COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA

Case No.: 46/LM/Jun02

In the large merger between:

Anglo American Holdings Ltd

and

Kumba Resources Ltd

with the Industrial Development Corporation intervening

Decision and Reasons [*Non-Confidential Version*]

Introduction

1. In this case we have to decide whether a series of transactions by Anglo American Holdings Ltd (from now on 'Anglo') in which they have purchased up to 34,9% of Kumba Resources Ltd (from now on 'Kumba'):

    1) Amount to an acquisition of control by it of Kumba, in which case it is a notifiable merger in terms of the Act; and then, if so,

    2) Whether the merger should be approved, conditionally approved or prohibited in terms of the criteria set out in section 12A of the Competition Act. In so doing we will have to consider the competition issues raised by the merger in several implicated markets, any efficiency gains it might bring about and the impact on the public interest. All three of these issues are pertinently raised in this case.

Background

2. From the outset this merger proceeding has been dogged by controversy. Perhaps, this is because the prize, control of the country's largest iron ore mining company, has been the dream of many suitors.

Perhaps, because government at the highest level has been drawn in as the confidante of the players involved, and finally, perhaps, because the prospect of a battle for corporate supremacy, particularly when it is waged in the name of conflicting notions of the national interest, always invites titillation and speculation.

3. A brief description of the merger and the events that precipitated it are worth mentioning, not because a long decision requires an overture before it starts, but because some scene setting is necessary in order to appreciate why it is that we have to decide certain issues and why they have taken a particular form.

4. Up until March 2001 the firm that is now Kumba Ltd was a division of Iscor[1]. The integrated firm combined the mining of iron ore with steel making. This arrangement was dictated not by efficiencies, but by political considerations. The economically isolated apartheid government needed to ensure its self-sufficiency in manufacturing by having a domestic steel company. In turn the same logic dictated that the steel company was itself self-sufficient in terms of its supply of iron ore. Hence the integrated Iscor was an industrial giant combining it appears, unusually, both iron ore extraction and steel manufacture.

5. At the same time Iscor was a parastatal and it was not until 1989 that it was privatised under the previous dispensation.

6. After the political changes of 1994, the self-sufficiency-inspired imperatives that drove the old integrated Iscor no longer prevailed. Investors downgraded the value of the firm’s stock - it was neither fish nor fowl, neither wholly miner nor steel maker. Enter the Industrial Development Corporation (from now on, ‘the IDC’) as a key stakeholder. It began, partly due to a massive exposure it had incurred in Saldanha Steel, a greenfields steel mill that it owned jointly at that time with Iscor, to advocate the break up of Iscor into separate stand-alone mining and steel companies respectively. The idea was that the parts were greater in value than the whole. Whilst this episode was being debated, those who saw which way the wind was blowing began to buy up positions in Iscor. Amongst the firms stalking were Avmin and, so it was rumoured at the time, Anglo. It was Avmin who were most public in their intentions and according to reports at the time, wished, in partnership with the IDC, to procure the separation of the firms and then take control of the mining interests. Avmin was half owner of Assmang, which, amongst other assets, owned an iron ore mine and deposits in the Northern Cape, both adjacent to those of Kumba. The word synergies between these assets started to gain currency.

1 On 26 November 2001, Kumba was listed on the JSE.

7. The Avmin coup did not happen but the break up of the two companies did. The steel making plants remained in Iscor and through a swap with the IDC, Iscor acquired the whole of Saldanha Steel. The IDC was left with sizable stakes in both the new Iscor (holding 8.8% of the shares) and the mining company to be known as Kumba (holding 14% of the shares). The markets loved the divorce and the value of both shares increased dramatically. As in all friendly divorces the parting spouses, whilst still on civilised terms, negotiated a sophisticated access agreement. As the price for the break up, Iscor negotiated with its erstwhile mining division a complex set of supply agreements from Kumba's two iron ore mines, Thabazimbi and Sishen. The aim of the agreements was to ensure that Iscor enjoyed as favourable a supply situation post break-up as it had before. Whether it has succeeded in doing so is one of the issues in dispute in this hearing.

8. Meanwhile Avmin, concerned over its high gearing, abandoned its ambitious plan for control of the iron ore industry and sold its, not insignificant, stake in Kumba to a foreign owned company known as Stimela.[2]

9. Stimela and the IDC entered into a co-operation agreement in November 2001 in respect of their stakes in Kumba. Whilst the details are confidential it could be characterised as a joint intent with regard to strategic objectives in Kumba. Included was a clause granting the IDC first option to buy Stimela's Kumba stake, if it ever sold it.

10. So the stage was set at the beginning of 2002 for the IDC and its partner, Stimela, to take control of Kumba. At that stage their combined holdings would have been 24,5%.

11. But it was not to be. In a corporate announcement on 12 March 2002 Anglo American plc announced two significant acquisitions. In the one it had acquired, from Arctic Resources Limited, a 34,9% shareholding in Avmin. In the other, it acquired a significant stake in Kumba by acquiring all the shares in Stimela BVI, which is the ultimate beneficial holder of 10.5% of shares in Kumba, thereby raising its total shareholding in Kumba to 20.1%.[3] It was, it said, the start of a move to consolidate the Northern Cape iron ore assets of Kumba and Assmang.

12. The Anglo blitzkrieg had caught the IDC off-guard and certainly surprised the market. An acrimonious dispute broke out between Anglo

2 See Financial Mail dated November 9, 2001 article entitled "Menell keeps options open." The ultimate shareholder in Stimela was Israeli businessman Bennie Steinmetz also a key investor in Arctic Resources, whose shares in Avmin were later purchased by Anglo when it bought Stimela.

3 Prior to this Anglo had held a 9,6% stake in Kumba.

and the IDC over the Stimela shares. The IDC suggested that they had been sold to Anglo in breach of their option. Anglo and Stimela's erstwhile shareholder Murex Holdings S.A, assert that what has been sold is ownership of Stimela not the shares subject to the option. The rights and wrongs of this commercial dispute are not relevant for purposes of our jurisdiction. However it does explain two aspects - why the IDC and Anglo came to have such an acrimonious relationship, and secondly, how the IDC came to feel so strongly that its empowerment ambitions for Kumba, developed over time, had been frustrated. Which of the two set of frustrations to its ambitions more greatly animates the IDC is hard to know, but that these events would make Anglo its' *bete noir* is hardly surprising.

13. Anglo on 18 June 2002 duly notified two mergers with the Commission, the Avmin and Kumba deals. Although separate transactions, the Commission investigated them jointly and duly made its recommendation to the Tribunal that both mergers be approved without conditions.

14. At the first pre-hearing in respect of the mergers held on the 20th of September 2002, the IDC applied to intervene in the proceedings. Anglo opposed this application vigorously, and ultimately, unsuccessfully. This saga is more fully detailed in other decisions,[4] suffice to say that several Tribunal hearings and two Competition Appeal Court decisions later, the IDC were granted leave to intervene on stipulated grounds. This litigation lasted from September 2002 till 28 March 2003 when the CAC gave its final ruling.[5]

15. Whilst this battle between Anglo and the IDC was continuing in the Tribunal and the CAC there was another twist to the tale. The government and Anglo American announced that they had signed a Memorandum of Understanding in respect of the Northern Cape iron ore fields. Although all parties to this agreement claimed that it is confidential, a public statement indicates common objectives in respect of investment, development of the Sishen – Saldanha railway line, use of another railway line from the Northern Cape to Coega and the advancement of empowerment. Signatories to the agreement from government included three national departments. The IDC, although mentioned in the agreement, is not a party.

16. A second pre-hearing was held on the 23 April 2003 and the hearing

4 The two decisions by the Tribunal are: Case No: 45/LM/Jun02 // 46/LM/Jun02 dated 23 October 2003, Tribunal Case No:45/LM/Jun02 // 46/LM/Jun02 dated December 2002 and the two decisions by the Competition Appeal Court are: Case No:24/CAC/Oct02//25/CAC/Oct02 and CAC Case No:26/CAC/Deco2.

5 The Competition Commission had initially also opposed the IDC's application to intervene but abandoned this stance after the first CAC hearing.

was set down for 26 to 30 May 2003.[6] On the 5th of May 2003 came a dramatic development. Anglo announced that it was selling its Avmin stake to a consortium comprising Harmony Gold Mining Company Limited and Armgold, citing in its press statement inter-alia as a rationale, the competition concerns that had arisen because of its Kumba acquisition.[7] The sale of the Avmin stake reduced the extent of overlaps that would be created by the two mergers originally notified, most notably in iron-ore.

17. When we commenced our hearings on 26 May 2003 we were thus asked to consider only the Anglo/ Kumba notification as the Anglo/ Avmin notification had been withdrawn.

18. The late development meant that most of the filings, including the reports of the economic experts of the IDC and the merging parties were outdated in many respects as much of the consideration given in them was the significance of overlaps added by the Avmin leg. Nevertheless we are of the view that this deficiency in the record has been rectified by the oral evidence of the witnesses which addressed the Kumba transaction pertinently and from the point of view of fairness by the ample opportunity we have given the IDC to make further filings of expert reports. Since Anglo opposed this latter issue we have had to rule on the admissibility of the late filings and it is to this issue that we turn next.

