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COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 016329

In the matter between:

Industrial Development Corporation of South Africa Limited;	**Acquiring Firms**
Hebei Iron & Steel Group Co Limited; and	
Mauritius SPV	
And	
Rio Tinto South Africa Limited	**Target Firm**

Panel	:	Norman Manoim (Presiding Member) Yasmin Carrim (Tribunal Member) Andreas Wessels (Tribunal Member)
Heard on	:	03 July 2013
Order issued on	:	03 July 2013
Reasons issued on	:	31 July 2013

Reasons for Decision

Conditional approval

1. On 03 July 2013, the Competition Tribunal ("Tribunal") conditionally approved the merger between the Industrial Development Corporation of South Africa Limited ("IDC"), Hebei Iron & Steel Group Co Limited

("Hebei"), Mauritius SPV, the acquiring firms[1], and Rio Tinto South Africa Limited ("RTSA"), the target firm.

Background

2. The Competition Commission ("Commission") investigated the matter and identified no horizontal or vertical competition concerns resulting from the proposed transaction. It did however identify a public interest concern in terms of section 12A(3)(a) of the Competition Act of 1998[2] relating to the effect of the proposed transaction on a particular industrial sector. This concern related to the supply by the merging parties of Dense Medium Separation ("DMS") magnetite[3] iron ore, which is used in the washing of coal. The supply of washed coal affects the supply of electricity in South Africa.

3. During its investigation of the matter the Commission engaged with the merging parties regarding this public interest concern and the merging parties consequently tendered a set of conditions aimed at addressing the concern. The Commission accepted the merging parties' tendered conditions as adequate to address the identified concern and referred the matter to the Tribunal on that basis. At the hearing of the matter the Tribunal asked for clarity regarding certain aspects of the proposed set of conditions and suggested certain enhancements to those conditions. Consequently the merging parties incorporated those enhancements and submitted a final set of conditions. We accepted the merging parties' tendered final set of conditions as adequate to address the public interest concern resulting from the proposed merger and approved the transaction subject to those conditions.

[1] We note that "acquiring firms" in the context of the imposed conditions mean the IDC, Mauritius SPV, Hebei and any other firm that may jointly control Mauritius SPV (also see paragraph 57.8 below).
[2] Act No. 89 of 1998, as amended.
[3] Iron ore mines in South Africa produce two types of iron ore, namely magnetite and hematite iron ore. The main differences between magnetite and hematite iron ore relate to the iron content, sizing, physical (chemical) characteristics and the level of impurities.

4. The reasons for conditionally approving the proposed transaction follow. We deal mainly with the above-mentioned public interest concern and briefly discuss the horizontal and vertical issues.

Parties to transaction

Acquiring firms

5. The primary acquiring firms are the IDC, Hebei and Mauritius SPV.

IDC

6. The IDC is wholly-owned by the Government of the Republic of South Africa under the auspices of the Economic Development Department ("EDD"). The IDC is a national development finance institution set up to promote economic growth and industrial development.

7. For the purposes of the assessment of the proposed transaction, the IDC's 59% interest in Foskor (Pty) Ltd ("Foskor") and its 74% interest in Scaw Metals South Africa (Pty) Ltd ("Scaw") are of relevance.

Foskor

8. Foskor is a vertically integrated phosphate producer. Its acid division produces sulphuric acid, phosphoric acid and phosphate-based granular fertilisers.

9. As a by-product of its mining activities, Foskor has over time accumulated a stockpile of magnetite iron ore. It sells the magnetite iron ore locally as well as in certain export markets. We note that, according to the Commission's findings, Foskor's magnetite iron ore reserves have reduced substantially and it is currently not able to mine any ore that contain magnetite.[4]

[4] See *inter alia* pages 3 and 22 of the Commission's Report.

Scaw

10. Scaw is an integrated steel maker producing products for the mining, rail, power, offshore oil and gas, construction, commercial and other industrial sectors. It *inter alia* supplies grinding metal to Palabora Mining Company Limited (see paragraph 18 below) on a non-exclusive basis. The grinding media are used in *"ball mills"* as part of the process to separate minerals and metals from ore.

