Editorial note: Certain information has been redacted from this judgment in compliance with the law.

REPUBLIC OF SOUTH AFRICA

IN THE HIGH COURT OF SOUTH AFRICA
GAUTENG DIVISION, PRETORIA

CASE Number: **63670/2021**

(1) REPORTABLE: YES/NO
(2) OF INTEREST TO OTHER JUDGES: YES/NO
(3) REVISED: YES/NO

2024 . [redacted]

In the matter between: -

INDUSTRIAL GAS USERS ASSOCIATION OF SA **Applicant**

and

NATIONAL ENERGY REGULATOR OF SA **First Respondent**

SASOL GAS LIMITED **Second Respondent**

JUDGMENT

This Judgment was handed down electronically by circulation to the parties' and or parties representatives by email and by being uploaded to CaseLines.

The date of the handing down of this judgment shall be deemed to be the date on which it is distributed to the parties.

Introduction

[1] The applicant is the Industrial Gas Users Association of South Africa ("*IGUA-SA*"), a body corporate whose members are large industrial users of gas. IGUA-SA states that its central purpose is to ensure the efficient availability of hydrocarbon gas in Southern Africa to meet significant and growing demand, both by organisations requiring more gas to expand the operations and by those intending to switch to gas from alternative energy sources that are more costly than gas and/or are more harmful to the environment.

[2] The first respondent is the National Energy Regulator of South Africa ("*NERSA*").

[2.1] NERSA is established by section 3 of the National Energy Regulator Act, Act 40 of 2004 ("*the NERSA Act"*);

[2.2] NERSA is mandated in terms of the NERSA Act to regulate the electricity, piped gas and petroleum pipelines industries in terms of the Electricity Regulations Act, 2006[1], the Gas Act, 2001[2] and the Petroleum Pipeline Act, 2003[3], respectively;

[2.3] Specifically in terms of section 4 of the Gas Act, NERSA must, *inter alia:*

---

1 Act No. 4 of 2006.
2 Act No. 48 of 2001.
3 Act No. 60 of 2003.

"(g) Regulate prices in terms of section 21(1)(p) in the prescribed manner".

[3] The second respondent is SASOL GAS LTD ("*Sasol"*). Sasol is a recognised monopolist in the piped-gas industry.

The nature of the relief sought

[4] IGUA-SA approached this court for the review and setting aside of a decision made by the first respondent (dated 31 March 2021, but published on 8 July 2021, referred to as the "*2021 decision*"), to approve Sasol's maximum gas prices for the period from March 2014 to June 2023.

[5] IGUA-SA contends that the methodology adopted by NERSA to determine the maximum gas prices is unreasonable and irrational.

[6] IGUA-SA seeks the following specific orders:

"1.1 [that] the first respondent's decision, dated 31 March 2021 but published on 8 July 2021, to approve the second respondent's maximum gas prices for the period from March 2014 to June 2023, is reviewed, declared unlawful and set aside.

1.2 [that] the matter is remitted to the first respondent to take a new decision.

1.3 [that] the first respondent must determine the second respondent's maximum prices by the cost-build-up or cost-plus method which allows

the second respondent to recover its prudently incurred costs and a return commensurate with risk, but no more.

1.4. The first respondent, and the second respondent if it opposed this application, are ordered to pay the applicant's costs."

[7] The following main issues are therefore to be determined:

[7.1] Whether the 2021 decision is unlawful and stands to be set aside. It is not in dispute that, if I decide the 2021 decision was unlawful, it ought to be remitted to NERSA;

[7.2] Whether, if I decide to set aside the 2021 decision and remit it to NERSA, I should direct that it apply a specific method in determining piped gas prices.

Legislative framework

[8] During the late 1990s, Sasol embarked on the "*Sasol Natural Gas Project*", in which it pioneered the development and commercial supply of natural gas from gas fields in Mozambique to the Southern African market via an 865km pipeline. The commercial supply of natural gas to South Africa commenced in March 2004.

[9] Sasol entered into an agreement with the Government of South Africa, the Mozambican Gas Pipeline Agreement of 2001, in terms of which Sasol was permitted to charge customers based on the cost to the customer of switching from gas to an alternative fuel. That regime endured for 10 years

after gas first landed in South African under that agreement, which, as stated, occurred in 2004. It therefore ended on 25 March 2014.

[10] When the Mozambique Pipeline Agreement came to an end, Sasol's maximum price for piped gas came to be regulated by the Gas Act, 48 of 2001 ("*the Gas Act*") read with Regulation 4 of the Piped-Gas Regulations.

[11] Section 2 of the Gas Act set out the objects of that Act, being:

> *"2.* ***Objects of Act.—The objects of this Act are to—***
>
> *(a) promote the efficient, effective, sustainable and orderly development and operation of gas transmission, storage, distribution, liquefaction and re-gasification facilities and the provision of efficient, effective and sustainable gas transmission, storage, distribution, liquefaction, re-gasification and trading services;*
>
> *(b) facilitate investment in the gas industry;*
>
> *(c) ensure the safe, efficient, economic and environmentally responsible transmission, distribution, storage, liquefaction and re-gasification of gas;*
>
> *(d) promote companies in the gas industry that are owned or controlled by historically disadvantaged South Africans by means of licence conditions so as to enable them to become competitive;*
>
> *(e) ensure that gas transmission, storage, distribution, trading, liquefaction and re-gasification services are provided on an equitable basis and that the interests and needs of all parties concerned are taken into consideration;*
>
> *(f) promote skills among employees in the gas industry;*
>
> *(g) promote employment equity in the gas industry;*
>
> *(h) promote the development of competitive markets for gas and gas services;*

(i) facilitate gas trade between the Republic and other countries; and

(j) *promote access to gas in an affordable and safe manner.*"

[12] Section 3 of the Gas Act established the National Gas Regulator (the "*Gas Regulator*"), whose functions are set out in section 4 thereof. In particular, it is the function of the Gas Regulator to *"regulate prices in terms of section 21(1)(p) in the prescribed manner*."

[13] In terms of section 4(1)(a) of the NERSA Act, NERSA must undertake the functions of the Gas Regulator as set out in section 4 of the Gas Act.

