Association of Competition Economics
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Session III, Panel 9 –
Sasol/Engen and vertical mergers

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The proposed Sasol/Engen merger

The merging parties

sasol
reaching new frontiers

- Major synfuels manufacturer – previously state owned;
- Produces most of the fuel consumed in the “inland area” around Johannesburg/ Durban;
- Regulation had previously prevented it from entering downstream – but it has now started to acquire a presence.

- Strong presence in downstream retail and commercial markets;
- Has its own refinery in Durban: from which it can bring some fuel inland through a pipeline (but not enough to supply its entire downstream needs).

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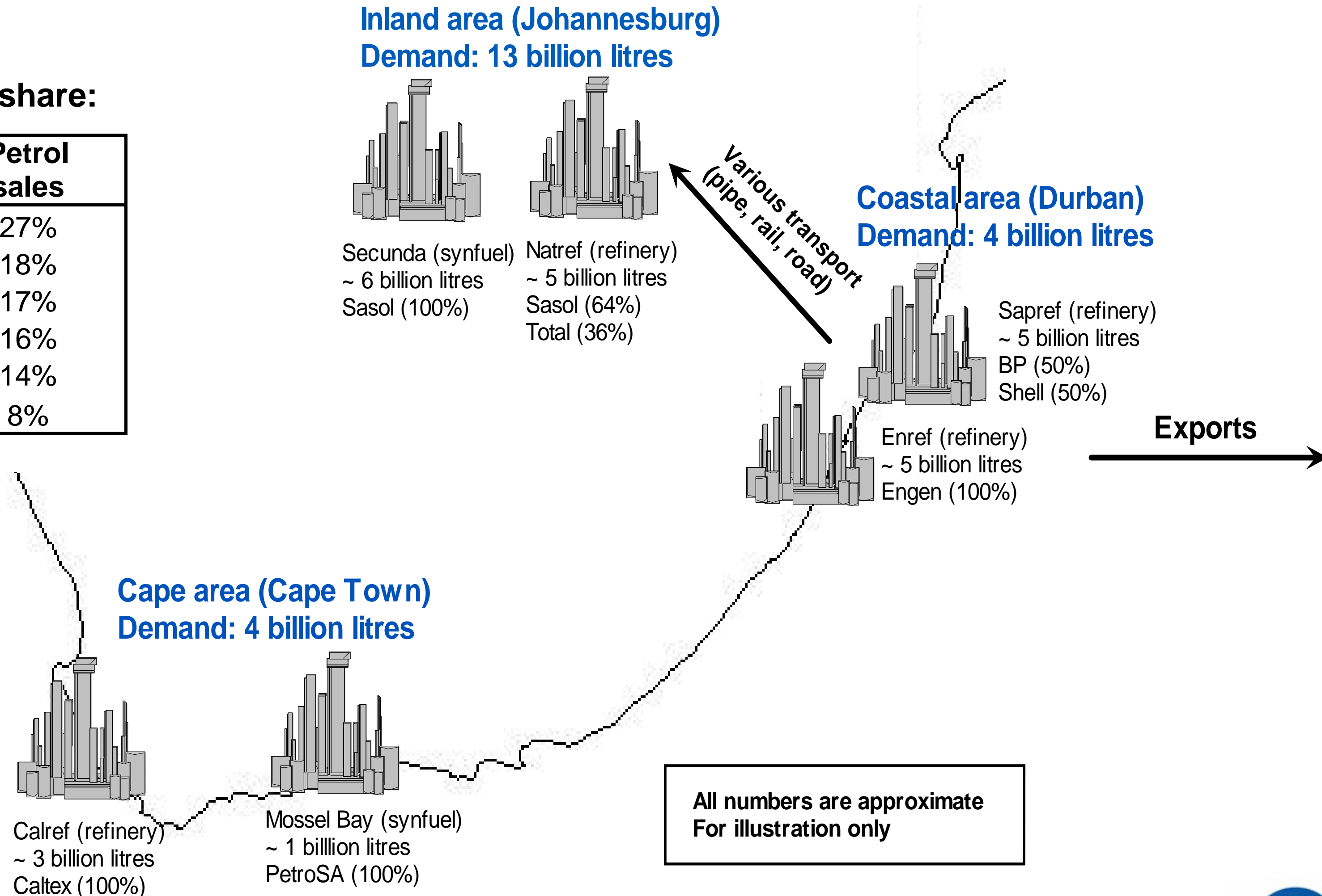
Regional structure of demand and supply