Hebei

11. Hebei is a Chinese State-owned company and its sole shareholder is the State-owned Assets Supervision and Administration Commission of the People's Government of Hebei Province. Hebei is primarily focussed on steel production in China. It is also active in mining, product manufacturing and the financial services and logistics sectors. It however does not currently conduct any of its business activities in South Africa.

Mauritius SPV

12. Mauritius SPV is a yet to be formed special purpose vehicle which is to be created solely for the purposes of concluding the proposed transaction.

13. Mauritius SPV will be wholly-owned by another special purpose vehicle in Hong Kong, namely Smart Union Resources (Hong Kong) Co Ltd ("Hong Kong SPV"). Hong Kong SPV has also been established exclusively for the purposes of the proposed transaction. Hong Kong SPV is not controlled by any firm. The shareholding in Hong Kong SPV is as follows: (i) Hebei - with a 43.75% shareholding; (ii) Tewoo Group Co Limited - with a 25% shareholding; (iii) General Nice Development Limited - with a 25% shareholding; and (iv) China-Africa Development Fund Co Limited - with a 6.25% shareholding.

14. General Nice Development Limited is principally engaged in resources development and production, logistics and trading and it has developed two main business chains. The first chain is based on coal mining, coal

selecting and washing, coking, coke export, gangue electricity generation and railway transport. The other chain is based on iron ore mining and the importation of iron ore.

15. Tewoo Group Co Limited operates as a general trading company in China and internationally. It engages in the trading of products such as steel, coal, fuel and oil.

16. China-Africa Development Fund Co Limited is the development finance arm of the China Development Bank and it aims to support Chinese companies to develop cooperation with Africa and enter the Africa market.

17. In these reasons Mauritius SPV and the firm(s) that will control it are also referred to as the "Chinese Consortium".

Target firm

18. The primary target firm is RTSA. It is a holding company and does not sell any products or render any services. Its primary asset is the Palabora Mining Company Limited ("PMC"). RTSA holds, directly, 33.66% of the issued share capital in PMC and has an effective 54.43% shareholding interest in PMC. PMC is a public company listed on the Johannesburg Stock Exchange ("JSE"). PMC *inter alia* holds 100% of the issued share capital in Palabora Copper (Pty) Ltd.

19. PMC operates a large block cave copper mine and smelter complex. Its mine and production plant are located in the Ba-Phalaborwa area in Limpopo adjacent to the Foskor mine. Its main business is to mine and beneficiate copper. It is South Africa's only producer of refined copper.

20. Of relevance to the assessment of this transaction are PMC's activities in respect of (i) sulphuric acid; and (ii) iron ore. PMC produces sulphuric acid as a by-product of its copper smelting activities. The sulphuric acid is placed in storage tanks on PMC's premises. PMC's copper mining process also gives rise to the production of iron ore (in the form of magnetite). According to the merging parties, PMC exports the bulk of its iron ore

produced.[5] According to the Commission's market investigation, PMC continues to produce magnetite iron ore as part of its copper mining activities.[6]

Proposed transaction and rationale

21. The merging parties submitted that the proposed transaction comprises a series of inter-related and cross conditional steps which will culminate in the acquisition of control by a consortium comprising the IDC and Mauritius SPV of PMC and its Rio Tinto and Anglo American-controlled and related holding companies.[7] According to the merging parties, the IDC and Mauritius SPV will acquire: (i) direct control over RTSA; and (ii) indirect control over PMC. In addition, Hebei will acquire direct control over PMC.[8]

22. In Part A, Mauritius SPV will acquire 100% of the issued share capital in RTSA (and, as a result, indirect control over PMC). In Part B, as an inter-related and conditional step, the IDC will subscribe for 20% of the issued share capital in RTSA. This issuing of and subscription for shares, together with certain minority protections, will confer upon the IDC *de facto* control over RTSA (and hence indirect control over PMC). In Part C, Hebei will acquire control over PMC in terms of section 12(2)(g) of the Act.

