THE SUPREME COURT OF APPEAL OF SOUTH AFRICA
JUDGMENT

Reportable
Case No: 150/2017

In the matter between:

PG GROUP (PTY) LTD	**FIRST APPELLANT**
THE SOUTH AFRICAN BREWERIES (PTY) LTD	**SECOND APPELLANT**
CONSOL GLASS (PTY) LTD	**THIRD APPELLANT**
NAMPAK LIMITED	**FOURTH APPELLANT**
MONDI LIMITED	**FIFTH APPELLANT**
DISTRIBUTION & WAREHOUSING NETWORK LTD	**SIXTH APPELLANT**
ILLOVO SUGAR SOUTH AFRICA LTD	**SEVENTH APPELLANT**

and

NATIONAL ENERGY REGULATOR OF SOUTH AFRICA	**FIRST RESPONDENT**
SASOL GAS LIMITED	**SECOND RESPONDENT**

Neutral citation: *PG Group & others v NERSA* (150/2017) [2018] ZASCA 56 (10 May 2018)

Coram: Lewis, Ponnan and Leach JJA and Davis and Makgoka AJJA
Heard: 26 February 2018
Delivered: 10 May 2018
Summary: Administrative action – whether the determination of a methodology used to regulate gas prices under s 21(1)*(p)* of the Gas Act 48 of 2001 is administrative action – whether a determination by the regulator under that section which resulted in an increase in permissible maximum gas prices was rational.

ORDER

On appeal from: Gauteng Division of the High Court, Pretoria (A Louw J sitting as court of first instance):

1 The appeal succeeds with costs, including the costs of two counsel.

2 The order of the court a quo is set aside and substituted by the following:

'(a) The decisions by the first respondent on 26 March 2013 to approve applications by the second respondent (i) for maximum gas prices and for a trading margin for the period 26 March 2014 to 30 June 2017, and (ii) for transmission tariffs for the period 26 March 2014 to 30 June 2015, are reviewed and set aside.

(b) Any maximum gas prices subsequently approved by the first respondent for the second respondent shall apply retrospectively with effect from 26 March 2014 until the date of termination of such approval.

(c) The costs of this application shall be paid by the respondents jointly and severally, the one paying the other to be absolved.'

JUDGMENT

Leach JA (Lewis, Ponnan JJA and Davis, Makgoka AJJA concurring)

[1] The first respondent, the National Energy Regulator of South Africa (NERSA), was established as a juristic person under s 3 of the National Energy Regulator Act 40 of 2004 (the Energy Regulator Act). One of its functions is to regulate the piped gas industry. Piped natural gas is a safe and environmentally friendly fuel used in a number of production industries as well as in the generation of power. Its use is on the increase, gas consumption having tripled during the decade before December 2012.

[2] On 26 March 2013, NERSA granted an application made by the second respondent Sasol Gas Limited (Sasol Gas) to determine a tariff of the maximum prices it is permitted to charge for piped-gas. Sasol Gas effectively enjoys a monopoly in respect of the supply of piped-gas in this country and this tariff determination had profound effects on the piped-gas industry. The seven appellants are all large-scale consumers of piped-gas, and the new tariffs led to substantial increases in the prices they had been paying. Complaining that these increases were unreasonable and irrational, they applied to the Gauteng Division of the High Court, Pretoria to review and set aside NERSA's decision.

[3] The court a quo did not enter into the merits of the application. Instead it held that there had been an unreasonable delay before the proceedings were launched and, on that basis alone, it dismissed the application. The appeal to this court is with leave of the court a quo.

[4] The history of the matter is important to the resolution of the dispute. Sasol Gas is a wholly-owned subsidiary company of Sasol Limited (Sasol), an international energy and chemical company listed on both the Johannesburg and New York stock exchanges. At the turn of the last century, Sasol formed a joint venture with a partner in Mozambique to develop natural gas fields in that country in order to pump gas from there to South Africa, for it to be used either as a feedstock and energy source in Sasol's factories or for distribution to consumers, distributors and reticulators.

[5] By its very nature, a project such as this required a large capital investment and the taking of substantial commercial risks. On 26 September 2001, in an attempt to minimise its exposure, Sasol concluded a written agreement (the regulatory agreement) with the South African government which recorded Sasol's investment and the risks it was taking, as well as the government's commitment to promoting the introduction of natural gas in the South African economy 'at the lowest cost and as fast as possible'. The agreement went on to provide that Sasol would be the operator of the transmission pipeline from Mozambique, and would do so 'at cost plus a profit margin of 10% to compensate for operating risk'.

[6] In addition, a schedule to the regulatory agreement provided for charges for gas supplied to Sasol's 'external customers' (defined as being customers other than Sasol and its subsidiaries) to be subject to a price cap determined by way of reference to prices charged in certain European countries. Within the constraints of the price cap, prices were to be determined by way of 'Market Value Pricing' defined in the schedule as follows:

'(D)etermining the gas price by comparison with:

(a) The cost of the alternative fuel delivered to customer's premises or anticipated place of use . . .; plus

(b) The difference between all the operating costs of the customer's use of the alternative fuel and all the operating costs of using natural gas; plus

(c) The difference between the Nett Present Value (NPV) of the capital cost of the customer's continued use of the alternative fuel and the NPV of the capital cost involving and switching to natural gas, as would be reflected in the customer's accounts.'

