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COMPETITION FOR-THE-MARKET – Contribution from South Africa

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This contribution is submitted by South Africa under Session IV of the Global Forum on Competition to be held on 5-6 December 2019.

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

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Competition for-the-market

– 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 Competition for the Market to be held on 6 December 2019.

1. Introduction

2. The OECD described *competition for the market* as that which occur when firms compete to serve the entire market rather than competing for market shares. These might include:

- natural monopolies (with large economies of scale);
- publicly funded monopolies (which would otherwise not be provided);
- legally protected monopolies (e.g. products protected by intellectual property); and
- platform monopolies (e.g. digital platforms with powerful direct or cross-platform network effects that generate increasing value from scale).

3. The OECD's primary focus for the roundtable will be on natural monopolies and publicly funded monopolies. The specific request is to focus on the enforcement and advocacy challenges that arise when concessions are offered to natural and publicly funded monopolies. The Commission has chosen to use the land based public transport market inquiry, electricity generation and natural gas markets as case studies in this submission to demonstrate some of the challenges encountered in markets formed as a result of competition for the market.

4. The Commission has recently undertaken a market inquiry in public transport to understand the state of competition in the sector. Some of the issues identified relate to the way in which subsidised bus contracts are awarded and the effect of the duration of these contracts in entrenching monopoly position of the winning bidders. Furthermore, the electricity generation entity (Eskom) relies on coal supply contracts with mines to provide coal to its power stations. The mines must tender for such contracts. The Commission has also investigated complaints in the natural gas industry where Sasol Gas is the sole importer and distributor of natural gas in South Africa. This paper commences by giving an overview of the transport industry in South Africa, followed by a discussion on electricity generation and finally competition issues in the natural gas industry.

* This contribution was prepared by the Competition Commission of South Africa.

2. Overview of the South African Transport industry

5. The land-based public passenger transport market in South Africa consists of minibus taxis, metered taxis, e-hailing services, commuter buses, long distance buses (intercity buses) and commuter rail. The public transport sector is dominated by the minibus taxi industry accounting for approximately 70 per cent of total public transport usage. Buses and rail account for 20 per cent and 10 per cent respectively. Rail in South Africa is provided by government, minibus taxis are privately owned, and buses are privately owned but some are contracted by government to provide subsidised commuter services.

6. Taxis can be distinguished in respect of the types of services they provide and vehicle capacity as promulgated by the National Land Transport Act (NLTA).[1] Taxis broadly include (i) minibus taxis, (ii) metered taxis, (iii) e-hailing services[2] and (iv) other niche players in the market such as tuk-tuks, and four-plus-ones defined in the NLTA as follows:

- Minibus taxis ferry between 9 and 16 seated persons, including the driver and it is an unscheduled service operating on pre-determined route(s).
- Traditional metered taxis are authorised to carry between 1-9 passengers and available for hire (though hailing, telephone or otherwise) and should be equipped with a sealed meter for the purpose of determining the fare payable.
- E-hailing or App-based services refer to technological platforms that provide private operators or drivers with a platform to source passengers using global positioning system (GPS) technology to connect the nearest active linked driver to a passenger who demands the service.
- Four-plus-one taxi-type services refer to unscheduled transport services provided by sedan motor vehicles and must carry not more than five passengers including the driver.
- Tuk-tuk refers to a three-wheeled motor vehicle designed to convey not more than three seated persons, including the driver.

7. With respect to buses, South Africa has both subsidised and non-subsidised commuter bus services. The former are scheduled commuter bus services contracted and subsidised by the government, while the former does not receive any support from the government and are unscheduled. Bus services are provided largely by private operators and government contracts private operators to provide scheduled bus services.

8. Commuter rail is largely a national government competency and the responsibility of this service lies with Passenger Rail Agency of South Africa (PRASA), which is a public entity wholly owned by Government. PRASA has two main divisions, Metrorail for commuter rail within metros and Shosholoza Meyl for intercity services. Metrorail operates in four regions including Western Cape (Cape Town), Eastern Cape (East London and Port Elizabeth), Gauteng (Johannesburg, Pretoria and Ekurhuleni) and KwaZulu-Natal

[1] All land public transport services are regulated by Government through the National Land Transport Act 5 of 2009. South Africa.

[2] E-hailing services, predominantly termed ridesharing or ride-hailing services in other countries include services that use technology platforms such as GPS to connect riders with passengers. Transport Amendment Bill (B7-2016) in South Africa seeks to make explicit the provisions for these types of services to be regarded as public transport.

(Durban). Metrorail is the cheapest of all modes of transport and are mostly used by the low-income households.