23. The IDC submitted that it is mandated by the Department of Trade and Industry ("DTI") and the EDD to promote the deepening and the widening of the manufacturing processes in the industry by investing in mid- and downstream manufacturing to potentially capitalise on South Africa's competitive advantage in the upstream beneficiation of natural resources. The current transaction is in line with such mandate and will serve to secure the supply of an iron ore resource. The proposed transaction may

[5] Merger record page 110.
[6] Commission's Report, *inter alia* pages 24 and 31.
[7] Merger record *inter alia* pages 7 and 99.
[8] The merging parties have provided a detailed description and explanation of the proposed transaction in their *Competitiveness Report*, pages 2 to 6 (record pages 100 to 104), and the structure of the transaction is also set out in the *Consortium Agreement*.

also present opportunities to explore certain synergies between Foskor and PMC.

24. From Hebei's perspective, the proposed transaction will enable it to contract with PMC for the supply of iron ore and serves as a development opportunity for Hebei in South Africa.

25. The ultimate shareholders of Mauritius SPV view South Africa as an emerging market with significant growth opportunities.

26. Rio Tinto is seeking to divest its shareholding to a buyer who will be able to develop the iron ore business.

Impact on competition

27. The overlap in the activities of the merging parties arises out of the IDC's control over Foskor. The activities of Foskor and PMC overlap in relation to the production and sale of (i) magnetite iron ore, specifically DMS iron ore; and (ii) sulphuric acid.

Magnetite iron ore

28. Both Foskor and PMC sell magnetite iron ore. Magnetite is one of the many naturally occurring forms of iron ore and is produced and stockpiled by PMC and stockpiled by Foskor. We note that Foskor has stockpiled the iron ore material over time and has since started selling the iron ore.

29. In relation to magnetite iron ore, the Commission found that none of the existing steel mills in South Africa have the capacity to use magnetite iron ore in their production processes since the local steel mills are configured to use hematite iron ore.

30. Almost all magnetite iron ore sold locally is used for coal washing. Coal washing entails a process where magnetite iron ore is mixed with water to create a medium where higher and lower calorific coal (or other impure materials/minerals) can be separated. The magnetite iron ore used for coal washing is generally referred to as DMS iron ore.

31. As mentioned above, PMC currently produces magnetite iron ore and both PMC and Foskor have stockpiles of magnetite iron ore that can be upgraded to DMS iron ore. We note that the magnetite iron ore from both Foskor and PMC must be beneficiated in order to reach an acceptable standard for use as DMS iron ore. The Commission found that neither PMC nor Foskor's stockpiled product can be supplied directly to coal mines for coal washing since the product does not have the required Fe content[9] and is too coarse. For the same reasons, the magnetite iron ore mined by PMC during its run of mine operations cannot be supplied directly for coal washing.[10]

32. The beneficiation of the Foskor stockpile is carried out by Idwala Industrial Holdings (Pty) Ltd ("Idwala") (an independent entity) that has a beneficiation plant situated at Foskor's premises,[11] while PMC is able to beneficiate the magnetite iron ore itself. The beneficiation of the stockpiled magnetite iron ore first requires the drying thereof and it then goes through a magnetic separator where the iron ore content is enriched. Second, the magnetite iron ore is then milled and finally put through a classification process to class the magnetite to size. The finer material which has been upgraded is supplied to the coal mining industry as DMS iron ore, whereas the coarser upgraded material is either exported or supplied to customers for further milling.

33. Coal producers contacted by the Commission submitted that they cannot use hematite iron ore to wash coal.[12] This is because of the non-magnetic character of the hematite iron ore. They further indicated that in order for magnetite iron ore to be used for coal washing it must have the following qualities: (i) iron oxide levels in excess of 95%; (ii) a Fe content of 65%; (iii) a particle size distribution between 80% - 86% passing -45μm; and (iv)

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[9] I.e. the iron content of the magnetite iron ore.
[10] Commission's Report page 43.
[11] Idwala purchases magnetite from Foskor's stockpile and beneficiates it on its own behalf. Foskor does not currently have the necessary equipment (beneficiation plant) to carry out the beneficiation of the magnetite iron ore.
[12] Commission's Report page 35.

must be able to create a dense medium separation at 4.6g to 4.9g per cubic centimetre.[13]

34. Market participants interviewed by the Commission confirmed that there are currently no alternative suppliers of DMS iron ore and that no alternative sources of magnetite iron ore can be used as DMS iron ore.[14]

35. The Commission thus found that PMC and Foskor are the only South African firms that have magnetite iron ore that can be upgraded to DMS iron ore that is used by the local coal mines in their coal washing processes.

