Sasol's submission to the National Treasury Task Team assessing possible reforms to the Fiscal Regime applicable to windfall profits in South Africa's Liquid Fuel Energy Sector, with particular reference to the Synthetic Fuel Industry

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Although Sasol believes the information provided in this submission to be true and correct to the best of its knowledge, it has been collated and analysed within very short and strict time constraints and is intended solely for engagement with the Task Team appointed to consider possible reforms to the fiscal regime applicable to windfall profits in the South African liquid fuel energy sector. Accordingly Sasol makes no representation as to the completeness of material contained in this submission and shall not have or accept any liability for statements, opinions, information or matters expressed or implied in this submission or arising out of it, contained therein or derived or omitted therefrom, or any other written or oral communication transmitted or made available to any other party in relation to the subject matter of this submission. We accordingly reserve the right to amplify our comments where necessary.

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Abbreviations

ASGISA	Accelerated Shared Growth Initiatives of South Africa
BEE	Black economic empowerment
BFP	Basic Fuel Price
BJM	Barnard Jacobs Mellet
CEF	CEF (Pty) Ltd
CGT	Capital gains tax
CPI	Consumer Price Index
CSP	Customised sector programme
CTL	Coal to liquids
DEAT	Department of Environmental Affairs and Tourism
DJP	Durban – Johannesburg Pipeline
DME	Department of Minerals and Energy
DTI	Department of Trade and Industry
E&P	Exploration and production
GTL	Gas to liquids
IBLC	In Bond Landed Cost
IDC	Industrial Development Corporation of South Africa (Pty) Ltd
IPP	Import parity pricing
JSE	JSE Limited
mboe	million barrels of oil equivalent
MPAR	Marketing-of-Petroleum-Activities Return (Wholesale margin in liquid fuels industry)
MPRD	Minerals and Petroleum Resources Development Act 2004
MRG	Methane rich gas
MSA	Main supply agreement (between Sasol and other oil companies)
NATREF	National Petroleum Refiners (Pty) Ltd
NER	National Electricity Regulator
NERSA	National Energy Regulator of South Africa
NIOC	National Iranian Oil Company

OOC	Other oil companies (traditionally crude oil refiners and marketers in SA)
OP26	Prospecting Lease No. OP26
OPEC	Organisation of Petroleum Exporting Countries
PAR	Petroleum Activities Return
PASA	Petroleum Agency of South Africa
PetroSA	Petroleum Oil and Gas Corporation of South Africa (Pty) Ltd
PIC	Public Investment Corporation
PPM	Parts per million
PRT	Petroleum revenue tax
RATPLAN	Retail rationalisation plan
RPM	Retail price mechanism
RSA	Republic of South Africa
SAPIA	South African Petroleum Industry Association
SAPREF	South African Petroleum Refiners (Pty) Ltd
SAR&H	South African Railways and Harbours
SARB	South African Reserve Bank
SARS	South African Revenue Services
SATMAR	South African Torbanite Mining and Refining Company
SATS	South African Transport Services
SFF	SFF Association (association not for gain)
SPD	Supplementary petroleum duty
STC	Secondary tax on companies
TOR	Terms of reference
UK	United Kingdom
UN	United Nations
US	United States of America
VAT	Value Added tax
WPT	Windfall profit tax

Submission Overview

This submission comprises Sasol's response to the National Treasury Task Team's consideration of possible reform to the fiscal regime applicable to windfall profits in South Africa's liquid fuel energy sector. A brief overview of the content of the sections of this document is provided here.

After some introductory remarks the document follows the outline of the Discussion Document. It considers the Terms of Reference, and makes some suggestions on matters for inclusion in the Terms of Reference for the Task Team.

The third section moves on to an assessment to the fiscal policies and alludes to the timeousness of the simultaneous investigation of the upstream fiscal regime.

In the following section the concepts of super-normal profits, windfalls and economic rent are reviewed. The acid test for the application of windfall tax is applied to the synfuels industry and some international historical precedents discussed to assess the outcome of such a policy.

Section 5 deals with the history of the synthetic fuels industry of South Africa in some detail. The extent of funding and tariff protection received by Sasol is explained, providing a response to various aspects such as the development of the manufacture of synthetic fuels, regulation and empowerment raised in the Discussion Document. The specific conditions set around the establishment of Natref are also clarified in this section, addressing the perceptions around it being advantaged due to its inland position and shareholding.

Sasol's role in the South African economy in the form of contribution to GDP, Sasol's payment to the fiscus and employment are points of discussion in the next section. The various steps that form part of the synthetic fuels value chain are also incorporated into the discussion, illustrating the savings to the foreign exchange of the country.

The criteria to determine if Sasol's synfuels business should qualify for either forward-looking or retroactive windfall tax are applied in section 7. The extent to which Sasol has improved the efficiency and productivity of its operations, thereby improving the return on investment, is included here as an aspect pertinent to determining the validity of imposing windfall taxes on this industry. An international comparison of the South African fuel prices and a summary of protection received by other industries in South Africa are included as points pertinent to this discussion.

It is expected that South Africa will require additional refining capacity in the medium term. In this context, the incentivisation of future investments is particularly relevant in this review. The importance of this question being addressed at national level is emphasised in the penultimate section. The Task Team's concern about transfer pricing when floor prices are under consideration is also addressed.

The submission concludes with answers to the list of questions laid out in the last section of the Discussion Document. The answers draw on the discussion in the preceding chapters, providing conclusions and issues for consideration by the Task Team.

1. Introduction

We recognise that because of Sasol's size, technology and history we are entrusted with a special responsibility with regard to the role the company should play in the development of South Africa as a country, as well as in relation to the consumer. We are intent on discharging this responsibility having full regard to the interests of our country, our shareholders and our customers. We are deeply committed to South Africa, and will continue our very substantial investment, employment and wealth creation to the benefit of many thousands of our fellow citizens. It is our sincere belief that windfall taxes will impede our ability to discharge this responsibility.

We are also very aware of the plight of the consumer, who has had to bear the brunt of recent high fuel prices. In a price-regulated environment, with global uncertainty and supply disruptions creating historically high oil prices, the price of fuel becomes an emotive issue. It is our sincere belief that the price-mitigating effect of a windfall tax, if imposed, will be minimal. It will not solve the problem of high fuel prices. In fact, it may cause the South African motorist to become more exposed to supply interruptions. **As our economy accelerates its growth rate, with greater demands made on the secure supply of fuel, the time is right for a dialogue with all stakeholders, including consumer groups, to understand how South Africa's fuel needs will be addressed in future.** Sasol believes, for the reasons set out in this document, that a windfall tax should not form part of the equation.

Sasol welcomes the opportunity for public consultation on the possible introduction of windfall taxes on companies in the liquid fuels industry, and in particular, in the synthetic fuels industry, as this will afford all parties an opportunity to provide input into an issue of great importance for our

industry and country. It is appropriate that transparency and public scrutiny are brought to bear on an industry that has in the past been characterised by secrecy and a lack of public involvement. It should, however, be pointed out that any debate on the concept of WFT should not be confined to a particular industry only.

Perhaps as a result of its history, the liquid fuel industry today is characterised by complexity, with a number of very large multinational crude-based companies, two local synthetic fuels companies, emerging BEE companies and a comprehensive regulatory superstructure covering virtually all elements of the value chain. This makes any intervention in the industry fraught with the potential for unintended consequences, rendering comprehensive consultation all the more necessary.

We are furthermore reassured by the extensive analysis contained in the Discussion Document[1]. It is clear that the Task Team has endeavoured to reflect its understanding of the liquid fuels industry in South Africa as comprehensively as possible. Its openness to further input and comment is to be commended.

This submission document comprises comments by an internal Sasol Task Team (augmented by input from various industry experts and advisers such as Prof. M Katz, Deloitte, PwC, Prof JA du Pisanie, Deutsche Bank, DRI-WEFA, CRA and others) on the Discussion Document released on 20 July 2006 by the Task Team appointed by the Minister of Finance to consider possible reforms to the fiscal regime applicable to windfall profits in South Africa's liquid fuel energy sector.

[1] "*Possible reforms to the fiscal regime applicable to windfall profits in South Africa's liquid fuel energy sector, with particular reference to the synthetic fuel industry, A discussion document for public comment"* issued on 20 July 2006 by the Task Team appointed by the Minister of Finance in May 2006

For ease of reference, we have followed the same structure as that of the Task Team's Discussion Document. In each section, factual issues are analysed and assessed, and where necessary, corrected. The same approach is followed with regard to fiscal and economic theories underpinning the Discussion Document in order to augment and amplify the Task Team's assessment of its assignment. Where appropriate, Sasol has commented on matters that can fruitfully be added to the Discussion Document, in order to ensure that all relevant considerations are taken into account. We have refrained from comment on matters pertaining exclusively to PetroSA.

From time to time, the Discussion Document contains perceptions and observations that may result from different paradigms being applied to the facts at hand. Where appropriate, we have commented on these in order to illuminate the matter at hand from a different perspective.

While the Terms of Reference for the Task Team and the Discussion Document itself contain substantial motivation for the present investigation, the approach of the investigation and its policy and economic implications have prompted further questions that we believe may be usefully considered by the Task Team. Where appropriate, we have raised such questions.

We believe that our approach is consistent with the invitation posed by the Task Team in its introduction to the Discussion Document and look forward to engaging with the Task Team in the public hearings on this matter.

2. Scope of the Investigation

The Terms of Reference give a broad mandate to the Task Team. In addition to matters pertaining to the synthetic fuels industry *per se*, the Discussion Document deals with issues such as the Basic Fuel Price ("BFP"), pipeline structures and tariffs, locational advantage and wholesale and retail margins. While consideration of these aspects significantly broadens the scope of the investigation, their inclusion is apposite, as an analysis of these factors will enable a full appreciation of the constraints imposed on Sasol. A distinction that the Task Team is careful to make is which elements of the liquid fuels industry would be better served by regulatory scrutiny, and which elements fall within the scope of a windfall tax investigation. We support this distinction, particularly in view of the nascent regulatory institutions that have recently been established, and which should have an opportunity of asserting their independent jurisdiction. There are, however, some omissions from the scope of the investigation that, if pursued, may provide valuable insights.

2.1 Consideration of alternative policy instruments

The Terms of Reference for the Task Team posit that the possibility of windfalls having accrued may merit the application of fiscal measures, in particular the imposition of windfall taxes. However, the Terms of Reference do not require the Task Team to consider either:

a) the objectives of possible windfall taxes (such as recovering past Government support, garnering additional revenue to address budget deficits, reducing fuel prices or shaping investment or dividend decisions); or

b) discrete alternative ways in which these objectives may be achieved (regulatory changes, deregulation or the addition of infrastructure).