9. In Gauteng province, there is another commuter rail operator called Gautrain. Gautrain is an 80 km long mass rapid transit railway system that links Johannesburg, Pretoria and OR Tambo International Airport in the province. It provides two types of commuter rail services, namely: (1) General Passenger Services ("GPS") and (2) Airport Passenger Service ("APS"). Gautrain is a private-public partnership between the Gauteng Provincial Government ("GPG"), Gautrain Management Agency ("GMA") and Bombela Concession Company ("BCC"). In contrast to Metrorail, Gautrain is mostly utilised by the middle-income individuals who use this service as a substitute to private car use.

10. For the purposes of this note, the focus is on the contracted commuter bus services insofar as transport market is concerned, electricity generation and natural gas market.

3. Competition for the market - contracted bus services

11. Competitive bidding for contracts is predominantly used in various markets to ensure that an efficient firm is identified and selected to offer services to the customers. Competitive bidding principles were embedded in the policy documents guiding public transport. The contracts have been used by government in the commuter bus sector to procure commuter bus services.

12. The government has long recognised the need for competition in the commuter bus services. The 1996 White Paper on National Transport Policy formally proposed bus tender system as a method to procure commuter bus services through a competitive bidding process.[3] National Land Transport Transition Act of 2000 (the Transition Act) empowered provincial government departments to enter into subsidised service contracts with bus operators if services to be rendered are put out to public tendering.[4] Prior to 1996, there was no tendering process for bus contracts based on the configuration of the system at the time. There might have been attempts to pilot the tendering system.

13. The envisaged principles of competitive tendering have not been routinely followed in practice due to several reasons which will be discussed later. This section starts with a brief synopsis of various types of contracts that have been used in the commuter bus services. It discusses how these contracts have been used to establish monopolies in the sector and inefficiencies related to these contracts.

3.1. Types of contracts in the bus sector

14. In the bus sector, there are various kinds of contracts which are governed by the NLTA; namely (i) interim, (ii) negotiated and (iii) tendered contracts. The contracts are provided by the contracting authorities (i.e. national and provincial transport departments)[5] to private bus operators for them to provide commuter bus services. These are subsidised

[3] South Africa. 1996. White Paper on National Transport Policy 1996. Pretoria: Government Printers.

[4] section 47 (2).

[5] Although all the three spheres of government are empowered to enter into contracts with bus operators, provincial government is largely a contracting authority.

contracts and the provincial government award these subsidies to private bus operators and monitor operators' compliance with the terms of contracts.

15. Prior to democracy in 1994, bus subsidies were initially introduced as a temporary measure (in 1944) to avert bus boycotts that ensued between 1939 and 1945. Some of these boycotts were trigged by increase of bus fares in Johannesburg and Pretoria. This, together with other effects arising from the implementation of the Group Areas Act, forced the state to agree to subsidise transport costs incurred by Africans. No tendered contracts were put in place, but large bus companies were allocated subsidised contracts for an unspecified duration.

16. In 1997, prior to the Transition Act coming into effect in 2000, government entered into *Interim Contracts* with bus operators that were already providing subsidised bus services (from the apartheid regime). These contracts were to serve as a bridging mechanism until a new tendering system was put in place. Government's plan was to have all subsidised bus services on tendered contracts by end of 2000. Interim contracts were therefore put in place pending the introduction of the bidding system. Interim contracts were meant to be effective for a period of one to three years, however, majority of these contracts have now been in existence for 21 years.

17. Although competitive bidding was recognised as the best way to promote competition, the provisions of the Transition Act also gave legal recognition to negotiated contracts. Negotiated contracts were entered as a compromise given the labour issues that arose from the implementation of the tendering process. Bus operators who were beneficiaries of the contracts, raised concerns about the possibility of job losses in instances where they lost the contracts. The envisaged new operator was not liable to take over all the employees. These concerns led to negotiated contracts as opposed to tendered contracts. The Transition Act at that time prescribed three instances upon which negotiated contracts may be entered into:

- integrating services forming part of integrated public transport networks in terms of the integrated transport plans;
- promoting the economic empowerment of small business or persons previously disadvantaged by unfair discrimination; or
- facilitating the restructuring of a parastatal or municipal transport operator to discourage monopolies.

18. Tendered contracts were subsequently introduced on some routes, but these contracts are in the minority. Most incumbent bus operators managed to get these new tendered contracts. **Table 1** below shows the split between tendered, interim and negotiated contracts.