36. The Commission therefore concluded that the effects of the proposed transaction are likely to be observed in the DMS iron ore market. The Commission further concluded that this market was national in scope and that imports of DMS iron ore are not economically viable even when compared to export parity prices. This was confirmed by the Commission's cost analysis. There is however no need for us in this case to take a definitive view on the exact geographic scope of the market, i.e. whether it is national or narrower, since it does not affect our ultimate conclusion.

37. In assessing the potential unilateral effects of the proposed transaction in the DMS iron ore market, the Commission considered the supply agreements entered into between Foskor and its only local customer and those entered into between PMC and its local customers. The Commission also considered the closeness of competition between Foskor and PMC and the ability of coal mines to switch between the above-mentioned customers of Foskor and PMC.

38. The Commission found material differences in the magnetite iron ore and the beneficiation capability of Foskor and PMC and concluded that they do not currently compete with each other for customers of DMS iron ore. This

[13] Commission's Report page 35.
[14] Commission's Report page 41.

position was unlikely to change post-merger. Customers are therefore unlikely to switch between Foskor and PMC for DMS iron ore. Given the lack of competitive constraint between the merging parties, the Commission was of the view that the proposed transaction was unlikely to raise unilateral concerns in relation to the market for DMS iron ore.

39. The Commission further found that PMC can sell magnetite iron ore into the international market at a higher price than what has been achieved in the domestic market. The Commission was however of the view that any potential price-increases in the domestic market to export parity levels are not a merger-specific concern.

Sulphuric acid

40. As stated above, both Foskor (a subsidiary of the IDC) and PMC (a subsidiary of RTSA) produce sulphuric acid.

41. Based on an analysis of the product costs of sulphuric acid and its transportation costs, the Commission found that because of the distance between the sulphuric acid production facilities of respectively Foskor and PMC and the transport costs associated with the product, it was highly unlikely that Foskor and PMC would be competing for the same customers. The Commission noted that PMC supplies product to the *"inland market"* whereas Foskor supplies a *"coastal market"* (primarily the KwaZulu-Natal region).[15] From a horizontal perspective, the Commission thus concluded that the proposed transaction is unlikely to raise significant competition concerns in relation to the production and sale of sulphuric acid.

42. The Commission further found that there are a number of vertical overlaps (agreements) between the merging parties that arise due to the proximity of the PMC and Foskor mines. Also, the [...] which will give rise to a vertical relationship. These vertical relationships are unlikely to raise any

[15] See page 27 of the Commission's Report.

significant competition concerns and our analysis below only focuses on two possible vertical overlaps.

43. The first vertical dimension arises since Foskor uses sulphuric acid as an input in its production processes. Foskor however produces sulphuric acid for its internal use in the production of phosphoric acid and, according to the merging parties, are self-sufficient in the production of sulphuric acid for its internal requirements. It supplies excess volumes of sulphuric acid to third parties.[16]

44. The Commission found that PMC does not have the capacity or the consistency of supply to meet the sulphuric acid requirements of Foskor.[17] The Commission thus concluded that the merging parties are unlikely to post-merger have the ability or the incentive to engage in a foreclosure strategy in relation to sulphuric acid.

Grinding media

45. As mentioned in paragraph 10 above, a further vertical dimension of the proposed transaction is that Scaw (a subsidiary of the IDC) has in the past supplied grinding media, specifically grinding balls, to PMC as an input.

46. The Commission found that PMC does not have the ability to absorb significant volumes of high chrome grinding media and that there was no financial incentive for Scaw to refuse supplying existing customers. It thus concluded that foreclosure with respect to grinding media as a result of the proposed transaction was unlikely.