[14] In terms of section 15 of the Gas Act, no person may without a license issued by the Gas Regulator:

*"**15. Activities requiring licence**.—(1) No person may without a licence issued by the Gas Regulator—*

(a) construct gas transmission, storage, distribution, liquefaction and re-gasification facilities or convert infrastructure into such facilities;

(b) operate gas transmission, storage, distribution, liquefaction or re- gasification facilities; or

(c) trade in gas."

[15] Section 21(1) provides the framework of requirements and limitations within which the Gas Regulator may impose license conditions. Of particular relevance to the present matter is section 21(1)(p) which provides:

"*Maximum prices for distributors, reticulators and all classes of consumers must be approved by the Gas Regulator where there is inadequate*

competition as contemplated in Chapters 2 and 3 of the Competition Act, 1998 (Act no 89 of 1998)"

[16] As stated, it is not in dispute that Sasol has a monopoly in the piped gas industry and that therefore, the determination of maximum prices is subject to section 21(1)(p).

[17] On 20 April 2007, the Minister of Minerals and Energy promulgated regulations in terms of section 34(1) of the Gas Act, referred to herein as the "*Piped Gas Regulations*".

[18] Subregulation 4(3) of the Piped Gas Regulations provides as follows:

"(3) *The Gas Regulator must, when approving the maximum prices in accordance with section 21 (1) (p) of the Act—*

(a) be objective i.e. based on a systematic methodology applicable on a consistent and comparable basis;
(b) be fair;
(c) be non-discriminatory;
(d) be transparent;
(e) be predictable; and
(f) include efficiency incentives."

[19] Subregulation 4(4) provides as follows:

"(4) Maximum prices referred to in subregulation (3) must enable the licensee to—
(a) recover all efficient and prudently incurred investment and operational costs; and
(b) make a profit commensurate with its risk."

[20] It is in this legislative framework that NERSA's 2021 decision should be considered.

The history leading up to this application

[21] There is some history to this matter, which I will briefly set out below.

[22] In October 2011, NERSA published a methodology to approve maximum prices of piped-gas in South Africa which provides for two approaches by which to approve maximum gas prices, being:

[22.1] A pass-through (or costs-plus) approach; or

[22.2] A basket of alternative approach.

This is referred to for purposes of this judgment as the "*first methodology"*.

[23] As stated, the first methodology permitted Sasol to choose between a pass-through or cost-plus approach and one based on a basket-of-alternative fuel prices.

[23.1] The cost-plus approach is a price based on Sasol's costs plus a reasonable return;

[23.2] The basket-of-alternative fuel prices approach is based on the weighted average price of a basket-of-alternative fuels, namely coal, diesel, electricity, heavy fuel oil and liquified petroleum gas.

[24] Sasol opted for the basket-of-alternatives approach.

[25] On 23 December 2012, Sasol submitted an application to NERSA to approve its transmissions tariffs for the period 25 March 2014 to 30 June 2015, which were approved by NERSA on 26 March 2013.

[26] Also on 23 December 2012, Sasol submitted an application to NERSA in which it sought approval of maximum gas prices for the period 25 March 2014 to 30 June 2017 and approval of a trading margin for the period 25 March 2014 to 30 June 2015.

[27] On 26 March 2013, NERSA made a decision:

[27.1] Approving an overall maximum gas energy price of R117.69/Giga Joule ("*GJ*") as at 23 March 2013;

[27.2] Approving a trading margin of R8.1/GJ for the period 25 March 2014 to 30 June 2014 and R10.40/GJ for the period 1 July 2014 to 30 June 2017; and

[27.3] Giving approval for various distinguishing features in terms of section 22 of the Gas Act.

("*the 2013 decision*")

[28] Sasol chose not to charge up to the maximum price based on the basket-of-alternatives approach.

[29] Certain members of the applicant's predecessor, the Gas Users Group of Southern Africa, sought to have reviewed and set aside the 2013 decision,

based on the main contention that the 2013 decision failed to achieve the objects of the Gas Act and the Piped Gas Regulations, namely, to mimic competitive prices in the piped gas market. That application culminated in a judgment by the Constitutional Court, (reported as National Energy Regulator of South Africa and another v PG Group (Pty) Ltd and others[4]), on which IGUA-SA has placed considerable significance in the present matter. I will return to the findings of the Constitutional Court below. Suffice to say for the moment, that the Constitutional Court set aside the 2013 decision. Khampepe J in the majority decision of the Constitutional Court made the following finding:

"[63] In Democratic Alliance this court held that it is an established principle of administrative law that a failure to consider a relevant material factor in the process of coming to an administrative decision can render the decision irrational. The entire process is tainted as irrational if the relevant factor that was not considered ought to be central to finding a rational or even reasonable final outcome.

[64] Rationality is concerned with one question: do the means justify the ends? Democratic Alliance developed the test for rationality by explaining that an absence of a sufficient link can arise for procedural reasons. This is not a new or different type of irrationality, but rather a way of evincing a broken or missing link between the means and the ends. The means chosen by an administrator include everything done (or not done) in the process of making that decision.

[65] In this case Nersa failed to consider Sasol's marginal costs in the method it used to determine the maximum gas price for Sasol. The decision to apply the basket-of-alternatives approach specifically to

4 2020 (1) SA 450 (CC).

Sasol was not rational. Sasol is a monopolist and any rational attempt at regulating its prices needed to consider its costs in order to fairly and equitably divide the economic surplus between Sasol's profit and the economic value for Sasol's consumers.

[66] There are a number of interrelated reasons why Sasol's marginal costs are a necessary factor in determining its maximum price. It is important to note that Nersa was regulating the prices of a recognised monopolist. Section 2(e) of the Gas Act requires Nersa to take into account the interests and needs of all parties on an equitable basis. This is given expression in the fairness requirement found in reg 4(3). Importantly, this can be seen in reg 4(4), which requires Nersa to account for both costs and profits of the regulated entity. This is set out in more detail below.

[67] Once Nersa made the second decision that there was inadequate competition in the piped-gas market, it was obliged to consider a maximum gas price specifically for the monopolist —Sasol.

[68] In both the draft and final inadequate-competition determination Nersa itself stated that the spot price for gas in a market environment would tend towards its marginal costs. Nersa stated that —

'in competitive market conditions, a firm prices its products at the level where the price equals the marginal cost. If the price is above marginal cost, the economics theory concludes that such a firm has market power to influence prices without losing business to competitors.'

[69] Despite this acknowledgment, Nersa did not consider Sasol's marginal costs when trying to set a competitive maximum price. In a traditional competitive market, Sasol's marginal costs would be a required input for finding the competitive maximum price.