Late filings

19. After the merging parties and the IDC had concluded with their oral evidence and immediately prior to us hearing the closing arguments of the various participants, the IDC filed various additional expert reports which were, we were told, a response to various questions put to their expert economist in cross-examination and to which he had not been given an adequate opportunity to deal. Anglo, for its part, although it had filed further documents in response, objected to the late filings, as the documents were not available at the time neither for comment by its own experts nor for cross-examination.

20. The presiding member indicated that the Tribunal would rule on the admissibility of these documents at the time we gave our decision. We have decided to accept this documentation as part of the record. Anglo's belated announcement that it would be selling its Avmin stake

6 As it happened this time was insufficient and the hearing continued on 15,17 and 19 June while closing argument was heard on 6 and 7 August.

7 In its press statement dated 2nd May Anglo states: " Subsequently it became apparent to Anglo American that there were concerns about it owning an effective interest in both Assmang and Kumba iron ore assets and combining the iron ore assets in the Northern Cape."

had a profound effect on the emphasis of the record up until that date in respect of the competition issues. The IDC had focussed its opposition to the merger up until then on the creation of what it termed as a local monopoly in iron ore and the merging parties had in turn focussed on the efficiency gains from consolidation in the Northern Cape iron ore industry.

21. The announcement thus meant a change in focus by all participants and it was therefore in our view legitimate for the IDC to argue that it required an additional opportunity to address certain of the economic issues. We have decided to admit these additional documents including those filed in response by Anglo to the record.

22. That being said we have approached the additional documents with caution, bearing in mind that they were not the subject of testimony during the proceeding and accordingly must be accorded less weight than those documents that were.

23. Finally, we have also admitted, and therefore considered, proposals that the IDC made in respect of conditions to be attached to the approval of the merger despite the fact that these proposals were not made during the course of the proceedings. Although the specific conditions were not canvassed, the issues to which they relate were, and for that reason they would have been matters that we, in any event, considered in evaluating the merger.

Approaches adopted by the participants

24. The merging parties were separately represented during the course of our proceedings. The acquiring firm, Anglo, argued that the transactions amounted to a merger and that the merger should be approved unconditionally. Kumba, which is the target firm, was represented but did not participate in the proceedings in any meaningful manner. Kumba's legal representative put the issue quite frankly when at the end of proceedings he stated that his client was reluctant to involve itself in a dispute among its shareholders.

25. The Commission had initially, when both the Kumba and Avmin transactions had been notified, recommended their approval without conditions. It maintained this position throughout the proceedings and largely made the same case that Anglo did, although the Commission did not call any of its own witnesses. The Commission was also in agreement with Anglo that the series of transactions amounted to a merger.

26. The IDC having been given leave to participate in the proceedings, opposed the merger from the outset. This stance did not alter despite the withdrawal of the Avmin leg of the transaction. The IDC was initially of the view that the transactions did not give rise to a merger as there was no evidence that there had been an acquisition of control in the record. It later, after the evidence given during the hearing, altered its position to argue that the 'notification' of the merger was defective.

27. In the alternative it argued that if the transactions gave rise to a merger this merger should be prohibited on both competition and public interest grounds. Later, as we have already mentioned, the IDC proposed that if we were inclined to approve the merger it should be subject to various conditions, which it suggested.

28. Although we have not found for the IDC in this decision, we benefited from its participation as an intervenor given the economic and social significance of this transaction. Our deliberations were enhanced by the fact that information placed before us was subject to vigorous scrutiny and critique, by a party with an adverse interest.

Jurisdiction

29. The IDC initially raised a jurisdictional challenge premised on the basis that the transaction contemplated by Anglo did not amount to a merger in as much as the shareholding contemplated did not give rise to a change of control. Later, apparently after hearing the evidence of Anglo's chief executive officer Mr. Trahar who testified as to the fact that Anglo currently held equity and options amounting to 34,3% of Kumba and that it intended to acquire up to 49%, this attack shifted to the adequacy of the manner in which the transaction was notified and it is this issue which we will now consider.[8]

30. When merging parties notify a merger the rules of the Competition Commission require them to do so in accordance with a prescribed form. The form in question, CC 4(2) requires the merging party to provide details concerning the transaction. Question 11 asks for the following information:

> *Describe the merger, including: the parties to the transaction; the assets, shares, or other interests being acquired; whether the assets, shares, or other interests are being purchased, leased, combined or otherwise transferred; the consideration,*

8 Although Kumba is a new company the evidence concerning the shareholder meetings it has held thus far, suggests that a shareholder with 34,3% equity would command a majority vote at a general meeting. The same would have been true of previous meetings in Iscor in the last few years prior to the unbundling of Kumba.

the contemplated timing for any major events required to bring about the completion of the transaction; and the intended structure of ownership and control of the completion of the merger.

31. In answer to this question Anglo provided the following information:

1) *On 8 March 2002 AAH (Anglo American Holdings) concluded an option agreement with Murex (attached as Annex C) in terms of which AAH acquired a call option to purchase, and Murex acquired a reciprocal put option to sell, either:*

2) *the shares that Murex holds in Stimela BVI, which is the ultimate beneficial holder of 10.5% of the shares in Kumba); or*

3) *the shares of Stimela SA, provided that Murex ensured that the shareholding in Kumba by Stimela BVI was transferred to Stimela SA; or*

4) *the underlying assets of Stimela BVI, being the shareholder in Kumba;*

5) *in each case, subject to the suspensive condition that the necessary competition approvals were obtained prior to the shares being transferred.*

6) *In terms of a letter dated 10 April 2002, AAH exercised the call option to purchase the Stimela BVI shares. A copy of the letter exercising the call option is attached marked Annexure G….*

7) *AAH has been advised by Stimela BVI that it has concluded a co-operation agreement with the IDC, (the other major shareholder in Kumba, whose current shareholding in Kumba is 14%), in terms of which Stimela BVI and the IDC have agreed to co-operate in respect of certain specific issues with respect to then iron ore assets of Kumba. The parties to the agreement have undertaken to keep the agreement confidential.*

8) *In addition to the Stimela BVI shares, Anglo American has concluded a further option with a third party, in terms of which it has the option to acquire up to an additional 3.8% shareholding in Kumba.*

9) *Anglo American (through ASAC) already holds 9.6% of the equity in Kumba, which it acquired through open market*

purchases. <u>Furthermore, Anglo American intends to acquire further shares in Kumba as and when opportunities arise.</u> (Our emphasis)

10) *In summary, when Anglo American has exercised all the relevant options and acquired the relevant shareholdings pursuant to such options, it will hold at least 23.9% in Kumba.*

11) *Anglo American has appointed Mr Cedric Savage to Kumba's board of directors.*

12) *Accordingly, in the circumstances, Anglo American's aggregated shareholding together with its board representation would afford it the ability to materially influence the policy of Kumba for the purposes of section 12(2)(g) of the Competition Act as a result of the transaction.* (Our emphasis)[9]

32. The IDC argues that this information was incomplete at the time and that, as a result, the notification is a nullity. It argues that information subsequently provided, namely the extent of Anglo's ambitions about acquiring an interest in Kumba, was not disclosed in the form. Since the information disclosed on the form became the basis on which trade unions and the Minister were notified, they were obliged to respond to incomplete information. In turn, since their responses form part of the Commission's investigation and subsequent recommendation to the Tribunal, the whole process is tainted by this want of proper compliance.

33. In our view there is no substance to this objection. The CC4(2) makes it perfectly clear that Anglo already owns shares of 9.6%,has acquired options of a further 10.5% and 3.8% respectively, and will be continuing to purchase further equity in the target company. Anyone reading this form would clearly have understood that Anglo was intending to enlarge its existing stake and that its end was to control the company in the manner contemplated in section 12(2)(g). Anglo argues that a more precise description at the time of how much it was still purchasing, and from whom, would have been impossible given that this was equity to be purchased on an open market in a public company from possibly numerous sellers. This explanation for the deficiency at the time is perfectly reasonable.

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9 Suitably paraphrased section 12(2)(g) states that a firm controls another firm if it has the ability to materially influence the policy of a firm in a manner comparable to a person who controls a company either by virtue of owning the majority of its shares or controlling appointment of the majority of the board.

34. Whilst one could not expect firms to notify a merger where their ability to acquire control was at that stage still academic it is not necessary for them to have completed the process of acquisition as a jurisdictional prerequisite to notification. To do so would create burdens on merging firms who would then be faced with the Scylla of not implementing a merger prior to approval, and the Charybdus of not adequately completing a transaction prior to notification. In our view, unless information not notified, materially affects the evaluation of the merger, failure to detail the final series of transactions is not fatal. It might well be that the extent of an acquiring firm's interest in the target may affect the competition analysis, but that is an issue that may form part of the analysis and does not detract from the adequacy of the initial filing.[10]

35. The answer to the question must also be read with the competitiveness report where again a description of the transaction and Anglo's intentions are set out. Included as part of its filing was an executive summary served on both the Minister and the unions which contained the following:

> "Anglo American also has prospective interests in other shares in Kumba, which may be acquired in due course…(and later on)...*For the purpose of competitive analysis, as the largest single shareholder, Anglo American will be able to exercise material influence over Avmin and Kumba, and those companies in which they have a significant stake (such as Assmang)."*[11]

36. We may assume that the diligent reader of the notification will read all the information filed. That reader could have no doubt that Anglo intended through a variety of transactions, some of which had already taken place, to acquire control of Kumba. Granted, Anglo did not disclose how large a stake in Kumba it intended to acquire and that this fact only emerged during the hearing in the evidence of Mr. Trahar, its chief executive officer, but once it had disclosed in the notification its intention to acquire sole control by virtue of some stake in excess of 23.9%, the remaining issues were matters for evaluation of the merger, not to found jurisdiction.