47. We have no reason to doubt the Commission's above-mentioned findings and do not deal with the horizontal or vertical effects of the proposed transaction in any further detail in these reasons.

[16] Merger record page 129.
[17] See page 31 of the Commission's Report.

48. However, as already mentioned, the Commission identified a public interest concern in relation to the supply of DMS iron ore and its effects on industry in South Africa. We discuss this concern below.

Public interest

Effect on a particular industrial sector or sectors

49. As stated in paragraph 2 above, the Commission concluded that the proposed transaction raised a significant public interest concern with respect to its impact on a particular industrial sector.

50. The concern was that the implementation of the proposed transaction would result in the diversion of locally produced DMS iron ore volumes to the merging parties, or entities in which they have an interest, to the detriment of domestic customers of DMS iron ore. The Commission found that both the IDC and the Chinese Consortium have several projects and / or interest in various firms that require magnetite iron ore as an input material and that the merging parties are likely to post-merger supply DMS iron ore to firms in which either the IDC or Chinese Consortium have an interest.

51. DMS iron ore has a crucial role in the beneficiation of coal for both the domestic and export coal markets. The export coal market is primarily supplied with higher calorific coal that has been washed. The coal mines interviewed by the Commission confirmed that DMS iron ore plays a critical role in their production processes, specifically in the washing of coal to improve its quality, and that the inability to access a secured source of DMS iron ore will have a detrimental impact on (i) overall local coal production levels; (ii) the ability to supply local coal customers, specifically Eskom; and (iii) the ability to export coal, and as a result potentially the viability of certain coal producers.[18]

[18] The Commission based this on its telephone interview of 04 April 2013 with Exxaro, the letter of Exxaro of 23 May 2013, the telephone interview of 09 May 2013 with Anglo Thermal Coal, the telephone interview of 17 May 2013 with GX and the telephone interview of 24 May 2013 with BHP. See Commission's Report page 65.

52. From the perspective of Eskom as a domestic coal customer, a number of Eskom power stations are (to some extent) reliant on washed coal and the inability of the local coal mines to supply washed coal to Eskom is likely to have a detrimental effect on Eskom's coal-related energy production processes. Eskom further indicated that the Medupi power plant will use mainly washed coal due to environmental concerns.[19] Thus, an inability to access sufficient volumes of DMS iron ore and wash sufficient quantities of coal are likely to have a significant impact on the local coal industry, specifically on the quality of coal supplied, and consequently on Eskom's ability to meet South Africa's growing electricity needs.

53. We note that we specifically had regard to the merging parties' internal documents and also to the *Consortium Agreement* which set out the merging parties' post-merger magnetite iron ore requirements. These documents underscore the merging parties' post-merger incentive to self-supply.[20] Furthermore, the Commission's analysis indicated that PMC's current beneficiation capacity is insufficient to meet the demands of the IDC, the Chinese Consortium and local customers from about [....].

54. We therefore find that the merging parties have the incentive to first supply the firms in which they have an interest in circumstances where there is a shortage of DMS iron ore. This is likely to result in the domestic customers of DMS iron ore post-merger not having access to sufficient volumes of product to meet their own needs.

55. We conclude that the likely inability of existing domestic customers to post-merger access sufficient volumes of DMS iron ore raises a significant public interest concern given its effect on a particular industrial sector, i.e. the supply of DMS iron ore to domestic coal customers (i.e. the domestic coal industry) which in turn will affect the supply of electricity in South Africa.

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[19] See letter from Eskom dated 29 May 2013.

[20] Also see *inter alia* pages 63 and 64 of the Commission's Report.

