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COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 33/LM/Mar12
(014795)

In the merger between:

GLENCORE INTERNATIONAL PLC	**PRIMARY ACQUIRING FIRM**
And	
XSTRATA PLC	**PRIMARY TARGET FIRM**

Panel	:	Norman Manoim (Presiding Member) Andreas Wessels (Tribunal Member) Merle Holden (Tribunal Member)
Heard on	:	18 January 2013
Order issued on	:	22 January 2013
Reasons issued on	:	06 March 2013

Reasons for Decision

Conditional approval

[1] On 22 January 2013, the Competition Tribunal ("Tribunal"), in terms of section 14A(1)(b) of the Competition Act of 1998[1], conditionally approved the merger between Glencore International plc ("Glencore") and Xstrata plc ("Glencore").

[2] The reasons for conditionally approving the proposed transaction follow below.

[1] Act No. 89 of 1998, as amended.

Background

[3] On 18 October 2012, the Competition Commission ("Commission") referred the above-mentioned proposed large merger to the Tribunal recommending the approval of the merger subject to certain employment-related conditions. The Commission however recommended no conditions in relation to any competition issue to be placed on the approval of the transaction.

[4] During the Commission's investigation, *inter alia* the National Union of Mineworkers ("NUM") and Eskom Holdings SOC Limited ("Eskom") raised certain concerns regarding the proposed merger.[2]

[5] NUM raised concerns relating to the effects of the proposed merger on employment *inter alia* the alleged non-disclosure by the merging parties of the imminent retrenchment of 180 employees as a result of the proposed merger.[3]

[6] Eskom raised concerns with regards to the post-merger supply by the merging parties of thermal coal used in electricity generation and suggested that it would be advantageous if certain coal supply-related undertakings could be obtained from the merging parties (also see paragraph 11 below).[4]

[7] The Tribunal convened a pre-hearing on 30 October 2012 at which the merging parties and the Commission were present, as well as Eskom, NUM and the National Union of Metalworkers of South Africa ("NUMSA"). A time table was agreed upon between all parties concerned, including the provision that Eskom could file an intervention application by 07 November 2012 and that NUM and NUMSA could make further submissions to the Tribunal by 07 November 2012.

[8] Both Eskom and NUMSA (in support of Eskom) consequently filed intervention applications. The merging parties consented to these interventions, the scope of which was agreed at a pre-hearing of 16 November 2012.

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[2] Although other domestic customers of Eskom raised concerns during the Commission's investigation they did not, despite an invitation from the Tribunal to do so, attend the first pre-hearing to consider objections raised to the merger by third parties.

[3] See NUM's submission to the Commission dated 15 August 2012.

[4] See Eskom's submission dated 05 May 2012 to the Commission and received by the Commission via email on 10 May 2012.

[9] In relation to Eskom, we note that it is an important coal customer. The electricity supply sector dominates the domestic coal consumption, with Eskom being the largest domestic consumer of thermal coal. Eskom generates approximately 95% of the electricity used in South Africa, and subject to limited exceptions, power is generated by coal-fired plants (presently, Eskom relies on coal-fired power stations to produce approximately 90% of its electricity).[5] Eskom thus has a need for competitively priced coal to run its coal-fired power stations effectively and to produce reasonably priced electricity to the domestic economy. Higher input costs for Eskom would feed through into higher electricity prices (certainly over the medium to longer term).

[10] Eskom raised a variety of competition-related concerns, which it claimed were merger-specific, i.e. that the proposed merger was the cause of these concerns. These concerns related to *inter alia* the post-merger supply of coal and its quality, higher post-merger domestic coal prices and adverse post-merger effects on the development of new mining projects and future production of coal in South Africa given the long-term nature of the industry. In Ms. Kiren Maharaj's words (Eskom's factual witness, see paragraph 18 below) these concerns were that "*Eskom anticipates that the merger will result in Xstrata adopting a different and less favourable pricing strategy towards its negotiations with Eskom*";[6] and "*Glencore may dictate that Xstrata not develop a mine that it would otherwise have developed with Eskom.*"[7]

[11] Subsequent to Eskom being granted the right to intervene, it was required to file a statement of proposed conditions that it believed should be contemplated to address its competition concerns. Eskom at the time suggested that the following conditions should be imposed on the merged entity to address its concerns regarding obtaining competitively priced coal in a timely and sufficient manner: (i) maintaining the current ratio of tonnes supplied to Eskom compared to exports in respect of the current and future mining operations of each of the merging parties; (ii) new supply contracts, to keep the above-mentioned ratio intact, should be at least of medium term duration (i.e. more than five years); (iii) the

[5] Maharaj's witness statement, paragraph 6.
[6] Maharaj's witness statement, paragraph 33.
[7] Maharaj's witness statement, paragraph 34.

merged entity must negotiate in the utmost good faith to ensure that coal supply projects are aligned with Eskom's requirements in terms of timing, volume and quality; (iv) the merged entity must negotiate in the utmost good faith to establish an equitable mechanism for the pricing of coal-supply to Eskom which will ensure a "fair return" to Glencore and result in Eskom having a transparent cost of coal with a predictable medium term price path; (v) export parity pricing shall not be applied to domestic supply contracts, whether during the initial determination thereof or by way of any pricing adjustment mechanism, insofar as such pricing would exceed pricing based on the cost of production together with a fair return; (vi) that a certain minimum percentage of Eskom supply, being no less than the current proportion of coal so supplied, be subjected to cost-based pricing, together with a fair return; and (vii) that the Commission be required to actively exercise its advocacy role in general.[8]

[12] NUMSA's intervention application was based on retrenchments which had taken place after the closure of Silicon Technology (Pty) Ltd ("Siltech"), a subsidiary of Glencore, which retrenchments NUMSA claimed resulted from the proposed merger.[9] It also raised the concern that if the proposed merger adversely affected the supply of coal to Eskom and the price thereof, it will have a negative effect on the price of electricity charged to (energy-intensive) industry in South Africa. This ultimately would impact negatively on employment in such industries. However, NUMSA decided not to persist with the Siltech issue and to only support Eskom in the concerns that it raised.