Imbalances and fuel transport

National retail share:

Company	Petrol sales
Engen	27%
Shell	18%
Caltex	17%
BP	16%
Total	14%
Sasol/EXEL	8%



All numbers are approximate
For illustration only

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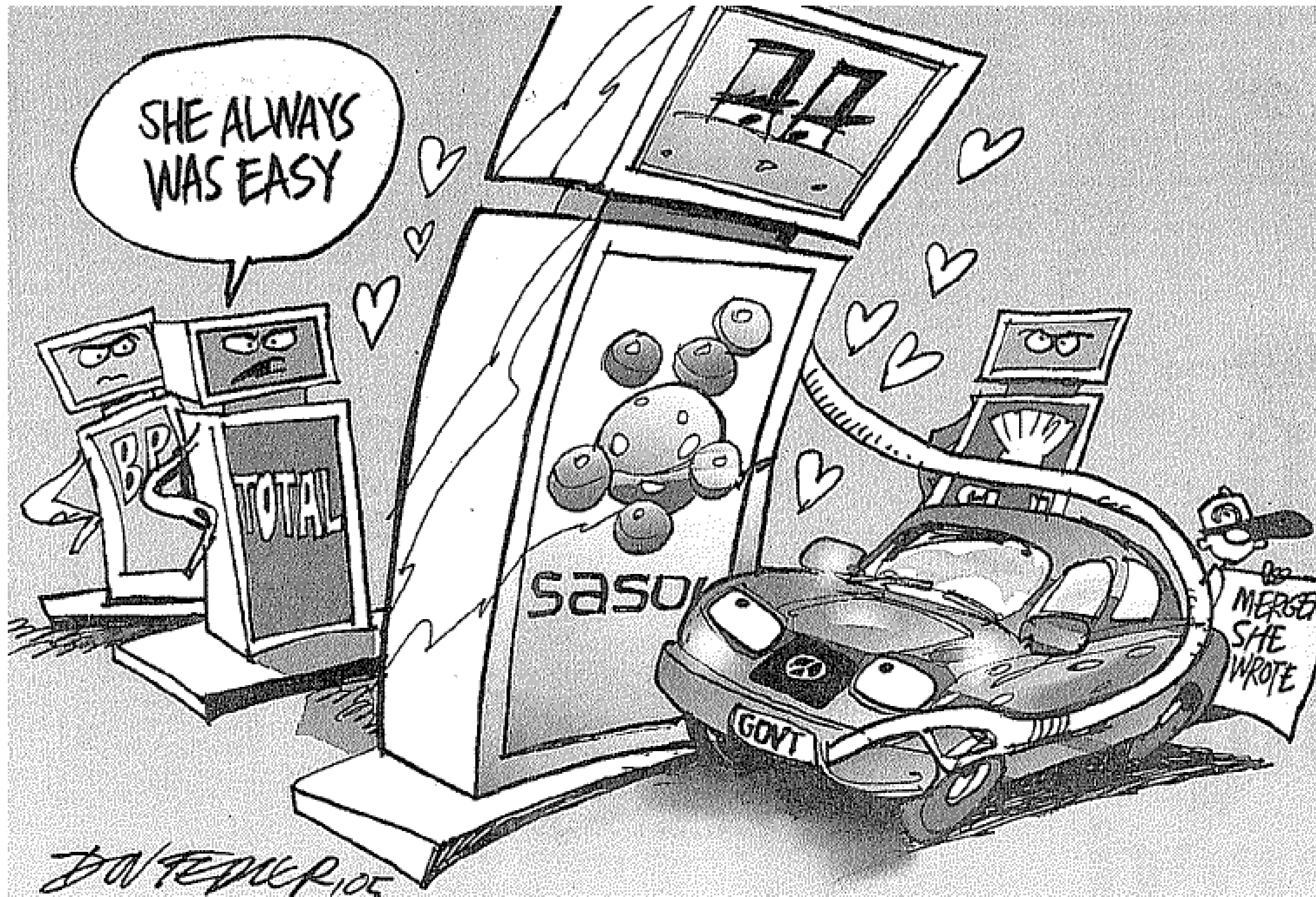
High profile and controversial case…



