an efficient potential rival. The lack of competitive pressure on Transnet likely contributed to the cost overruns and project delays. The alleged undue support from National Treasury and NERSA, largely (perhaps even solely) because Transnet is an SOE may signal to potential competitors that the state will favour state owned entities, thus acting as a powerful and lasting disincentive for entry by private sector firms.

4. Conclusion

41. In the course of enforcing competition law the Commission generally treats SOEs in the same manner as normal corporate entities. In addition to challenge of establishing jurisdiction (contested successfully in the Telkom case), the Commission has faced two general challenges when investigating SOEs:

- Firstly, the South African experience indicates that SOEs are often repeat offenders. The repeated transgressions by Telkom and SAA, despite heavy penalties, is suggestive that financial penalties are likely not a strong enough deterrent for SOEs who are supported by the fiscus and thus somewhat insulated from market-based fiscal discipline. Well thought-out behavioural and structural remedies may be more effective, as shown in the Telkom example where vertical separation removed Telkom's ability and incentive to leverage its upstream monopoly into related markets and stimulated competition.
- Secondly, the current South African legal framework does not allow investigations by the Commission into regulators of SOEs, despite complaints of anti-competitive actions and often substantial inefficiencies arising from such conduct, highlighted in the Petroline case. This means that competition is not always the primarily motivating factor and that potential private sector rivals do not always compete on a level playing field.

42. As the Telkom and Eskom examples above indicate, South African SOEs are mostly natural monopolies which are vertically integrated into other parts of the relevant value chain. Such vertical integration creates incentives for the SOEs to extend their market dominance into the more competitive levels of the value chain, often through anti-competitive means. Importantly, these industries (telecommunications and electricity) form the basis of South Africa's infrastructure and effective competition in these sectors will have substantial positive externalities across a multitude of other industries.

43. Overall, absent a government-backed competitive neutrality framework initiative, the Commission can only investigate complaints after the activity has occurred. In terms of forward looking enforcement, the Commission is limited to engaging in advocacy and conducting market inquiries. The development and acceptance of competitive neutrality principles across government and greater consideration of the benefits of competition in markets where SOEs are dominant may diminish distortions arising from state ownership and should thus remain an important area of competition advocacy going forward.