[70] *Nersa defends its decision not to use Sasol's marginal costs by pointing out that it was trying to mimic a competitive supply-constrained market. While it is true that there is a supply constraint, the reality of the situation is that Sasol is a monopolist and there are no competitors. Without a real-world competitor, Nersa's inclusion of the supply constraint as its justification for not considering Sasol's marginal costs is a back door which allows it to choose almost any imaginary maximum price it wants.*

[71] *I do not think Nersa is justified in trying to mimic the outer bounds of an imaginary supply-constrained market if that approach would not allow it to regulate the monopolistic vices it seeks to address. This would heavily favour the monopolist, which would be absurd for a legal regime meant to rein in the monopolist. Therefore, in trying to quell the market power of the monopolist by setting a maximum price, it is vital that a regulator considers the monopolist's marginal costs, even if there is a supply constraint. Without that inclusion, there is no way to test whether the maximum price will address the mischief of monopolistic market power.*

[72] *This is supported by the actual language of the Gas Act and the Regulations. As explicated below, the requirements to consider the interests of all parties in this market, and equitably divide the economic surplus, strongly support requiring Nersa to consider Sasol's marginal costs when regulating its maximum price.*

[73] *Nersa was required to act in a manner consistent with s 2(e) of the Gas Act, read with the fairness requirement found in reg 4(3), as set out above. To adhere to this section and regulation, Nersa had to set a maximum gas price that would balance the interests of both the monopolist and the consumers. This means that Nersa needed to find a way to evaluate the economic surplus being created in the piped-gas market and to divvy it up between the interested parties.*

[74] Nersa recognised the importance of finding a formula that 'reflects a balance between encouraging new entry and equitable sharing of any economic surplus between consumers and producers'. It is hard to imagine how Nersa could decide how to equitably split the surplus without considering Sasol's profits and thus costs. Under the basket-of-alternatives approach, Nersa has no way of calculating Sasol's profit from any given price, and therefore has no way of adequately judging the equities of distribution of the surplus.

[75] Nersa was tasked with setting a ceiling price for Sasol that allowed it to recover its costs and to make a profit that was commensurate with its undertaken risks, as set out in reg 4(4). In order for Nersa to rationally decide the maximum price which would include both costs and the chosen allowable profit, it needed to know and consider Sasol's marginal costs of production."

…

[77] Instead of considering Sasol's costs, Nersa considered the imaginary marginal costs of production for an admittedly unknown gas seller. The basket-of-alternatives option of the Maximum Pricing Methodology represents these imaginary marginal costs of production. There is likely some merit in this approach when trying to understand the limitations of an entrant into an imaginary supply-constrained market. However, it is totally divorced from a rational approach to choosing the maximum profit allowed by a recognised monopolist and then adding that profit onto the monopolist's actual costs.

[78] In trying to replicate a competitive market, Nersa considered what the maximum marginal costs of production of a fictional gas seller might be before it could no longer compete with the energy substitutes. Nersa then used those imaginary marginal costs of production when setting Sasol's maximum reasonable gas price.

One of the most relevant factors in Nersa's entire equation for specifically regulating Sasol ought to have been Sasol's own marginal costs of production. Without considering Sasol's costs, Nersa could not set a maximum price that included an equitable division of profit for Sasol and economic value creation for consumers. Sasol's costs are a mandatory input to this kind of exercise. Nersa failed to consider this mandatory input, and thus I cannot find that Nersa acted rationally in deciding Sasol's maximum gas price."

[30] In 2017, and whilst the outcome of the review application brought in respect of the 2013 decision was awaited, Sasol Gas brought another application for the approval of maximum gas prices for the period 1 July 2017 to 30 September 2018. On 23 November 2017, NERSA approved Sasol Gas' application through the application of the basket-of-alternatives approach. Following the decision of the Constitutional Court in respect of the 2013 decision, IGUA-SA brought an application to review and set aside the 2017 decision. That application was granted on an unopposed basis on 3 May 2021.

[31] On 27 March 2019, NERSA again made a determination of inadequate competition in the gas market.

[32] On 13 November 2019, NERSA published a draft new methodology and discussion document inviting industry stakeholders to submit written comments on the draft. IGUA-SA submitted its comments on 4 February 2020.

[33] On 15 April 2020, NERSA approved a new methodology for determining the new maximum pipes gas price that regulated entities like Sasol are permitted to charge (referred to as the "*second methodology*") together with its reasons for this decision.

[34] The second methodology:

[34.1] does not rely on either the pass-through or the basket-of-alternatives approach;

[34.2] applies an international benchmarking approach, in which the maximum gas price is calculated as a weighted average of the prices associated with the United States' HH, the Dutch TTF and the UK's NBP;

[34.3] applies a rationality test to check whether the resulting maximum gas price lies between Sasol's marginal acquisition cost (serving as the lower bound of the maximum price) and the price of Liquified Natural Gas (LNG) sold in Japan (serving as the upper bound of the maximum price).

[34.4] It allows for Sasol's costs to be taken into account, in addition to the weighted average of the prices associated with the three foreign hubs as listed above.

[35] The following is an extract from NERSA's published new methodology:

"4. DETERMINATION OF THE MAXIMUM PRICE

The Maximum Price Formula

4.1 The maximum price of piped-gas proposed by an Applicant or licensee shall be reviewed for purposes of approval by the Energy Regulator based on the following formula:

Max Price = 0.4 (HH) + 0.5 (TTF) + 0.1 (NBP)

Where:

Maximum Price of Gas = *Maximum price for gas energy (ZAR/GJ)*

Henry Hub (HH) = *Twelve months simple average of the Henry Hub monthly prices with a 40% weight in the energy basket*

Transfer Title Facility (TTF) = *Twelve months simple average of the TTF monthly prices with a 50% weight in the energy basket*

National Balancing Point (NBP) = *Twelve months simple average of the NBP monthly prices with a 10% weight in the energy basket.*

4.2 The maximum price of gas energy does not include distributor tariffs, transmission tariffs, storage tariffs and levies. Once the maximum price of gas is arrived at, all other charges (tariffs and levies) mentioned above shall be included to arrive at the 'total gas charges' to be invoiced by a licensee.