Table 1. Current status of bus subsidy contracts

Type of contract	Estimated Number of buses	Number of contracts	% of bus subsidy budget	Contract characteristics	Duration
Interim contracts	3 849	39	68%	Foreseen as a transition arrangement in 1997. ICs are now 21 years old	3 years originally. Contract extensions are between 1 and 3 months.
Tendered contracts	1 834	66	28%	Based on a standard contract document. Mostly “stand alone” services in rural/ urban areas	5 years originally. Contract extensions are between 1 and 3 months.
Negotiated contracts	1 300	10	4%	Mostly applicable to state-owned and operated by bus companies	5 years originally. Contract extensions are between 1 and 3 months

3.2. The current subsidised bus services as publicly funded monopoly

19. The Commission notes that the current bus subsidy system, in its current form, prevents competition between commuter bus operators and serves as an artificial barrier to entry, especially for small bus operators. The extension of the current subsidy contracts in perpetuity created *de facto* monopolies on subsidised routes, contrary to what was envisaged in the 1996 White Paper. The White Paper envisaged competition for the market with periodic tendered contracts. The situation is exacerbated by the fact that competition in the provision of subsidised commuter bus services only occurs at the contracting phase (competition for the market) and not on the routes (competition in the market). Given the limited instances of tendered contracts, the subsidised bus services exhibit characteristics of publicly funded monopoly.

20. The contracted bus operators are allocated routes as provided for in the contracts. On the allocated routes, bus operators do not compete with any other subsidised mode of transport. There is, however, very little competition from unsubsidised modes such as minibus taxis given the low fares charged by contracted bus operators. In most of provinces in South Africa, the contracted buses only operate during peak periods and off-peak periods are usually serviced by unsubsidised modes. This is prevalent given the lack of public transport integration in most cities of South Africa. Subsidised buses were meant to transport workers and therefore the need to provide peak period transport.

3.3. Inefficiencies of the current subsidised bus system

21. As posited in economic literature, monopolistic markets have inefficiencies such as lack of innovation, research and development and poor quality services. There has not been meaningful entry in the subsidised bus sector for many years and this contributed to the lack of innovation in the sector. New efficient entrants may bring innovation and improve quality of services in the market for the benefit of consumers, increased entry barriers restrict this development.

22. The Commission received submissions from various stakeholders regarding inefficiencies of bus services, most of which operate on interim contracts. From a commuter perspective, there are concerns around punctuality of buses, breakdowns

experienced during trips and the use of old buses. While these concerns are acknowledged by the contracting authorities (national and provincial transport departments), bus operators have pointed out that these challenges arise as a result of insufficient funding. The bus operators have indicated that funding is a main challenge as operators are unable to buy buses while they are on short term contracts (contracts being renewed on a month to month basis in some cases). Financing institutions require relatively long contracts to provide additional funding to procure buses.

23. Equally, government has raised funding concerns as the main reason for not putting the bus contracts under competitive bidding. Government indicated that the contract price is likely going to double if a competitive process is undertaken and has therefore resorted to the status quo with some of the contracts renewed on the same terms. Limited funding has also resulted in contracting authorities offering the current bus operators' rates that are low. There is limited funding to accommodate new routes as a result of growth in population and the emergence of new settlements.

24. Despite these challenges and limitations, government has been able to keep the bus subsidy system running over the years, based on the available budget. However, this has come at great cost to commuters who are ultimately the intended beneficiaries of the system. For example, commuters have had to endure poor service quality in some of the provinces. Because of inadequate financial support, bus operators have also not been able to adequately respond to the changing and growing needs of commuters by, for example, extending their services to new areas without incurring significant losses. Lack of adequate funding has also had negative effects on the entry of new players, especially small bus operators.

25. Government appears to have reached an impasse, but lack of competition is an undesirable outcome, given the inefficiencies in the current system.

3.4. Impact on entry of small bus operators

26. The Commission received numerous submissions from small bus operators who have been excluded from the bus contracts and challenging the lack of competition in this market. Small bus operators indicated preference for negotiated contracts (as opposed to tendered contracts). In one of the rural provinces in South Africa, Eastern Cape, to empower small bus operators, the contracting authority entered into a negotiated contract with a company made up of 166 small bus operators from different regions within the province. The company operates 3 negotiated contracts and the contracts are for seven years.

27. Although the government's initial plans were to convert interim contracts to tendered contracts, this has not been the case, and this has lead to deterioration in service quality. Several submissions to the Commission revealed that these perpetual interim contracts are predominantly given to the already established and larger bus operators and as a result, entrance of smaller bus operators has been impeded.