[13] NUM's concerns related to the retrenchments specific to this merger and it opted to stand by the submissions it had made to the Commission.[10]

[14] At a pre-hearing of 16 November 2012 provision was further made for *inter alia* the filing of witness statements by the merging parties, the Commission, Eskom and NUMSA. The matter was set down for hearing from 10 to 14 December 2012.

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[8] See *inter alia* Maharaj's witness statement, paragraph 5.
[9] The merging parties did not include information on Siltech in the merger filing.
[10] See NUM's submission to the Tribunal of 08 November 2012.

[15] On 30 November 2012, Eskom filed the expert report of Prof. Nicola Theron[11] of Econex, an economic consultancy.

[16] On 06 December 2012, the merging parties filed the expert report of Dr. Jorge Padilla[12] of Compass Lexecon, also an economic consultancy.

[17] On 06 December 2012 the Commission filed a supplementary report which specifically addressed the issues raised by Eskom as intervener and its economic advisers Econex.

[18] However, despite Eskom having filed an expert report, it informed the Tribunal that it did not intend calling its expert witness to give evidence at the hearing. Surprisingly, it also did not intend to call any factual witnesses. The Tribunal then directed that it wanted to hear evidence from an Eskom factual witness about its coal procurement concerns as a result of the proposed merger and to hear evidence from its economic expert as well. Eskom agreed thereto and on 07 December 2012 filed the factual witness statement of Ms. Kiren Maharaj ("Maharaj"), the Divisional Executive for the Primary Energy Division of Eskom. Maharaj oversees Eskom's procurement of coal.

[19] NUMSA, in support of Eskom, filed the factual witness statement of Mr. Stephen Nhlapo, the National House Agreement and Eskom Sector Coordinator of NUMSA.

[20] At the Tribunal's request, the merging parties agreed to make two executives from the respective merging firms available to give evidence during the hearing. On 10 January 2013 the merging parties filed the factual witness statements of respectively (i) Mr. Clinton Martin Ephron ("Ephron"), a director of Glencore's coal-producing subsidiaries in South Africa; and (ii) Mr. Murray James Houston ("Houston"), the Chief Operating Officer of Xstrata Coal South Africa.

[21] The hearing was scheduled to commence on 10 December 2012. As it happened it did not and on that day the merging parties brought an application for postponement and other procedural relief asking for a declaratory order regarding

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[11] The authors of the report submitted also include Dr. Grove Steyn and Mr. Laurie Binge.
[12] The authors of the report submitted also include Dr. Peter Davis and Dr. Urs Haegler.

issues raised in Maharaj's statement which the merging parties argued travelled beyond the initial request from the Tribunal. Although each side blamed the other for the need for a postponement since both agreed that the mater could not proceed in December 2012, we agreed that it should be postponed to the next convenient dates which were in January 2013. At the same meeting, the Tribunal was informed that NUM's employment-related concerns might be settled by means of proposed amended employment conditions.

[22] At the commencement of the Tribunal hearing on 18 January 2013, Eskom and the merging parties advised the Tribunal that a confidential private agreement had been reached and that, as a result, Eskom was withdrawing as an intervener in the merger proceedings. Thereafter, NUMSA also announced its withdrawal, given that it supported Eskom in the merger proceedings. In the circumstances NUMSA was of the view that it could provide no further assistance to the Tribunal.

[23] Given that the private agreement between the merging parties and Eskom was claimed as confidential, the Tribunal directed that the fact of the agreement be made known during a public part of the hearing. During the in-camera hearing, the contents of the agreement were discussed with submissions made by Eskom, the merging parties and the Commission.

[24] After hearing these submissions, the Tribunal decided that notwithstanding the private agreement, it still wished to hear from Eskom's factual witness, Maharaj, concerning Eskom's coal procurement concerns. The reason for that decision was that the Tribunal is not bound by private arrangements and still has a statutory duty to consider whether the proposed merger may be lead to anti-competitive effects or raise substantial public interest concerns.

[25] At the hearing on 18 January 2013, the Tribunal was further advised that the merging parties and NUM had reached agreement on a set of employment-related conditions which would regulate the employment loss that may come about as a result of the merger. We shall below elaborate on the nature of these employment-related conditions (see paragraphs 99 to 102 below).

Parties to transaction

Acquiring firm

[26] The primary acquiring firm is Glencore, a public company listed on the London and Hong Kong Security Exchanges. Given that Glencore's shares are widely held by a number of shareholders, it is not directly or indirectly controlled by any one firm. Glencore, through its 100% subsidiary Glencore International AG ("Glencore AG"), controls a number of subsidiaries and companies worldwide.[13]

[27] Glencore provides services relating to natural resources. It has worldwide activities in the mining, smelting, refining, processing, marketing and trading of metals and minerals, energy products and agricultural products. It operates on a global scale, marketing physical commodities that it either produces itself using its own industrial assets or purchases from third parties for onward sale to industrial consumers, such as those in the automotive, steel, power generation, oil and food processing industries.

[28] Glencore's marketing and trading activities include the sourcing of a diversified range of physical commodities (comprising various metal, energy and agricultural commodity products) from third party suppliers and from industrial assets in which Glencore has full or part ownership interests (including Xstrata). These commodities are sold to a broad range of consumers and industrial commodity end users. Glencore's activities in this regard often include the provision of value-added services to customers such as freight, insurance, financing and storage.

[29] Relevant to the assessment of this transaction is that Glencore owns shares in firms which produce and sell thermal coal, as well as the fact that it is a trader of thermal coal. The relevant coal mines are located in Mpumalanga and in KwaZulu-Natal. Glencore currently already has a 33.65% shareholding in Xstrata. Of further relevance are the following interests of Glencore in South Africa:

- a 49.99% shareholding interest in Shanduka Coal (Pty) Ltd ("Shanduka").[14] Glencore has joint control of Shanduka. Shanduka owns two operating thermal coal mines in the Witbank coalfields (Middelburg Townlands and

[13] See Appendix "A" attached to Form CC4(1).
[14] The remaining shares in Shanduka are held by Shanduka Resources (Pty) Ltd.