[7] It is common cause that only a monopolist, unrestrained by competitors seeking to penetrate the market by way of lower prices, in the absence of a viable substitute can exact the highest possible price each individual customer is prepared to pay. Bearing that in mind, it is clear from this method of determining prices under the regulatory agreement that Sasol was entitled to charge a monopoly price for the natural gas it imported from Mozambique. Subject to the price cap, this placed consumers at its mercy to the extent that it could charge higher prices than would have been the case if there had been a competitive market driving down prices.

[8] At the time of this agreement, Sasol Gas conducted a piped-gas business in this country which involved the transportation, distribution and sale of gas by means of a network of pipelines through which hydro-carbon gases produced from coal were pumped. It was therefore the obvious platform of choice for Sasol to develop a piped-gas industry using the natural gas obtained from Mozambique. This was done either by supplying natural gas directly to its customers, or by using it to enrich synthetic gas produced at Sasol's production plant at Secunda, and from there storing the enriched gas until supplying it to its commercial customers through a pipeline network. As the only supplier of such gas, Sasol Gas was able to charge the monopoly price prescribed in the schedule to Sasol's agreement with the government. Although it serviced its own end-user clients, Sasol Gas also supplied piped-gas to other gas distributors who, in

turn, sold it on to their clients, presumably at a price higher than that at which they bought it.

[9] When Sasol's agreement with the government was concluded there was no specific legislation in this country regulating the piped-gas industry. The Gas Bill had been published on 23 March 2001 but had not yet been passed. It took until 12 February 2002 before the bill was assented to and became the Gas Act 48 of 2001 (the Gas Act); and then it only came into operation on 1 November 2005.

[10] The preamble to the Gas Act states its objective to be '(t)o promote the orderly development of the piped gas industry; to establish a national regulatory framework; to establish a National Gas Regulator as the custodian and enforcer of the national regulatory framework . . .' In seeking to achieve this, the Gas Act introduced the office of the Gas Regulator, defined in s 1 of that Act as being NERSA. Section 4(1)*(a)* of the Energy Regulator Act, in turn, bestowed the functions of the Gas Regulator upon NERSA. In this way NERSA came to exercise regulatory control over the natural gas Sasol was importing from Mozambique. However, in terms of s 36(2) of the Gas Act, NERSA was bound by the regulatory agreement for a period of 10 years from the date natural gas was first received from Mozambique. As a result, it is common cause that the dispensation extended by that agreement lasted until 25 March 2014, from which date Sasol's gas prices first became subject to NERSA's regulation.

[11] In this way, during the ten year period preceding March 2014, (referred to by counsel for the appellants as 'the decade of grace' – a convenient label I shall use as well) the government allowed Sasol, through Sasol Gas, to charge monopoly prices in order to compensate it for its investment in the Mozambican gas fields and the pipeline from that country.

[12] NERSA's function to regulate gas prices is prescribed by s 4*(g)* as read with s 21(1)*(p)* of the Gas Act. The latter section provides that maximum prices for distributors, reticulators and all classes of consumers must be approved by the Gas Regulator (ie NERSA) where there is 'inadequate competition' as contemplated in Chapters 2 and 3 of the Competition Act 99 of 1998. Importantly, reg 4(3)(a) of the Piped-gas Regulations promulgated under the Gas Act on 20 April 2007 (the Regulations)[1] requires NERSA, in considering maximum prices, to base its approval of maximum prices 'on a systematic methodology applicable on a consistent and comparable basis.'

[13] As the approval of maximum prices is conditional upon there being inadequate competition in the industry, I would have thought logic demanded that NERSA investigate the state of competition as a necessary preliminary issue. Instead it proceeded in reverse order, and first set out to determine a methodology to be applied in setting maximum prices. On 21 October 2010, it published a consultation document to provide a basis for discussion on the issue. After having received representations, this was followed in June 2011 by it publishing a draft methodology. Thereafter, on 28 October 2011, it approved its methodology in what it said was its final form and, on 24 November 2011, gave its reasons for doing so.

[14] Throughout this process, NERSA favoured a method of determining a maximum price by having regard to the comparative cost of a basket of alternative fuels. In its initial consultation document of August 2010, it drew attention to some 20% of gas users having switched from coal and went on to state that coal, heavy fuel oil (HFO), crude oil, distillate and liquefied petroleum gas (LPG) might be appropriate alternatives to use as comparable. However, it

[1] Published under GN R321, Government Gazette 29792, 20 April 2007.

is apparent from this document that all these alternatives were likely be more costly than natural gas. Indeed it suggested a formula in which the maximum price of gas would be determined by a basket of HFO and crude oil with other alternatives such as coal, distillate and LPG having zero effect.

[15] By the time it published its draft methodology in June 2011, NERSA's views on the appropriateness of using a basket of alternatives had hardened. It stated that the maximum price of gas energy, excluding trade margins, distribution tariffs and transmission tariffs and levies, would be determined by way of a formula using different energy price indicators. As appears from the various options it suggested, it no longer felt that much weight needed to be given to the price of HFO and crude oil, and coal had become a favourite alternative. Thus in one suggested option, it was given a weighting of 37% whilst, in another, its weighting was increased to 90%. Be that as it may, stakeholders were called on to comment on its suggestions.