2.2 Policy overlap and consistency

The document quite correctly acknowledges the need for any windfall tax to integrate with other Government policies and objectives, and acknowledges that failure to do so could result in overall Government objectives not being met. However, the analysis in the Discussion Document does not arrive at any definitive conclusions in this regard. **It is Sasol's opinion that the imposition of windfall tax may inhibit the achievement of our Government objectives such as greater domestic investment, greater in-country beneficiation and economic growth.** In this regard, the different Government strategies as they pertain to different industries may need to be considered in conjunction with the Department of Trade and Industry, the Department of Minerals and Energy and other relevant regulatory authorities.

2.3 Unintended consequences

An omission from the scope of the document is an analysis of the possible unintended consequences of fiscal intervention through windfall taxes**.** It has been demonstrated repeatedly that, where markets respond to incentives, and regulatory intervention that seeks to inhibit normal corporate activity, through the imposition of special targeted fiscal measures, this is often met with unintended consequences. Historically, windfall taxes have tended to have greater negative than positive impacts on an industry. **In particular, the example of the US windfall tax on the**

oil industry is illustrative of the unintended consequences on an industry which today has severe crude oil production and refining capacity constraints, arguably caused by a dearth of investment as a result of unfavourable policy environments.

2.4 Precedent

It is fairly common knowledge that the imposition of windfall taxes based on past Government assistance may create significant uncertainty in other business sectors. In particular, the resources industry and certain manufacturing sectors which received and continue to receive significantly higher levels of protection than those enjoyed by the synthetic fuels industry, may be discomfited by the prospect of Government seeking to impose windfall taxes when perceived high returns on assets coincide with past tariff protection. Consideration must be given to whether or not the consideration of windfall taxes on the synthetic fuels industry is intended as a precedent for similar interventions in other industries.

2.5 Benefits of the synthetic fuels industry

While the Discussion Document does make reference to the benefits that South Africa derives from the synthetic fuels industry, the analysis omits many important strategic, economic and social considerations. While we have endeavoured to amplify this analysis with the results of its own investigations, the potential benefits of future expansion of the synthetic fuels industry may warrant further study of the cost/benefit equation for South Africa.

3. The South African Fiscal Regime as applied to the Liquid Fuel Value Chain

3.1 Purpose of a windfall tax

The Discussion Document points out that it has endeavoured to "adhere to, the core principles that … have been utilised by the South African fiscal authorities…particularly in regard to maintaining certainty in the tax regime"[2].

Certainty is but one of the traditional principles or canons of tax policy arising from any contemplation to impose a new tax. There are several other fundamental questions of tax policy and design which the Task Team, in our opinion, do not appear to have considered in the context of a potential windfall tax but which should be addressed at this stage of the debate. These issues are detailed in Annexure A to this report.

Consideration of the Discussion Document, however, does not reveal what the intended purpose of a possible windfall tax on Sasol, PetroSA or any other company associated with the liquid fuels industry for that matter would be.

It is unclear from the discussion on fiscal policy whether the proposed windfall tax would seek:

- to raise additional revenue for general Government expenditure;
- to act as an energy policy instrument;
- to guide capital allocation;

[2] Par 3.1, p 14 of Discussion Document

- to apply windfall tax in order to recover tariff protection extended to Sasol in the past;
- to redress perceived imbalances caused by past regulatory dispensations; or
- to seek, in the public interest, the redistribution of profits enjoyed by a specific industry.
- a combination of the above

This section of our comments seeks to illuminate these alternatives with a view to understanding whether or not any of the potential motivations for a windfall tax might be justified.

3.1.1 Imposition of a windfall tax to raise additional revenue

Windfall taxes have in the past been imposed by Governments in order to secure revenue required to address budget deficits. The oil and gas industry for the emotive reasons acknowledged by the Task Team has been an obvious target for such fiscal activity, particularly where such deficits have coincided with times of high oil prices. The imposition of a supplementary petroleum duty on North Sea oil production by the British Government in 1981 is an example of such a conjunction of economic factors.

In South Africa, however, Government revenue currently exceeds expenditure. **An independent firm of economists has predicted that if Government revenue is collected at the same rate than currently, the fiscus may have a budget surplus of some R20bn for the 2006/2007 fiscal year.**[3]

[3] Econometrix Ecobulletin No 15806/0723, 31 July 2006

It would therefore seem that additional revenue collection would not be an immediate objective that would justify the imposition of a windfall tax on Sasol. Furthermore, the *ad hoc* imposition of a windfall tax would significantly detract from the principle of "maintaining certainty in the tax regime"[4].

3.1.2 Imposition of a windfall tax to act as an energy policy instrument

Appropriately, the Discussion Document considers fiscal policy as one of the key levers at Government's disposal to ensure that its energy policy is implemented. Recent announcements of resource royalties, in particular the Minerals Royalty Bill (coal) and the Royalty Bill (oil and gas), are expected to play a key role in shaping investor behaviour.

It is less clear, however, how windfall taxes would be applied to energy policy, and how these taxes fit into the overall superstructure of energy regulation. The White Paper on Energy Policy[5] states that Government's energy policy is aimed at creating a stable and internationally competitive liquid fuels industry. According to the White Paper, some of the key policy challenges facing the South African liquid fuels industry include the need, amongst others, to achieve:

- an efficient and internationally competitive industry;
- the stable and continued availability of quality product throughout the country at internationally competitive and fair

[4] Par 3.1, p 14 of Discussion Document
[5] White Paper on the Energy Policy of the Republic of South Africa 1998

prices within appropriate health, safety and environmental standards;

- an equitable balance between the interests of industry participants and consumers;
- an environment conducive to synergistic investment in the liquid fuels industry and the related petrochemicals industry;
- an industry supportive of Government's broader social and economic goals;
- a restructuring of the State's involvement in the industry to one more appropriate to South Africa's changed political and economic circumstances;
- the meaningful inclusion of those interests that have historically been disadvantaged;
- the optimum and efficient utilisation of liquid fuels; and
- an efficient network of pipeline and storage infrastructure, whilst protecting against the abuse of market power and restrictive practices in these natural monopolies.

A windfall tax on the synthetic fuels industry could counter the achievement of many these objectives by:

- reducing available funds for reinvestment required both for the creation of additional capacity to meet increased product demand[6] and more stringent environmental requirements, including new fuel specifications (which in turn impact on the stable and continued availability of product);
- disincentivising synergistic investment by encouraging greater depletion of the fuel pool in favour of additional

[6] Refer to Graph 1, illustrating the expected supply/demand balance for the liquid fuels industry in South Africa which clearly demonstrates that significant investment in local fuels production capacity will be imminently required to avoid large-scale imports of final product.

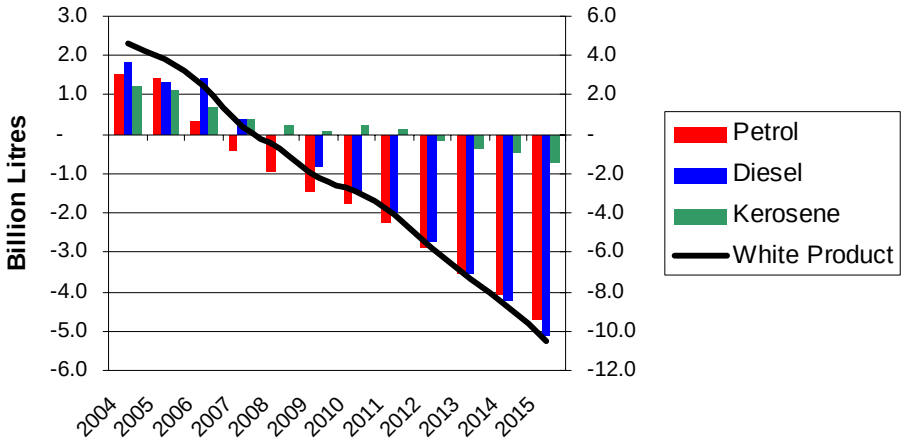
petrochemical production at a time that greater investment in liquid fuels production is required;

- reducing the attractiveness of assets included in Sasol's liquid fuels BEE transaction undertaken in accordance with the Liquid Fuels Charter for BEE;
- reducing Sasol's ability to compete against the multinational oil companies in terms of competing with their integrated subsidiaries in South Africa or in attracting investors that are keen to invest in the oil and petrochemical industry. As discussed in section 7 of the submission, the multinational oil companies are all fully integrated upstream where they earn the vast majority of their income. The integrated margins earned by these companies far exceed the comparable margin of Sasol;
- reducing dividend streams to Sasol shareholders, many of whom are pension funds and public investment institutions; and
- reducing South Africa's ability to improve its security of supply of liquid fuels. The major international topic currently being debated is how to improve security of energy supply with a specific focus on non-crude derived production**. There are no international precedents where a windfall tax is imposed on the production of alternative fuels. In fact, significant incentives are in place and are being expanded for the development of alternative fuel sources – particularly CTL processes.**

A windfall tax on Sasol could therefore be incongruent with the achievement of Government's stated energy policy objectives.

This aspect is particularly relevant in view of the fact that final product imports into South Africa are increasing as economic growth translates into higher fuel consumption figures. The graph below indicates that **there is likely to be a substantial and rapidly increasing shortfall in locally produced fuel when Government's stated 6% growth rate outlined in the ASGISA framework is achieved.** In a supply-constrained world, this leads to concerns regarding petroleum supply security for South Africa.

Graph 1: Projected Supply Shortfall at 6% GDP Growth



Source: Sasol

Graph 1 illustrates the expected supply/demand balance for the liquid fuels industry in South Africa demonstrating that significant investment in local fuels production capacity will most likely be required to avoid large-scale imports of final product.

Because supply security is a key objective of our Government, the construction of a new crude oil refinery or an additional synthetic

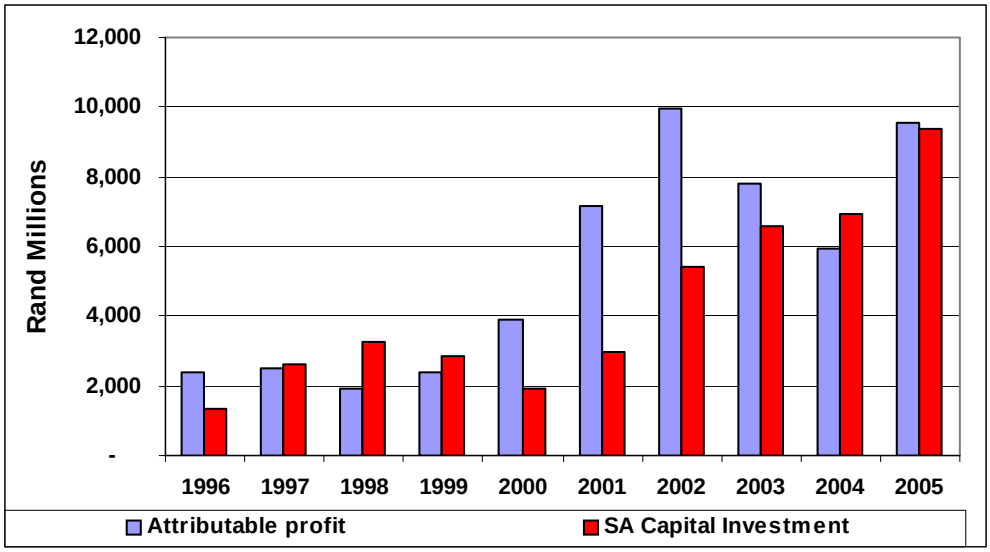
fuels plant should be planned for the near future. Rather than inhibiting investment, Government may wish to give consideration to facilitating the construction of such a new facility for strategic and economic reasons. As is explained later in this submission, **increased fuels production through a synthetic fuels production facility adds significantly more jobs, beneficiation to local minerals, enhancement of GDP growth and foreign exchange savings when compared to a conventional crude oil refinery.**

3.1.3 Imposition of a windfall tax to guide capital allocation

It is arguably justified to impose special or windfall taxes where an industry is depleting resources in an irresponsible manner without reinvestment, or where further capital investment in an industry is not deemed to be desirable.