Determining the Weights in the Formula

4.3 The weights used in the maximum price formula will be taken from the maturity and liquidity of the hub concerned. The evaluation of the maturity of hubs is based on the following five key elements, which will assist in judging whether the criteria of depth, liquidity and transparency of hubs are being met and to what degree. The five key elements are: market participants, traded products, traded volumes, tradability index and churn rates. The churn rate is regarded as the most important measure of a gas hub's commercial success. The churn rate is calculated as the ratio between the volume of all trades, in all time frames, executed in a given market and its total demand. Churn rates are regarded as an appropriate measure of a hub's real liquidity and maturity. As a result, churn rates are used in most commodity and financial markets.

4.4 In this regard, the Energy Regulator took guidance from the churn rates of each of the aforementioned gas hubs in determining its weight allocation for the identified competitive gas hubs. Below is how the churn rates are used to establish the weights used in the methodology.

Table 1: Weight allocation for Dutch's TTF, US' Henry Hub and Britain's NBP, 2018

Hub	***Churn rate***	***Share/weight***
TTF	*70.9*	*50%*
HH	*53.9*	*40%*
NBP	*16.9*	*10%*
Total	*141.7*	*100.00%**

** the percentage weight is to the nearest 10.*

Source: NERSA's own compilation,2020."

[36] The second methodology also provides for a price adjustment in terms of which maximum gas prices will be reviewed over a period of 12 months, using the preceding 12 months' average prices of the Henry Hub, the TTF and NBP each afforded the weight as shown in the formula quoted above. It is described in the second methodology as follows:

> *"4.5 The maximum price in the formula in section 6.12 above will be adjusted as detailed below.*
>
> *4.6 The maximum gas prices will be reviewed over a period of 12 months, using the preceding 12 months average prices of the Henry Hub, the TTF and NBP prices as shown in the formula. Should licensees choose a different review period based on their commercial agreements, they would request the Energy Regulator to approve such a different period. However, in all instances, the preceding 12 months' average price of the Henry Hub, TTF and NBP will be used.*
>
> *4.7 The implication of this approach is that it will minimise the volatility that may result from the use of a shorter period.*
>
> *4.8 The approach adopted by NERSA is in line with the comments received from stakeholders as they have stated that the use of international hubs would lead to high volatility in the maximum price.*
>
> *4.9 NERSA also retained the use of the pass through of costs as a second option in the Methodology. This option is discussed further in section 10 below."*

[37] NERSA also retained the use of the pass-through of costs as a second option in the second methodology.

[38] After the publication of the second methodology, Sasol published on 4 December 2020 an application for maximum prices of piped gas for the period 26 March 2014 to 30 June 2023. In this application, Sasol sought to deviate from the second methodology and included arguments in court of the proposed changes to the second methodology.

[39] In its 2021 decision, published in July 2021, NERSA rejected Sasol's proposed amendments to the second methodology and approved the maximum price that Sasol may charge based upon the second methodology, as quoted above.

[40] Nersa stated as follows its reasons for its 2021 decision:

> *"6.56. NERSA, in its own decision on the Methodology, stated that it will consider Sasol Gas' acquisition costs plus the trading costs as the floor price of the maximum price. Therefore, NERSA requested Sasol Gas to submit its acquisition costs of the gas molecule to enable this assessment. The figure below shows the rationality test as alluded to in the Methodology. The test shows the maximum price calculated using the published Methodology (the blue line. The maximum price calculated by Sasol Gas using its amended formula is shown as well (red line). Both maximum price calculations lie between Sasol Gas' costs and the cost of LNG as described in the methodology.*
>
> *6.57 The difference between Sasol Gas' costs and the benchmark price is the margin that will be allowed to Sasol Gas.*

6.58 NERSA also noted Sasol Gas' inclusion of its opportunity costs and its motivation wherein it requires NERSA to consider this as the floor price. NERSA has addressed this issue in the above paragraphs."

[41] It is this 2021 decision that is the subject of the review application.

[42] IGUA-SA contends that the 2021 decision is:

[42.1] so unreasonable that no rational decision-maker could have taken it; and

[42.2] irrational because it does not achieve the purpose of the maximum price setting under the Gas Act, namely to mimic the price of gas in a competitive market.

The requirements of rationality and reasonableness

Rationality

[43] Rationality is a requirement of the rule of law entrenched in section 1(c) of the Constitution. It is also a fundamental requirement of administrative law. Section 6(2)(f)(ii) of PAJA provides that the administrative action is reviewable if it:

"*is not rationally connected to –*

(aa) the purpose for which it was taken;

(bb) the purpose of the empowering provision;

(cc) the information before the administrator; or

(dd) the reasons given for it by the administrator…"

[44] In Democratic Alliance v President of the RSA[5] the Constitutional Court considered the law on the requirement of rationality.

[45] When assessing the rationality of an administrative decision, the Court is not concerned with whether the same purpose could have been achieved by less restrictive means. It is only concerned with whether there is a rational relationship between the means chosen and the end sought to be achieved.[6] If the decision furthers its purpose, then it is a rational one and it matters not that the same purpose might have been achieved by less restrictive means.

[46] As Nugent JA has explained, "*a decision is 'rationally' connected (to the purpose for which it was taken etc) if it is connected by reason, as opposed to being arbitrary or capricious.*[7] *The principle is this*:

> "*an enquiry into rationality can be a slippery path that might easily take one inadvertently into assessing whether the decision was one the court considers to be reasonable … [R]ationality entails that the decision is founded upon reason – in contra-distinction to one that is arbitrary – which is different to whether it was reasonably made. All that*

---

5 2013 (1) SA 248 (CC).

6 Affordable Medicines Trust and others v Minister of Health and Others 2006 (3) SA 247 (CC) at para 78; Albutt v Centre for the Study of Violence and Reconciliation, and Others 2010 (3) SA 293 (CC) at para 51; Democratic Alliance v President of the Republic of South Africa 2013 (1) SA 248 (CC) at para 32.

7 Calibre Clinical Consultants (Pty) Ltd v National Bargaining Council for the Road Freight Industry 2010 (5) SA 457 (SCA) at para 58.

is required is a rational connection between the power being exercised and the decision, and finding of objective irrationality will be rare."[8]

Reasonableness

[47] The requirement of reasonableness is entrenched in section 6(2)(h) of PAJA which provides that the administrative action is subject to review if:

"*the exercise of the power of the performance of the function authorised by the empowering provision, in pursuance of which the administrative action was purportedly taken, is so unreasonable that no reasonable person could have so exercised the power or performed the function…"*

[48] In Bato Star Fishing v Minister of Environmental Affairs,[9] the Constitutional Court held that an administrative decision is reviewable under section 6(2)(h) of PAJA if "*it is one that a reasonable decision-maker could not reach*".