[16] Having received comments, on 28 October 2011 NERSA published its final methodology to be used in approving maximum prices. In the third part of this document, it stated that the maximum prices proposed by an applicant or licensee were to be reviewed on the basis of a formula using indicator prices in a basket of coal, diesel, electricity, HFO and LPG, their respective weightings being apportioned at 37% for coal, 24% for diesel, 37% for electricity and 1% for both HFO and LP gas. Allowance was also made for discounts in respect of different categories of customers. In part 3.5 of the methodology, after stating that it recognised the basket of alternatives method to be 'appropriate under the prevailing conditions'. NERSA went on to state:

'However, where the licensee deems the price determined by this methodology to be materially lower or higher than its preferred and appropriate gas price in that it impacts the ability to compete and/or recover efficiently and prudently incurred costs and make a profit commensurate with risk, then the Energy Regulator will allow such a licensee to opt for the use of the "pass-through" approach to ensure that the licensee fully recovers all its efficiently and prudently incurred costs and makes a profit commensurate with its risk as provided for in the legislation. This will of course apply to instances when the preferred and appropriate price is either higher or lower, than the one determined by using the approach explained in Sections 3.1 to 3.4. This approach will then become the systematic methodology to be consistently applied throughout the licence period for such a licensee electing to use this "pass-through" approach.

The pass-through approach requires a cost-based price build-up, including at the least the cost of the procured or produced gas, and any transportation or regasification costs, to justify the price for gas energy applied for. The transmission and distribution tariffs and the trading margin, determined in accordance with this methodology, would be added to the maximum gas energy price.'

[17] The 'pass-through' approach to which NERSA referred is nothing more than a simple 'cost plus percentage' method of determining a price. Its use is commensurate with reg 4(4) of the Regulations which provides:

Maximum prices referred to in sub regulation (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.'

The importance of this is that the choice of methodology to be used was not set in stone but was left up to an applicant applying to NERSA for a determination of a maximum gas price, to decide upon.

[18] One further issue arising from the methodology must be mentioned. On 1 May 2009, NERSA had published guidelines for monitoring and approving piped-gas transmission and storage tariffs under s 4*(h)* of the Gas Act. These contemplated licensees submitting tariff applications for approval by NERSA using one of several methodologies. In its methodology of 28 October 2011, NERSA stated:

'Several stakeholders indicated that issues of "price" and "tariff" were conflated in the first consultation document . . . Moreover, the inclusion of distribution tariffs in the maximum price was strongly opposed . . . In the final methodology the Energy Regulator has therefore separated the maximum price of Gas Energy, from tariffs for transmission, distribution and storage. The methodology refers to the approval of the maximum price of GE, to which the following must be added:

- Monitored and approved, and if necessary regulated, transmission and storage tariffs (as contained in the Tariff Guidelines, 2009);
- Unregulated distribution tariffs;
- The piped-gas levy; and
- The trading margin.

The resultant sum will be the total "charges of gas". The Energy Regulator has noted the concerns raised about expanding the scope of the methodology to regulating distribution tariffs and confirms that in line with Gas Act, distribution tariffs are not subject to regulation and are considered a "pass-through" in the final charges.'

[19] In the light of this, I must immediately mention that the appellants' review challenges the maximum price which, as indicated in the quotation above is a composite of both gas prices and other charges, on the sole basis that the gas price element of the composite charge had been irrationally and unreasonably determined. It does not embrace a challenge to the transmission and storage prices.

[20] A month or so before it had approved this final methodology, NERSA decided to call for comment on the issue of whether there existed inadequate competition in the piped-gas market. After soliciting input from various stakeholders, NERSA announced in February 2012 that, despite Sasol Gas's contrary assertion, it had decided that there was in fact inadequate competition in the piped-gas market as contemplated in Chapters 2 and 3 of the Competition Act. In the reasons it gave for this decision, NERSA stated that for seven years Sasol Gas had sustained the price of gas consistently above a competitive level or marginal cost. It described the effect of the regulatory agreement as follows:

'i. At present there is one licensee that provides transmission and distribution of piped-gas in the South African piped-gas market, namely Sasol Gas, who is effectively the sole supplier of gas and importer of natural gas into the South African market. This licensee is vertically integrated in that it owns and operates the pipeline network both at transmission and distribution level. It also owns the focal product which is the subject of the competition assessment being undertaken by the Energy Regulator. Furthermore, Sasol Gas is also a dominant player in the trading of gas at wholesale and retail levels. Currently there are four traders of natural gas in South Africa in addition to Sasol Gas most of whom resell gas purchased from Sasol Gas. It is important to point out that these independent traders do not own the infrastructure or network critical in transporting or distributing gas to customers around the country in competition with Sasol Gas.

ii. *The conditions in South African piped-gas market manifest those of a monopolist who has an influence in the market in terms of gas supply and prices. Notably, the price of natural gas and synthetic gas is referenced to the cost of an alternative energy source available to an individual customer*. . . .' (Emphasis added)

[21] Taking all of this into account, NERSA concluded:

'The monopolist has market power, and as evidenced by current pricing practices and previous complaints concerning discriminatory and high prices as well as challenges in accessing and/or sourcing gas supply, it is our submission *that market power has been exercised and misused*,' and that '. . . *the gas prices are higher than those charged in a situation of perfect competition or in a competitive market*.'(Emphasis added)

This appears to have been a perfectly valid conclusion, particularly in the light of the appellants' unchallenged allegations that the price changes in its case reflected a mark-up of 227% over the cost price of importing gas.

[22] Consequently, by February 2012 NERSA had both concluded that there was inadequate competition in the piped-gas industry, and decided upon a methodology to determine the maximum gas prices licensees might charge. Later that year Sasol Gas was persuaded to apply to NERSA for an early determination of the maximum gas prices it could charge when its decade of grace came to an end.