Sasol's investment pattern in the recent past and its future plans for investment in South Africa are such that it is clear that we are operating our local operations in a sustainable manner. This is substantiated by the very large proportion of attributable profit and cash flow that has historically been reinvested by Sasol in its South African operations. It is important to observe that reducing, by imposing windfall taxes, the amount of profit available for reinvestment inevitably reduces the amount available for investment.

Graph 2: Sasol's Capital Investment in SA



Source: Sasol

If a windfall tax were to be imposed, it would significantly reduce the encouragement for new investment in synthetic fuel manufacture represented by the 1% royalty rebate on low-grade coal that is used domestically in the production of synthetic fuel. Conceptually, there appears to be a contradiction between windfall taxes and the Minerals Royalty Bill, as the latter seeks to incentivise synfuels investement while the prior disincentivises it.

3.1.4 Imposition of a windfall tax to recover tariff protection extended to Sasol in the past

It is not clear from the Discussion Document whether it is Government's intention to apply windfall taxes to recover benefits that are deemed to have accrued due to tariff protection enjoyed in the past. In view of the important precedents that such a policy could create for other industries that currently receive or in the past have received tariff protection, it will be important for the Task

Team to indicate its view on this matter. This matter is further discussed in section 8 of this submission, where a comparative analysis indicates that there are other industries that have benefited to a substantially greater extent from tariff protection than Sasol.

The matter of tariff protection is comprehensively dealt with in our comments on Chapter 5. It suffices for the purpose of this analysis to conclude that the recovery of past Government support through targeted taxation would lead to significant investor uncertainty in industries receiving tariff protection or Government support. Investors may be concerned about the stability of the fiscal regime applicable to their operations and investments in such assisted industries receiving tariff protection or Government support. **It remains important to note that most industries in South Africa have received some form of protection in the past and that in many instances the protection was at a significantly higher percentage or value, when compared to that received by Sasol.**

Furthermore, the nature of tariff protection extended to Sasol was of a quasi-contractual nature, with clear conditions and terms contained in each of the different dispensations. The *ex post facto* amendment of these terms could be regarded as a retroactive intervention in a prior agreement[7]. If Government is of the opinion that amounts are due to it as a result of the quasi-contractual arrangements that determined tariff protection for the synthetic fuels industry, it would be more appropriate and fair to rely on the express terms of such arrangements than to attempt to recover tariff protection through the implementation of a targeted windfall tax on Sasol.

[7] See also our comments on retroactive taxation in Section 4.

3.1.5 Imposition of a windfall tax to address perceived imbalances caused by past regulatory dispensations

The Discussion Document encompasses within its scope a wide range of issues relating to the liquid fuels industry, including refinery economics, pipeline routes and tariffs and regulated price mechanisms. If the objective of windfall taxes is to counter or rectify perceived industry distortion that has transpired as an indirect result of previous Government intervention, then the appropriate policy response may lie in the regulatory arena. This may consist of modified regulations, or complete deregulation, whichever is more desirable. Modified regulatory structures have to a very large extent already been put in place with the introduction of the National Ports Authority Act, the Petroleum Pipelines Act, the Petroleum Products Amendment Act and the National Energy Regulator Act[8]. These Acts grant broad powers to the relevant Ministers and appointed regulatory bodies to intervene in and regulate matters relating to:

- petroleum pipeline and distribution infrastructure capacity allocation and tariffs, including the issue of Natref's putative locational advantage;
- product price regulations;
- marketing regulations, including the number and location of service stations, and the margins and economic returns applicable to each link in the value chain; and
- fuel specifications.

8 National Ports Act, No 12 of 2005; Petroleum Pipelines Act, No 60 of 2003; Petroleum Products Amendment Act, No 2 of 2005 and the National Energy Regulator Act, No 40 of 2004

Government therefore now has in place many of the regulatory levers to correct perceived distortions in the liquid fuels industry by following due process. This raises the possibility of a compounded regulatory intervention in addition to windfall profit taxes being imposed with possibly significant margin reductions. As the Task Team points out in its analysis[9] of the possible policy responses to potential windfall profit, it is more appropriate for the nascent regulatory institutions to be given the opportunity of fulfilling their mandates before windfall taxes are used as a blunt instrument to redress perceived past regulatory imbalances. It remains critical that any new regulations should ensure that the competitive playing field between local companies like Sasol and its multinational competitors is equitable in order to ensure fair competition. **Crude oil based integrated margins remain significantly higher that those of its integrated coal derived counterparts.**

3.1.6 Imposition of a windfall tax to seek, in the public interest, the redistribution of super-normal profits enjoyed by a specific industry

The assumptions underpinning this possible objective are comprehensively analysed elsewhere in this document[10]. For the purposes of this section, it is sufficient to point out that, relatively, the returns made by Sasol cannot be considered to constitute super-normal profits. Furthermore, if the ceiling price for repayments were adjusted to (say) $50/barrel, and Sasol was required to refund 25% of its before-tax synfuels profits[11], and if the proceeds were applied to a reduction in the fuel price, the fuel price

9 Table 13, pp 77 – 79 of Discussion Document

10 Please refer to Section 7 of this submission

11 Returns have been calculated on a re-valued asset basis having regard to efficiency improvements

would drop by only 5c/l. A $1,00/barrel change in the oil price would have an impact of 4,5c/l, and a 10% change in the $/ZAR exchange rate would have an impact of 40c/l in a deregulated market. Any redistributive benefit enjoyed by the motorist would therefore quickly be eliminated by changes in macroeconomic factors.

If the windfall tax is applied to all players in the liquid fuels industry the impact on the fuel price would of course be more significant.

3.2 Fiscal policy and energy policy considerations at the upstream end of the energy value chain

The Discussion Document quite correctly points out that "striking a balance between a range of key policy considerations will be a challenge for policymakers"[12]. Sasol has requested expert opinion on the matter of fiscal and tax policy from Professor Michael Katz. This opinion is respectfully submitted to the Task Team for consideration during its deliberations and is attached hereto as Annexure A. Professor Katz draws attention to the observation that the absence in British reform of any cohesive view of the tax structure, is a "warning against the ad hoc imposition of new taxes without taking cognisance of where any such new tax fits into the entirety of the tax system."[13]

The imposition of a windfall tax on Sasol will not support any of the considerations pertaining to fiscal policy, energy and industrial policy and environmental policy listed in the Discussion Document, with the notable exception of the intent to raise "fiscal revenue to

[12] Par 3.2, p 14 of Discussion Document
[13] See page 4 of the report by Prof. M Katz (Annexure A to this submission)

finance the national budget[14]". However, as pointed out above, it appears that with a projected surplus of R20 bn, it would be surprising if the desire to raise additional funds were to be the primary motivation for the imposition of windfall taxes.

An often repeated goal of fiscal policy is to provide consistency and transparency in tax policy. Furthermore much of the reform undertaken in the tax code in South Africa has been with a view to simplification of the tax code and a broadening of the tax base. The imposition of a windfall tax would appear to contradict both these objectives.

In particular, by reducing the capital available for investment, the imposition of a proposed windfall tax will not, in all probability:

- encourage investment in the extraction industries;
- encourage beneficiation; or
- encourage the extraction and production of alternative and renewable energy sources.

Windfall taxes will therefore at the very least not support and possibly even negate many of the policy objectives identified by the Task Team.

3.3 The fiscal treatment of resource extraction

The Discussion Document deals with the taxation of resources in a comprehensive manner, which represents a fair analysis of the varying policies and levers available to the fiscus. The need for policy consistency and coordination is, however, highlighted by the fact that windfall taxes on

[14] Ibid

Sasol, a major and sustainable beneficiator of a low grade South African resource (coal), are being considered at the same time that the DTI "is considering the development of incentives to encourage the beneficiation of primary and primary-processed minerals."[15] This apparent contradiction is further reinforced by the inclusion in the draft Minerals Royalty Bill of a 1% rebate on low-grade coal used in synthetic fuel processes, a clear signal from Government that it wishes to encourage greater domestic beneficiation of this resource.[16]

Sasol therefore concurs with the Task Team that "an integrated approach will need to be adopted by National Treasury, DME and DEAT toward the various fiscal measures that are applied to the liquid fuels industry"[17]. A notable omission from the list of Departments that would need to be involved in such an integrated approach is the DTI, in particular given the incentive packages currently under consideration by DTI to encourage greater beneficiation. In order to ensure a coordinated policy approach to the windfall tax issue, we concur with the Discussion Document that it will be essential for the Task Team, prior to the finalisation of its recommendations, to gain "an understanding of these policy coordination issues and the extent to which they might overlap with windfall tax-related issues."[18]

The Discussion Document cites the example of the Occidental/BHP joint venture decision to delay a drilling campaign pending finalisation of the Royalty Bill[19]. This is a particularly instructive example of the consequences of uncertainty in the minds of investors. The commitment

[15] Par 3.3.3, pp 17, 18 of Discussion Document
[16] It should be noted that potential environmental taxes are also being considered for the coal mining industry. This should be added to the Discussion Document.
[17] Par 3.5, p 25 of Discussion Document
[18] Par 3.6, p 26 of Discussion Document
[19] The constitutionality of a retroactive and/or targeted tax similar to the supplementary corporate tax imposed by the UK Treasury requires careful consideration.

of the Task Team to expedite the submission of its recommendations to Treasury and the Minister of Finance is therefore welcomed.

3.4 International precedents and examples

In various forms, taxes that have been called windfall profit taxes have been levied by other nations. In addition, there are other instances of such a tax being proposed but never enacted. The industry targeted by these special taxes has, with the exception of the wartime excess profits taxes, most commonly been oil production, though taxes have been levied against industries as diverse as banking and coffee bean farming.

More recently, the US Government rejected calls for the re-imposition of a windfall tax on US oil producers, instead calling for these companies to reinvest their profits in alternative fuels and new energy technologies:

> *"…oil companies need to be mindful that the American people expect them to reinvest their cash flows in such a way that it enhances our energy security."*

Similarly, during May 2006, European Union Finance Ministers' rejected a proposal to impose a windfall tax on oil companies within their jurisdiction benefiting from high oil prices.