Graspan Colliery) and an anthracite mine in KwaZulu-Natal (Springlake). Shanduka has a non-controlling interest in Kangra Coal (Pty) Ltd, which owns a coal mine in Piet Retief. Shanduka currently has a total export allocation of [...] Mtpa at the Richards Bay Coal Terminal ("RBCT");

- joint control of Umcebo Mining (Pty) Ltd ("Umcebo") pursuant to Glencore's effective 43.66% shareholding in Umcebo and its director nomination and veto rights. Umcebo currently operates three coal mines: Klippan, Middelkraal and Kleinfontein, together with a stand-alone coal beneficiation plant at Strathrae. All these mines are located in Mpumalanga and in all cases the coal mined is thermal coal. Umcebo has a total export allocation of [...] Mtpa at the RBCT; and

- an effective shareholding of 67.01% in Optimum Coal Holdings (Pty) Ltd ("Optimum"). Optimum operates two coal mines in the Mpumalanga province. Optimum Collieries is a large opencast and underground coal mining complex. The Koornfontein Mine is an underground coal mine held through a wholly owned subsidiary of Optimum, Koornfontein Mines (Pty) Ltd. Optimum has an export allocation of [...] Mtpa at the RBCT.[15]

Target firm

[30] The primary target firm is Xstrata. Xstrata is a public company listed on both the London and Swiss Security Exchanges. Xstrata directly or indirectly controls a number of subsidiaries and companies worldwide,[16] including its 100% subsidiary Xstrata South Africa (Pty) Ltd ("Xstrata SA").

[31] Xstrata is involved in the production of coal, ferrochrome, vanadium, copper, nickel, cobalt and zinc. Relevant to the assessment of this transaction are its activities in the production and sale of thermal coal. It has interests in operating thermal and coking coal mines in South Africa, Australia and Colombia, as well as an exploration project in Canada.

[15] Ephron's witness statement, paragraphs 12 to 18.
[16] See Appendix "B" attached to Form CC4(1).

[32] Xstrata SA has the following interests in firms operating in the coal industry in South Africa:

- a 100% share in Duiker Mining (Pty) Ltd, which owns and controls a number of companies including Tavistock Collieries (Pty) Ltd and Duiker Coal (Pty) Ltd (collectively "Duiker group"). Duiker group primarily mines and sells thermal coal;

- a 49% interest in the Goedgevonden Joint Venture ("GGV");[17]

- a 49% interest in ARM Coal (Pty) Ltd ("ARM Coal");[18]

- a [...]% interest in Tweefontein Complex, which consists of five mines, namely Tweefontein Underground, Tweefontein Opencut, Tavistock Underground, South Witbank Underground and Tavistock 5 Seam. The Tweefontein Complex produces thermal coal in South Africa;

- a [...]% interest in the iMpunzi Mining Complex, which consists of three opencast pits called the Arthur Taylor Colliery Opencast Mine (now called Impunzi North Opencast), Arthur Taylor Colliery Butterfly Opencast and Impunzi East Opencast. The iMpunzi Complex produces thermal coal for the export and domestic market. The new iMpunzi East pit was acquired from the dissolution of the Douglas Tavistock Joint venture with BHP Billiton Energy Coal; and

- an approximate 16.54% interest in the Richards Bay Coal Terminal Company (Pty) Ltd. ARM Coal has a 3.52% interest in the Richards Bay Coal Terminal Company (Pty) Ltd.[19]

[33] As stated above, Glencore AG is currently the largest shareholder in Xstrata with a 33.65% shareholding.

[17] ARM Coal (Pty) Ltd holds the other 51% in GGV.
[18] The other 51% of ARM Coal is held by African Rainbow Minerals Limited.
[19] Houston's witness statement, paragraph 6.

Proposed transaction and rationale

[34] Glencore intends to acquire all the issued shares in Xstrata which it does not currently own. The proposed transaction will be implemented in terms of a scheme of arrangement under the United Kingdom's Companies Act. Upon implementation Xstrata will become a wholly owned subsidiary of Glencore.

[35] As rationale for the proposed transaction the merging parties submitted that the transaction is a combination of two complementary businesses with long-standing links. The combined group will benefit from enhanced scale and market positions in the production and marketing of key commodities.[20]

Competition assessment

Horizontal overlap

[36] The activities of the merging parties horizontally overlap in South Arica in respect of the mining and sale of thermal coal.

[37] The Commission's market investigation showed that coal is not a homogenous product but is differentiated according to the stage of development of the coal, which effectively is the age of the coal. These stages are termed "ranks". These different coal ranks have different uses because the coals have different properties when they burn. Of importance to coal consumers is the calorific content of the coal. The calorific value of the coal determines its grade and ultimately its price. The coal sold in South Africa ranges from exportable coal to so-called "Eskom-grade" coal (also see paragraphs 56 and 57 below).

[38] The Commission summarised the potential unilateral effects of the transaction as follows: the proposed transaction may result in unilateral effects by virtue of Glencore's shareholding in Optimum, Shanduka and Umcebo which are all potentially in competition with Xstrata. The concern was that post-merger the merged entity might unilaterally increase coal prices or restrict coal output by diverting coal supplies to the export market or by changing from RB1 exports to RB3 exports with the effect being a reduction in the quality of the middlings sold

[20] Commission's merger record page 1152.

to Eskom (RB1 and RB3 coal and middlings are explained in paragraphs 56 and 57 below.) The Commission, however, ultimately concluded that the proposed merger raises no merger-specific competition concerns and that no competition-related conditions are warranted. It did, however, raise a broad sector-wide public interest concern that was not merger-specific (see paragraphs 103 to 105 below).

[39] We note that we have found no evidence that the proposed transaction would lead to likely coordination or enhance any existing coordination in the coal market(s) and we therefore do not deal with this aspect in these reasons.

Vertical dimension

[40] The proposed transaction also has a vertical dimension. The proposed merger will bring together the specific marketing expertise of Glencore and the mining assets of Xstrata. Historically a marketing services agreement existed between Xstrata and Glencore for the Xstrata coal exports into the international market. The proposed merger will enable Glencore to also undertake the domestic marketing of Xstrata's coal.

Market delineation

[41] The Commission defined three distinct product markets for thermal coal, namely the (i) tied domestic market; (ii) residual domestic market; and (iii) export market. We shall discuss each of these segments below. We note that Econex disagreed with the Commission's market delineation and suggested that there is increased substitution between the tied, residual and export markets.