Drivers of the proposed merger

The parties' acknowledged motivations

- **"Better balanced" – but why is this desirable?**
  - Efficiencies (pricing, distribution, product mix, etc.)
  - Reduce spend on new stations and distribution facilities (no need for "go it alone" downstream entry)
  - Improve bargaining power over rival oil companies ("OOCs") for sales of refined product in the inland area:
    - These volumes were formally guaranteed under the MSA: now Sasol has terminated that agreement and has to negotiate placement.
    - Does Uhambo have better outside options than Sasol (pushing additional volumes through its own retail network rather than exporting)?
    - *"…we would have a better negotiating power to be able to negotiate fairer prices with our oil company friends…"*

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Main competition issues raised by the merger

Theories of harm raised by all the major oil companies

- **Vertical concerns – foreclosure (BP & Shell)**
  – Would Uhambo refuse to sell fuel to rivals in the Inland area, in order to gain downstream share?
- **Horizontal concerns – upstream (Caltex)**
  – Product from Engen's coastal refinery is sold in the inland area in competition with Sasol's inland production.
  – Upstream unilateral effects post-merger?
- **Horizontal concerns – downstream (BP)**
  – Sasol was in the process of entering downstream markets (retail and commercial sales).
  – This competition would be lost.
  – Rather a strange thing for a rival to complain about, and as a result (?) not pushed particularly hard

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Caltex's upstream horizontal argument was rejected

Enref is never the pivotal source of Inland supply

- **The theory:**
  - Coastal area is a net exporter (price = export parity);
  - Enref exports more, forcing OOCs to import (price = import parity);
  - If that price increase is also transmitted to the inland area it could be profitable for Uhambo, where it was not for Engen?
- **Impact on the inland area – prior to pipeline expansion:**
  - Reduction in supplies from Enref offset by increase from Sapref;
  - Transport capacity rather than availability from Sapref is the binding constraint.
- **Impact on inland area – after pipeline expansion:**
  - Transport capacity no longer binding: coastal price becomes influential inland – so now the theory has legs?
  - But by then demand growth means South Africa will already be a net importer (with prices set at import parity) - therefore increasing Enref exports would have no impact on prices.

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The key vertical issue

Would Uhambo have a (stronger) incentive to foreclose rivals inland?

- **The inland supply balance changes due to the merger:**
  - Uhambo is less "long" inland than Sasol was (Engen was short);
  - Sasol inland excess sold to OOCs: but after termination of the MSA a stand-off remained;
  - Would the merger change the balance of power in this negotiation? Does that harm customers?

Sasol	Uhambo
• **Production:** • 9 billion litres • **Downstream requirements:** • 1 billion litres • **Excess fuel available:** • 8 billion litres	• **Production:** • 9 billion litres • **Downstream requirements:** • 5 billion litres • **Excess fuel available:** • 4 billion litres