> *An oil-company tax is "not realistic,"* Austrian Finance Minister Karl-Heinz Grasser said. *"It's not really a proposal that has a big chance of being implemented. If it's possible to have such a tax on a worldwide basis, then I think we could discuss it."*

The Discussion Document considers a wide range of international precedents for the fiscal treatment of liquid fuels. However, such

comparisons should be applied with caution, as the synthetic fuel industry in South Africa cannot be compared directly with fiscal measures applicable to crude oil and gas extraction. It is perhaps more instructive to compare fiscal policies that apply to the production of alternative or non-conventional fuels, including bio-fuels and synthetic fuels.

Sasol commissioned research by an independent consultant, the Washington Tax Policy Division of Deloitte[20], which concluded that windfall taxes have never been levied on producers of alternative fuels. On the contrary, it is common for tax jurisdictions, especially in recent times, to provide incentives to taxpayers that engage in the production of alternative fuels.

In the USA, for example, there is a mixture of investment and production based tax credits designed to stimulate capital investment in the alternative and renewable fuels industries. In a notable minor irony, the most important of these were introduced as part of the original Windfall Profit Tax legislation applicable to the crude oil industry.

The USA legislature recently expanded and extended tax credits and initiatives as part of an effort to reduce dependency on imported fuel supplies, as well as to promote environmentally sound alternatives to conventional fuels. These credits include production-based credits for renewable and alternative energy sources including wind, geothermal, biomass, the production of synthetic coal, and the gasification of coal among others, and investment based credits for capital investment in many of these types of properties as well. The credits were designed to

[20] See Annexure B for a detailed analysis

try and level the economics for alternative and renewable fuels when compared to the integrated profitability of crude derived fuels.[21]

Two pieces of US legislation[22] are aimed at incentivising investment in synthetic fuels capacity and in particular Coal-to-Liquids processes using Fischer-Tropsch technology, where Sasol has a unique position as the acknowledged world leader in the commercial application of this technology.

In addition to the USA, most other petroleum importing or producing countries in the world provide similar economic and/or tax incentives for the production or investment in alternative and renewable fuels, in most cases providing expressly for Fischer-Tropsch technology which is used by Sasol to produce synthetic fuel. Incentives of this nature have been crucial in Sasol's decisions to invest in Gas-to-Liquids plants in Qatar and Nigeria. Similar incentives are being considered in the context of similar potential investments in China, the USA and India. Details of these incentives are contained in a Deloitte report on this subject, attached hereto as Annexure B.

3.5 Conclusion

We believe that any discussion of the imposition of windfall taxes on the synthetic fuels industry in South Africa will need to be underpinned by clearly articulated policy considerations setting out the aims intended to be achieved by such a policy. From the above analysis, it is apparent that a windfall tax would not be consistent with current energy and resource

[21] Because the primary driver for these incentives is economic parity, certain of these credits were designed with funding limitations or phase-out provisions based on prevailing energy prices.

[22] 1.) The Coal-to-Liquid Fuel Promotion Act of 2006
2.) The Energy Policy Act of 2005 (public law 109-58)

extraction policies, in particular as these apply to the encouragement of domestic minerals beneficiation and the production of alternative fuels, as well as the objectives articulated in the Energy White Paper.

Furthermore, **the available international precedents for windfall taxes in the liquid fuels industry have focused on the upstream production of oil and gas. The production of alternative or synthetic fuels has internationally been treated in exactly the converse manner with incentives and attractive fiscal dispensations on offer to encourage additional investment. A windfall tax on Sasol would therefore appear to be inconsistent with current international practice**.

4. The Concepts: Super-normal Profits, Windfalls and Economic Rent

The Task Team has gone to some lengths to define windfall profits. In order to do so, it has chosen to use the concept of economic rent. This is defined as "excess revenue", or profit in excess of the cost of capital. Allowances are made, however, for economic rent to be earned in certain discrete circumstances. In this section, we consider this and other definitions. Section 7 will apply these definitions in order to assess whether or not Sasol has in fact earned windfall profits or economic rent to the extent that it would qualify for the imposition of windfall tax. While it is possible to summon economic wisdom from many different schools, it is likely that such a debate will not succeed in producing a definitive result. Sasol therefore accepts, for the purpose of the Discussion Document, the definition of economic rent as defined by the Task Team, and will also apply the four acid tests as formulated by the Task Team.

4.1 Economic Rent

The Task Team defines windfall profits from an economic perspective rather than an accounting perspective. More specifically, windfall profits are equated to economic rent, which is defined as all profit in excess of the cost of capital. It is noteworthy that Postner as cited by the Discussion Document, does not use condemnatory terms to refer to economic rent. However, the Task Team appears to deem economic rent to be egregious as a matter of course. We do not support this assumption. To quote from a report by CRA International, an independent consultant appointed by Sasol:

> *"The primary goal of policy makers should not be the elimination of economic rents* per se*, but rather the promotion of the healthy functioning of a competitive market economy. Competition will erode transitional situations where firms can earn high economic rents. Where significant monopoly power exists, this can be dealt with through competition policy or through regulation. However, taxation initiatives that are directed at eliminating economic rents are seldom an option that is used as part of either of these options"*[23] *(our emphasis)*

Far from being egregious, economic rent is a vital part of an efficiently functioning market economy. Particularly in industries with high barriers to entry, the periodic generation of economic rent acts as a signal to potential investors to enter a market. This in turn will give rise to increased supply and a convergence of returns toward a long term mean return. As highlighted below in the experience cited of European utilities, Government policy should be focused upon the reduction of regulatory barriers to entry to reduce the size of pricing signals required. We believe that the imposition of windfall tax will merely act as an additional barrier to further investment into the liquid fuels industry in South Africa.

In practice companies target a rate of return in excess of the cost of capital as a matter of course. This is partly related to limited sources of funding and other resources (which means that only projects with the highest return make it to the implementation phase) but also reflects the demand from shareholders that returns exceed the company's cost of capital. Furthermore, targeting returns that exceed the cost of capital will enable a business robustly to survive market cycles.

[23] CRA International Report, Page 4, par 3. The full report is attached as Annexure C.

Capital will flow to where the highest return can be derived, given a specific risk reward profile. Companies that seek only to recover their cost of capital will be inhibited from growing, as so-called excess profits will not be available for reinvestment. Furthermore, because they will only be meeting their cost of capital, funding will generally be less available to such companies, or will be priced at a higher rate, which in turn means that returns will have to increase in order to meet the cost of capital.

The concepts of return and the cost of capital are left undefined in the Discussion Document. This may prove problematic in the practical application of the concept of economic rent. In our view, given that a normal profit is defined as the opportunity cost of the entrepreneur, certain adjustments to the traditional accounting measurement of returns will be required. At the very least an allowance for the inflation adjustment of asset values should be considered when computing returns. It is furthermore assumed that the expectation of shareholders to receive dividends is included in the cost of capital, and that the profits required to pay sufficient dividends to shareholders to entice them to buy shares and remain invested in a company therefore fall within the ambit of *normal profits* as defined by the Task Team[24].

The existence of economic rent is therefore likely to be much more common than the four instances highlighted in the Discussion Document. **Indeed, in practice the majority of companies need to earn returns in excess of their cost of capital if they are to be in a position to attract new investors, fund investment and provide adequate returns to shareholders.** Although such firms might be deemed to have earned an economic rent in accordance with the Task Team's definition, we believe that the application of windfall taxation would still be inappropriate.

[24] Par 4.5, p 37 of Discussion Document

4.2 Acid test for windfall profit

The Discussion Document's acid test for whether a profit is of a windfall nature is fourfold:

a) When rents arise in the natural resource, or essential infrastructure service or essential goods sectors

Economic rent in essential infrastructure service or essential goods sectors does not *ipso facto* attract additional taxation measures in other parts of the world. The examples of the UK utilities tax and the crude oil windfall tax in the US during the 1980s, were more reflective of a desire to tax away a benefit derived as a direct result of regulatory failure or the consequences of precipitous privatisation. The recently introduced windfall tax in China on crude oil producers is another example where windfall taxes seek to redress the consequences of a regulated product price. Determining a condition based on these international examples should therefore focus on distortions resulting from deregulation or inappropriate regulation rather than distilling a general principle from specific examples in the natural resources sector.

The implication that economic rents might arise in the liquid fuels industry because of the existence of "consumers with no alternatives" carries an implication that the oil business is an essential goods/infrastructure service industry, and as such should be regulated as a utility. This assertion does not take cognisance of the characteristics of utilities, which are by nature networked industries, in that all participants tend to share a monopoly distribution infrastructure (e.g. wires, railway tracks or in some

cases pipelines). This is clearly not the case in either upstream, midstream or downstream oil.

The Discussion Document places utility, or deemed utility industries at the centre of the windfall profits definition. In this regard the evolution of the European utility industry may prove instructive. Following deregulation over the past two decades there have been numerous instances where both state and publicly owned public utilities earned windfall profits by intentionally delaying the rate at which deregulation and third party access progressed in their home countries. However, in almost all instances EU authorities have chosen to continue to work toward greater deregulation, rather than imposing additional taxation.

Furthermore, the Task Team fails to address the question of price and demand elasticities in an environment where prices are regulated. Again, the appropriate response to perceptions of iniquitous economic rent may be to change the regulatory framework to allow for market forces to operate, rather than to tax the profits emanating from a tightly controlled regulatory environment.

b) When economic rents do not arise from efficiency improvements or the creation of valuable intellectual property

We concur with the Task Team that companies should be rewarded for improving on their efficiency. Proprietary intellectual property, trade secrets and know-how are intangible assets which lead to a return being earned on physical assets which exceeds a company's cost of capital. Accordingly, a company should not be penalised for

having an Intellectual Property portfolio at its disposal which it applies to maximise the return to its shareholders.

c) *When, in the case of infrastructure and essential services, economic rents are caused by market power, possibly combined with regulatory failure*

The comments under (a) above have indicated that it is inappropriate to consider the liquid fuels industry to be either of an infrastructural nature, or of having the characteristics of essential services. While "market power" is not defined, it appears as though the assumption is closely linked to the presence of dominance in the same sense as defined for competition law purposes. **The ability to exert market power in a non-forward integrated value chain, as well as the presence of regulated prices, will need to be considered. In Sasol's case the effect of its low ratio of retail marketing service stations to fuel production volumes caused by the previous regulatory dispensation will have to be carefully considered. The imbalance is further perpetuated with the imposition of recent regulations which increases the difficulty for Sasol or any other new industry player to enter the retail market.**

d) *Economic rents are derived that were not anticipated in policy*

The Discussion Document points out that the addition of this criterion inescapably leads to windfall taxes assuming a retroactive nature. It correctly points out that there has been only one precedent for the application of such a fiscal intervention, viz the

UK's windfall tax on privatised utilities[25]. The singular nature of this precedent should in and of itself indicate that a retroactive windfall tax could potentially be fraught with complexity, especially where rights are constitutionally protected.