Tied domestic

[42] This relates to the sale of thermal coal through long-term contracts, which generally are entered into for a number of decades. The relevant coal customers are Eskom and Sasol. Sasol however largely sources its coal supply from its own coal mines.

[43] To understand the dynamics of this market segment, we provide some information regarding the history thereof. Eskom has traditionally procured its required coal supplies through long-term supply agreements with coal mines

situated in close proximity to its power stations. The origin of the tied market segment was that Eskom would build a power plant calibrated according to the quality characteristics of the coal (or middlings) produced at a nearby or even adjacent colliery which served as "base supplier" to the specific power station. Maharaj confirmed that "*Eskom power stations are typically configured to accept a particular grade of coal with reference to its source, which is why power stations are often tied to a mine in close proximity*".[21] She further described the relationship that existed between coal producers and Eskom as symbiotic and stated that the coal mines were tied to Eskom power stations and had Eskom as their *raison d'être*.[22] Often Eskom would have financed part or all of the capital required for these coal mines. As *quid pro quo* where Eskom contributed to financing a mine, or a negotiated outcome where Eskom did not contribute to financing the mine, Eskom and the mine would sign a "life of mine"[23] contract for a specific volume of coal.

[44] The Commission concluded that the geographic scope of this market is local where the feeder mine has a monopoly position and competition takes place *ex ante*. The Commission found that Eskom had the opportunity to play all potential coal mines off against one another when negotiating the life of mine contract. Eskom would then build a power station next to the winning bidder and grant them monopoly rights and lock in the price. In such case that price would not be a monopoly price because of the *ex ante* competition.

[45] These long-term contracts were however concluded when the Eskom power stations were not operating at full capacity and thus required relatively lower volumes of coal. The intention of the life of mine contracts was to have a power station fully supplied by a feeder mine for the entire life of the mine. This has however not been the case given the increased electricity demand in South Africa and concomitantly Eskom's growing coal requirements.

[46] Whilst in the past nearly all of Eskom's coal was supplied on long-term contracts, this has significantly declined in recent years given Eskom's increased

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[21] Maharaj's witness statement, paragraph 35.
[22] Maharaj's witness statement, paragraph 8.
[23] Based on the expected lifespan of a particular mine, typically between 20 and 30 years.

coal demand, while some of the long-term contracts with base suppliers are also coming to an end. Due to this increased demand for coal, most of the Eskom power stations today procure coal from more than one source.

[47] While the tied domestic market is per definition "tied" up with long-term coal contracts, a coal producer with the ability to export coal arguably has the incentive to supply the bare minimum that it has to under these contracts given that coal exports would increase revenues compared to the local tied sales (also see paragraph 59 below).

Residual domestic

[48] This is the domestic sale of thermal coal to customers, excluding the long-term contracts in the tied domestic market. The residual market is possibly best defined as the market for all coal after tied contracts have been satisfied and export capacity (see discussion below) has been reached. As such it is the most sensitive market to potential export capacity expansions as well as any potential anti-competitive activity as a result of the proposed merger.

[49] The Commission found that thermal coal is not suitable for spot transactions because coal is an input that requires more planning both by suppliers and consumers than a simple *ad hoc* approach. The shortest term contracts that exist are three month contracts. Eskom has a number of contracts with one to three year durations and other customers, such as cement and paper producers, have similar contract terms.

[50] As stated above, Eskom increasingly participates in this market segment due to its tied contracts being insufficient for its current coal demand to produce electricity. Eskom thus sources on the residual domestic market for the coal volumes that it requires over and above the volumes guaranteed in the long-term agreements, as its demand for coal grows and its coal-fired power stations run at full capacity. A significant proportion of Eskom's current overall coal requirement is fulfilled by short-term contracts.[24] Moreover, this trend of Eskom increasingly procuring coal through short- and medium-term contracts, compared to traditional

[24] See Commission's supplementary report dated 03 December 2012, pages 31 and 32.

long-term contracts, is expected to continue into the future.[25] This situation is exacerbated by the fact that the local demand for coal is expected to very significantly rise over the next ten years.[26]

[51] It is important to note that coal prices in the residual domestic market are more closely linked to export parity levels. Of the three identified market segments, coal prices in the tied market, under the long-term contracts, are the lowest.

[52] The geographic scope of this market depends on the location of a specific coal customer relative to the coal mine(s) in a specific geographic area. There is, however, no need for us to in this case make a definitive finding on the exact parameters of the relevant geographic market for residual coal sales since this does not alter our ultimate conclusion. We have assessed the competitive effects of the proposed transaction from the perspective of the individual Eskom coal-fired power stations supplied by both Glencore and Xstrata (see paragraphs 69 to 84 below).

Coal exports

[53] Most of South Africa's export coal is shipped through the RBCT, the world's largest coal export terminal, and the balance is shipped out of Matola in Mozambique and the Durban Harbour. The major shareholders in the RBCT are Anglo American, BHP Billiton and Xstrata but other shareholders include Eskom, Total Coal, Sasol Mining, Kangra Coal and Exxaro Coal.[27]

[54] Transnet Freight Rail ("Transnet") owns and operates a dedicated coal line which runs between Witbank, Ermelo and Richards Bay on the east coast for the transportation of export coal from the Witbank coalfields to the RBCT. Capacity constraints of the Transnet rail system and at the RBCT put an upper limit on the coal exports from South Africa. Transnet however is planning to upgrade its rail line. Although the RBCT has a design capacity of 91 Mtpa, given the current logistics bottlenecks, the last declared quarterly throughput rate (Q4 2011) was at

[25] See *inter alia* pages 1 and 5 to 8 of the Econex Report for a quantification hereof.
[26] Econex Report, page 6. Maharaj's witness statement, paragraph 10.
[27] Ephron's witness statement, paragraph 25.

73 Mtpa.[28] According to the Richards Bay Coal Terminal Company (Pty) Ltd's submission, Transnet intends to achieve a rail capacity for the transportation of coal exports of 81 Mtpa by 2015.[29] In other words, coal exporting capacity is expanding, albeit gradually.