[49] What is reasonable in a particular case depends on the circumstances. In Bato Star Fishing (*supra*) the Constitutional Court set out the factors relevant to determining whether a decision is reasonable or not:

"*the nature of the decision, the identity and expertise of the decision-maker, the range of factors relevant to the decision, the reasons given for the decision, the nature of the competing interests involved and the impact of the decision on the lives and well-being of those affected."*

---

8 Minister of Home Affairs v Scalabrini Centre 2013 (6) SA 421 (SCA) at para 65.
9 2004 (4) SA 490 (CC).

[50] The SCA, in Calibre Clinical Consultants (Pty) Ltd v National Bargaining Council for the Road Freight Industry[10] stated that "*there is considerable scope for two people acting reasonably to arrive at different decisions*" and stated further:

> "*I am not sure whether it is possible to device a more exact test for whether a decision falls within the prohibited category than to ask, as a Lord Cook did in RV Chief Constable of Sussex, ex parte International Trader's Ferry Ltd – cited with approval in Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs – whether in making the decision the functionary concerned 'has struck a balance fairly and reasonably open to him [or her].'*"

The review grounds advanced in argument

[51] In argument, IGUA-SA advanced the following as the main reasons for its contention that the 2021 decision is unreasonable and irrational:

[51.1] The fact that the decision uses an international benchmarking method, which applies prices for piped-gas in three international hubs, that are totally disconnected from South Africa and have none of the supply and demand type characteristics of the local South African market;

[51.2] The second methodology generates maximum prices well above the prices that Sasol Gas was charging when it was an unconstrained

[10] 2010 (5) SA 457 (SCA) at para 59.

monopolist. A methodology that generates prices higher than the prices that Sasol Gas was charging as an unconstrained monopolist will not achieve NERSA's legislative mandate to mimic a competitive market;

[51.3] The second methodology does not achieve the requirement set in regulation 4(4) of the Gas Regulation that NERSA set a maximum price for piped gas that will enable a licensee to recover its efficient and prudently incurred investment and operational costs and make a profit commensurate with its risk. IGUA-SA contends that the focus of the regulatory scheme is cost-plus and that this is the approach NERSA ought to have adopted. This is also the approach which IGUA-SA wishes this court to direct NERSA to adopt in the event of it remitting the 2021 decision to it.

[52] Any one of these review grounds listed above is sufficient to justify the setting aside of the 2021 decision and remitting it to NERSA.

Is the use of international benchmarking unreasonable and/or irrational?

[53] IGUA-SA contends that:

[53.1] the use of the foreign gas hubs in the USA, the Netherlands and the UK, in the specific context of the South African Market for piped gas is inappropriate;

[53.2] these international hubs have no cognisable connection to the dynamics of the South African market for piped gas. They are geographically and economically disconnected from South Africa;

[53.3] they generate unreasonable prices far above what local consumers can afford.

[53.4] it makes no sense to base the maximum price of piped gas in South Africa on prices prevailing elsewhere in the world unless the costs incurred by these foreign suppliers, and the conditions of supply and demand in those markets, are appropriately similar to the costs and competitive market conditions in South Africa.

[54] IGUA-SA adds that it became clear, in 2022, that NERSA itself came to realise the inherent limitation of the second methodology. In that year, NERSA issued three consultation documents ("*the 2022 consultation documents*"), highlighting the problems produced by the international benchmarking method.

[55] These consultation documents were published against the background of what has been referred to as the "*black swan*" events during 2022 in global politics. The maximum gas price, as a result of that impact which these events had on the international benchmark prices relied on in the second methodology soared to R273.43 / GJ, a price almost four times the price calculated in the comparable period a year earlier.

[55.1] In February 2022, NERSA published a consultation document entitled *"Consultation document on the inquiry on the impact of the implementation of uniform pricing by Sasol Gas (Pty) Ltd*". The following are quotations taken from this document:

(a) "*This discussion document is intended to assist stakeholders to engage with the National Energy Regulator of South Africa (NERSA) on the inquiry on the impact of the implementation of uniform pricing by Sasol Gas. The discussion document is made in line with section 10 of the National Energy Regulator Act, 2004 (Act No.40 of 2004)."*

(b) "*3. DISCUSSION*

3.1 NERSA has been informed that Sasol Gas is adopting a uniform pricing approach, whereby it sets all of its customers' actual GE prices at the maximum level approved by NERSA, without providing any volume discounts to its customers, or differentiating in its actual prices to its various customers in any way.

3.2 The paragraphs below provide detailed information on the NERSA assessment of the impact of the implementation of uniform pricing by Sasol Gas and covers the following: theories of harm associated with Sasol Gas' uniform pricing approach, potential incentives for Sasol's uniform pricing approach and possible contravention of the Gas Act."

(c) "*Theories of Harm Associated with Sasol Gas' Uniform Pricing Approach*

3.3 NERSA has identified the following theories of harm associated with Sasol Gas' uniform pricing approach:

(a) Negative impact on third-party traders and their customers

(b) Negative impact on Sasol Gas' large external end-user customers."

(d) "*Sasol Gas' unform pricing policy and its abandonment of volume-based discounts to its various classes of customers mean that the prices at which Sasol Gas sells gas to third-party traders will increase in value…*"

(e) "*This will have significant negative impact on third-party traders, their end-user customers, as well as competition in the relevant markets in which both third-party traders and their end-user customers operate. In particular, it will:*

- *Remove an important competitive constraint on third-party traders; and*
- *Squeeze the margins of third-party traders and their end-user customers*."

(f) "*4.1 NERSA has identified the following potential ways in which Sasol Gas' uniform pricing approach may contravene the provisions of the Gas Act:*

4.1.1 Margin squeeze/constructive refusal to supply (section 21(1)(o) of the Gas Act.

4.1.2 Hinders the achievement of certain objectives of the Gas Act, which includes section 2(b), 2(d), 2€ and 2(h) of the Gas Act."