In this regard, it is instructive to consider the findings of CRA International as disclosed in their attached report:

> *"For example, few regulatory systems provide for retrospective clawback of abnormal profits, even when these are considerable (and could thus be deemed to be a result of regulatory failure rather than economic gains). The UK utility regulatory systems adjust their price control every five years, based on the five year history, but with future impact. Thus firms can make surplus profits for a certain length of time before being stopped. This encourages efficiency and innovation.[26]"*

It is apparent from the analysis in (a) above that Sasol does not display any of the characteristics of a utility. Extrapolating from the British precedent should therefore be an exercise to be performed with caution.

The fact that the criterion requires profit to be unanticipated in policy appears to attribute special foresight to policy-makers. It appears to suggest that only to the extent that policy-makers are able to anticipate profits will a company be allowed to make them. Policy-makers are therefore put in a position where they determine a level of return that will be politically and economically acceptable

25 Par 4.5, p 38 of Discussion Document

26 CRA International, p 4, par 4

after the return has been made. Should conditions change to the extent that their initial assumptions when making policy are no longer valid, they retain the right *ex post facto* to change the rules applicable to the industry.

This approach is inherently in conflict with the typical approach of an investor. An investor first of all considers the rules of the game applicable to an industry. He/she then takes a view of the risk of conditions in the industry (e.g. oil prices or refining margins changing) and based on his/her view of both the upside risk (conditions changing in his/her favour) and the downside risk (conditions deteriorating) he/she takes a decision on whether or not to invest.

If, however, the rules of the game can be changed after the fact by a regulator who decides that the investor has been too handsomely rewarded, the investor's risk profile changes significantly for the worse. This is even more true when a policy-maker seeks to reach back to tax not last year's profit, but profits derived through policies and rules applicable decades ago.

It is a fundamental tenet of tax law that a taxpayer is entitled to structure his/her affairs in order to minimise his tax liability within the bounds of the then existing law. Any retroactive taxation denies a taxpayer this opportunity, and exposes him/her to a potentially greater liability than would have been the case had he/she known which rules the tax collector intended to apply.

In conditions of such uncertainty, investors will be loath to accept any tax benefit or Government incentive to invest, or will price in the probability that policies may change retroactively. Either way,

investment decisions will be adversely affected, and any jurisdiction entertaining such interventions will be burdened with a higher risk premium. This will increase the risk-weighted cost of capital, which will lead to investors requiring higher returns before investing, which will reduce investment and lead to less entrepreneurial activity. An unintended consequence might well be the increase in cost of future Government incentives to industry.

This is particularly pertinent given the identification by Government of the Business Process Outsourcing and Tourism sectors as priority sectors in the Accelerated and Shared Growth Initiative[27].

4.3 Implied protection against "windfall losses"

The Discussion Document argues that certain industries already have implicit state protection against extreme downsides and that society should therefore also receive protection against extreme upsides[28]. In our view, the validity of the above argument hinges on the effective probability that Government will be called upon to actually make good on this implicit downside protection. We note that the argument does not propose protection against a slump in profits but protection against bankruptcy and the cessation of the provision of essential goods and services.

We believe that the actual probability of such an outcome is extremely low and that it therefore does not put any real burden on society. This is because firms in these industries are inherently robust and are therefore

[27] Background Document – Media Briefing by Deputy President Phumzile Mlambo Ngcuka 6 February 2006

[28] To some extent, this sentiment is contradicted by the Task Team's statement in Par 6.2.1, p72 of the Discussion Document: "All indications from the material available to us, are that Sasol's synthetic fuels operations as well as the Sasol Group have moved to maturity and are not longer in need of "incubator" assistance."

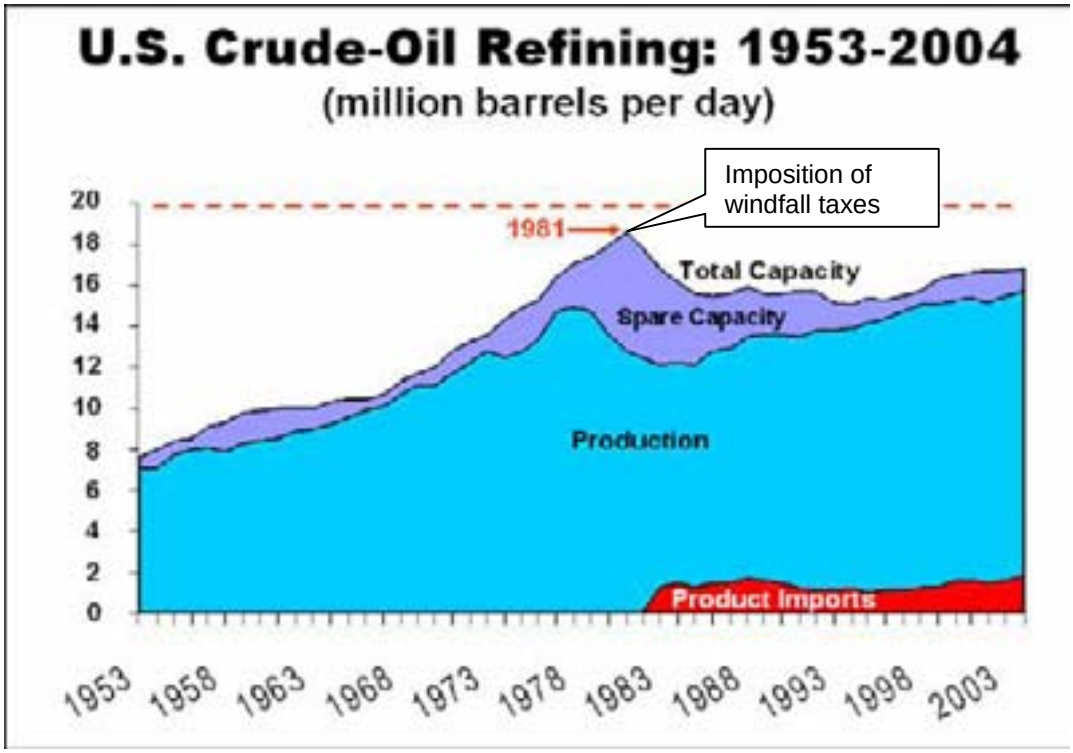
likely to withstand prolonged periods of adverse operating environments. Even if some of these firms are driven to bankruptcy the nature of these markets (being markets for essential goods) suggests that there will be no shortage of operators willing to take over the assets and operate them. So, even in the case of bankruptcy the probability of a cessation of provision of these essential goods and services may prove to be remote.

There are any number of industries that receive not only implied protection, but actual protection. It is unclear whether or not such industries might, at some point in the future, become candidates for windfall taxation.

4.4 Historical precedents

The Task Team's description of historical precedents is in our opinion complete and comprehensive. An important omission, however, from the consideration of these precedents, are the consequences on the companies and industries so taxed.

Any regulatory intervention in an economy creates incentives or disincentives for the participants in that economy. Windfall taxes are no exception. **When the Carter administration introduced windfall taxes on the US oil industry in 1980, investment in oil exploration and refining dropped precipitously in response**.

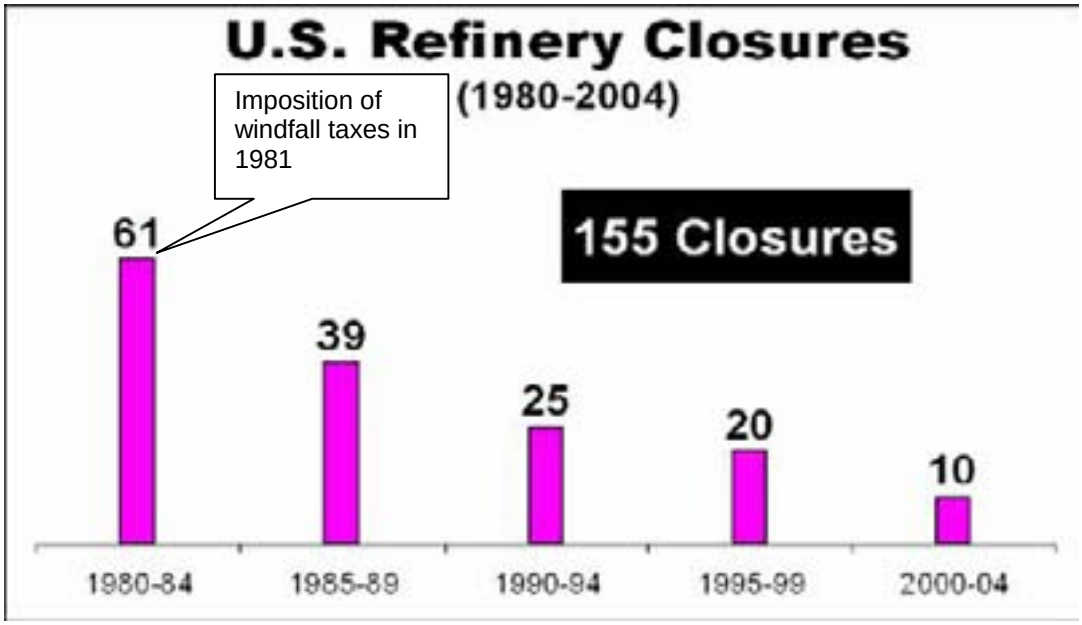


Source: US Institute of Energy Research, Dec. 2005

Graph 3: US crude-oil refining: 1953-2004

The Congressional Research Service estimates that the impact of the tax was an annual decline in domestic oil production of between 3% and 6%, which compromised US energy security. Oil imports rose 8-16%, resulting in a loss of 1,6 bn barrels of US production[29]. Refinery closures also accelerated. While some of these closures may have been attributable to life-cycles and optimisation, it is apparent that investors have not regarded US refinery investments as attractive at least in part due to the imposition of windfall taxes.

[29] US Chamber of Commerce, November 10, 2005



Source: US Institute of Energy Research, Dec. 2005

Graph 4: US refinery Closures 1980-2004

The problem is that short-term political expediency in the US has had long term consequences for the US refining and crude oil production industry. While the immediate impacts of the windfall tax were not obvious, the recent devastation wreaked by hurricanes Katrina and Rita exposed significant weaknesses in the US refining industry where, even after the windfall tax was repealed, refinery investment stagnated for two decades. Fuel shortages and a greater reliance on imported product have been the unintended consequence of windfall taxes.

It is therefore salutary to consider that after the impact of windfall taxes became apparent, two pieces of legislation have been passed by the US Congress that seek to incentivise investment in coal-to-liquids plants to the tune of $21/per barrel.[30]

[30] 1.) The Coal-to-Liquid Fuel Promotion Act of 2006 (currently awaiting final approval)
2.) The Energy Policy Act

As the Task Team points out, the UK has also imposed windfall taxes from time to time on the upstream oil industry. The phlegmatic reaction of a BP spokesman to the imposition of windfall taxes on crude oil extraction is telling: "Governments levy taxes and we will do what we have to. But any extra tax that we pay is money that is no longer available for investment in North Sea oil and gas fields."[31]

4.5 Conclusion

The above analysis indicates that the Task Team equating economic rent with above-normal profits is not consistent with current business practice. To survive business cycles, to provide for the unforeseen and, most importantly, reward the risk inherent in business, firms will and must pursue returns greater than the cost of their capital. If taxes disincentivise businesses from striving to exceed their cost of capital, initiative and enterprise would not be rewarded, and economic growth will suffer as a result. Economic rent as defined by the Task Team is not a bad thing; rather, it is what drives an efficiently functioning market economy.