[55] South African coal exports have approached 65m tons in recent years, with 2011 volumes reaching 65.5m tons.[30] The Commission concluded that the geographic scope of the export market is international.

[56] From a demand-perspective, the Commission concluded that export coal customers' quality requirements differ from those of domestic coal customers. Export coal is typically of two specifications, namely (i) RB1 (high quality) coal, mainly exported to Europe; and (ii) and RB3 (mid-range quality) coal with a calorific value of 23.5 MJ/kg, exported specifically to India.

[57] To a large extent thermal coal mined in South African is not suitable for export in its run of mine or "unwashed" state and requires washing to a higher calorific value. Crushed coal produced by a colliery is sorted in a primary wash to separate out the export quality coal. A second wash of the coal then produces so-called middlings coal as well as discard. "Eskom-grade" coal has traditionally been supplied from the coal stream (the middlings) that remains after the run-of-mine coal has been washed to yield RB1 coal. Historically only grade A coal and some grade B coal (RB1 specification) were exported because this was what the European power stations required. However, today many power stations, particularly in Asian markets, are designed to burn lower quality coal (specifically RB3 grade). The introduction of coal washing, which increases the calorific value of the coal, but at the same time decreases the per ton volume of the coal, resulted in significant increases in the exportability of the South African produced coal.

[58] From a demand-perspective RB3 coal is only used to a limited extent by domestic customers. The Commission however found that Eskom does compete

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[28] Commission's merger record, page 3014. Also see transcript pages 117 and 118, as well as Ephron's witness statement, paragraph 28.
[29] Commission's merger record, page 3016. Also see Ephron's witness statement, paragraph 29.
[30] Commission's supplementary report, page 6.

for some RB3 specification coal since some of its power stations use coal with a calorific value greater than 23.5 MJ/kg.[31]

[59] We further note that the available evidence shows that the revenues generated by export sales are significantly higher than that generated by local sales due to higher export prices achieved compared to domestic coal prices.[32] Ephron confirmed that "*[e]xport coal has historically secured better prices for the grades exported when compared to the grades of coal supplied to the domestic market and in particular to Eskom. As a result, Glencore, like most coal producing firms in this country, generally utilises its full export allocation.*"[33]

[60] Of importance to the assessment of the coal market(s) are the supply-side characteristics of coal exports, namely the possibilities offered to coal mines (and the merged entity) by coal washing and blending to configure the coal supply. We describe these dynamics and recent shifts therein below. This is a key consideration since the export-related competitive decisions of a coal miner can impact the volume and quality of the coal supply to domestic customers such as Eskom. This is also explained below.

[61] A coal mine can produce different coal streams of different grades from the same run-of-mine coal stream in order to meet its strategic objectives and optimise its overall margins. This means that the run-of-mine coal stream can be beneficiated in order to supply different markets through applying strategic washing or blending with the aim of maximising revenues. Of specific relevance to the concerns raised by Eskom is that the export of coal with a RB3 specification has increased in recent years with increased demand specifically from India. The RBCT data of coal shipments indeed confirm that the eastern markets, including India and China, have started receiving an increasing portion of South Africa's coal exports.[34] Thus whilst the total volume of coal exports from South Africa is constrained, the composition of these exports has meaningfully changed over time.

[31] Commission's supplementary report, page 9.
[32] See *inter alia* Commission's recommendation, pages 32 and 33.
[33] Ephron's witness statement, paragraph 34.
[34] *Coal 2011: A Review of South Africa's Coal Sector*, page 6. Commission's supplementary report, page 36. Also see Houston's witness statement, paragraph 9; as well as Ephron's witness statement, paragraph 37.

[62] In simple terms, the issue from Eskom's perspective is how much of a coal mine's coal stream goes to the export market and how much is left to sell to Eskom, i.e. (i) RB1 and its middlings; or (ii) RB3 with less and possibly lower quality middlings, as explained below.

[63] Econex submitted that compared to washing for RB1 coal, the washing process for RB3 coal would include a much larger amount of the material – that would have been available as RB1 middlings (so-called "Eskom grade" coal) in the RB1 coal, with the result that: (i) there would be a smaller portion of middlings from the run-of-mine stream available as "Eskom grade" coal, and (ii) there would be a greater risk that it would be of a lower quality.[35]

[64] To illustrate Eskom concerns about significant reductions in the quality of coal procured as middlings when washing to a lower coal grade, we give the following example: if a coal mine targets a float of RB1 specification coal then the middlings will have a calorific value of 21 MJ/kg and if it targets a float of RB3 specification coal, then the middlings produced will have a calorific value of less than 18.5 MJ/kg.[36] Thus if a coal mine washes to the RB3 coal specification then the middlings produced would be of insufficient calorific value to supply certain of Eskom's power stations. Thus there is a relationship between RB3 coal supply and the supply of middlings to Eskom. Maharaj testified that "*if the mining industry continues to meet an RB3 specification, the amount of reserves that are available for Eskom to access in Mpumalanga for its long-term coal supply are significantly diminished.*"[37]

Conclusion

[65] One cannot take a static approach to market delineation in the coal market(s). The market dynamics of the coal market(s) will continue changing as the demand for domestic produced coal and electricity demand increases and market forces react. What is evident is that there is a relationship between certain of the Commission's identified coal market segments and that supply-side competitive decisions in one sub-market may affect the supply of coal, specifically the

[35] Econex Report, page 16.
[36] Commission's supplementary report, page 8.
[37] Transcript page 83.

volumes and quality of supply, in another sub-market. We specifically note the following trends: (i) Eskom is increasingly procuring coal in the residual market to satisfy its increasing electricity demand; (ii) the proportion of coal volumes supplied to Eskom through long-term contracts in the tied market is declining; and (iii) from a supply-side perspective the South African coal producers increasingly export RB3 coal and this affects the volumes and quality of the domestic coal supply to Eskom.

[66] However, there is no need for us to in this case take a definitive view on market delineation. Whether one defines three separate product markets as the Commission did or one broad product market as argued by Econex[38], this does not alter our ultimate conclusion on the competitive effects of this particular merger.