[55.2] The second consultation document, entitled "*Consultation document on the impact of the surge in international gas prices into the South Africa Gas prices, interim methodology and review of the methodology to approve maximum prices of piped-gas*" was published on 8 March 2022. The following are extracts taken from that document:

(a) "*This discussion document is intended to assist stakeholders to engage with the National Energy Regulator of South Africa (NERSA) on the impact of the surge in international gas prices on the South African gas industry, proposals on an interim methodology while the methodology is reviewed, and proposals on the review methodology to approve maximum prices of piped-gas.*"

(b) *"1. PURPOSE*

1.1 The purpose of this consultation is to invite the stakeholders to provide comments on the following:

1.1.1. NERSA's proposal on how to ameliorate the impact of the increase in international gas price into South African gas prices.

1.1.2. NERSA's proposal of the interim methodology to be used in determining maximum prices of gas whilst the current methodology is being reviewed.

1.1.3. NERSA's proposal on the review of the current methodology to approve maximum prices of gas."

(c) "*4.1. The global natural gas market has tightened substantially since the end of the first quarter of 2021 due to an astronomical increase in demand outstripping supply. This phenomenon has shaken the entire global natural gas market without exception, with a clear demonstration that gas on gas competition is the leading price formation mechanism. As a result, natural gas price regimes anchored on market-based hub pricing principles have become volatile. In addition, pricing regimes outside competitive benchmarking rules have also displayed similar trends, thus clearly indicating that there is a global transmission and influence of price formulation between and within hub prices or oil-indexed."*

(d) "*4.2 Considering the need to adopt a market-based hub pricing regime for natural gas in South Africa, the Energy Regulator approved a methodology to approve maximum prices for piped-gas in South Africa. This was also in compliance and consistent with the judgement passed by the Constitutional Court in July 2019. The Netherlands TTF, British NBP and the US Henry Hub price were identified as the most competitive benchmark prices to which the South African price could be linked. The formula designed to facilitate the linkage was set under the assumption that the hub price benchmarks exert a linear, additive and symmetrical long-run relationship given global gas price convergence. The trio would then contribute to natural gas pricing being disproportionate with weighted contributions established through the churn rate system. The Japan Korean Marker (JKM) was identified as a benchmark for LNG importers and third-party traders. Overall, the JKM would be the ceiling price that no natural gas trader would exceed in any pricing dispensation. NERSA contemplated this approach as a*

logical market-oriented basis for natural gas price formation in South Africa, among other possible alternative regimes"

(e) *"4.3 NERSA's confidence in opting for the competitive benchmark approach is both supported by appropriate conceptual or theoretical considerations and empirical evidence (see Labson, 2021). Benchmark prices chosen as contributors to price formation in South Africa were selected based on their liquidity and global competitiveness. However, these hub prices have become very volatile due to a persistent winter in the Northern Hemisphere, aggravated by LNG and piped-gas bottlenecks in most regional markets. The Henry Hub price has risen by more than 90% as the Dutch TTF rose by more than 150% between July and November 2021 and almost with a similar trajectory on the British NBP. As these influence price formations in South Africa with a 12-month lag, local stakeholders are concerned about the implications of such unintended outcomes on the maximum price and the actual price that they are bound to pay for a gigajoule*."

(f) "*4.4 This regulatory encounter has been worsened by the global energy crunch that has led to escalating prices of all energy commodities worldwide. There have been contemplations and effective substitution of natural gas with coal in electricity generation activities in Europe, Asia and America. Coal prices have also risen due to excess demand and inter-fuel competition, given that natural gas could be fairly substituted by coal in various industrial activities.*"

(g) *"4.5 It is extensively reported that part of the natural gas price spikes is attributed to geopolitical tensions between Germany and Russia over the commissioning of the Nord Stream 2 dual 1234km pipeline. The twin pipeline is earmarked to boost piped-gas supplies to Baltic states and North-West Europe. It is said that the pipeline has been fully constructed and ready to supply but is very unlikely to do so before the end of the second quarter of 2022. Furthermore, some sections of media have indicated that Russia has deliberately reduced supplies of natural gas to Western Europe to exert pressure on the German Energy Regulator to expedite its regulatory protocols for a determination on how the dual Nord Stream 2 pipeline should operate. In addition, the escalating tension between Russia and Ukraine may affect supply in Europe and keep gas prices high in the near future. Therefore, natural gas shortages may persist for some time, thus aggravating the price spikes in Europe despite hopes that weather conditions may ease excess demand*."

(h) "*4.6 In North Africa, the pipeline supplying natural gas from Algeria to Italy and Spain via Morocco has ceased to do so after the expiry of the contract between the two nations. This has caused supply bottlenecks and added to shortages of this essential commodity in Western Europe. Supplies from the Groningen fields have dried up, and prolonged maintenance programmes of natural gas wells in Norway have further worsened the crisis. Electricity production is heavily dependent on fossil fuels, especially coal and natural gas in Europe, to which demand has risen due to exceptionally cold weather conditions."*

(i) "*4.7 The key question that has triggered this consultation process is that the natural gas price spikes in America, Europe and Asia may have unintended consequence to the South African gas prices. The energy crisis in Europe, Asia, America and other parts of the world has resulted in energy price increases in Africa, to which South Africa has been adversely affected. However, NERSA may not fold arms and leave natural gas customers to be unfairly exposed to the global energy crunch and surge in hub prices that will negatively impact gas prices in South Africa. Global transmission of the price spike is inevitable through the key hub prices that are drivers of the natural gas price regime in South Africa."*

[56] The concerns raised by NERSA in these two consultation documents seem to echo what was predicted in the RBB report relied upon by IGUA-SA, which had been compiled prior to these consultation documents. In fact, the prices which realised as a result of the application of the second methodology far exceeded that expected or predicted by RBB in its report.