The Task Team's emphasis of the role of regulatory foresight is concerning. If businesses have the risk of having all upside removed through retroactive regulatory intervention, the risk of their investment will increase, limiting the amount of projects that are pursued. This will not support economic growth.

The Task Team may wish to consider the unintended consequences of windfall taxes in greater detail, as the Sasol analysis demonstrates that they have had significant negative long term effects elsewhere in the world. When these precedents are considered, it will be appropriate to rely on

[31] BBC interview, 5 December 2005

more than one example to construct policy. The international trend has been to rely on the invisible hand of market forces to guide asset allocation and business behaviour, assisted by deregulation, rather than to use regulatory intervention to achieve greater efficiency and economic growth. We believe that this approach is also appropriate for South Africa.

5. History of the Liquid Fuels and Synthetic Fuels Industry in South Africa

5.1 Introduction

In view of the Task Team's definition of when an industry should be subject to windfall taxes, in particular the proposed retroactive assessment of potentially excessive regulatory benefits for tax purposes, the history of the liquid fuels industry assumes an important role in the Discussion Document. Given our comments on the Task Team's proposal for retroactive taxes, we are not in agreement that an historical analysis is pertinent to the consideration of a possible windfall tax. However, we consider it essential to address the historical analysis in order to place certain perceptions into context.

There are seven major areas of history that are dealt with in the Discussion Document. These are:

- The establishment of the synthetic fuel industry, with particular reference to Sasol;
- The payment of tariff protection, and matters pertaining thereto;
- Benefits accruing to Sasol;
- Payments of synfuels levies to crude oil refiners;
- The history of Natref and perceptions around it being advantaged relative to other refineries;
- Empowerment; and
- Impact on the consumer.

This section of our comments will deal with these different areas and will attempt to clarify some of the perceptions around these matters. The

Discussion Document also contains a number of historical inaccuracies that we wish to make the Task Team aware of for the sake of completeness. Where these do not have direct relevance to the windfall tax discussion, the correct facts will merely be noted for the sake of completeness.

5.2 The establishment of the synthetic fuel industry, with particular reference to Sasol

For a variety of reasons that are adequately aired in the Discussion Document, the Government of the day regarded it as desirable to establish a synthetic fuel industry in South Africa. The creation of an industry with Government support is not unprecedented; on the contrary, there are numerous international examples of Governments doing that. Steel, automotive, information technology, armaments, aerospace and other industries have been established internationally with Government assistance, which has ranged from Governments being the sole shareholder through to the creation of incentives or the designation of geographical areas that will be conducive to the establishment of industries that Governments deem desirable. In fact, as mentioned earlier in the report, **the majority of industries in South Africa (and in fact worldwide) have received some form of support over time, whether through tariff protection or by other means.** It is interesting to note that two major policy initiatives of the present Government, viz ASGISA and the draft National Industrial Policy, seek to use policy instruments to create new industries such as bio-fuels and call centres. The creation of special trade zones such as the Port of Coega is another example of Government facilitation of industrial development.

a) The establishment of Sasol One

In view of this background, and the fact that the Fischer-Tropsch process was, at the time, an immature and non-commercial technology, it is to be expected that the only entity willing to risk capital on unproven technology was Government itself.

It is correct that the capital and operating costs for Sasol One were such that this plant could not be considered to be economically justified at the time of its construction.

Government, as sole initial shareholder, would most likely have been tempted to use its regulatory powers to enhance the viability of its synfuels plant. However the "tradition of upliftment of indigenous fuels" [32] did not begin with SATMAR as they marketed their own production through SATMAR pumps. Sasol One's production could have been marketed through Blue Pumps on service station forecourts or by opening single brand service stations like the other oil companies were then just starting to do. There was never any obligation on other oil companies to purchase Sasol One's product[33] as they requested Sasol to sell the majority of the production to them[34] for the simple reason that they wished to limit competition in the retail market.

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The first Sasol Supply Agreement for Sasol One was not negotiated by Government but by Sasol Management[35]. This agreement was signed between Sasol and the individual oil companies in March

32 Par 1, p49 of the Discussion Document

33 As incorrectly stated in Par 1 , p49 of the Discussion Document

34 In a letter to Vacuum Oil Company dated 17 March 1952 it was acknowledged that the oil companies were prepared to distribute the hydrocarbon spirit produced at Sasol One.

35 As incorrectly suggested in par 5.6.3.ii, p 49 of the Discussion Document

1954. In terms of this agreement, the OOCs purchased their requirements in the Sasolburg vicinity (Vereeniging, Parys etc.) from Sasol One. As blue pump sales increased these purchases decreased. At stages Sasol had to purchase volumes from the OOCs to fully supply the Blue Pump sales.. Government intervention was therefore not required to ensure that the production of Sasol One was placed in the market. It is accordingly incorrect to state that the Government required the OOCs to purchase the full Sasol One production[36] from Sasol One's inception. This undertaking by the OOCs only originated when Natref was commissioned in 1970 in order to allow the OOCs to retain their exclusive marketing rights.

With reference to comments on page 49 of the Task Team's Discussion Document, it should be borne in mind that prior to the early 1950s all service stations were multi-branded, meaning that they had pumps from many or all of the oil companies on their forecourts. This included pumps of indigenous producers of which there were two at the time, SATMAR (fuel from Torbanite) and Union Spirit (alcohol from sugar cane).

The International Oil Companies wanted to open single brand service stations for a variety of reasons. Government was concerned about this development and the impact thereof on the position of the producers of indigenous fuels as becomes apparent from a letter to the OOCs dated 19 November 1951. Government eventually acceded to the request with the proviso that indigenous fuel producers would be allowed to have a pump on any single branded service station forecourt. When Sasol One commenced

[36] Par 5.6.3.ii, p 49 of the Discussion Document

with production in 1955 they started marketing by converting existing SATMAR pumps to “Blue Pumps”.

b) The establishment of Sasol Two and Three

In the mid 1960s, the South African Government wanted to establish a further synfuels plant. Sasol advised against this, as the economics were not favourable. Sasol also advised against the Mossel Bay plant because Sasol did not consider it economically justified at the time.

Contrary to the assertions made in the Discussion Document, the decision to build Sasol Two was not prompted by the mandatory crude oil sanctions but rather by the crude oil price shock in 1973 (when the oil price increased from $3/per barrel to $12/per barrel). This prompted a combined Government/Sasol investigation into the feasibility of additional synfuels capacity. The study concluded that it would indeed be viable in the light of the improved technology developed by Sasol since the start up of Sasol One and the high crude oil prices being foreseen for the future. There is no doubt that the decision to go ahead with Sasol Two carried substantial financial and technical risks that a privately owned company most probably would not have taken without some sort of government support. Government was prepared to provide such support in the form of tariff protection indicating the strategic importance they attached to greater self-sufficiency and foreign exchange savings.

In contrast to the decision to build Sasol One, the decision to build Sasol Two and Three, on the other hand, was made by taking both strategic intent and financial considerations into account. In

retrospect, all three plants have been proven to have been economically and financially justified.

The Discussion Document states that "both plants were heavily subsidised"[37]. This is not accurate. Sasol Two and Sasol Three were constructed using interest-bearing Government loans of some R4 924 million, the detail of which is reflected in Table 1. Government funded these loans through a fuel levy.

Table 1: GOVERNMENT INVESTMENT	**R-MILLION**
Sasol One *(original investment plus additional investment 1955-1979)*	215
Sasol Two	2 076
Sasol Three	2 633
Total investment by Government	**4 924**

Sasol paid for the acquisition of Sasol One, Sasol Two and Sasol Three in cash and through the issue of shares, and repaid the loans as listed in Table 2 below.

Table 2: RETURN RECEIVED BY GOVERNMENT *	**R-MILLION**
Cash received from selling Sasol One (in addition IDC received 112 500 000 shares in Sasol Limited – included shareholding below)	400
Dividends received from the 100% shareholding in Sasol One prior to the acquisition by Sasol in 1979 *(to June 1979)*	69

[37] Par 5.4, p 44 of Discussion Document

Net cash received from selling Sasol Two (in addition the IDC received 56 250 000 shares in Sasol Limited – included the shareholding below)	888
Net cash received from the repayment of the Sasol Two loans	1 492
Dividends received from the 50% shareholding in Sasol Two prior to the acquisition by Sasol in 1983	48
Interest received on Sasol Two loans from the date of acquisition by Sasol	726
Net cash received from selling Sasol Three	617
Net cash received from the repayment of the Sasol Three loans	2 243
Dividends received from 50% shareholding in Sasol Three prior to the acquisition by Sasol in 1990	310
Interest received/receivable on Sasol Three loans (prior to and after the acquisition of Sasol Three)	2 206
Value of 168,75 million Sasol Limited shares *(At June 1996 closing price of R47.00 per share[38])*	7 931
Total return received by Government[39]	**16 931**

[38] On the assumption that CEF kept all the Sasol shares received until the final payment on Sasol Three was made in 1995/1996, the shares at the end of June 1996 would have been worth R 47,00 each. The total value of the shares would have been R7 931 million. The Government would thus in total have received R16 931 million for an investment of R4 924 million.

The details provided above show that up to 1996 Government received R16 931 million for an investment of R 4 924,1 million in Sasol One, Sasol Two and Sasol Three.

Subsequent to 1996, the Government's shareholding through the PIC and the IDC (originally Konoil) varied between 156,8 million in 1996 to 156,5 million shares in 2006 with the lowest shareholding reaching 127 million in 2000. During this period, the Government received dividends on its shares of more than R4 283 million. The market value of its shares increased from R7 344 million in 1996 to R43 057 million in 2006.

If all these numbers are added, Government received an additional benefit from its shareholding in Sasol since 1996 of more than R39,996 billion or nearly R40 billion. These numbers, of course do not include any corporate and other taxes paid over the years by Sasol.

It is therefore clear that far from being an imposition on the fuel consumer, the loans advanced for the construction of Sasol Two and Sasol Three, as well as the subsequent privatisation, actually represented a handsome return on investment.