28. The Commission will therefore be engaging in advocacy work to advocate for negotiated contracts to introduce more small operators in the contracting system. In addition, to achieve efficiencies while promoting competition in the provision of subsidised commuter bus services, the Commission will champion the gradual introduction of competition in the market and reserving a certain percentage of the bus contracts to emerging bus operators.

4. Electricity generation in South Africa

29. Electricity generation in South Africa is dominated by Eskom. Eskom is a South African state-owned entity and sole supplier of electricity in the country. The power utility relies on coal fired power stations to produce approximately 90 per cent of its electricity and uses over 90 million tonnes of coal per annum. The remaining 10 per cent of electricity is generated from alternative power sources such as renewables, but Eskom is responsible for the distribution.

30. Given the amount of coal required to generate electricity, Eskom strategically built most of its power stations close to coal mines for easy access to the coal reserves. Historically, Eskom used to rely on coal mines within 5km to 20km from its power stations and invited bids for the supply of coal from only those mines. The coal mines have to prove the existence of adequate coal reserves to supply Eskom's specific power station during the power station's lifespan (usually between 40 to 50 years). This led to Eskom entering into long-term supply agreements with surrounding mines. In the recent years however, Eskom started contracting relatively smaller coal suppliers on short-term contracts to supplement the coal sourced through the long-term contracts.

31. Most of the coal suppliers who are contracted on the short-term basis are further away from Eskom's power stations and some are located as far as 200km. The motivation for Eskom to contract the small suppliers was to provide a platform for them to tender in the future and to encourage competition in the coal supply industry. Currently, Eskom has three types of coal supply contracts, namely: cost-plus agreements (long-term contracts), fixed price/indexed contracts (long-term contracts), fixed price/Indexed contracts (short/medium-term contracts).

- Cost-plus agreement (long-term contract) - Eskom has five cost-plus Coal Supply Agreements("CSAs") with three mining companies. These agreements were all entered into in the early 1980s and were concluded only with mines that are adjacent to a power station. These agreements provide for dedicated supply to Eskom and coal is transported to the power station via conveyor belt. The duration of these contracts is aligned to the life span of each power station. Eskom assists the mining companies by contributing a significant portion of capital and working capital to facilitate seamless supply.
- Fixed price/indexed contracts (long-term contract) - In the early 1990s Eskom further entered into four fixed price contracts with three mining companies. These contracts are typically span for more than 40 years and are concluded with mining companies adjacent to power stations.
- Fixed Price/Indexed Contracts (short/medium-term contract**)** **-** Recently, Eskom started entering into fixed price contracts with small coal producers often owned by black South Africans. The duration of these contracts is typically less than 30 years. Eskom use these contracts to increase the participation of black owned businesses in the coal mining industry. The mines are not usually close to power stations, and rail or road transportation modes used to transport coal. Eskom does not contribute any capital for start-up and operations of these mines.

4.1. Competition for coal supply contracts

32. Competition for coal supply takes place only when Eskom issues a tender to the coal mining companies to respond. Some of the mining companies that currently provide

Eskom with coal, were appointed through tender processes whilst the others were appointed through negotiations after unsolicited offers were made by the coal suppliers. Given the need to secure coal supplies, Eskom rely on long-term contracts. However, the long-term contracts create de facto monopolies if one power station is supplied by one mining company. Competition is also limited given the high transport costs of moving coal over long distances which limit the number of mining companies that can effectively participate in the tender process. To minimise coal transport costs, and ultimately the cost of electricity, it is necessary for the thermal power stations to be built next to coal mines to enable Eskom to use the cheapest mode of transport (conveyor belt) to transport coal.

33. The use of long-term supply contracts by Eskom is alleged to foreclose smaller coal suppliers in the market. The Commission is currently investigating two complaints in relation to the contracts for the supply of coal to Eskom. The first complaint is in relation to the long-term supply agreements that are alleged to lead to exclusion of small firms from supplying Eskom with coal. It has also been alleged that the long-term contracts are entrenching the dominance of incumbent coal suppliers, at the cost of small, black owned coal mines as competitors and go against the objectives of an inclusive economy. The second complaint relates to alleged collusion by mining companies that supply thermal coal to Eskom. These cases are still under investigation.