37. Thus by way of example, a firm may indicate in its filing that at that stage it has 20% of a company but will have control by virtue of section 12(2)(g). It may be that if the acquirer's stake did not exceed this figure its incentives would be different than if it owned 100% of the target.[12]

10 For instance a firm's incentives may differ depending on whether it holds 20% or 100% of a company post merger.

11 See Record page 32.

12 For instance the target may be a supplier of the acquirer and the acquirer might have an incentive to use its control of the target to squeeze its margins in favour of itself.

This however is a substantive not a jurisdictional issue. If the transaction might give rise to competition concerns only if the firm owned a controlling stake of more than X% of the equity, then the way to cure that problem, might be to either (i) prohibit the merger, on the assumption that the problem may occur later or (ii) to conditionally approve the merger, either by prohibiting the acquiring firm from acquiring a stake above X% or to require it to notify again if it went above X%. In other words, the inherent uncertainty as to the extent of ownership in a notified transaction need not be cured by deciding that the merger is inadequately notified, but rather by the Tribunal appropriately utilising the substantive powers that it has in terms of section 16.

38. In this merger, whilst the threshold for Anglo's ambitions in respect of Kumba is not known with any certainty,[13] we have approached the evaluation by not merely evaluating its incentives in respect of its present holding of 34,9% or its proposed holding of 49% but also if it went past that threshold and acquired the remaining equity. Had we felt that the size of the holding would have altered its incentives or behaviour other than as a profit maximising shareholder in Kumba, we would have imposed conditions to this effect. However, we see no reason to do so.

39. Whilst there may have been an element of opaqueness in Anglo's approach to the notification, and even some inconsistency during this process about when control is reached, we are by no means certain that there was information that it did know at the time and that it failed to disclose in order to present the proposal in a more palatable form at the time of filing, lest it stir controversy.[14]

40. We find that the merger has been adequately notified, constitutes an acquisition of control, and that the Commission and the Tribunal have jurisdiction over the transaction in terms of the Act. We need not decide various arguments made by Anglo as to whether proper notification is a

13 Mr. Trahar's conversation with Minister Erwin notwithstanding there is nothing to bind Anglo legally to this level of shareholding.

14 On the inconsistency front the IDC makes much of the fact that Anglo had seemingly relied on its existing stake plus the Stimela option and another to reach control yet had a few months later implemented the Stimela option after having obtained a favourable opinion from the Commission that this did not amount to implementation as it did not amount to a change of control. On the lack of adequate disclosure the IDC suggested that an option Anglo had obtained in respect of Deutsche Securities (Proprietary) Limited holdings in Kumba and which was only announced on 22 November 2002, in an announcement by Kumba after the Commission had filed its recommendation, was in existence at the time of the filing of the CC(4) and should have been mentioned then. There is no evidence that this is in fact so and the IDC seem to be relying for this on a remark made by Anglo's counsel in response to a question from the Tribunal about what Anglo's holding was at the time of filing. Perhaps the real reason for Anglo's apparent cloak and dagger behaviour is not an ulterior anti-competitive motive that it wished to conceal from scrutiny during the regulatory process, but a desire to quietly build its stake in Kumba without attracting the attention of rival suitors.

peremptory requirement in terms of a proper reading of the Act and rules. For the purpose of this decision we have assumed it is, but that it is a requirement that has been met.

Competition Analysis

41. Anglo and Kumba's products overlap in four areas (1) coal (2) mineral sands (3) zinc and (4) iron ore.

42. The IDC's competition concerns related to the latter two markets only, and for this reason although we examine all four, we devote more time to the analysis of the effects of the merger on zinc and iron ore.

<u>Coal</u>

43. Both Anglo and Kumba, through Anglo Coal and Kumba Coal respectively, produce coal. Anglo Coal's operations in South Africa include eight wholly owned collieries located mainly on the Witbank coalfields.[15] Kumba's operations include three wholly owned collieries, Leeuwpan, Grootgeluk and Tshikondeni.

44. Coal is a differentiated product that is categorised according to the degree of transformation of the original plant material to carbon. The ranks of coal from lowest to highest are lignite, sub-bituminous, bituminous and anthracite. Bituminous and anthracite are the only two ranks mined in South Africa, with bituminous accounting for most of the sales.

45. Within bituminous coal a distinction is made between thermal coal, also referred to as "steam coal" that is used for power generation and metallurgical coal, referred to as "coking coal, which is used in the production of steel.

46. Yet even within metallurgical coal the product is differentiated, depending on the amount of coke.

<u>Thermal coal</u>

47. The four largest producers of thermal coal, excluding Sasol and Eskom's suppliers,[16] are: BHP Billiton with a market share of 27%, Kumba with a market share of 18%, Duiker (Xstrata) with 11% and

15 Anglo operates the following coal mines: Bank, Greenside, Goedehoop, Kleinkopje, Landau, Kriel, New Denmark and New Vaal.
16 Sasol is excluded because it consumes its entire thermal coal production internally and suppliers to Eskom are excluded because they are locked into long-term contracts.

Anglo Coal with 9%. Post merger the market share of the merged entity will be 27%.

48. Approximately 70% of South Africa's thermal coal is used to generate electricity or produce synthetic fuels. The two largest consumers of thermal coal in South Africa are Sasol and Eskom and they account for more than 90% of the coal used. Eskom consumes 56% of thermal coal produced in South Africa and Sasol 35%, while Highveld Steel, Iscor and municipal power stations use the remaining 9%.

49. Anglo mainly supplies thermal coal, inter alia, to customers such as Eskom, Scaw Metals, Highveld Steel and certain municipal power stations. Kumba supplies customers such as Eskom, PPC and certain municipal power stations.

50. It is unlikely that the merger will give rise to a substantial lessening of competition in the thermal coal market. Coal supplies to Eskom are covered by long-term contracts, the prices of which are fixed and indexed to adjust for inflation or cost-plus. Sasol supplies its own coal with BHP Billiton being the only external contractor to also supply Sasol.[17] Smaller players can source their coal from a number of alternative players such as BHP Billiton, Duiker, Eyesiswe and Kangra.

Metallurgical coal

51. Metallurgical coal accounts for less than 3% of coal used in South Africa. Of this percentage 40% is imported.

52. Firms that use metallurgical coal in their production process, design their operations in a way that requires metallurgical coal with very particular specifications, for instance, Iscor requires and also imports metallurgical coal that has a high measure of "coke strength after reaction".

53. Nearly all of the metallurgical coal sold in South Africa by Kumba is hard coking coal sold to Iscor under long-term contracts. Anglo Coal does not have such reserves and sells 60% of its production to its own related entities. The rest is sold to Siltech and CMI (known as Xstrata-Lydenburg).

54. Because of the differentiated use of metallurgical coal there is no direct overlap in this product segment between Anglo and Kumba and they are not regarded as competitors in this product market.

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17 Subsequent to the filing of this merger Sasol Mining and Anglo Operations, through its coal division, concluded a merger transaction through which Anglo will supply Sasol with Coal from its Kriel opencast Colliery, see Tribunal Case No: 26/LM/May03.

Mineral Sands

55. In South Africa three companies produce products from mineral sand mining, namely, Anglo, which owns Namakwa Sands on the west coast of South Africa, Kumba, which owns Ticor SA[18] on the east coast and Richards Bay Minerals, which is also on the east coast. BHP Billiton and Rio Tinto jointly own Richards Bay Minerals.[19]

56. The principal products obtained from mining and processing mineral sands are titanium dioxide feedstock, high purity pig iron and zircon. We deal with each one separately.

Titanium Dioxide Feedstock

57. The three firms mentioned earlier are the only local producers of titanium dioxide. Their market shares are:

Richards Bay Minerals	80%
Namakwa Sands	15%
Ticor	5%

58. Both Richards Bay Minerals and Ticor are situated on the east coast of South Africa, while Namakwa Sands is situated on the west coast.

59. The largest domestic customer for this feedstock is Huntsman Tioxide, which consumes around 97% of domestic production that it sources largely from RBM, as it is also located on the east coast.

60. According to Anglo its' Namakwa Sands plant has a locational disadvantage in respect of domestic customers, as it is located on the west coast whilst the major domestic customers like Huntsman, and to a lesser extent Chiesa, are located on the east coast. Presently the only customer domestically that would now find that its choice of suppliers had reduced from 3 to 2 is Afrox, but they do not constitute a major source of consumption, accounting for sales of only R 6 million.

61. Whilst the merger will lead to the number of producers declining from three to two this is unlikely to reduce competition substantially given that:

18 Ticor SA is a new company that began its operations in 2001. The ownership of Ticor SA is split 60:40 between Kumba and Ticor, an Australian mining company. Kumba's effective interest in Ticor SA, however, is significantly greater than 60% because Kumba also owns 46.5% of Ticor.

19 A fourth player is currently entering the South African market, namely Mineral Commodities, a company from Australia, which will be situated on the east coast.

- Huntsman accounts for 97% of the consumption and appears from a location point of view committed to RBM as its supplier;
- The location of Namakwa Sands suggests it is not a viable competitor for RBM and Ticor.