[23] Sasol Gas did so on 24 December 2012, when it filed two applications: the first for determination of maximum gas prices, the second for determination of transmission tariffs (for reasons already mentioned, the application in respect of transmission tariffs are not directly relevant to the task at hand). Not surprisingly, given that the alternative fuels in the basket used to determine the gas price were more costly than the price it was then charging for its piped-gas, it opted for the basket methodology rather than a pass-through cost approach in respect of its application. After obtaining public comment and holding hearings, NERSA made a final determination of both applications on 26 March 2013. A month later, on 24 April 2013, it gave its reasons for its decisions.

[24] The end product of this process was that NERSA determined a total gas energy price of 117.69 R/GJ, this being a composite price of both the maximum price of piped-gas and various tariffs. Allowing for proposed reductions, this led to maximum prices being determined in a range from 108.86 R/GJ to 73.56 R/GJ in respect of different customer classes. These were substantially higher than had previously been the case, despite the entire operation having been undertaken due to the monopoly prices charged by Sasol Gas in its decade of grace having been regarded as too high. Indeed it meant that the mark-up in respect of the cost price of the gas the appellants were buying had increased from 227% to 398%.

[25] Aggrieved at this, the appellants applied to review and set aside the maximum price determination which they alleged had been both irrational and unreasonable. As I have mentioned, in seeking to impugn the maximum price their review was directed at the determination of the gas component alone, but they argued that if they succeed in respect of the price of the gas, the composite maximum fee must also fail. I did not understand the respondents to disagree with this.

[26] As mentioned at the outset, the review failed, not because of a finding that it lacked merit, but as the court a quo decided that there had been an undue delay after the methodology had been determined in October 2011 before the review was brought some two years later. The respondents argued in this court that the court a quo had been correct in doing so. They also raised a further objection to this court deciding the merits of the review, based on a contention that the matter is now of academic interest only.

[27] It is convenient to deal with the latter issue first. It arises out of the maximum price determination approved by NERSA, having applied from the end of the decade of grace until 30 June 2017 (we were informed from the bar that Sasol Gas had submitted a new maximum price application to NERSA for the period 1 July 2017 to 30 September 2018 which was currently being considered. In the light of this, it was argued that this court should decline to hear the appeal as the determination until June 2017 was no longer of any effect and the matter had become moot.

[28] There is of course a long standing rule of practice that this court should not decide issues of academic interest which would have no practical effect – see *Legal Aid South Africa v Magidiwana & others* 2015 (2) SA 568 (SCA) para 2. In the present case, however, there still exists a live issue between the parties. In its amended notice of motion, the appellants seek an order that should the approval of Sasol's prices be set aside, any maximum prices for that period 'shall apply retrospectively with effect from 26 March 2014 until the date of termination of such approval.' In addition, there is considerable public interest in resolving whether the basic methodology NERSA adopted, and which it presumably intends to utilise again in the future, is valid. The issue is therefore one which cannot be regarded as having no practical effect.

[29] Turning to the issue of undue delay, the reasoning of the court quo, supported by the respondents in this appeal, was that s 7(1) of the Promotion of Administrative Justice Act 3 of 2000 (PAJA) requires a judicial review to be brought 'without unreasonable delay' and not later than 180 days after the person concerned became aware of the administrative action; that reg 4(3) required NERSA to use a systematic methodology in determining a maximum price application; that after the final methodology had been determined in October 2011 and its reasons for adopting it given on 24 November 2011, NERSA was bound thereby and was not free to jettison it; the appellants ought therefore to have reviewed NERSA's final methodology decision within 180 days of 24 November 2011, but had unreasonably delayed doing so until October 2013, some two years later.

[30] The appellants contended that the court quo had erred in this reasoning, and argued that the determination of the methodology was not, in itself, an administrative action subject to review. The question is, whether the determination of the methodology to be used in respect of future price applications is 'administrative action', defined in part in s 1 of PAJA as being a decision '. . . which adversely affects the rights of any person and which has a direct, external legal effect'?

[31] In her discussion of the meaning of 'direct, external legal effect', Professor Hoexter, in her seminal work *Administrative Law in South Africa* (2 ed) at 227-228, states that the phrase was a last-minute addition to the definition borrowed from German Federal administrative law, and quotes the following comment from certain German writers regarding the position in that country:

'If, for example, a decision requires several steps to be taken by different authorities, only the last of which is directed at the citizen, all previous steps taken within the sphere of public administration lack direct effect, and only the last decision may be taken to court for review.

This applies, for instance, to many planning or licence granting processes where a sequence of procedural decisions leads to a final decision against which a legal remedy is available. Therefore, all the preparatory decisions are in principle not reviewable by the administrative courts.'[2]

[32] The appellants argued, correctly in my view, that whilst reg 4(3)(a) requires NERSA to 'be objective ie based on a systematic methodology applicable on a consistent and comparable basis' when determining gas prices, it does not require it to make what their counsel described as 'a freestanding upfront determination of the methodology' before doing so. Accordingly they argued, again correctly in my view, that the determination of the methodology and the determination of the maximum gas price form part of the same process under s 21(1)*(p)*of the Gas Act and that, whilst NERSA may choose to carry out that process in a step-by-step fashion, it is not obliged to do so.

[33] In the light of these considerations, the appellants argued that the decision which had a 'direct, external legal effect' was not the decision in regard to the methodology but the determination of the maximum gas prices, and as there is no suggestion of the review of that decision not being timeous, the court quo reached the wrong decision.