5. Natural gas industry in South Africa

34. Sasol Gas Limited ("Sasol") is the sole supplier and importer of piped gas transmitted through Republic of Mozambique Pipeline Investment Company (ROMPCO). ROMPCO is a joint venture (JV) between the governments of South Africa (25 per cent) and Mozambique (25 per cent), and Sasol (50 per cent). As part of the JV, Sasol was appointed by ROMPCO as the operator of Mozambique to Secunda Pipeline ("MSP") through Operating and Maintenance Agreement (OMA). The gas pipeline from Mozambique to Secunda (South Africa) is 865km long.[6] The gas is produced in Mozambique and is transported through MSP into the gas transmission and distribution pipeline network owned and operated by Sasol based in Secunda in Mpumalanga Province.[7]

35. In consideration of the investment made by Sasol Gas, the South African government and Sasol concluded the Mozambican Gas Pipeline Agreement ("Pipeline Agreement") on 26 September 2001. The agreement allowed Sasol to determine its gas prices with reference to "market value pricing". Under market value pricing, each customer is charged just below the cost of switching to an alternative fuel and this was done to compensate Sasol for its investment in the Mozambican gas field development. The Pipeline Agreement was binding for a period of ten years up to March 2014 and thereafter gas prices are subject to regulation by the National Energy Regulator of South Africa ("NERSA") under the Gas Act. In terms of the Gas Act, NERSA is required to regulate maximum prices. NERSA uses the Maximum Pricing Methodology which is based on a

[6] The construction project costed around $721 million dollars.

[7] http://www.nersa.org.za/Admin/Document/Editor/file/Piped%20Gas/Pricing%20and%20Tariffs/Tariff%20Decisions/Reason%20for%20Decision%20for%20ROMPCO%20tariff%20application%20-%2023%20February%202017.pdf

formula using indicator prices in a basket of coal, diesel, electricity, heavy fuel oil and liquefied petroleum gas with corresponding weights.

36. Major natural gas consumers took Sasol and NERSA to court to challenge the substantial price increases of gas resulting from NERSA's decisions. The companies sought to review and set aside the Maximum Price Decision on the basis that NERSA's determination had been irrational and unreasonable. The Constitutional Court set aside the decision of NERSA to approve the maximum gas price based on the shortcomings in the application of the maximum pricing methodology. This case is an illustration of challenges of price regulation of natural monopolies.

5.1. Competition issues in the natural gas market

37. Both the upstream and downstream market for natural gas have competition issues due to the structure of the markets. In October 2008, NERSA granted Sasol twenty-nine licences for the operation of gas distribution facilities as well as 29 licences for gas trading in various areas of the Gauteng, Free State and Mpumalanga provinces in terms of the Gas Act. Sasol is vertically integrated across the value chain – sole importer, own distribution pipelines, gas distribution facilities in provinces and gas trading. Some of the areas in respect of which Sasol was granted distribution and trading licences by NERSA were allocated within the area of exclusive licence granted to Egoli Gas by the Greater Johannesburg Transitional Metropolitan Council ("GJTMC", now City of Johannesburg). Egoli Gas objected to the granting of distributional trading rights to Sasol and argued that it will be in conflict with its existing rights in terms of the City's Gas Licence by-laws. NERSA maintained that the commercial agreement precluding competition between Sasol Gas and Egoli Gas may be in conflict with the Competition Act. Sasol filed for leniency in respect of corporate leniency policy and the Commission initiated a complaint against Sasol Gas and Egoli Gas. The Commission found that the agreements between Sasol Gas and Egoli Gas had non-compete clauses for the respective allocated markets. Egoli Gas settled and paid administrative penalty of R1 627 910.

38. The second case, similar to Egoli Gas case, also relates to a suite of agreements concluded between Sasol Gas and Spring Lights. Spring Lights was restricted to selling gas it sourced from Sasol Gas to customers in the Durban South region only. Spring Lights admitted having entered into these agreements to divide markets in contravention of section 4(1)(b)(ii) and fixing prices in contravention of 4(1)(b)(i) of the Competition Act. Spring Lights thus settled with the Commission by paying administrative penalty of 3% of its annual turnover for the previous financial year.

6. Conclusion

39. Competition for the market using the three case studies in South Africa produced different outcomes. The perpetual contract extensions in the bus sector has not promoted innovation and the quality of the service has been declining over time. Government has funding constrains to issue new tenders and this affect negatively on service quality. In relation to the commuter bus services, greater benefits could have been derived had the competitive tendering process been used to appoint the bus operators for the provision of the service. The current system has created de facto monopolies due to the use of perpetual contact system that impeded competition. This has led to inefficiencies in the provision of the commuter bus services.

40. In electricity generation, the use of entrenched coal suppliers may be foreclosing small coal producers and creative ways to promote transformation in the sector is required which will not worsen the financial position of Eskom. The market for natural gas is dominated by Sasol and the energy regulator (NERSA) has to play an active role to mitigate the exertion of market power by Sasol across the value chain.