Zircon

62. In South Africa, where Zircon has a limited application, it is used mainly in ceramic applications as a glazer. It is also used in foundries, refractories and TV glass.

63. South Africa exports 98% of its Zircon production. In South Africa, Richards Bay Minerals enjoys a market share of 62%, Namakwa Sands 33% and Ticor 5%.

64. Post the merger Anglo will have a market share of 38%. However, the merger would have little effect because Richards Bay Minerals will still be the largest producer in the country. Anglo has argued that there is again here limited competition between Namakwa and Ticor not only because location is relevant in respect of this product but also because there are distinctions in the types of zircon produced by the firms making the one firm's products not suitable as substitutes for the products of the other.[20]

High purity pig iron

65. High purity pig iron is an output product from the ilmenite smelting process. Currently only Richards Bay Minerals and Namakwa Sands produce high purity pig iron since Ticor does not have a smelter yet.

66. Richards Bay Minerals' market share is 86% and Namakwa Sands 14%. The price of pig iron in South Africa is at export parity and there are no capacity constraints that limit the ability of South African producers to increase exports. South Africa exports 94% of its high purity pig iron.

67. In summary, we agree with the Commission that there would not be a substantial lessening of competition in the various mineral sands product markets as a result of the merger.

Zinc

68. The dispute between Anglo and the IDC on the competition issues

20 Mention is made of Foskor, which requires the particular Zircon produced by Namakwa Sands.

associated with this merger starts with zinc.

69. The zinc industry is for our purposes composed of an upstream and downstream market. The upstream market is for the production of what is know as zinc concentrate. This entails the mining and some preliminary beneficiation of the ore to produce zinc concentrate. The mining and beneficiation is typically an integrated operation and for our purposes, we can speak of the production of zinc concentrate as a relevant market.

70. Zinc concentrate however is an intermediary product. It needs to be further processed into zinc metal the final product, which is then sold in the market. The process of transformation is achieved through the refining and smelting of the concentrate into metal, which is then sold to customers in various industries.[21]

71. The process of refining is not an integrated operation in South Africa and is performed by a single refiner, Zincor. We will for this reason refer to the zinc metal market as a separate downstream market.

72. It is common cause between Anglo and the IDC that the merger leads to overlaps between Anglo and Kumba in the zinc concentrate market. It is also common cause that Kumba is, because of its ownership of Zincor, in the downstream market. What is not common cause is whether Anglo is a potential entrant into the downstream market and that whether its choice to enter that market by acquisition rather than independent entry will lead to an increase in the price of zinc metal in South Africa.

73. Anglo American operates a zinc/lead mine in the Northern Cape Province, called Black Mountain. It also owns the undeveloped Gamsberg ore reserves.[22] Anglo is also in the process of constructing a zinc refinery in Namibia, called the Skorpion project, as part of an Export Processing Zone. However, this development will not have an effect on South Africa because, according to Anglo, sales to SADC members are prohibited.

74. Zincor, a wholly owned subsidiary of Kumba, is the only zinc refiner in South Africa. Zinc is supplied to Zincor by all the South African producers. Kumba also operates the Rosh Pinah lead/zinc mine in

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21 Zinc metal used mainly to galvanize steel products. In the chemical industry its compounds are used as filters in rubber and paints. South Africa is ranked fifth in terms of global zinc reserves, however we are a relatively small producer and exporter of zinc by world standards, ranked only 18th. China, Australia and Canada are the largest producers of zinc metal. Canada is also the leading exporter.

22 The Gamsberg project has been postponed indefinitely because of the depressed zinc market, which is at a 20 year low.

Namibia.

75. In the upstream market Anglo has a market share of 28% (it owns the Black Mountain mine), Kumba 36% (it owns the Rosh Pinah mine), BHP Billiton 11% (it owns the Pering mine), Metorex 12% (it owns the Maranda mine) and imports 17%. Post the merger Anglo will have a market share of 64% in the upstream zinc market. However, both the Pering and the Maranda mine will stop producing by 2004. Black Mountain is expected to close in 2013 and Rosh Pinah has 8 years of production left.

76. Zinc concentrate is not traded on the London Metal Exchange ("LME") because all of the zinc concentrate produced in South Africa is supplied to Zincor. It is sold by way of long-term contracts between the mine and smelter.[23] The price is, however, tied to the LME benchmark price for Special High Grade zinc ("SHG"). The lack of exports of zinc concentrate from Southern Africa is an indication that the prices paid by Zincor for zinc concentrate have been sufficiently high to make it more economic for independent producers of zinc concentrate to supply Zincor than to sell their product on the export market. We therefore regard the geographic market as international.

77. In the downstream market the zinc refinery, in this case Zincor, receives concentrated ore from the various mines and refines it into one of the primary grades of zinc metal.[24]

78. The local input of zinc concentrate is insufficient to meet Zincor's demand. Zincor, therefore, imports 4% of its concentrate requirements. It receives 24% of its zinc concentrate from Rosh Pinah, 36% from Black Mountain, 12% from Maranda and 20% from Pering.

79. Nearly all of the output of the Zincor refinery, 87%, is used within South Africa and 13% is exported. The majority of its output, around 24%, is sold to Iscor, its largest customer, and 63% to other domestic customers. Its zinc customers are all located within a 100km radius of its plant, located near Johannesburg. Approximately 10% of domestic consumption is imported, mostly by customers located close to the coast in Cape Town.

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23 For historical reasons mines are paid for only 85% of the zinc in concentrate. This has persisted even though smelters now recover 95% of the zinc in the concentrate. The difference between the 85% paid for and the 95% recovered is referred to as "free zinc". The zinc that is paid for is called "payable zinc". The mine pays the smelter a fee known as the treatment charge to transform the concentrate into saleable zinc metal. The treatment charge is set in annual negotiations with reference to a base price, normally an expected SHG price. The treatment charge is typically about 40% of the actual SHG price.

24 Zincor is regarded as the 3rd lowest cost producer of zinc metal in the western world, according to international benchmarking by Brook Hunt 2000.

80. Zinc metal is an internationally traded commodity and is traded on the LME. The price paid for zinc metal in South Africa equals the LME price plus a premium that is individually negotiated between buyers and sellers to reflect the quality of the zinc purchased and logistical issues.[25] It is priced at near import parity.[26] We thus regard the geographical market as international.

81. According to the IDC the transaction will have a horizontal effect on the zinc market leading to the diminishing or prevention of future competition in the zinc market.

82. Zincor, operated by Kumba, is the only zinc refinery that is operating in the downstream market. According to the IDC there are, from an anti-trust perspective, two possible future entrants that could come into the market and compete with Zincor. The first is Anglo's Gamsberg project, not yet established, but which in terms of its proposal would have included a refinery, and the second, the Skorpion refinery in Namibia, also being developed by Anglo.

83. The Gamsberg project was, according to Mr Trahar, mothballed indefinitely in 2001 because of a depressed zinc market and the Skorpion refinery in Namibia is prohibited from selling into the Customs Union Area because it is part of an Export Processing Zone. Anglo, therefore, argues that these two refineries could not be regarded as potential entrants.

84. However, should the Gamsberg project be reactivated it would, according to Anglo, not affect prices in the zinc market.

85. The IDC argues that the coincidence between the decision to mothball the Gamsberg project and the date at which Anglo must have considered acquiring its interest in Kumba could lead one to draw the inference that the only reason the project was abandoned was because with the merger, Anglo had no need to own its own refinery. The explanation that Anglo would never have entered because of the present state of the market is not credible, according to the IDC.

86. Anglo vehemently deny this and state that the Gamsberg project would not have happened in the present state of the zinc market even absent the merger.[27] Whilst we are in no position to resolve this dispute of fact we need not do so. The evidence turns on whether, if

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25 Transport only represents 2% of total cost. Thus if the local price is raised by 5%, customers will turn to imports.

26 Dr Hilmar Rode of Anglo, told the Tribunal that Zincor indicates on its website that it purchased zinc concentrate on international terms, see transcript p. 297.

27 Given its location in the Western Cape, well away from the bulk of the domestic customer base for zinc metal which is inland, the project needed to be largely dependent on exports to be viable.

Gamsberg had come on line as a refinery, it would have led to a substantial reduction of zinc metal prices for domestic consumers.

87. The zinc metal pricing is pinned somewhere between export and import parity. According to Anglo the Johannesburg PWV area is the largest zinc metal market and the difference between import and export parity pricing is of the order of 2-3%. In terms of the two import satellite markets being Cape Town and Durban, the difference in export and import parity pricing is 1% and less. These percentages will thus be the maximum potential reduction in pricing, should Gamsberg enter the market. Firms involved in galvanising, who are the most important downstream consumers of zinc metal, indicated to Anglo that zinc represents 20% of their costs. Thus the reduction of 2-3% of a 20% cost input is very small and will thus not have a substantial effect on competition.

88. The evidence of Anglo,s Dr Rode, who was the only witness on this point which was not disputed by the IDC, was that the price reduction if Gamsberg had been on line would have been felt in Gauteng only, but that nevertheless even this fact was uncertain as Gamsberg, given its location, is not favourably situated to supply Gauteng.[28]

89. Thus, we find that in light of the relative small affect that a potential entrant would have on prices in the local zinc market, that zinc concentrate can easily be imported[29] and that prices are capped by import parity for zinc concentrate lying between import parity and export parity for zinc metal, competition will not be substantially lessened or prevented in the zinc market.