[34] I find this argument compelling. Notably, it is in line with the reasoning of the Constitutional Court in *Minister of Health & another NO v New Clicks South Africa (Pty) Ltd & others (Treatment Action Campaign & another as amici curiae)* 2006 (2) SA 311 (CC). In that matter the court was obliged to deal with a review of regulations promulgated by the Minister of Health under s 22G of the Medicines Act after having received recommendations of a pricing committee. In his judgment, paras 136-138, Chaskalson CJ said:

[2] Rainer Pfaff & Holger Schneider 'The Promotion of Administrative Justice Act from a German Perspective' (2001) 17 *SAJHR* 59 at 72.

‘The making of the regulation . . . involves a two-stage process. First, a recommendation by the Pricing Committee and, second a decision by the Minister as to whether or not to accept the recommendation. . . In the circumstances of the present case, to view the two stages of the process as unrelated, separate and independent decisions, each on its own having to be subject to PAJA, would be to put form above substance.

The Minister was not obliged to act on the Pricing Committee’s recommendations. She had a discretion whether to do so. But ultimately there had to be one decision to which both the Pricing Committee and the Minister agreed. Neither had the power to take a binding decision without the concurrence of the other. It was only if and when agreement was reached that regulations could be made.’

[35] On a similar process of reasoning in the present case, the determination of maximum gas prices was made by way of a staged process which only became binding on its completion when NERSA gave its decision on Sasol Gas’s application. The fact that there were various steps in the process does not render each of these steps, individually, an administrative action which adversely affects the rights of any person. For, as Nugent JA stressed in *Grey’s Marine Hout Bay (Pty) Ltd & others v Minister of Public Works & others* 2005 (6) SA 313 (SCA) para 24, administrative action in general terms involves the conduct of the bureaucracy having ‘direct and immediate consequences for individuals or groups of individuals’. NERSA’s determination of the methodology to be used did not have consequences of that nature. It could only have had such an impact once it had determined what Sasol Gas’s maximum prices should be. Until then, it did not bind any party and, in my view, did not constitute administrative action.

[36] There are two further reasons why the determination of the methodology cannot be regarded as administrative action which determined the outcome of Sasol Gas’ maximum price application. The first is that it is apparent from the methodology itself that no finality had actually been reached on how prices

would be assessed; the second is that, in any event, NERSA did not apply the methodology it had decided upon in March 2011.

[37] In regard to the first, I have already pointed out that in part 3.5 of the methodology NERSA extended a choice to a licensee applying for a maximum price determination to opt for either the basket of alternatives method or the pass-through approach. It was only when Sasol Gas made its choice that the method it had chosen would become 'the systematic methodology to be consistently applied through (its) licence period . . ..' In the present instance, that only occurred when Sasol Gas applied for a maximum price determination. Before then, the terms of the methodology were purely theoretical, and had no effect. That is all the more so once one remembers that, at the time the methodology was published in October 2011, NERSA had not even decided whether there was inadequate competition in the market and had, so to speak, put the cart before the horse.

[38] The second reason flows from the reasons NERSA gave for its decision on Sasol Gas's maximum tariffs. It stated that the issue of 'revenue neutrality' had been raised during its public consultation process, and led to it approving a transitional mechanism to ameliorate the effects of its decision on maxima which would otherwise lead to industry-wide price increases. This it did with the specific intention of ensuring that the price restructuring would 'leave Sasol Gas neither better off or worse off as in terms of revenue earned and profitability, *ceteris paribus'* compared to the starting point before restructuring'. Consequently, NERSA did not apply the methodology it had earlier decided upon but, instead, altered it in order to achieve what it felt was a more equitable result. Put differently, the final maximum price determination was achieved not by consistently following its methodology but by using a revised method in order to ensure that Sasol Gas suffered no financial loss.

There are important consequences which flow from this to which I shall later return.

[39] What is apparent from the two reasons I have just mentioned, however, is that there was no final decision having a direct external effect until such time as a decision was announced on Sasol Gas's maximum price application. The court a quo therefore erred in not recognising that the administrative action that fell to be reviewed was NERSA's decision on Sasol Gas's application. Consequently, it ought not to have declined to hear the matter due to an undue delay. Rather it should have considered the merits of the review, to which I now turn – it having been agreed amongst the parties that in that regard we are in as good a position as the court a quo to do so.

[40] It is a fundamental requirement of administrative law that an administrative decision must be rational. This is entrenched in s 6(2)*(f)*(ii) of PAJA which provides for an administrative action being reviewable if it is not rationally connected, inter alia, to the purpose for which it was taken, the purpose of the empowering provision, or the reasons given for it by the functionary who took it. Administrative action is also reviewable under s 6(2)*(h)* of PAJA if 'it is one that a reasonable decision-maker could not reach' – see *Bato Star Fishing v Minister of Environmental Affairs* 2004 (4) SA 490 (CC) para 44. Bearing these principles in mind, I turn to consider whether the decision taken by NERSA passes muster.

[41] Unfortunately, the papers in the review application became unduly lengthy, with opinions being filed from experts who locked horns on a vast array of issues, many of which appear to have played no part in NERSA's decision, but were relied upon in an ex post facto attempt to either justify or condemn it. The criticism by counsel for the appellants that the 'expansive

attempts' by the experts employed by NERSA to justify its determination of maximum prices 'range far and wide but have precious little to do with the considerations that actually motivated' the decision, is by no means unmerited. The dust of this conflict seems to have obscured what was a relatively straightforward issue that fell to be decided on certain elementary and undisputed principles of economics, the common cause facts and the reasons NERSA set out when it gave its decision in October 2011. Any further reasons are irrelevant to the task at hand – see *National Lotteries Board & others v South African Education and Environment Project* 2012 (4) SA 504 (SCA) paras 24-28.