[57] NERSA's position is as follows:

[57.1] NERSA views churn rates as an indicator of liquidity, to be a good indicator of the competitiveness of prices discovered at gas hubs internationally whilst also providing an objective, appropriate and verifiable way to determine the composition and weights of Saso's maximum price basket, without having to make value judgments regarding the weight that each component in the benchmark should carry;

[57.2] Benchmark pricing, such as international gas hub prices that reflect the actual prices paid in gas markets where the market price has been formed through a competitive process involving multiple suppliers and buyers, is an acceptable approach;

[57.3] The use of such benchmarks would be consistent with its objective to regulate maximum prices so that they mimic a more competitive outcome and provide an objective means to divide surplus value between suppliers and customers;

[57.4] NERSA chose to use the US Henry Hub, the Dutch TTF, and the UK NBP for the maximum pricing formula as they are highly liquid and will ensure that the maximum price mimics a competitive market. These three hubs are currently the main gas trading hubs that are classified as liquid in the world and as such gas prices these trading hubs are largely determined by the interplay between supply and demand (gas-on-gas competition);

[57.5] These three hubs are suitable benchmark hubs against which a gas price that seeks to mimic competition can be linked;

[57.6] Maximum prices/profit margins set, using these competitive market price benchmarks as a guide, would be considered fair, in that it would mimic prices/profit margins prevalent under competitive conditions, and would allocate the economic surplus between producers/suppliers and consumers of gas in a fair manner;

[57.7] In addition, NERSA also used Sasol Gas' costs as a guide or floor and these costs were compared to the price calculated by the competitive benchmark prescribed by the second methodology;

[57.8] By using the second methodology, NERSA acted within the ambit of section 4(g) of the Gas Act, which requires it to regulate prices in terms of section 21(1)(p) in the prescribed manner.

[58] Sasol relies on what it refers to as the "*Genesis report*", prepared by Genesis Analytics, in response to the RBB report relied upon by IGUA-SA. Based on the Genesis report, Sasol contends that:

[58.1] Natural gas has a number of features that affect how gas prices are formed in competitive market setting. These features include:

[58.1.1] That gas is a scarce and exhaustible natural resource that cannot be replicated, the underlying value of which is volatile depending on expectations such as elative supply and demand balances;

[58.1.2] Gas is a homogenous product, which means competitive markets tend toward a single reference price;

[58.1.3] The development of gas fields is a specialised and high-note activity that requires substantial sunk investments, made over a long-term and across long-term cycles of commodity prices;

[58.1.4] Gas is an internationally-traded commodity with gas supply and demand across the globe becoming increasingly interlinked;

[58.1.5] Gas prices follow cyclical trends and are not closely linked to the extraction costs of producers;

[58.2] International price benchmarking is a widely accepted regulatory instrument used as a proxy for a competitive market;

[58.3] International price benchmarking is used as a regulatory proxy for a competitive price level within the gas sector internationally;

[58.4] International price benchmarking is also widely used as a non-regulatory tool for setting prices in gas contracts which international gas hubs use as reference prices. This means, according to the Genesis report, that even where the gas is not physically supplied from the international hubs, the pricing of these hubs is still used to determine the price of gas. The underlying reason for this is that the international hubs are seen as providing an accurate and competitive indication of the value of the gas molecules;

[58.5] The use of international gas hub prices achieves NERSA's objective of mimicking a competitive outcome, because it reflects the actual prices that are paid for gas molecules in markets where the price is determined by a competitive process involving multiple suppliers and buyers;

[58.6] The criticism from IGUA-SA that the benchmark hubs selected by NERSA are detached from the South African market, does not have merit. Sasol contends that there is no need for South Africa to be directly connected to these foreign markets via pipeline for them to be meaningful benchmarks;

[58.7] Any realistic conceptualisation of a competitive and developed gas market in South Africa would need to be premised on a diversity of supply options, as opposed to postulating a competitive market narrowly based only multiple duplicates of the current supply arrangement in South Africa. No truly competitive market has only one source of gas supply;

[58.8] Gas is a commodity that is internationally traded and it would be naive to insulate South Africa artificially from global gas dynamics. This is particularly true in light of the fact that virtually all gas consumed in South Africa is imported and this will continue to be the case into the foreseeable future.

[59] In my view, the use of international benchmarking as a method to determine maximum gas prices is not reasonable in the context of the South African gas market.

[60] The prices of the hubs referred to in the second methodology would include the operational costs of supplies to those markets.

[61] Suppliers in every international jurisdiction may be (and are likely) to be affected by facts and/or circumstances that may have little to no impact on the supply to the South African market. This could include aspects such as natural disasters, war, sanctions and the like.

[62] This is evidenced by the massive upswing in gas prices midst the “black swan” events in 2022.

[63] NERSA and Sasol’s argument that such upswings could be counted by the rationality test does not hold water. Subregulation 4(3) require that NERSA must, when determining maximum gas prices, be transparent and predictable.

[64] The application of the rationality test or the alternative methodology, as proposed by NERSA and Sasol, would render the determination of a maximum price so uncertain that no reasonable decision maker would have come to such a decision.

[65] For this reason, I find the 2021 decision to be unreasonable.

[66] It follows that the decision should be set aside and remitted to NERSA for a new decision.

[67] The next issue to decide is whether this court should direct NERSA to apply the cost-plus approach in determining the maximum gas prices according to the relief sought by IGUA-SA in prayer 1.3 of its notice of motion.

[68] IGUA-SA seeks this order on the argument that the Constitutional Court held that NERSA must adopt a pricing methodology that starts with Sasol's actual costs and then determine a maximum price relevant to those costs.

[69] Both NERSA and Sasol dispute that the Constitutional Court came to such a finding.

[70] The Constitutional Court's findings ins PG Group (*supra*) were made in the context of the first methodology where the gas users complained, that in determining the maximum price, NERSA had failed to have regard to Sasol's actual costs. It is in this regard that the Constitutional Court held (at paragraphs [63] to [69]):

> *"[63] In Democratic Alliance this court held that it is an established principle of administrative law that a failure to consider a relevant material factor in the process of coming to an administrative decision can render the decision irrational. The entire process is tainted as irrational if the relevant factor that was not considered ought to be central to finding a rational or even reasonable final outcome.*
>
> *[64] Rationality is concerned with one question: do the means justify the ends? Democratic Alliance developed the test for rationality by explaining that an absence of a sufficient link can arise for procedural reasons. This is not a new or different type of irrationality, but rather a way of evincing a broken or missing link between the means and the ends. The means chosen by an administrator include everything done (or not done) in the process of making that decision.*

[65] In this case Nersa failed to consider Sasol's marginal costs in the method it used to determine the maximum gas price for Sasol. The decision to apply the basket-of-alternatives approach specifically to Sasol was not rational. Sasol is a monopolist and any rational attempt at regulating its prices needed to consider its costs in order to fairly and equitably divide the economic surplus between Sasol's profit and the economic value for Sasol's consumers.