90. If the market is viewed as an international one, then post merger, Anglo would have 3,7% of the zinc concentrate and 2,2% of the zinc metal market, figures of no significance from a competition perspective.[30]

<u>Iron ore</u>

91. Iron ore is used to make iron and steel.[31] Steel can be manufactured in an integrated steel mill by using iron ore as an input, or alternatively in an electric arc furnace using recycled scrap steel or direct reduced iron ore.

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28 Transport cost from a South African port to Johannesburg by truck represents approximately 2% of the zinc price.

29 The evidence of Dr Rode was that in relation to the value of the product, transport costs were about 3%.

30 By way of comparison with its international competitors in zinc concentrate this is small. Pasminco has 11% and Glencore 12,5%.

31 98% of iron ore is used to manufacture steel.

92. Iron ore is found in a variety of physical forms:

1) Fines, which are "sintered" to form sintered fines of 17-18mm average diameter,
2) Pellets, which are pelletised, to form pellets of 5 -10 mm in diameter, or
3) Lump, which has a width greater than 76mm.

93. Lump ore and pellets can be charged directly to an integrated steel mill's blast furnace, but fines must be sintered first. The majority of South Africa's production consists of lump ore and fines.

94. The world's three largest producers of iron ore, BHP Billiton in Australia, CVRD and Rio Tinto in Australia account for approximately 59% of the world production. These three firms in turn supply 71% of the export market. Together Kumba and Assmang, by comparison, supply only 5% the export market.

95. In South Africa, Kumba and Assmang produce iron ore for sale to steel producers. The other significant player is Anglo American that owns the Mapochs mine, referred to in par. 99 below.[32]

96. Kumba is the largest iron ore mining entity in South Africa. Kumba owns three mines, the Sishen mine in Northern Cape Province and the Thabazimbi mine in the Limpopo Province. The third mine is the Sishen South Mine that is expected to start production in 2004.[33]

97. The Sishen mine accounts for 90% of Kumba's production of iron ore and is the 3rd largest open pit iron ore mine in the world. Most of the output of the Sishen mine, 75%, is exported via Saldanha Bay. The remaining 25% is sold to Iscor[34] and Saldanha steel. The volume exported through Saldanha is limited by the capacity of the Orex railway line that connects Sishen with Saldanha.[35]

98. Thabazimbi sells all of its output to Iscor's Vanderbijlpark and Newcastle mills and is thus a 'captive' mine. The Thabazimbi mine is near the end of its life and the estimated remaining mine life is eight

32 Foskor Limited, which is a wholly owned subsidiary of the IDC, produces limited amounts of iron ore as a by-product in the mining of phosphate rock, its primary business. Foskor states that, at present, it is stockpiling the iron ore that it produces for possible future sales.
33 Kumba also owns the Hope Downs iron ore mine project in Australia.
34 Iscor has an undivided share in Sishen mineral rights, which entitles it to 6.25 metric tonnes of iron ore per annum.
35 Orex is owned and managed by Spoornet, a division of Transnet. The Orex railway allows for the shipment of 28 million tonnes of iron ore per annum. Kumba has been allocated capacity rights of 23 million tonnes per annum and Assmang 5 million tonnes.

years.

99. Currently Anglo American has no direct link to the iron ore mining industry other than its interest in Highveld Steel, which obtains its feedstock ore from its wholly-owned Mapochs Mine. The Mapochs Mine is a vertically integrated operation that produces vanadium rich iron ore, which is consumed entirely by Highveld Steel.

100. Post the merger Anglo will have a market share of 78.8%, based on production of iron ore. Assmang will have a market share of 13.6% and Highveld 7.6%.

101. Assmang's iron ore mine is located at Beeshoek in the Northern Cape Province, adjacent to Kumba's undeveloped Sishen South mine. Assmang exports its iron ore and also sells to Scaw Metals, a subsidiary of Anglo, and to Davsteel an independent steel producer in Gauteng province.

102. Iscor is the largest consumer of iron ore in South Africa, accounting for 72% of South African steel production in 2001. Highveld Steel and Scaw Metals, both subsidiaries of Anglo, are the next largest steel producers, accounting for approximately 20% of production. The only other steel producer in South Africa that uses iron ore as feedstock is Davsteel, which accounts for 4% of production. The remaining 2% of production is accounted for by small firms that use scrap metal rather than iron ore as an input to their steel making processes.

103. There are no imports of iron ore into South Africa. The price paid for iron ore in South Africa is approximately 30% less than the import parity level. However, Iscor is protected by two long-term contracts with Kumba, one in respect of Thabazimbi and the other in respect of Sishen. Although the contracts differ, the material term, which is a guarantee that Iscor is supplied iron ore at cost plus 3% is the same for both.

<u>The issues</u>

104. The merger raises potential competition issues in the iron ore market because Anglo controls two steel factories, Highveld and Scaw, which compete not only with Iscor, Kumba's largest customer, but also with any potential entrants into the steel market.

105. This became the major focus of disagreement between Anglo and the IDC in these proceedings. Both parties relied on expert evidence. Anglo called Dr Robert Stillman, an economist from Lexecon, an international consultancy and Dr Sigurd Mareels an expert in the steel

industry, who consults with the firm McKinsey, while the IDC called Dr Timothy Daniel, an economist from another international consulting firm, NERA.

106.Dr Daniel identified the following competition concerns with the merger:

At a horizontal level he said that the merger would lead to a reduction in competition as the market presently had three players and that post merger there would be only two.

Secondly, the merger raised what can be categorised as vertical issues. One species of vertical concerns was that the merger would enable Anglo to raise the costs of its existing and potential rivals in the steel market. The second was that the merger could be used to facilitate collusion between Anglo's steel companies and Iscor.

107.We will examine these issues separately.

Horizontal issues.

108.Dr Daniel examines both the pre-merger and post–merger concentrations in the iron ore market and comes to the conclusion that the markets are highly concentrated pre-merger and even more so post-merger.[36]

109.This evidence about the concentration level in the industry is common cause. What is novel about his evidence is his theory that Anglo is presently engaged in the iron ore production market through Mapochs and that this has served as a constraint on Kumba. He argued that presently Kumba is constrained from increasing its price to Iscor and others. If prices in steel become uncompetitive and customers switch to Highveld this will decrease iron ore sales domestically for Kumba. Post the merger, however, Kumba will have no such constraint as it will be controlled by Anglo who have the incentive to bring about such an outcome. He further argues that new entrants to the steel market will now be faced with the choice of two iron ore suppliers instead of three.

36 See p 499 of the Exhibits file where Daniel analyses the HHI results as follows:

- The iron ore market in SA is highly concentrated
  - 1,800 vs 9,232 in sales
  - 1,800 vs 7,650 in production
- The HHI increment is very significant
  - 50 vs 3,150 in sales
  - 50 vs 1.198 in production

110.Anglo had little difficulty in disposing of this theory, which much like the rest of Dr Daniels evidence, was theoretically sound but lacked any application to the empirical data of the case. The reason that Mapochs is not a competitor to Kumba and Assmang is technical. Its iron ore is not substitutable for that of other iron ore as it has a low content of iron ore and a high presence of other ingredients, which have to be eliminated in the production process of steel. This means that a steel plant using Mapochs iron ore has to be designed to achieve this at great cost. Highveld is the only steel plant in the country at the moment configured to make use of this iron ore. For a new entrant wishing to enter into steel manufacture there is a choice of spending $400m to $500m for a mini mill or $750m for a DRI mini mill, as opposed to one billion dollars for a mill that could use Mapochs ore.

111.It appears from the evidence of Dr Mareels that it would only be viable to use Mapochs iron ore if one was to enter the market primarily using vanadium as the core product and steel as a secondary by-product, as Highveld do. In addition it appears that the Mapochs mine ore will last for another 40 years at the current rate of production. If that rate were to be increased to supply another firm this would greatly reduce the life of the mine.

112.A new entrant is not faced with a diminished choice in supply. Prior to the merger the entrant would have to choose between a factory designed for Mapochs iron ore, in which case it would be faced by a monopoly supplier or the more conventional plant, in which case it would face a duopoly in Kumba and Assmang. The situation is no different post merger and the fact that Anglo controls Kumba would not alter the equation.

113.In our view Mapochs does not compete with Kumba or Assmang because of these technical difficulties, and accordingly the IDC's objection fails at the first hurdle and we need not examine the issue of incentives here. Incentives are examined later in the section dealing with vertical issues.

Vertical Issues

114.Dr Daniels on behalf of the IDC raised two vertical competition issues – one, foreclosure in the downstream steel market where Anglo also competes through Highveld and Scaw Metals and the other a horizontal issue, collusion, between Iscor, Highveld and Scaw Metals.

115.We will firstly consider the foreclosure or raising rivals' costs theory. It will be recalled that earlier, we stated that post the unbundling of

Kumba, Iscor had secured its supply position by entering into long term supply agreements with Kumba for supply from Sishen and Thabazimbi. These contracts are highly favourable to Iscor as they ensure that Iscor is supplied on a cost plus 3% formula. Dr Daniels argues that notwithstanding the existence of these contracts, they allow an Anglo-controlled Kumba enough "wiggle room" to interpret them in a manner that would permit them to raise the level of costs so as to raise the costs of steel production for Iscor.[37]

116.There was much dispute as to whether the contracts properly interpreted allowed for this flexibility. We need not involve ourselves in this interpretative exercise, as Dr Daniel's case is dependent on whether Anglo has, in addition to the contractual wiggle room, an incentive to behave in this manner.