[42] In considering the rationality of NERSA's decision, it is necessary to bear in mind the process upon which it had embarked in the first place. It had set out under s 21(1)*(p)* of the Gas Act to determine a maximum competitive price for piped-gas to replace the monopoly price being charged when the decade of grace that Sasol Gas had enjoyed came to an end. In the first draft of its methodology of 21 October 2010, NERSA in fact described its mandate as being 'to apply regulation in the absence of a competitive market' so as to 'replicate competitive market outcomes in approving maximum prices'. It set this task for itself in the light of its finding of there being inadequate competition in the piped-case industry.

[43] In its reasons for reaching that decision, NERSA stated that for seven years Sasol Gas had sustained the price of gas consistently above a competitive level or marginal cost, and described the effect of the regulatory agreement as follows:

'i. At present there is one licensee that provides transmission and distribution of piped-gas in the South African piped-gas market, namely Sasol Gas, who is effectively the sole supplier of gas and importer of natural gas into the South African market. This licensee is vertically integrated in that it owns and operates the pipeline network both at transmission and distribution level. It also owns the focal product which is the subject of the competition assessment being undertaken by the Energy Regulator. Furthermore, Sasol Gas is also a dominant player in the trading of gas at wholesale and retail levels. Currently there are four traders of natural gas in South Africa in addition to Sasol Gas most of whom resell gas purchased from Sasol Gas. It is important to point out that these independent traders do not own the infrastructure or network critical in transporting or distributing gas to customers around the country in competition with Sasol Gas.

ii. *The conditions in South African piped-gas market manifest those of a monopolist who has an influence in the market in terms of gas supply and prices. Notably, the price of natural gas and synthetic gas is referenced to the cost of an alternative energy source available to an individual customer*. . . .' (Emphasis added)

[44] In conclusion, NERSA found:

'The monopolist has market power, and as evidenced by current pricing practices and previous complaints concerning discriminatory and high prices as well as challenges in accessing and/or sourcing gas supply, it is our submission *that market power has been exercised and misused,*' and that '. . . *the gas prices are higher than those charged in a situation of perfect competition or in a competitive market*.'(Emphasis added)

[45] Gas prices higher than what would have been charged in a competitive market, and the abuse by Sasol Gas of its market power, were therefore the evils NERSA had set out to address. NERSA itself stated that Sasol Gas's unduly high prices were due to them being referenced to the cost of alternative energy sources available to its customers. One would have thought that in these circumstances, to stop the abuse of market power and to avoid overly high prices, NERSA would have sought a methodology designed to lower maximum prices to those which would have prevailed in a competitive environment – and it would have adopted a methodology different to that used by Sasol Gas.

[46] Instead, and in my view irrationally, NERSA did the very opposite. It proceeded to determine a methodology which was once again referenced to more expensive alternative sources of fuel, and which had the effect of

permitting an increase rather than reducing Sasol Gas's monopolistic prices which NERSA had already concluded were too high. By employing the cost of a basket of alternative fuels as a proxy for a maximum price of gas, NERSA set a benchmark which established a price that a monopolist would have charged. This was hardly a reasonable or rational decision taken to mimic a competitive price. The price it set ought to have been designed to compensate for the lack of a competitive market but the method it employed did not, and could not, achieve that end. Indeed, although there is a dispute between the experts regarding the precise effect upon customers such as the appellants, the adoption of the methodology NERSA used resulted in the maximum price being determined in an amount arguably some 300% higher than what the appellants had previously been paying.

[47] In an attempt to meet this, the respondents argued that a comparison between the actual prices Sasol Gas had charged its customers during its decade of grace and its prices thereafter, showed that there had not been a significant increase across the board and that many of its customers were being charged less than they had been before. However, this loses sight of the fact that we are not concerned with a comparative analysis of prices actually charged and that NERSA has not attempted to prescribe what prices Sasol Gas should charge. Instead it determined what prices could be charged as a competitive maximum. And as, so to speak, 'the proof is in the pudding', the fact that its new methodology permitted such a huge increase above what NERSA had already determined were excessively high prices, speaks volumes in respect of the irrationality of using a methodology which produces such an absurd and unreasonable result. As was correctly stated in the report dated 16 September 2014 prepared of behalf of RBB Economics by Mr PB Smith, an expert witness relied upon by the appellants:

‘Despite having kept average piped-gas prices roughly the same, Sasol Gas has set its current prices significantly below what it is permitted to charge under the Methodology. This, too, highlights that the Methodology is not effective in alleviating the effects of a lack of effective competition: it permits Sasol Gas to achieve significantly higher prices (and profits) than it did when it was an unregulated monopolist. Clearly, this is irrational. As I say above, the aim of price regulation in a market lacking adequate competition is to constrain the regulated firm’s market power.’

[48] In summary, the fundamental error which NERSA made was to use a basket of fuel alternatives as a reference point to determine a competitive price for piped-gas. The mere fact that those sources of energy were not being used by piped-gas consumers is in itself an indication that they were too expensive. To then use them as the yardstick is simply illogical. In effect, the methodology adopted by NERSA was one which by its very nature would determine a price for piped-gas at which consumers would seek alternative sources for their requirements – in other words a monopoly price – which was precisely the situation NERSA had set out to avoid. In this regard the following passage in a further report of Mr Smith dated 9 February 2015, encapsulates the difficulty the respondents face in this regard.