Central supply basin and market shares

[67] Glencore and Xstrata both have interests in various coal mines located in the so-called central coal basin, i.e. the greater Witbank coalfields (which includes the Highveld, Witbank and Ermelo coalfields), where nine of the ten largest coal mines in South Africa are located. All the other large mining companies, including Anglo Coal, BHP Billiton and Exxaro Coal, as well as most of the other significant junior coal mining firms, have mines situated within the Witbank coalfields, within a range of approximately 50-100 km. The central coal basin produces 84% of South Africa's saleable coal. Other operations include two mines in Limpopo, two collieries in the Free State and six anthracite operations in KwaZulu-Natal.[39] The Witbank coalfields have a well-established infrastructure for the transportation of coal within the region.[40]

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[38] To test the Commission's market delineation, Econex did certain price tests on a few price series from the Commission's three identified sub-markets. Econex concluded as follows on this price correlation analysis: "*It seems that Eskom's tied market prices (cost plus and fixed price) do not have a significant correlation over the sample period with either residual market prices (ST/MT) or our series for exports prices (PPI exports or Exports). This would indicate that they do not move together sufficiently to be included in the same market.*" Econex further found that stationarity analysis tests might point to the residual and tied markets being related over the longer term. It however found no evidence of a link between the domestic markets (residual and tied) and the export markets. See pages 20 to 22 of the Econex Report.

[39] Commission's recommendation, pages 22 and 23.

[40] Commission's merger record, page 30. Also see Ephron's witness statement, paragraph 21.

[68] The national market positions of the merged entity in each of the markets identified by the Commission are as follows: in the tied market [10-20]%, in the residual market [20-30]% and in the export market [20-30]%. In an overall coal market in South Africa the merged entity's national market share would be [10-20]%. Competitors in each of these markets include Anglo, Exxaro and BHP Billiton. We below deal with our assessment at a local/regional level.

Assessment at power station level

[69] The important issue from an Eskom perspective is where it would be able to turn to for coal supplies after the proposed merger in the face of a SSNIP[41]. Should a need for additional coal supplies arise, Eskom would usually approach its main coal supplier to that particular power station as a first option. If this fails, any coal miner who is in close vicinity to the power station with the required coal quality at an acceptable price and logistical facilities would be the next best alternative. In a situation where an Eskom power station is linked to a feeder mine, the proposed merger thus might have a negative competitive effect if one of the merging parties owns the feeder mine to that power station and the other merging party owns the mine that is the next best alternative to Eskom. In such a scenario Eskom's bargaining position would be reduced post-merger. We therefore focussed our competition assessment on those Eskom power stations where one of the merging parties is the current (main) coal supplier (i.e. the feeder mine) and the other merging party is the (potential) next best alternative. This is the best way of uncovering the potential competition effects of the proposed transaction given the historic features of the tied domestic market and how Eskom would go about sourcing additional coal supplies.

[70] Our assessment targets the three Eskom power stations as identified as problematic by Econex, namely the Majuba, Komati and Hendrina power stations. Econex submitted that at these three power stations there were not enough equally favourable options to the merging parties for Eskom, post-merger. It is for this reason that we required Eskom to put up a factual witness to address the issue of coal procurement at a power station level. Below we assess the likely competitive effects at each of the above-mentioned three power stations.

[41] A small but significant and non-transitory increase in price.

Majuba power station

[71] Maharaj confirmed that Majuba does not have a tied mine as supplier. She explained that this is due to historical reasons since when Majuba was constructed, there was an adjacent mine selected to supply the power station. However, due to geological problems that mine could not be operated.[42]

[72] She went on to explain that Eskom therefore had to source coal from other suppliers and that there were no suppliers of suitable quality (given the plant configuration) available in the direct vicinity of Majuba. Hence at the moment coal is transported from the Witbank area to Majuba.[43] Majuba is on average about 150 kilometres distant from the heart of the Mpumalanga coalfields.[44] This means that all coal destined for Majuba has to be transported a long distance and Eskom has no option but to engage these logistics.

[73] Maharaj confirmed that the current suppliers to Majuba include Glencore and Xstrata. The Glencore supply is from the Shanduka Colliery, i.e. Graspan Colliery, and the Xstrata supply is from Goedgevonden. Goedgevonden supplies approximately [...] Mt of coal per annum to Eskom (the "GGV contract").[45] The GGV contract provides for the supply of coal to Majuba. Maharaj confirmed that Eskom has the option to divert some of the GGV quantities of coal to other power stations.[46]

[74] Maharaj further confirmed that the long-term contract with Xstrata's Goedgevonden to supply Majuba runs till 2026.[47] She also confirmed that the two sources of supply that are provided by Glencore-controlled companies are "life of mine" arrangements.[48]

[75] Under cross-examination, Maharaj conceded that there were two significant coal suppliers to Majuba other than the merging parties, as well as a number of other

[42] Transcript page 70.
[43] Transcript page 71.
[44] Transcript page 91.
[45] Houston's witness statement, paragraph 10.2.
[46] Transcript pages 98 and 99.
[47] Transcript page 89.
[48] Transcript page 90.

sources supplying smaller quantities of coal at this stage.[49] Thus there appear to be alternative coal suppliers to Majuba, specifically when the current rail constraints from the central coal basin are lifted in approximately three to five years.[50]

Komati power station

[76] There is currently also no feeder / tied mine for the Komati power station. Maharaj explained that the Komati power station was mothballed in the 1990's when Eskom found itself in an excess capacity situation, but in the early 2000's it started to re-commission Komati when the looming capacity shortages became far more obvious and the need to address them were imminent. When Komati was mothballed it had a tied colliery, i.e. the Koornfontein Colliery. Through agreements between Eskom and the then owners at the time, the colliery was sold off to another entity to mine for the export market.[51]

[77] When Komati was re-commissioned the then owners of the Koornfontein Colliery (not Glencore at the time) indicated that their coal was being exported but there was a small portion of coal that could still be offered to Eskom for sale. Eskom thus entered into a short-term supply arrangement with the then owners.[52] Currently Koornfontein (now owned by Optimum in which Glencore has a share), supplies [...] Mt to the Komati power station. This contract is up for renegotiation in 20[...].[53]