117.Kumba as we have noted produces iron ore from two mines, Sishen and Thabazimbi. As about 75% of Kumba's total output is destined for the international market, and as the Thabazimbi mine is contracted to sell 100% of its output to Iscor, these exports originate entirely from the Sishen mine and require the incentive structure in both mines to be analysed separately.

118.The cost of iron ore to Iscor is calculated on the basis of a cost plus 3% management fee. Dr Daniel is of the view that Anglo indeed has the incentive to raise costs of Iscor by artificially or actually increasing mining costs at both Sishen and Thabazimbi. This increase in cost to Iscor will then compel Iscor to raise the price of steel and hence benefit Highveld and Scaw, either by having consumers switch to their products or enable them to raise their domestic price without losing business to Iscor. Dr Daniel recognizes that if Anglo were to increase the costs incurred at Sishen this would impact adversely on exports that have to be sold at world prices or export parity. However, he was

37 When the Commission did its initial investigation of the merger it met with Mr Van Niekerk, the chief executive officer of Iscor, who according to the Commission's counsel expressed no concerns about the merger and gave as the reason the fact that Iscor was protected by its contracts with Kumba. This meeting took place in June or July 2002 . On 14 May 2003,approximately one week before the merger hearing commenced, Mr Van Niekerk wrote to the Tribunal to state that Iscor had serious concerns about the merger. Concerns were that under Anglo, Kumba might not invest sufficiently in iron ore expansion at Sishen South and might favour investment in Australia instead. Secondly, he raised concerns that Iscor's strategic information might become available to its competitors in the Anglo stable. He did not however offer to testify at the hearing nor ask for Iscor to intervene. Iscor was represented throughout the proceedings by its attorneys who had a watching brief. What accounts for the Iscor volte- face is difficult to discern - all of these issues would have been known to Iscor when it met with the Commission in 2002. Anglo suggest, cynically, that the change is explicable by the change in dynamics on the Iscor board- LNM is now the dominant shareholder and Mr Ngqula, the IDC's chief executive officer, is now Iscor's chairperson. We are not in a position to comment on this but were Iscor as concerned about the merger as the tone of the letter suggests, we have no doubt that it would have been more robust in communicating this point of view to us. Given that we find that Anglo has no incentive to raise Iscor's costs, we need not probe this further.

also of the view that the benefits would arise from an increase in profits from higher prices or volumes in the downstream market for Highveld and Scaw and that these benefits would outweigh the costs.

119.Anglo's expert, Dr Stillman, in response to this theory then performed a calculation based on figures that they had to test Dr Daniel's central proposition. Upon calculating the impact of a hypothetical 10% increase in iron ore costs by Kumba on the upstream export market and the downstream steel market it was shown by Dr Stillman that the costs vastly outweighed the benefits to Anglo of pursuing this particular strategy of raising rivals' costs. Even though the calculation assumed Highveld would be able to pass on the full cost increase into domestic prices, the loss of sales and profits incurred by Kumba on the export market dwarf the increase in Highveld's sales into the domestic market. Therefore we can conclude that the costs far exceed the benefits of this strategy to Anglo. The IDC failed to contradict the data presented and therefore we can comfortably dismiss the likelihood of this scenario occurring at the Sishen mine.

120.With regard to the Thabazimbi mine on the other hand, the incentive to raise costs to Iscor does not appear to exist. The contract between the mine and Iscor rather provides a strong incentive to reduce costs. Under the contract, if costs are reduced, Kumba gets to keep [***confidential information***] of the cost reduction. Once again a numerical example demonstrates that under the most stringent assumptions, the incentive to reduce costs outweighs any benefit to Anglo at Highveld of allowing costs to be increased at Thabazimbi.

121.Even if Anglo were to operate in such an irrational manner and allow costs to rise at Thabazimbi, given that only a small amount of iron ore is sourced from the mine, the calculations show that a 10% increase in the cost of iron ore sourced from the Thabazimbi mine would only increase total steel making costs at Iscor by 0.3%.

122.Finally, given the agreement between the expert witnesses that the marginal cost of steel production in South Africa is determined by export parity, higher iron ore costs would fail to impact on domestic prices charged by Iscor for steel. Therefore, in conclusion, on the basis of evidence before the Tribunal there is little support for the contention that Anglo would follow a strategy of raising rivals' costs in steel making at either of the two mines.

123.The foreclosure argument is a variant of the above argument for raising rivals' costs. The argument made was that Anglo would raise costs to Iscor in order to benefit Anglo's Highveld steel operation. This would be achieved by raising costs to other existing steel manufacturers such as Davsteel.[38] Anglo would also raise the costs of new entry in order to either foreclose such entry or reduce the profitability of such entry.

124.Dr Daniel suggested that while complete foreclosure may not be profitable to Anglo, partial foreclosure would be if Anglo were maximizing profits. Unfortunately once the calculations of the benefits and costs of raising costs are done, given the importance of exports in the Kumba portfolio, there is no possibility of even partial foreclosure being profitable.[39] Interestingly these calculations suggested that given the global focus in Kumba's business the major disciplining factor in the iron ore market is the pressure in world markets to keep costs down in order to be competitive.

125.The second theory raised by the IDC, that we need to consider, is the horizontal issue and the question being asked is whether the merger will facilitate collusion between Anglo's downstream steel interests, Highveld and Scaw Metals and Iscor, currently Kumba's largest customer.

126.Dr Daniel suggests that the possibilities for collusion are enhanced by the possibilities for information sharing that the Iscor /Kumba supply contracts provide and secondly, that the ability to raise Iscor' s price via Kumba, gives a post-merger Anglo a weapon for enforcing the cartel if Iscor cheated, a weapon it lacks pre-merger.

127.Both experts are at least in agreement that three elements are required for a stable collusive agreement. Firstly, the ability of the parties to reach agreement to collude; secondly, the parties need to monitor compliance of the agreement by the members because of the incentive to cheat and; thirdly, there needs to be an ability to enforce the collusive agreement so that if cheating takes place the members would be able to discipline that member.

128.Dr Stillman in his analysis, focussed only on the possibility of collusion whereby the members of the cartel agree to restrict output in order to have higher prices in the steel industry for the benefit of the members.

129.In order for such an arrangement to succeed, Anglo will have to know how much steel Iscor plans to sell in the local market because exports would be excluded in this scenario. Dr Stillman doesn't doubt that

38 According to Dr Stillman, Davsteel accounts for less than 10% of local steel sales. It currently buys iron-ore from Assmang, however, 85% of its feedstock comes from scrap metal. The iron-ore portion of Davsteel's total cost is less than 1%. (See page 59 of the transcript.)

39 Various theoretical models of partial foreclosure were proposed during the hearing, but once these models were calibrated to the actual data, the model proposed by Dr Daniel became an empirical impossibility. (See page 551 and 552 of the Exhibits file.)

Anglo could learn from its control of Kumba about Iscor's expansion plans by knowing the amount of iron-ore that it was going to need in future. However, says Dr Stillman, this kind of information would not assist Anglo in trying to solidify collusion in the steel industry because Anglo would still not know how much of this expanded production Iscor plans to sell domestically and how much is intended for the export market.[40]

130. Moreover, Iscor, according to its annual report, prices its steel at import parity, which means that domestic prices are as high as they can go. There is thus no advantage in colluding to raise prices because it will only attract imports.[41] Collusion to raise prices could, therefore, not succeed in the South African market.

131. In our view, the only horizontal concern that remains and which, is not addressed by the merging parties, is the possibility of collusion by dividing the steel market between Highveld, Scaw Metals and Iscor.

132. The evidence of Dr Mareels is that there is presently very little competition between Iscor, Highveld and Scaw:

> "Most of the steel products that Iscor makes, they have a de facto monopoly. Anything that is colder (sic) rolled or galvanised, basically is not produced by Highveld or Scaw. In fact the overlap is minimal. So in fact products…. I would argue that there is a 90 % virtual monopoly , if you want , from Iscor".[42]

133. This evidence suggests that it is possible that the steel firms already have some understanding to 'avoid' one another in relation to the products that they produce - we can put it no higher than that on this record. Nevertheless the merger might offer an opportunity for Iscor's managers and Anglo's steel managers, if they were placed into Kumba, to legitimately meet to discuss production issues and thus if a cartel does exist, to disguise its meetings through a legitimised forum. It might also offer the opportunity for Anglo's steel and iron ore directors to cross-pollinate information learned on one board to the other.[43]

134. At our request Anglo proposed a condition to address our concerns on

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40 Dr Stillman testified that Iscor in any event regularly publishes information about its production levels and it supplies to the domestic and export markets. There is an abundance of information available on the steel markets, which is followed closely by analysts. (See page 32 of the transcript)

41 This assumption by Stillman accords with the evidence given to the Tribunal in the Iscor/Saldanha merger, Case No: 67/LM/Dec01, para 64, where it was stated that Iscor prices at import parity.