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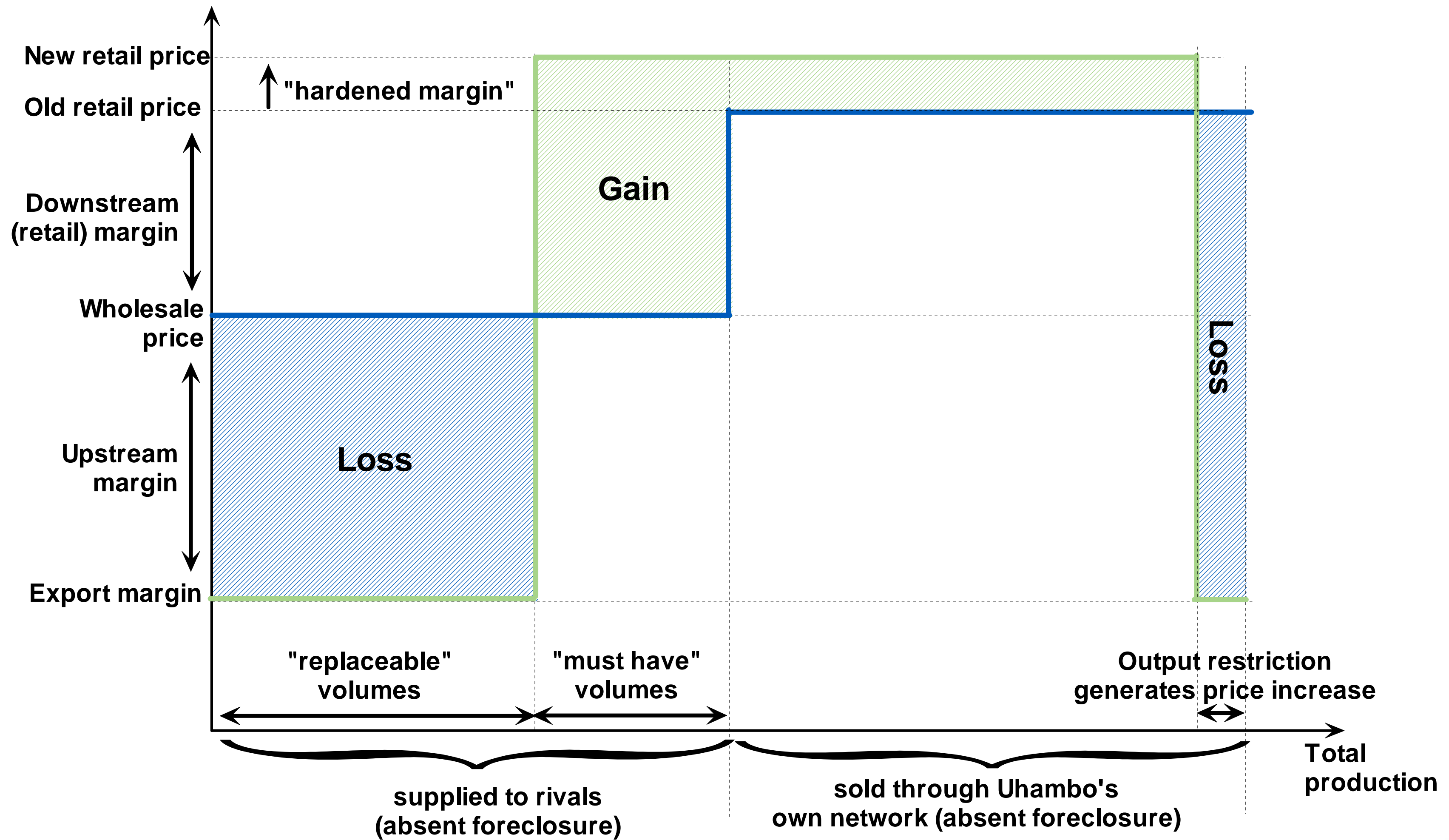
The vertical issue

Costs and benefits of foreclosure – key elements



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The vertical issue

Costs and benefits of foreclosure change – key drivers

- **The ability of rivals to bring product inland**
  - How much could rivals profitably bring in to replace foreclosed volumes?
  - This changes over time as (a) inland demand grows and (b) the pipeline connecting the coast to the inland area is expanded.
  - The dynamic element raises the question of “stickiness” of downstream share losses/gains: what are the costs of taking on new downstream business? How could rivals win this business back?
- **Wholesale and retail margins**
  - In turn driven by transport costs, export prices, etc. – all controversial.
- **Ability to “harden margins”**
  - Once (through foreclosure) rivals are right at the limit of what they can profitably bring inland, the merged firm can restrict output a little further inland to drive up downstream margins. In this case the extent of that was limited by price regulation.

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Weaknesses of the analysis

The analysis is not a comprehensive calculation of vertical effects

- **Is raising rivals' costs more likely than foreclosure?**
  - This is a more complex analysis: requires a full understanding of the shape of Uhambo and rival costs and calculating the optimal price to be charged by Uhambo:
    - Uhambo costs of serving additional downstream volumes;
    - Rivals' costs of bringing in additional upstream volumes.
- **No account taken of merger efficiencies**
  - Particularly pricing efficiencies (double marginalisation).
- **In this case the analysis of "hardened margins" downstream was simplified due to price regulation**
  - In other cases this would require a more detailed "unilateral effects" type analysis, where the merged firm post-foreclosure acts as a monopolist over the residual demand curve (which is close to the market demand curve where rivals have hit capacity constraints).

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The Tribunal's findings

A mix of vertical and horizontal

- **Tribunal finds that foreclosure is at least possible – a "credible likelihood" (paragraph 500):**
  - The Sasol figures on transport (in particular) were found to be unreliable.
- **However, the theory of harm actually needs foreclosure to be unprofitable: only threatened as a device to discipline a coordinated outcome (paragraph 488).**
- **Therefore in the end the key drivers of the decision were horizontal – with the merger resulting in:**
  - The loss of Sasol's "go it alone" entry into fuel retail (para 527), and
  - Uhambo gaining a larger share of the cartel pie than Engen and Sasol would benefit from individually (paras 591-3).
- **Remedy offered to guarantee supply (making refusal impossible)**
  - Rejected as out of time (should have been submitted earlier given complexity of behavioural remedies in general, and this one in particular).

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