‘. . . (W)hat makes the choice of Sasol Gas’ comparators so unsuitable is that they include the very alternative energy sources that Sasol Gas, as a monopolist, has already taken into account when increasing gas prices without regard to costs, up until the point allowed by these weak outside options. NERSA has defined the relevant market as one for the supply of piped gas. This necessarily means that alternative energy sources are simply too expensive to be sufficiently attractive to customers of piped gas, even if the price of piped gas were to rise significantly above competitive levels. As might be expected, and as NERSA confirmed, Sasol Gas exploited its market power by increasing the price of piped gas to the level at which those alternative energy sources started to become attractive to customers. For NERSA now to approve and apply a methodology built upon those very same alternative energy sources is circular and defeats the purpose of regulation.’

[49] Consequently, the methodology NERSA adopted resulted in an even higher monopoly price than that which Sasol Gas was already charging – and which NERSA itself regarded as too high and a misuse of market power – rather than a price in a hypothetical competitive market. What it was obliged to do was to think away the monopoly Sasol Gas enjoyed and determine the maximum price which would have been charged in a hypothetical competitive market in which suppliers competing with each other would have sought to under-cut each other's prices in order to take business from each other. By its very nature, the methodology NERSA adopted did not do this. Using that methodology to determine a maximum competitive price was therefore irrational for a regulator such as NERSA.

[50] NERSA attempted to support its determination of maximum prices by stating that it had performed a 'sanity check' by looking at gas prices being charged in various countries abroad, particularly in Europe and had ascertained that the maximum prices it determined were reasonable having regard to these foreign markets. However, charges in other countries, many of which are substantially lower than those determined by NERSA, can only be relevant in cases in which the market factors which determine those prices are similar. Without that information, broad comparisons such as that relied upon are of no meaningful assistance. As is set out in a report dated 15 September 2014 prepared by The Brattle Group, experts in the international electricity and gas markets:

'Gas prices in other parts of the world are irrelevant to determining whether the gas price resulting from the methodology is reasonable. In South Africa, consumers should benefit from a relatively low gas price since they are near a large source of gas, in Mozambique. Relatively high prices in Europe and Japan cannot justify a gas price above the competitive level in South Africa. The markets in Europe and Japan are not directly accessible to gas sellers in South Africa, and South African consumers cannot buy gas from the United States of America. The relevant benchmark is not the price of gas in a market such as Japan, Europe or the US, but what the gas price in a competitive South African gas market would be.'

[51] A factor of particular significance is that while internationally the regulation of gas prices is based on the cost of acquiring the gas plus a reasonable mark-up, there is no evidence that the methodology adopted by NERSA – using the cost of a basket of alternative fuels as a reference – has ever been adopted in any other market. An expert report to this effect relied upon by the appellants was not disputed, and so it seems that the formula adopted by NERSA is, as was described by appellants' counsel, 'maverick' as no other regulated country in the world has used it. And the reason for this would seem to me to be clear. It truly does not, and cannot, be used to mimic a competitive market and determine a competitive price. Instead, it determines a price level at which consumers would look elsewhere for their requirements – the hallmark of a monopoly price, unrestrained by direct competition.

[52] I have already mentioned NERSA's amendment of its methodology to ensure a period of price neutrality followed by an incremental increase in prices. In its reasons for decision of 26 March 2013, it stated that the introduced maximum prices were likely to lead to industry-wide price increases and that it had therefore included a specific element of revenue neutrality as applied for by Sasol Gas. It went on to state:

'7.10 Hence the transitional mechanism was amended and approved as indicated below. It must be noted that the increases referred to are to be calculated as the percentage increase from the customer's prevailing market value price as at 25 March 2014 to the non-discriminatory actual price (that is, within the approved maximum price as appropriate) before addition of tariffs or the levy, that would be applicable on 26 March 2014. The approved maximum prices on 26 March 2014 will be those inclusive of the escalation to the maximum prices approved on 26 March 2013 and in accordance with the approved escalation mechanism from 26 March 2013.

7.10.1 Where a ≥15% increase is required of the customer's prevailing price as at 25 March 2014 to achieve non-discrimination, but where such increase is ≤30% of the customer's prevailing price, a maximum 15% increase will be effected on 26 March 2014; the remainder of the increase must be effected in quarterly adjustments between 26 March 2014 and 25 March 2015. This implies that increases below 15% may be implemented with immediate effect on 26 March 2014. The remainder of percentage increases up to and including 30% of the customer's prevailing price may be implemented in quarterly adjustments over 1 year. It must be noted that this implies that the quarterly adjustments will contain instalments of the phasing in of the increase as well as any adjustments required in terms of the approved maximum prices escalation.

7.10.2 For increases above 30% but ≤45% of the customer's prevailing price as at 25 March 2014, the increases must be effected as follows: a maximum 15% increase will be effected on 26 March 2014; a further 15% increase must be effected in quarterly adjustments between 26 March 2014 and 25 March 2015; and the remainder of the increase must be effected in quarterly adjustments between 26 March 2015 and 25 March 2017. This provision ensures that price increases up to and including 45% of the customer's prevailing price must be phased in over a 3-year period.