42 See Transcript page 217.

43 Recall that this is because of the kinds of meetings that the Iscor / Kumba contracts provide for between the respective firms' managements,

information sharing to facilitate collusion. We consider that this proposal is adequate, but we have included Scaw Metals in the undertaking, since it too, is controlled by Anglo. It now reads as follows:

> *Anglo American will undertake to use such votes as it may have as a shareholder of Kumba Resources Limited ("Kumba"), Highveld Steel & Vanadium Corporation Limited ("Highveld") and Scaw Metals Limited ("Scaw Metals"), to ensure that no person will simultaneously hold office as a director of both Kumba and Highveld or of both Kumba and Scaw Metals.*[44]

135.By including this condition we endeavour to set up a Chinese wall between directors of Highveld and Scaw in the downstream steel market and directors of Kumba in the upstream iron-ore market, to prevent the flow of information between competitors of Iscor.

136.Since we are satisfied that the condition proposed will address this concern adequately, we have decided to include it as part of our order.

Public interest

137.Although we have found that the merger will not lead to a substantial prevention or lessening of competition we must nevertheless evaluate whether it can be prohibited on public interest grounds.

138.As the IDC has contended, and in our view correctly, the use of the word *"otherwise"* in section 12A(1)(b) means that the public interest evaluation must still be undertaken by the Tribunal, regardless of the outcome of the section 12A(2) 'competition' analysis. As we have previously stated the public interest can operate either to sanitise an anticompetitive merger or to impugn a merger found not be anticompetitive.[45]

139.In this case, since we have found that the merger raises no competition concerns, we need only evaluate whether the merger is not in the public interest.

140.Both the IDC and Anglo have invoked the public interest in their favour. We have previously held that where the public interest is

44 Scaw Metals Limited is wholly owned by Anglo.
45 See the large merger between Distillers Corporation (SA) Limited and Stelenbosch Farmers Winery Group Ltd, Tribunal Case No: 08/LM/Feb02, para 210.

invoked to give rise to different conclusions we must first perform a balancing of the conflicting interests claimed to come to a net conclusion on whether there is a substantial public interest implicated by the merger.[46]

141.Anglo alleges that if it controls Kumba it will invest heavily in the company. Part of this investment will be in the Northern Cape and will not only create more jobs in a depressed area but also through growth, have a secondary knock-on effect on the local economy. It also claims that it will help invest in the Oryx railway line and in the proposed railway line through Postmasberg to the new port of Coega, which the government is anxious to develop.

142.There is no certainty that Anglo will do all or indeed any of these things. The only document, which comes close to imposing any binding legal obligation on it is the memorandum of understanding it has with the government, which we referred to in the background section, but the nature of that document is such that its status as a source of legal obligation is doubtful.

143.Nor do the probabilities suggest that Anglo is likely to increase investment in the Northern Cape when it might also see virtue in using that investment on the Hope Downs project in Australia if that proves to offer a better return on capital. Were the public interest issues Anglo raises determinative of the merger in its favour, we would have required undertakings to that effect.

144.Public interest gains from the merger, whilst possible, are still insufficiently certain to warrant recognition absent, the imposition of conditions to ensure their implementation.

145.We now turn to the various arguments raised by the IDC as to why the merger should be prohibited on public interest grounds. Here the IDC focuses its sights on section 12A(3)(c) and more particularly the consequences of the merger on the ability of firms controlled by historically disadvantaged persons ('H.D.P.'s') to become competitive.[47]

46 See Distillers Corporation decision referred to above.

47 Note that the term historically disadvantaged person is defined in section 3(2) of the Act as:

"For all purposes of this Act, a person is a historically disadvantaged person if that person –

a) *is one of a category of individuals who, before the Constitution of the Republic of South Africa, 1993 (Act No. 200 of 1993), came into operation, were disadvantaged by unfair discrimination on the basis of race;*

b) *is an association, a majority of whose members are individuals referred to in paragraph (a);*

c) *is a juristic person other than an association, and individuals referred to in paragraph (a) own and control a majority of its issued share capital or members' interest and are able to control a majority of its votes; or*

is a juristic person or association, and persons referred to in paragraph (a), (b) or (c) own and

146.This section states:

> *"12A(3) When determining whether a merger can or cannot be justified on public interest grounds, the Competition Commission or the Tribunal must consider the effect that the merger will have on-*
>
> *(a)…*
>
> *(b)…*
>
> *…..*
>
> *(c) the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive; …"*

147.The IDC asks us to give this provision a purposive interpretation and not to confine ourselves to the literal wording of the sub-paragraph as Anglo suggests we do.

148.The basis for this broad sweep approach, argues the IDC, is to be found in language that permeates from the preamble of the Act into the "Purposes of the Act" section. Thus they draw to our attention that in the preamble there is reference to the historical legacy of apartheid on the economy in these terms:

> *"The people of South Africa recognise:*
>
> *That apartheid and other discriminatory laws and practices of the past <u>resulted in excessive concentrations of ownership and control within the national economy</u>, inadequate restraints against anti-competitive trade practices, and unjust restrictions on full and free participation in the economy by all South Africans.*
>
> *That the economy must be open to greater ownership by a greater number of South Africans.*
> (Our emphasis)

149.In the "Purpose of the Act" section this theme, it argues, finds further development in sub-section 2(f), which states:

> *"The purpose of the Act is to promote and maintain competition*

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control a majority of its issued share capital or members' interest and are able to control a majority of its votes."

in the Republic on order –

…

> *(f) to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.*

150.If this is the policy of the Act, the IDC argues, then the only way to give it proper effect is to interpret section 12A(3)(c) in a manner that respects the objects of promoting a greater spread of ownership and in particular to increase the stakes of HDP's. Why would the Act have this objective if it could not be applied to give it effect, the IDC ask?

151.The IDC suggest that the answer is that section 12A(3)(c) must be interpreted in a manner consonant with section 2(f) notwithstanding the difference in language used.

152.Applying this approach to the facts of this case the IDC argue that Kumba is a strategic asset. It is the dominant iron ore mining company in the Republic. Iron ore is the key input into steel and steel in turn is a vital input into numerous manufacturing processes in our economy. Few assets of this strategic significance become available for HDP's to assume control over. The restructuring of Iscor that gave rise to Kumba has created an ideal moment to further the goal of empowerment in a vital industry - an opportunity that may not arise again.

153.On the other hand, it argues that were Kumba to fall under the sway of Anglo, one would not only not be promoting a greater spread of ownership but doing the exact opposite of what the preamble has intended the Act to do – increasing the ownership of a firm that already has a lion's share of the economy. The IDC claimed that there were empowerment firms who it was willing to assist, who were ready and willing to take a significant stake in Kumba, and who in conjunction with the IDC would be either in a position to control Kumba or to share control with Anglo. The clearest exposition of its scenario, were suggestions contained in a letter to the Tribunal after the end of the hearings, in which the IDC suggest that if the merger were approved the following conditions should be imposed:

> *That Kumba must be jointly controlled by a South African grouping of Historically Disadvantaged Persons ("empowerment shareholders") and Anglo…..It is suggested that the empowerment shareholders will hold a minimum of 26% of Kumba, IDC 14% and that Anglo's ownership of Kumba and Kumba's iron ore assets be restricted to 34%.*[48]

48 The IDC's position on this issue until that letter, was not entirely clear. In his affidavit in the

154. Various unflattering remarks were also made about Anglo's history and doubts were cast on its right to any longer claim a South African pedigree. These arguments it seems, whilst creating atmosphere did not seem necessary to support its central proposition, which is that the merger would lead to the increase of ownership of the advantaged at the expense of the disadvantaged.

155. Thus reading 12A(3)(c) through the lens of the preamble, and section 2(f), the IDC argues that the merger should, on public interest grounds alone, be prohibited.

156. Anglo for its part has approached the issue very differently both on the law and on the facts. Anglo argues that there is no warrant for embarking on a broader interpretation of section 12A(3)(c). To follow the approach of the IDC would be to interpret the Act not only in a manner contrary to its ordinary language, but also in a manner with dangerous policy consequences. Such an interpretation would transform the Competition Act from an antitrust statute, albeit with a public interest aspect, into an unchecked vehicle for redistribution. The legislature could not have intended to invest such an ambitious object in an unelected body without clear language in its operational provisions to that effect. The preamble and section 2(f), Anglo argues, speak broadly of the overall impact of the legislation on society, including the indirect benefits that the legislation may bring, they are not meant to be given effect to in interpreting an operational section such as 12A(3)(c), which has language carefully chosen for a limited purpose which, cannot be read away.

157. Anglo then turns to the facts adopting a sword and shield approach. Using the shield it defends its history and asserts that on the contrary it has sold key assets it owned in this country to HDP firms and points to its sale of its Free State goldfields, and some of its platinum and coal interests as examples. It further argues that it has complied with recent government initiatives in respect to empowerment. In particular it is a signatory to the recent Mining Charter and it will give effect to this charter in controlling Kumba. The Charter, Anglo argues, must be seen

application to intervene the IDC's Head of legal services, Mr Tshivhase stated that, in relation to both Assmang and Kumba, *"it is envisaged that 26% of each of such companies would be owned by companies controlled by historically disadvantaged individuals."* (See the Founding affidavit in the IDC'S application to amend its original intervention application, brought by Mr Tshivhase, dated 25 November 2002 paragraph 9.16, page 14.) However in her testimony, given during the hearing, the IDC's executive vice-president, Ms Morathi, testifying about what was wrong with the Anglo proposal had this to say: *"And for that to be meaningful we do not see the 26% or a lower percentage that was alluded to in the Anglo American evidence as being meaningful. We believe that meaningful participation would include control at a later stage or even at the beginning of the involvement of the BEE parties."* See transcript page 621.

as the key government initiative in respect of this industry and its primacy in this area must be respected.