[39] The information included in Table 2 has been reconciled as far as possible to Sasol Limited annual reports. Where this information was not directly extracted from these annual reports it is based on documentation that to the best of our knowledge is accurate
Included in Table 2 above are the dividends earned on the shareholding of Government in Sasol One, Sasol Two and Sasol Three prior to the acquisitions by Sasol, the cash payments made by Sasol for the acquisitions of the Government's interest in the companies, loan and interest payments made by Sasol and the value of the Sasol Limited shares issued for the acquisition of Sasol One and Sasol Two

5.3 The payment of tariff protection, and matters pertaining thereto

The Discussion Document contains a number of references to the tariff protection[40] enjoyed by the synthetic fuel industry[41] in the past. As indicated[42], the nature of tariff protection extended to Sasol was of a quasi-contractual nature and resulted from extensive negotiations took place between Government and Sasol as to the terms of the dispensation.

The tariff protection enjoyed from 1979 ranged between 4,5 South African cents per litre and zero. For the period from 1979 to 1989 it amounted to an average protection level of 9% gross of the in bond landed cost ("IBLC") value of the fuel. At this time tariff protection was applicable to a large percentage of goods and products, not only in South Africa but worldwide.

The full net tariff protection enjoyed by Sasol from 1979 through 2000 according to Sasol records is as follows:

- Tariff protection enjoyed R 7 945 million

Minus

- Taxation paid on tariff protection R3 080 million
- dividends paid based on tariff protection R 325 million

[40] The terminology of tariff protection has been debated from time to time. Some have averred that tariff protection was in fact a subsidy. For the purpose of the present discussion, the distinction is not particularly relevant. Government has extended support to the synthetic fuel industry, which was recovered from the consumer. While the mechanism is different from the levying of tariffs on imports (for example on automobiles), the effect is the same in that the recipient of the support recovers a benefit from the consumer.
[41] To our knowledge there was no repayment mechanism that operated for tariff protection enjoyed by Sasol One.
[42] Par 5.7.2, p 55 of Discussion Document

- STC on enhanced dividends R 187 million

- **Net tariff protection enjoyed R 4 353 million**

This protection amounts to approximately 14% gross of the value of the fuel produced over the years and 8% after taxes and dividends. It is assumed that tax paid was used by Government for general revenue purposes and not returned to the motorist who originally funded the protection.

The synthetic volumes produced by Sasol from 1979 to 2000 amounted to 101,6 million m^3. The net tariff protection enjoyed therefore amounted to 4,3 cents per litre of synthetic production. **To put this into context, if this is spread over the full consumption of South Africa then the motorist contributed around 1,5 cents per litre to support the Sasol Synfuels activities. If Sasol had not produced synthetic fuels, on the other hand, the exchange rate would, in all probability, have deteriorated and motorists would most probably have had to foot a significantly larger bill than 1,5 cents per litre.** Apart from the general economic benefits such as this the tariff protection received by Sasol should also be seen against the background of the investment returns the State has received and still receives from its investments in Sasol, as alluded to in paragraph 5.1(b) above.

In view of the fact that the windfall tax definition applied by the Task Team is based on unforeseen benefits arising from past regulatory action, the matter of tariff protection and whether or not Sasol complied with its obligations in terms for the relevant dispensations is of some importance. It could, however, be argued that the consideration of a recovery of past tariff protection lies outside of the scope of the investigation as stated in the Terms of Reference:

> "This price support arrangement also provided for a recovery by the fiscus of a share of the windfall profits to the industry when high oil prices resulted in a high-administered fuel price. An agreement was

in place that an offsetting reimbursement to the fiscus would be paid when oil prices exceeded $28,50 per barrel, **but this fell away in 1995.** A revised subsidy regime that provided for a subsidy in the case of low oil prices **without the requirement of a payback** during times of high oil prices was in place until 1999, this revised regime was based on recommendations by the Arthur Andersen report."[43] (our emphasis).

However, the Discussion Document itself appears to take a different view of the matter. Essentially the Discussion Document appears to rely on two arguments, which will be dealt with in turn.

a) *Tariff protection since 1979 was to have been repaid*

The first argument is that in terms of the so-called Pim Goldby dispensation, Sasol was under an obligation to repay tariff protection from 1979 when oil prices exceeded $28.70 per barrel. In the words of the Discussion Document:

> "When prices rose above $28,70/per barrel Sasol was required to refund the Equalisation Fund 25% of its revenue **until the slate of cumulative benefit of protection received since 1979** was wiped clean. The slate was never wiped clean". [44] (our emphasis).

This version is, however, not substantiated by the facts. The relevant Cabinet decision in December 1989 (Pim Goldby mechanism) as conveyed to Sasol was that the payback mechanism would only operate until tariff protection enjoyed from

[43] Background, p 11 of Discussion Document
[44] Par 5.7.2, p 55 of Discussion Document

July 1989 had been repaid. The Cabinet decision to this effect was conveyed to Sasol in a letter from Dr DJ de Villiers (then Minister of Minerals and Energy Affairs) dated 14 December 1989. The statement on the repayment reads as follows:

> "Cabinet has decided that the domestic industry should provide for the repayment of the amount of protection paid from 1 July 1989 after a crude oil price of $ 28,70 per barrel has been reached according to a system of income sharing.
>
> "When crude oil prices exceed the level of $ 28,70 per barrel, the domestic industry shall:
>
> (i) turn over to the Equalisation Fund 25% of the additional gross income above $ 28,70 per barrel on domestic production, before tax; and
> (ii) continue with this payment to the Equalisation Fund until such time as the cumulative amount of protection has been recovered. No interest will be calculated."[45] (*Sasol's translation*)

The position in the Discussion Document[46] that repayment was to continue until the cumulative amount of tariff

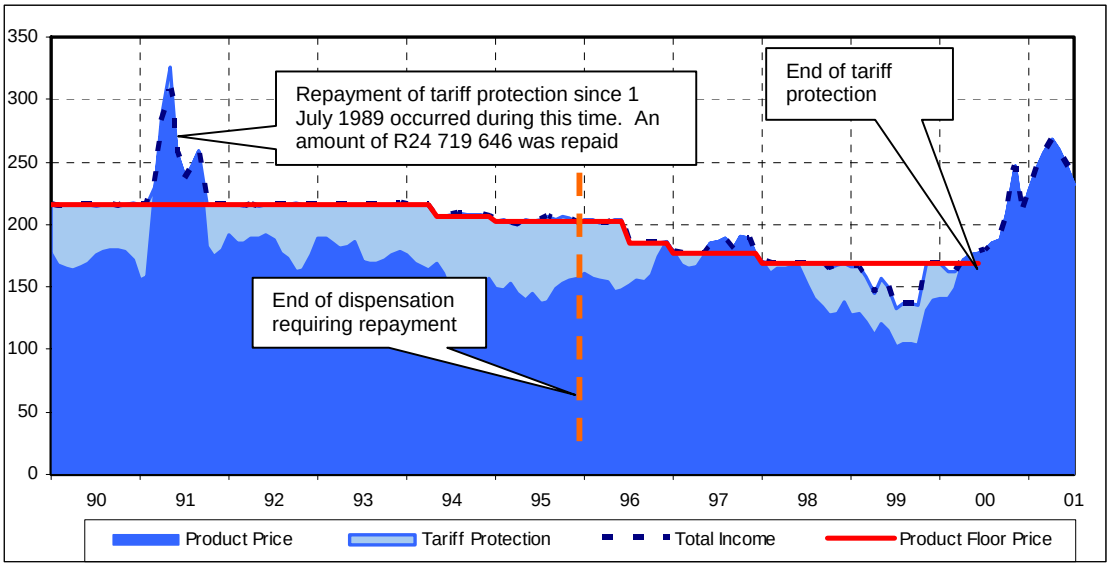
[45] The original reads as follows:

> "Die Kabinet het besluit dat die inheemse bedryf voorsiening moet maak vir terugbetaling van die beskermingsbedrag wat vanaf 1 Julie 1989 betaal is nadat 'n ru-olieprys van VSD 28.70 bereik is volgens 'n stelsel van inkomstedeling.
>
> By die bereiking van 'n ru-olieprys van VSD 28,70 per vat moet die inheemse bedryf:
> (i) 25 persent van die addisionele bruto onkomste bokant VSD 28.70 per vat op inheemse produksie, voor belasting, aan die Egalisasiefonds uitkeer; en
> (ii) met hierdie betaling aan die Egalisasiefonds volhou totdat die kumulatiewe beskermingsbedrag verhaal is. Geen rente sal in berekening gebring word nie."

[46] Par 5.7.2, p 55 of Discussion Document

protection since 1979 had been repaid is therefore incorrect. Sasol complied in full with all its obligations in terms of the rules applicable to each of the dispensations, as indicated in the graph below.

Graph 5: Sasol Synthetic Fuels: Product Price and Tariff Protection US $/m3



Source: Sasol

When the tariff protection dispensation (which required repayment) ended in 1995, the obligation to repay was not renewed. This is acknowledged by the Terms of Reference of the Task Team itself.

> "An agreement was in place that an offsetting reimbursement to the fiscus would be paid when oil prices exceeded $28,50 per barrel, **but this fell away in 1995.** A revised subsidy regime that provided for a subsidy in the case of low oil prices **without the requirement of a payback** during times of high oil prices was in place until

1999, this revised regime was based on recommendations by the Arthur Andersen report."[47] (our emphasis).

The Discussion Document's contention that Sasol still owes monies in terms of previous tariff protection dispensations is therefore inconsistent with the Terms of Reference, and also factually incorrect.

b) A "gentlemen's agreement" created an obligation to repay

The second argument that the Discussion Document relies on to substantiate the notion that Sasol has not complied with its obligations in terms of the various tariff protection dispensations, is a reference to an unwritten "gentlemen's agreement":

> "It is noteworthy that this[48] was achieved by means of a "gentleman's" agreement. When in 2003 Sasol believed that it no longer required tariff protection it refused to reintroduce such a "gentleman's agreement"[49].

After extensive consultation with various individuals (some now retired) who were party to negotiations with Government at the relevant times, Sasol has been unable to verify the existence of either a written or verbal so-called "gentlemen's agreement" with respect to the repayment of tariff protection above $28,70/per barrel. During discussions in 2003 regarding the reintroduction of tariff protection, no mention was made of the so-called "gentlemen's agreement".

[47] Background, p 11 of Discussion Document
[48] It is assumed that "this" refers to be a repayment mechanism.
[49] Par 5.7.2, p 55 of Discussion Document

There is no substantiation for the contention that there is or was an obligation on Sasol to repay the tariff protection extended to it, except insofar as this was indicated in Dr de Villiers' letter referred to above. This gives an important and very relevant indication of the mindset of the regulators at the time to the effect that the granting of tariff protection was done without an intention of repayment, as conceded in the Discussion Document itself:

> "Was it intended by Government/regulator that such repayments should at some stage balance the tariff protection given to synfuels manufacturers when oil prices were below the floor price? **It seems unlikely** because at the time of its introduction, oil price fluctuations over the life of the plant could not have been known."[50] (our emphasis).

In view of the discussion in Chapter 3 of the Discussion Document, which gives a substantial amount of weight to the mindset of the regulator that introduced regulations leading to subsequent economic rent, this is an important consideration that should be taken into account when considering the retroactive imposition of windfall taxes.