56. Therefore, the merging parties' tendered set of conditions is warranted to address this concern. We note that the Tribunal had several queries about the proposed conditions and that a number of enhancements were made to them following the Tribunal's questions and comments. One of these changes was that the definition of "acquiring firms" in the conditions was expanded to mean the IDC, Mauritius SPV, Hebei and any other firm that may jointly control Mauritius SPV (also see paragraph 57.8 below).[21]

57. We find that the tendered final set of conditions is proportionate to the identified public interest concern. We therefore approve the proposed transaction subject to the following conditions which, in essence, provide that local customers will post-merger have access to sufficient volumes of DMS iron ore:

57.1. Following the date of the Tribunal's order, PMC shall make available to South African firms[22] sufficient DMS iron ore[23] to satisfy the annual demand of the South African firms.

57.2. For the avoidance of doubt, the above-mentioned condition shall be:

57.2.1. subject to the demand for DMS iron ore by South African firms; and

57.2.2. subject to compliance by South African firms with their contractual and commercial obligations to PMC.

57.3. PMC's supply obligation in terms of the above conditions will be excused if any delay in performing, or failure to perform, any of its

[21] See transcript pages 36 to 41.

[22] "South African firms" mean firms with the exception of the merging parties or firms in which the merging parties have a shareholding interest, which will use magnetite iron ore for domestic consumption.

[23] "DMS iron ore" means magnetite iron ore that is currently supplied by PMC and used as a dense medium in the beneficiation (separation) of coal by coal mines. It is recorded that DMS iron ore has, typically, the following specifications: (i) a Fe content between 63% and 65%; (ii) a magnetic content between 92% and 95%; and (iii) a particle size distribution between 80% and 86% passing -45µm.

obligations under these conditions was beyond PMC's control or which PMC could not have avoided or overcome.[24]

57.4. In terms of the monitoring of the imposed conditions, PMC shall inform all of its existing customers in writing of the above conditions within two weeks of the date of the Tribunal's order. To this end, PMC must provide an affidavit by a senior official attesting to the notification and provide a copy of the said notice to the Commission within one month of the date of the Tribunal's order.

57.5. A senior official of PMC shall also depose to an affidavit on each anniversary date of the date of the Tribunal's order for the duration of the conditions attesting that PMC has fulfilled its obligations in terms of the conditions.

57.6. In the event that the Commission receives any complaint in relation to non-compliance with the above conditions, or otherwise determines that there has been an apparent breach by PMC of the conditions, the breach shall be dealt with in terms of Rule 39 of the Competition Commission Rules.

57.7. If PMC, subsequent to the date of the Tribunal's order, concludes any supply contract with a customer contemplated in paragraph 57.1 above, then it shall forward to the Commission copies of the contract within 30 days of its conclusion.

57.8. The above conditions shall remain in place for as long as any of the acquiring firms[25] controls[26] RTSA and/or PMC.

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[24] Including, without limitation as a result of fire, flood, explosion, breakdown of equipment or machinery, epidemic, riot, civil commotion, any strike, lockout or other industrial action, act of God, war or warlike hostilities or threat of war, terrorist activities, accidental or malicious damage, or any prohibition by any governments or other legal authority which is not in force on the date of drafting these conditions.
[25] "Acquiring firms" in the context of the imposed conditions mean the IDC, Mauritius SPV, Hebei and any other firm that may jointly control Mauritius SPV.
[26] "Control" means control as defined in terms of section 12(2) of the Act.

Employment and other public interest issues

58. The merging parties submitted that the proposed transaction will not have any negative effect on employment.[27] The proposed transaction raises no other public interest concerns.

CONCLUSION

59. We conclude that that the proposed transaction is unlikely to substantially prevent or lessen competition in any relevant market. However, given the public interest concern arising from the proposed transaction, we approve the transaction subject to the conditions as set out in the attached "**Annexure X**".

Andreas Wessels — 31 July 2013
DATE

Norman Manoim and Yasmin Carrim concurring

Tribunal Researcher:	Caroline Sserufusa
For the IDC, Hebei and Mauritius SPV:	Adv Hamilton Maenetje SC briefed by Edward Nathan Sonnenbergs
For PMC:	Daryl Dingley from Webber Wentzel Inc.
For Rio Tinto:	Derek Lotter from Bowman Gilfillan Inc.
For the Commission:	Werner Rysbergen

[27] See pages 16 and 133 of the merger record.