7.10.3 For increases above 45% of the customer's prevailing price, the increases must be effected as follows: a maximum 15% increase will be effected on 26 March 2014; a further 15% increase must be effected in quarterly adjustments between 26 March 2014 and 25 March 2015; another 15% increase must be effected in quarterly adjustments between 26 March 2015 and 25 March 2017, and the remainder of the required increase must be spread over an appropriate time period subject to approval by the Energy Regulator.

7.10.4 . . .

7.10.5 Sasol Gas must demonstrate revenue neutrality between annual revenues based on prevailing prices between 26 March 2013 to 25 March 2014 and the forecasted revenues for the period 26 March 2014 to 25 March 2015 based on the approved Maximum Prices as at 26 March 2014, less any revenue foregone due to the transitional mechanism.'

[53] It is clear from this that NERSA expected substantial increases for consumers, including increases over 45%, but that by way of price restructuring

Sasol gas would be neither better nor worse off in terms of revenue for the first 12 months after the increases in maximum prices came into effect. Thus in applying its methodology, NERSA recognised that it would lead to substantial price increases, the effects of which it sought to ameliorate to some extent. But when one bears in mind that the object of its exercise was to combat the prices that it already regarded as being too high, the application of a method that NERSA knew would lead to the opposite result was clearly irrational.

[54] Indeed, applying revenue neutrality, which effectively sought to extend Sasol Gas's decade of grace for a period, rather than bring it to an end, is in itself irrational. NERSA was mentored to ensure competitive prices, not to protect the person enjoying the benefit of high non-competitive prices due to its monopoly from suffering a loss of revenue when it was obliged to charge competitive prices.

[55] There is one final aspect of the issue of revenue neutrality which needs to be mentioned. In a letter of 15 August 2013, the appellants' attorney wrote to NERSA and asked it to clarify what revenue neutrality entails, how NERSA intended to measure it, what procedures and processes would be used to monitor compliance with the requirement and how NERSA intended to regulate it. NERSA's response to this is striking. In a letter of 16 September 2013 it stated the following:

'Therefore, (NERSA) has requested Sasol Gas to define and set out the parameters that will enable them to "*demonstrate how this principle will be achieved under the assumption of 'like-for-like', ie assuming that all variables are constant, such as volumes, costs, taxes etc (cetenis paribus)*". NERSA will then review the definition and parameters set by Sasol Gas and either refer back to Sasol Gas to amend or, if it is deemed acceptable, apply the definition and parameters set out.

This is the process currently underway and (NERSA) will notify all stakeholders of the criteria as and when it becomes available to be used to demonstrate revenue neutrality by Sasol Gas.'

From this it appears that NERSA adopted a principle in its methodology which it did not understand and which needed the party to be regulated and who had made an application for a price determination to decide how it would be effected. Put more simply, it decided to apply a criterion which it could not define and did not understand. The fact that this is both irrational and unreasonable is self-evident.

[56] Given all the circumstances, I have not the slightest hesitation in concluding that NERSA's decision of 26 March 2013, determining maximum prices for piped-gas supplied by Sasol Gas, was wholly irrational and unreasonable and, for that reason, ought to have been reviewed and set aside by the court a quo. The appeal must therefore succeed.

[57] In their heads of argument, counsel for the appellants suggested the form of an order which should be substituted for that of the court a quo in the event of the appeal being upheld. The effect of this would require NERSA to determine a new maximum price to be applied with retrospective effect during the period 26 March 2014 to 30 June 2017. Sasol Gas argued that this might possibly lead to it having to repay its customers a portion of what they had been charged during that period and that there was no reason to impose such an obligation. The appellants, on the other hand, argued that Sasol Gas should not be allowed to profit without restraint due to NERSA having failed in its duty of lawfully exercising price control, and that consumers were entitled to NERSA's protection against the unduly high prices charged during the decade of grace. They argued that in order to avoid consumers being prejudiced, the order would oblige NERSA to determine the maximum prices with retrospective effect and, thereby, avoid an injustice.

[58] I agree with the appellants' argument. As the Constitutional Court pointed out in *Allpay Consolidated Investment Holdings (Pty) Ltd & others v Chief Executive Officer, South African Social Security Agency* 2014 (4) SA 179 (CC) para 30, the consequences of invalidity should be corrected or reversed when they can no longer be prevented. The order suggested by the appellants will have such an effect and will therefore be reflected in the order set out below. Insofar as it refers to the determination of maximum transmission tariffs, which has not been impugned, it must be remembered that ultimately there was a composite maximum which cannot be allowed to stand.

[59] For the above reasons, it is ordered as follows:

1 The appeal succeeds with costs, including the costs of two counsel.

2 The order of the court a quo is set aside and substituted by the following:

'(a) The decisions by the first respondent on 26 March 2013 to approve applications by the second respondent (i) for maximum gas prices and for a trading margin for the period 26 March 2014 to 30 June 2017, and (ii) for transmission tariffs for the period 26 March 2014 to 30 June 2015, are reviewed and set aside.

(b) Any maximum gas prices subsequently approved by the first respondent for the second respondent shall apply retrospectively with effect from 26 March 2014 until the date of termination of such approval.

(c) The costs of this application shall be paid by the respondents jointly and severally, the one paying the other to be absolved.'

L E Leach

Judge of Appeal

Appearances:

For the Appellants:	W Trengove SC (with him J J Meiring)
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For the second Respondent:	A Cockrell SC (with him M D Stubbs)
	Bowman Gilfillan, Sandton
	Symington & De Kok, Bloemfontein