[78] Given the proximity of the Koornfontein coal mine to Komati, it remains a potential conveyor solution for Komati. The merging parties, however, argued that as matters stand at the moment if no further investment is made in Koornfontein, then it has about two years to run.[54] Maharaj agreed that the life of this mine could be extended but in order for this to happen both Eskom and the merging parties would have to negotiate a new agreement so that the investment in the

[49] Transcript pages 92 to 94. Also see Econex Report, Table 14, page 42. Specifically see Econex's conclusion that two suppliers other than the merging parties "*seem to be important suppliers to Majuba and could be viable alternatives to the merging parties*" (pages 42 and 43 of report).
[50] Transcript pages 86, 90, 91 and 97.
[51] Transcript pages 75 and 76.
[52] Transcript pages 76,102 and 103.
[53] See *inter alia* page 30 of Econex Report.
[54] Transcript page 104.

mine would be worth it for the merging parties.[55] She also conceded that Koornfontein's export capacity is going to be filled by Glencore and nothing about the merger is going to change that because of the premiums available in the export market.[56]

[79] Maharaj further explained that given the limited supply volumes from Koornfontein, Eskom had to start buying coal from other sources but this coal has had to be transported by road to Komati. Despite the added transport costs from these sources it was still cheaper for Eskom to do this than to buy more from Koornfontein at an export parity related price.[57]

[80] Maharaj went on to explain that one of the other coal sources is the Goedgevonden contract (see paragraphs 73 and 74 above) signed for Majuba. She again confirmed that in the case of Goedgevonden Eskom has security of supply until 2026.[58] This was consistent with Houston's evidence, who in his witness statement indicated that Xstrata does not have a contract to supply coal to Komati.[59] Maharaj confirmed that Eskom is taking coal to Komati under the BECSA Duvha[60] contract and under the GGV contract.[61]

[81] Furthermore, three other coal suppliers (other than the merging parties) also supply Komati, two of which supply very significant coal volumes to Komati.[62]

Hendrina power station

[82] Maharaj testified that the Hendrina power station is one of the oldest power stations in the Eskom fleet and that at the time it was commissioned, it was commissioned with a tied colliery, the Optimum Colliery, which is adjacent to the power station.[63] She went on to say that Hendrina essentially has two suppliers.

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[55] Transcript pages 106 and 107.
[56] Transcript page 110.
[57] Transcript page 77.
[58] Transcript pages 98 to 100.
[59] Houston's witness statement, paragraph 12.3.
[60] Xstrata currently has a long-term supply contract in relation to Eskom's Duvha plant via BHP Billiton Energy Coal South Africa Limited (BECSA). This is referred to as the "BECSA Duvha contract". See Houston's witness statement, paragraph 10.1.
[61] Transcript page 98.
[62] Econex Report, Table 11, page 39.
[63] Transcript page 78.

Optimum Colliery being its main supplier[64] that provides the bulk of the coal that it requires and a second supplier, which is not one of the merging parties, which supplies coal by road.[65]

[83] Maharaj confirmed that there currently is no significant overlap of coal supply by the merging parties with regards to the Hendrina power station.[66] Houston confirmed that Xstrata does not currently have a contract to supply coal to Hendrina.[67]

Conclusion

[84] Based on the available evidence, there is no reason to believe that there are any Eskom power stations where one of the merging parties is a current supplier and is significantly constrained by the (potential) alternative supply from the other merging party. Thus the acquisition of Xstrata by Glencore presents no opportunity for the merged entity to unilaterally raise prices of coal supply at any of Eskom's power stations.

Exports

[85] Econex argued that there is a clear rationale for the merged entity to actively pursue an export strategy through the combination of the merging parties' marketing and mining skills and a clear incentive for the merged entity to direct coal to the export markets.

[86] The Commission found that an analysis of Xstrata's coal exports for the past four years shows that pre-merger Xstrata's throughput at the RBCT has almost always been near or at full allocation. Houston confirmed that Xstrata already utilises its full export capacity allocation from existing mines.[68] Houston further indicated that Transnet will soon require Xstrata (and all coal exporters that use the RBCT export chain) to contract on the basis of a 90% take-or-pay commitment over the next 10 years to support its investment in and operating

[64] Optimum currently supplies the Hendrina power station with [...] Mt, with the contract expiring in 20[...]. See *inter alia* page 34 of Econex Report. Transcript page 120. Also see Ephron's witness statement, paragraph 60.
[65] Transcript page 79.
[66] Transcript page 120.
[67] Houston's witness statement, paragraph 12.2.
[68] Houston's witness statement, paragraph 16.

costs in respect of the export coal line. He further said that Xstrata therefore has planned to grow exports such that these rail commitments will be met.[69]

[87] The Commission further found that Glencore is already using almost all of its export allocation at the RBCT. Ephron also confirmed that Transnet is imposing 10 year take-or-pay obligations on coal exporters to ensure it secures contracts to cover the cost of its upgrade investment and financing costs and that those negotiations have been ongoing for 15 months.[70]

[88] We conclude that it is likely that Transnet's take-or-pay obligations will further incentivise all coal producing firms to use their full export allocations.

[89] We further note the uncontested evidence that Xstrata is already export focussed[71] and that it exports much more of its coal as a percentage of its production than does Glencore.[72] It is thus not a situation in which Glencore is acquiring domestic resources which are now domestically supplied in order to apply them to exports. It is buying a company that for historical reasons is already largely focused around coal exports.

[90] Although post-merger the merged entity will have the largest allocation at the RBCT terminal, displacing Anglo Coal that currently has the largest allocation, taking into account both the rail and port capacity, the Commission concluded that the merged entity has no more capacity to export coal than the merging parties did individually pre-merger. As the logistics infrastructure becomes de-bottlenecked, the opportunity to export more coal opens up. However, this opportunity exists even without the merger, i.e. the lifting of (some of) the export constraints is not a function of the merger. Export capacity will be utilised, in current market conditions, by Glencore and Xstrata whether together or apart and the merger does not give the merged entity the ability or incentive to export more coal.