158. Anglo questions why the Tribunal should be asked to impose on its merger, obligations that go further than the executive, the guardian of the public interest, presently requires. Post merger then, Anglo will take measures to increase empowerment in Kumba, but it should not be forced to take measures that go beyond the terms of the Charter.[49] Whilst we do not understand Anglo to be saying that it will confine its empowerment endeavours to meeting the demands of the Charter, we do understand it to be saying that it does not want to have imposed on it conditions that may make the investment unattractive. For instance Mr Trahar stated in his evidence that:

> " At a shareholding of 20 or 35%, you are neither fish now fowl. And I don't think it would be appropriate to have a full commitment to Kumba in those circumstances. I don't think that would be appropriate."[50]

159. As a part of its sword approach Anglo suggests that the IDC has not put an alternative scenario on the table that is credible. The IDC has not yet organised a credible consortium that are willing and able to invest nor has it got the balance sheet to make the expenditure available to such a consortium that could enable it to buy such a large stake in Kumba.

Analysis of the public interest

160. The only witness for the IDC in respect of the empowerment issue was its Executive Vice President of the Industrial Sectors Division of the IDC, Ms Raisibe Morathi. Her evidence was that although the IDC was in the process of assembling an empowerment consortium to purchase a stake in Kumba this had not yet been finalised. Names of some individuals were given on a confidential basis but it was conceded by her that the process was still in its infancy. Its tentative nature is illustrated by this exchange between her and Anglo's counsel during cross-examination.

Ms Morathi: Well this transaction is still being negotiated. It is

49 Anglo does say that it sees the best opportunities for empowerment occurring in participation in both equity and control in the underlying assets in Kumba. This is because empowerment here will be less expensive than in a widely held company. Recall that on Anglo's version it would prefer not to keep Kumba as a listed entity but that after discussions with government it will keep the firm's listing. Kumba as a listed entity offers less opportunities for empowerment at holding level for this reason than it does in its subsidiaries.

50 See transcript page 539.

not completed yet as yet. It is not a transaction that has been approved as yet and as a result the details of the transactions have not been completed.

__Adv Unterhalter__: Let's understand that answer. You say that it hasn't been approved by who?

__Ms Morathi__: By the Board of the IDC.

and further on,

__Adv Unterhalter__: Do you support it?

__Ms Morathi__: What I know of the concept of the proposed transaction, yes I support the idea, but the transaction will be properly submitted in due time when the due diligence and everything has been completed, and obviously I will have to take a view on the basis of what is being presented.

161.We thus cannot conclude that there is presently some alternative bid to Anglo's, for control of Kumba. Nor even if the IDC was able over time to compose such a group, does one know if it could command the resources to buy a stake that is large enough to secure control, even with the IDC, nor, most importantly, given that this is a widely held public company, that there are significant shareholders willing to sell, or agree to a dilution.[51]

162.Thus to prohibit the merger on the assumption that a certain state of affairs will occur thereafter, a state of affairs more consonant with the goals of section 2(f), is wholly speculative. Indeed the probabilities are that forming such a consortium if it has thus far not yet occurred, is not as easy as it seems given that the Iscor /Kumba umbilical cord was severed over two and a half years ago.

163.The other scenario suggested by the IDC as an alternative is no more feasible. In its letter dated 11 August 2003, the IDC suggested that the merger, as an alternative, should be approved subject to the following conditions:

1) Kumba must be jointly controlled by a South African grouping of

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51 Ms Morathi indicated, on page 741 of the transcript, that she could not give evidence on the financial viability of the IDC's counter proposal but that Mr Kriek, the IDC's Executive Official in charge of Projects, could. Although the IDC did indicate that Mr Kriek would be called as a witness, he was never called.

Historically Disadvantaged Persons ("empowerment shareholders") and Anglo. The precise mechanism for achieving this objective is to be negotiated between the parties and the IDC. It is suggested that the empowerment shareholders will hold a minimum of 26% of Kumba, IDC 14% and that Anglo's ownership of Kumba and Kumba's iron ore assets be restricted to 34%.

2) *The company through which Kumba's iron ore assets are directly owned and controlled is to remain a South African public company that is listed on the JSE Securities Exchange SA (JSE) and complies with JSE listing requirements.*

3) *The participation of Historically Disadvantaged Persons must be broad based and not merely limited to participation in the ownership/control of Kumba. Such participation must also take place at the operation, management and procurement levels.*

4) *The participation of the empowerment shareholders is to be secured up front and prior to the restructuring and expansion of Kumba's business and that of the broader South African iron ore Industry. Domestic requirements for iron ore are to carry priority over the export of iron ore and the investment in downstream beneficiation of iron ore is to be encouraged. Sufficient iron ore, at a competitive price, should be made available to current and future domestic users of this natural resource, in order to promote the expansion of existing iron ore beneficiation and the introduction of new beneficiation capacity in South Africa.*

5) *Anglo and Kumba are to commit to the expansion of the Northern Cape iron ore resources in preference to the expansion of any of Kumba's foreign iron ore resources.*

6) *Anglo and Kumba are to commit to unlocking synergies between all operators/owners of mine resources in the Northern Cape, including the optimisation, development and implementation of the transport infrastructure, both through the Orex and Saldanha transport infrastructure and proposed Coega rail and port transport infrastructure.*

7) *Anglo and Kumba are to commit to the ongoing operation of the Thabazimbi iron ore and Tshikondeni coal mine on terms acceptable to Iscor Limited.*

8) *Anglo must implement acceptable protections to protect against competition concerns raised by Anglo's vertical integration in the iron ore and steel industry, particularly it's ownership and control of*

Highveld Steel and Vanadium Corporation Limited and Scaw Metals (Pty) Ltd.

164.There are a number of problems with these conditions. In the first place they were proposed after the conclusion of the hearing, at a time when neither Anglo, nor Kumba, nor the Commission had an opportunity to respond to them.

165.The primary condition suggested, namely the proposed demographics for the new shareholding in Kumba post merger, presupposes that current shareholders would support the condition by offering their equity for sale. This view, as we suggest earlier, has no basis in reality. Had Anglo or Kumba's view on the practicality of such a scheme been canvassed it might have been a different matter but there is no evidence to suggest it would be practical and for all intents and purposes must be regarded as the equivalent of blocking the merger.

166.The remaining suggestions appear to deal either with the competition issues or are a stratagem to impose the IDC's own industrial policy objectives on Kumba by way of merger conditions. No basis for such an approach is advanced and, given our evaluation of the merger, it is certainly not justified.

Conclusion on public interest

167.In our view, even on the IDC 's own interpretation of the correct approach to empowerment issues in the statute, there is insufficient evidence to suggest that if the merger is implemented it would close the door on increasing the ownership of HDP's in Kumba. In their heads of argument the IDC's counsel claim that the merger if approved will have *"an irreversible impact on the ability of historically disadvantaged persons to acquire a meaningful stake in Kumba."*[52] Regardless of the legal validity of such an assertion, as a basis for prohibiting a merger, the record of the proceedings does not support it.

168.The evidence of Mr. Trahar is that at minimum, Anglo would ensure that Kumba comply with the Charter and that, at any rate, would lead to an increase in the ownership of HDP's from what they are in the present Kumba. Recall that Anglo has said that it views Kumba's underlying subsidiaries as the most fruitful avenue for extending empowerment and that it intends, if the merger is approved, to pursue this. This is not the same vision for empowerment as the IDC's, but it is still one that suggests that the doors to further empowerment remain

52 See IDC's heads of argument paragraph 12.44.

open under an Anglo controlled Kumba. The fact that Anglo has also signed the MOU with the government, which has empowerment as one of its key objectives, strengthens this likelihood, as, in addition to its Charter obligations, it is susceptible to external political pressures to ensure that it delivers meaningfully on empowerment.

169.The public interest objection to the merger also fails.

170.It is important to note that in adopting the IDC's approach in interpreting the legislation we have done no more than to evaluate whether, if that approach was found to be the correct one, there is evidence on the record to support prohibiting the merger on the basis that on a preponderance of probabilities it would frustrate the objects of the Competition Act the IDC seeks to invoke. We have found that the evidence does not establish this. This does not mean that we endorse this approach as the correct interpretation of the Act or that we have departed from our earlier decisions on the application of the public interest. [53] We deem it imprudent to make a decision on so difficult an issue when the outcome of such a debate would be academic given our conclusions on the evidence.

OVERALL CONCLUSION

171.We have found that, provided we include the condition proposed in relation to one of the horizontal issues in the iron ore markets, the merger between Anglo and Kumba raises no concerns that it will lead to a substantial lessening or prevention of competition. For this reason it is not necessary for us to consider whether the merger will bring about any efficiency gains.

172.We have also concluded that the merger is not against the public interest.

173.Accordingly we approve the merger subject to the condition set out in the attached order.

4 September 2003

N. Manoim **Date**

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53 See the following Tribunal merger decisions: Unilever/Robertson Case No: 55/LM/Sep01, Shell/Tepco Case No: 66/LM/Oct01and Distell Group/Stellenbosch Farmers Winery Case No:08/LM/Feb02.

Concurring: M.T.K. Moerane and M. Holden