[66] There are a number of interrelated reasons why Sasol's marginal costs are a necessary factor in determining its maximum price. It is important to note that Nersa was regulating the prices of a recognised monopolist. Section 2(e) of the Gas Act requires Nersa to take into account the interests and needs of all parties on an equitable basis. This is given expression in the fairness requirement found in reg 4(3). Importantly, this can be seen in reg 4(4), which requires Nersa to account for both costs and profits of the regulated entity. This is set out in more detail below.

[67] Once Nersa made the second decision that there was inadequate competition in the piped-gas market, it was obliged to consider a maximum gas price specifically for the monopolist —Sasol.

[68] In both the draft and final inadequate-competition determination Nersa itself stated that the spot price for gas in a market environment would tend towards its marginal costs. Nersa stated that —

'in competitive market conditions, a firm prices its products at the level where the price equals the marginal cost. If the price is above marginal cost, the economics theory concludes that such

a firm has market power to influence prices without losing business to competitors.'

[69] Despite this acknowledgment, Nersa did not consider Sasol's marginal costs when trying to set a competitive maximum price. In a traditional competitive market, Sasol's marginal costs would be a required input for finding the competitive maximum price."

[71] The statements further contained in the PG Group judgment (and on which IGUA-SA places reliance) are those at paragraphs [71] to [78] as quoted below:

"[71] I do not think Nersa is justified in trying to mimic the outer bounds of an imaginary supply-constrained market if that approach would not allow it to regulate the monopolistic vices it seeks to address. This would heavily favour the monopolist, which would be absurd for a legal regime meant to rein in the monopolist. Therefore, in trying to quell the market power of the monopolist by setting a maximum price, it is vital that a regulator considers the monopolist's marginal costs, even if there is a supply constraint. Without that inclusion, there is no way to test whether the maximum price will address the mischief of monopolistic market power.

[72] This is supported by the actual language of the Gas Act and the Regulations. As explicated below, the requirements to consider the interests of all parties in this market, and equitably divide the economic surplus, strongly support requiring Nersa to consider Sasol's marginal costs when regulating its maximum price.

[73] Nersa was required to act in a manner consistent with s 2(e) of the Gas Act, read with the fairness requirement found in reg

4(3), as set out above. To adhere to this section and regulation, Nersa had to set a maximum gas price that would balance the interests of both the monopolist and the consumers. This means that Nersa needed to find a way to evaluate the economic surplus being created in the piped-gas market and to divvy it up between the interested parties.

[74] Nersa recognised the importance of finding a formula that 'reflects a balance between encouraging new entry and equitable sharing of any economic surplus between consumers and producers'. It is hard to imagine how Nersa could decide how to equitably split the surplus without considering Sasol's profits and thus costs. Under the basket-of-alternatives approach, Nersa has no way of calculating Sasol's profit from any given price, and therefore has no way of adequately judging the equities of distribution of the surplus.

[75] Nersa was tasked with setting a ceiling price for Sasol that allowed it to recover its costs and to make a profit that was commensurate with its undertaken risks, as set out in reg 4(4). In order for Nersa to rationally decide the maximum price which would include both costs and the chosen allowable profit, it needed to know and consider Sasol's marginal costs of production."

…

[77] Instead of considering Sasol's costs, Nersa considered the imaginary marginal costs of production for an admittedly unknown gas seller. The basket-of-alternatives option of the Maximum Pricing Methodology represents these imaginary marginal costs of production. There is likely some merit in this approach when trying to understand the limitations of an entrant into an imaginary supply-constrained market. However, it is

totally divorced from a rational approach to choosing the maximum profit allowed by a recognised monopolist and then adding that profit onto the monopolist's actual costs.

[78] In trying to replicate a competitive market, Nersa considered what the maximum marginal costs of production of a fictional gas seller might be before it could no longer compete with the energy substitutes. Nersa then used those imaginary marginal costs of production when setting Sasol's maximum reasonable gas price. One of the most relevant factors in Nersa's entire equation for specifically regulating Sasol ought to have been Sasol's own marginal costs of production. Without considering Sasol's costs, Nersa could not set a maximum price that included an equitable division of profit for Sasol and economic value creation for consumers. Sasol's costs are a mandatory input to this kind of exercise. Nersa failed to consider this mandatory input, and thus I cannot find that Nersa acted rationally in deciding Sasol's maximum gas price."

[72] Again, these statements are made , in my view, in the context of the Constitutional Court's criticism of NERSA's failure to have regard to Sasol's actual costs in deciding on a methodology to determine maximum gas prices.

[73] I do not interpret the Constitutional Court's decision to have laid down the specific (and only) to be applied by NERSA in the fulfilment of its statutory duties. I have no doubt that, had the Constitutional Court intended to make such a far-reaching decision, it would have stated it, at least as part of its order of remit to NERSA, but also in absolute clear terms as part of its reasoning.

[74] I find that IGUA-SA is not entitled to an order directing the methodology NERSA should follow in determining maximum gas prices.

[75] Finally, Sasol has indicated that, in the event of the 2021 decision being reviewed and set aside, that such an order must only be made prospectively.

[76] Sasol relies as a basis for this contention, on the fact that it had refunded its customers approximately 1.7 billion as a result of the setting aside of the 2013 and 2017 decisions and, through this, demonstrated its *bona fides*. It claims that the retrospective adjustments of the previous decisions caused great prejudice to its business operations.

[77] In circumstances where I have found that the 2021 decision was unlawful, I am not open to enforcing this decision in any way.

ORDER

For these reasons the following order is hereby made:

[1] NERSA's decision dated 31 March 2021 and published on 8 July 2021, to approve Sasol's maximum gas prices for the period from March 2014 to June 2023 is declared unlawful and set aside;

[2] The matter is remitted to NERSA to take a new decision;

[3] NERSA and Sasol are directed to pay the applicant's costs of the application.

I JOUBERT

ACTING JUDGE OF THE HIGH COURT

GAUTENG DIVISION, PRETORIA

Date of hearing:	30 and 31 May 2023.
Date of judgment:	18 June 2024.

Appearance

On behalf of the Applicants	W TRENGOVE SC, K HOFMEYER SC, L PHALADI
Instructed by	Norton Rose Fullbright South Africa Inc
On behalf of the First Respondent	P ELLIS SC, T CHAVALALA
Instructed by	DM 5 Incorporated
On behalf of the Second Respondent	A COCKRELL SC, A FRIEDMAN
Instructed by	Bowmans Inc