[91] Although the attractiveness of exporting RB3 coal impacts coal supply to the local markets, this is not related to the merger. The switch from RB1 to RB3 coal

69 Houston's witness statement, paragraph 17.
70 Ephron's witness statement, paragraph 30.
71 Houston's witness statement, paragraphs 9 and 16.
72 See transcript pages 111 and 112.

exports is already an existing feature of the market and it is difficult to isolate the potential contributions of this particular merger to that trend. It is a natural strategy for all coal miners to direct their coal supply towards the higher priced and growing export markets. However, although the phenomenon of increasing RB3 coal exports is not independently anti-competitive, its impact has significant consequences for the supply of coal to domestic customers (see broader public interest concerns discussed in paragraphs 103 to 105 below).

[92] We concur with the Commission's assessment on the vertical issues since we have found no cogent evidence to the contrary.

Conclusion

[93] After considering Maharaj's testimony we conclude that Eskom's coal supply concerns, although legitimate, are not merger-specific, i.e. this merger is not the cause for those concerns. We have found no cogent evidence that the proposed merger, either from a horizontal or vertical perspective, would likely substantially prevent or lessen competition in any coal market.

[94] Given our above finding, there is no reason for us deal with the "private" agreement between Glencore and Eskom (see paragraphs 22 and 23 above). Counsel for Eskom stated that the terms of the agreement are confidential and said that in the light of the agreement and the assurances under that agreement, it was no longer necessary for Eskom to continue with its participation as an intervener. Eskom accordingly withdrew as intervener and as a participant in these merger proceedings. We shall not elaborate on the terms of the agreement, suffice to say that counsel for the merging parties described the agreement's terms as being *"largely about process"* and we would agree with this description.

[95] We do however note that customers with supply-related concerns would normally request the Tribunal to approve a proposed merger subject to specific conditions to address its concerns. This would render the conditions enforceable and ensure compliance by the merged entity with the conditions. The Commission would have the task of monitoring this compliance. However, as stated above, Eskom in this case took the unusual approach of withdrawing its intervention based on a "process" agreement and did not ask the Tribunal to

impose any of the supply conditions on the merged entity that it had originally argued for (see paragraph 11 above).

Public interest

Merger-specific employment concerns

[96] The merging parties in their merger filing submitted that it is contemplated that the merger will result in rationalisation in respect of duplicated positions in the acquiring and target firms. They however indicated that Glencore will use reasonable efforts to mitigate the impact of rationalisation on employees by methodologies such as redeployment of affected employees elsewhere in the merged group (to the extent possible) and/or the provision of re-skilling opportunities. Where feasible, voluntary retrenchment packages will be considered in lieu of compulsory retrenchment.[73] They however did not initially quantify the anticipated job losses.

[97] As stated above (see paragraphs 5 and 13), NUM raised the concern of the non-disclosure by the merging parties of the imminent retrenchment of 180 employees as a result of the proposed merger.

[98] NUM and the merging parties however ultimately reached agreement on a set of employment conditions that satisfied NUM's concerns. This agreement was a slight modification of the one suggested to the Commission.

[99] In brief, the condition provides for a ceiling on the number of employees that may be retrenched as a result of the merger. No more than 80 skilled employees may be retrenched and the retrenchment process in respect of this class of employee may commence once the merger has been implemented by the merging parties.

[100] In respect of the class of semi-skilled and unskilled employees, greater protection is provided. Following the effective date (i.e. the date of the last jurisdiction's competition approval of the merger), the merging parties must conduct a review to analyse whether retrenchments from this class of employees

[73] Commission's merger record, pages 1115 and 1116.

are required. This review period, which will involve engagement with the unions concerned, must be completed within 90 days. If after this review has been concluded, it is determined that retrenchments of this class are still required, then the merged firm may retrench, provided it does so; only two years after the end of the review period; and no more than 100 employees from this class may be retrenched. What this means is that retrenchments, of unskilled and semi-skilled employees, if they have to take place, are postponed for at least two years and 90 days after the effective date.

[101] For those semi-skilled and unskilled employees who are retrenched, a re-training fund has been established and each retrenched employee will be entitled to receive R10 000 towards an approved training course.

[102] We note that the Glencore Group and Xstrata collectively currently have more than 7 000 employees in South Africa.[74] We are satisfied that the agreed set of employment-related conditions, that we have imposed as a condition of approval of the proposed merger, is fair both to the affected employees and the merging parties.

Non merger-specific broad public interest concerns

[103] Although not specific to the proposed merger, it has become clear during our process that there are causes for concern around future coal prices in the domestic market and the impact of this on South Africa's electricity prices. We have taken note of a number of important trends and developments in the coal industry as a whole in recent years. These include (i) the impending ending of certain of Eskom's long-term coal contracts; (ii) the anticipated increased coal demand from Eskom and its increased buying on short-term contracts; (iii) the anticipated increase in rail transport capacities for coal exports; (iv) the incentives of coal miners to export coal given higher coal export prices and revenues; (v) increases in the export of coal and meaningful changes in the composition of these exports, specifically the increased demand from countries that use lower quality coal (i.e. RB3 coal) and thus increases in the exports of this coal from South Africa; and (vi) the trending of prices on the residual (short-term) market

[74] Commission's merger record, page 1115. These figures exclude the employees of contractors.

towards international export prices. These trends do not favour domestic coal users, specifically Eskom as the largest coal customer in South Africa.

[104] However, as noted above, these developments are occurring separate from the proposed merger, i.e. the merger is not the cause of these developments. These factors will no doubt have an impact on Eskom's ability to procure coal and the price thereof and to produce competitively priced electricity. Although the increasing prices of coal supply to our domestic market is a very serious concern, given its effect on electricity prices and potential detrimental effects on economic growth, South Africa's development goals and indeed the entire economy, we have no reason to believe that this merger is going to make that situation worse. These concerns, which are industry-wide, could be addressed by other policy instruments, if government deems it appropriate, and if Government wants to ensure that the strategic importance of South Africa's coal reserves to domestic industries is protected.

[105] The Commission should actively use its advocacy role to engage with all relevant stakeholders including policymakers to advise them on these broader public interest concerns and their causes.

CONCLUSION

[106] We approve the proposed transaction subject to the employment-related conditions as per the attached "**Annexure A**".

ANDREAS WESSELS

06 March 2013
DATE

Norman Manoim and Merle Holden concurring

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