5.4 Benefits accruing to Sasol

The Discussion Document contains a number of statements that seek to infer that Sasol was the beneficiary of greater Government support than tariff protection only. These perceptions are not always substantiated by the facts. In the following section, Sasol will attempt to address the most pertinent perceptions.

[50] Par 7.4.3, p 82 of Discussion Document

a) A skewed allocation of resources

The facts do not support a conclusion that there was a "skewed allocation of resources"[51] to the detriment of the consumer. Sasol has contributed significantly over many years to the economy and has benefited consumers and Government through:

- Savings in foreign exchange;
- Job creation;
- Capital investment; and
- Taxation and dividends paid to Government.
- Provision of critical mass for industrial and academic research and development

Every previous investigation into the synthetic fuels industry has confirmed this and found that the industry deserved to be supported.

b) Transportation infrastructure created to assist Sasol

The view that the transportation infrastructure was inordinately developed to accommodate Sasol's requirements[52] is similarly not supported by the facts. Obviously the development of pipeline infrastructure took the location and production levels of the Sasol plants into consideration. However, it also took into consideration the markets and the requirements to pipe products from the coast to meet inland demand. We believe that it is a misconception to

[51] Par 5.8, p 60 of Discussion Document
[52] Par 5.7.3, p 57 of Discussion Document

suggest that the building of infrastructure connecting a manufacturing facility with the market would only assist the manufacturer - the benefits to the consumer and the economy as a whole will be wide-ranging. This applies to all infrastructure and all manufacturers and producers of raw materials.

Synthetic fuels produced inland have always enjoyed a locational advantage since their raw material inputs do not require transportation – which means that the end product does not have a transport element in its price. This logistical advantage is a function of the physical proximity of the synthetic fuel production facility to its market and is not an advantage 'given' to it by anybody. Otherwise one could argue that Nigerian crude oil enjoys a locational advantage over crude oil from the Middle East because it is closer to the major markets of Europe and the US. In economic terms, therefore, the principle of locational advantage is entirely conventional and in no way considered to give rise to unfair or unreasonable profits.[53] Similar locational advantages apply to manufacturers and producers of other products in respect of markets in close proximity to their production or manufacturing facilities.

Since Sasol had an obligation under the Sasol Supply Agreement to supply products to destinations elected by the OOCs at Sasol's cost, Sasol worked very closely with Petronet to schedule deliveries. It always was and still is essential that Sasol, as the major supplier of product in the largest market in the country and Petronet, the major provider of transport, work together closely to ensure an uninterrupted supply of product to the market. It would

[53] Prof JA du Pisanie, Department of Economics, UNISA

be unfortunate and incorrect if this were seen by some as a bias in favour of Sasol.

Rather than being advantaged by the pipeline network, Sasol was at times impeded from establishing its own pipeline network. For example, Natref wanted in the 1990s to build its own crude oil pipeline from Durban to Natref. The South African Transport Services ("SATS", formerly known as South African Railway and Harbours, or "SAR&H") refused Natref servitudes across railway lines, thereby effectively stymieing Natref's attempts at building its own pipeline. Another example was the pipeline that Sasol owned from Secunda to Sasolburg that could transfer components between the two factories. SATS prevented Sasol from using this line for such transfers on the basis that SATS had an exclusive right to construct and operate pipelines. The result was that SATS transported the components between Secunda and Sasolburg[54].

The benefit Synfuels and Natref gained from the use of the pipeline system to ship refined products or components from Secunda to Sasolburg, was not at the expense of either Transnet, the OOCs or the consumer. It resulted from operational astuteness on the part of Petronet and Sasol, and increased the recovery of products from crude oil thereby reducing the importation of crude oil. In that sense it benefited the consumer through a reduction in import requirements resulting in a strengthening of the rand.

Since 2004, with the termination of the Sasol Supply Agreement, the OOCs wanted to bring additional product from the coast via the pipeline system. This move, combined with market growth,

[54] Reference documents in this regard may be made available on request.

resulted in the pipeline between Sasolburg and Alrode becoming constrained. This constraint could be relieved by utilising the pipeline that was being used to transfer products from Secunda to Sasolburg. An immediate conversion of the pipeline to meeting the OOCs needs without reasonable notification would have prejudiced Sasol unfairly. Sasol accordingly resisted an immediate conversion of the pipeline without reasonable notice to meet the OOCs requirement until an alternative could be found. Close cooperation between Sasol and Petronet has since resolved this problem.

The MRG or so-called "Lilly" pipeline allowed Sasol to extend its marketing of methane rich gas (MRG) to the KwaZulu-Natal area. The OOCs have benefited from this in that they have been able to meet stringent air quality restrictions in the Durban area by replacing fuel oil with clean burning MRG. In its turn, Petronet and the taxpayer benefited by deriving revenue from an asset built with public funds that would otherwise have lain fallow.

c) Market Access Engineered by Government

The perception that Government engineered preferential access for Sasol to the market is incorrect. On the contrary, having granted the OOCs exclusivity in the retail market, Government had no other option but to ensure that Sasol's production was placed in a market to which Sasol was denied access.

It is furthermore of great importance to note that for decades the OOCs were never under any obligation to buy all of Sasol's synfuels. **There was a five-year notice of termination period in the upliftment agreement which none of the oil companies**

utilized to rid themselves of the alleged burden of forced upliftment of Sasol production. The fact that Sasol (and not any of the OOCs) terminated the agreement indicates that the burden of the respective obligations probably was more onerous on Sasol than on the other oil companies.

In 1971 the OOCs elected to purchase the additional volumes from the Sasol share of Natref at import parity prices under a commercial contract. This was tied to a marketing restriction that Sasol did not want, but that was of value to the OOCs to protect their lucrative marketing activities. Although it can be said that this agreement was brokered by the Government, it was a fair *quid pro quo*, given Government's desire to maintain an attractive environment that would retain international oil company investment in South Africa. As such it must indicate that the agreement was attractive enough to the OOCs that they - in the face of sanctions – elected to remain in the country.

The Natref agreement was extended to the synfuels volumes in 1979 in a fair negotiation between Sasol and the OOCs. The OOCs were not "again required"[55] to purchase all the Synfuels production. The OOCs once again, as was the case when the Natref Agreement was negotiated, did not want Sasol to enter into unrestricted retail marketing and hence agreed to purchase the Synfuels production in return for marketing restrictions on Sasol. In addition, this was a period when sanctions threatened the oil company crude oil supplies which did not make the upliftment of Synfuels production burdensome at all. Sasol would all along willingly have marketed its own production given the opportunity to

[55] Par 5.4, p 44 of Discussion Document

establish retail stations the way Trek and Total entered the retail arena.

5.5 Payment of Synfuels Levy to Crude Refiners

The Discussion Document deals with the synfuels levy which was paid to crude oil refiners in a fairly brief manner. This aspect is, however, of importance, since it demonstrates that Government intervention and payments were features of the entire liquid fuels industry, and not limited to the synthetic fuels industry only[56].

The OOCs requested a marketing margin increase from Government in 1984. In those days, the petroleum activities return (PAR) calculation included the refining margin. The OOCs quoted the decrease in the international refining margin, as well as their spare capacity due to synthetic volumes, as the reasons for their plight.

Pim Goldby was requested to study and report on the matter. The recommendation was ultimately made that, instead of a increasing the marketing margin (which would have only have benefited the marketers), a declining levy would be provided to all crude oil refiners, thereby effectively increasing the refining margin.

The general impression created in section 5.6.6 of the Discussion Document is that the synfuels levy was given to the oil companies as a *quid pro quo* for agreeing to purchase the output volumes of Sasol Two and Three, which is not accurate.

[56] Par 5.6.6, p 52 of Discussion Document

It is worthwhile to note that Sasol's Natref production was cut back to the same extent as that of the crude oil refineries of the OOCs. This was in fact an integral part of the Supply Agreement that was negotiated between Sasol and the OOCs at that time. The OOCs therefore entered into an agreement to purchase Sasol Two and Three productions without any condition for compensation for lost refining margin. The introduction of the synthetic levy or 'synlevy' only took place in 1984, four years after Sasol Two commenced production.

5.6 The history of Natref and perceptions around it being advantaged relative to other refineries

The Discussion Document creates the impression that particular advantages were granted to Natref and its shareholders because of the fact that Sasol was a shareholder. This is an incorrect impression, as substantiated by the following analysis. It would be incorrect and inappropriate to bring Natref (and both its shareholders) into the ambit of windfall taxes because of alleged special treatment owing to its association with Sasol.

a) Incentives averred to have been received by Natref

The Task Team states that the Government enticed the shareholders of Natref[57] to construct an inland refinery, with a

[57] Sasol and Total SA purchased the NIOC shares in early 1989 after prolonged negotiations over many years. The Sasol payment for its additional shareholding was:

• Arrear dividends	$ 0,75 million
• Purchase price for shares	$ 1,10 million
• Compensation for use of NIOC's processing rights	$ 5,65 million
Total amount	**$ 7,5 million**

"range of incentives"[58] to locate the refinery inland instead of at the coast. Owing to the very real disadvantages of an inland location, Government agreed to put Natref in the same position as if it had been constructed at the coast and the product transported inland. The so-called incentives therefore did not make the investment decision any more attractive, but merely served to level the playing field with the coastal refineries[59]. SA coastal refineries have the inherent advantage of being located on top of the retail market, next to a crude offloading facility and the marine market for its bunker fuels that meant that the refineries require less capital investment and had lower operating costs. Also, the advantage of being at sea level means that no additional research or expense was required to operate the refinery at optimum conditions, contrary to an inland refinery situated at a substantial altitude. Government therefore put Natref in the same position as the coastal refineries except for the fact that Natref did not have the marine bunker oil market for the disposal of its fuel oil. This forced the Natref owners to invest additional capital in Natref on plant and equipment that was designed to convert most of the residual oil stream into white products. Natref currently operates at a white product yield of 91% as a result of significant investments to increase yield, including R800 million as late as 2001 and transfer of external energy to increase total yield.

The technology used was not fully commercialised at that stage and Natref's owners were exposed to additional risks that the coastal refiners did not face.

The effective date of the purchase was 28 February 1989.

Sasol was the majority shareholder in Natref at all times.

[58] Par 5.3, p 42 of Discussion Document
[59] Sasol's comments on the history on the pipeline tariffs are provided later on in this document.

In later years this additional investment and the subsequent development and perfecting of the conversion technology proved to be profitable. The high white product yields achieved by Natref contributed significantly to its profitability resulted from taking steps to overcome the disadvantages associated with the inland location of the refinery. The conversion technology, however, continues to face risks that the coastal refineries do not have to contend with.

Natref did not receive financial assistance from the South African Government. The refinery was built with shareholder capital and foreign external loans that were fully repaid. All these loans were granted at commercial interest rates and were repaid fully by the Natref shareholders[60]. The contention in the Discussion Document that "this was financed by Sasol through Government and the IDC"[61] is therefore incorrect.

b) Locational advantage enjoyed by Natref

It would be appropriate for the Task Team to approach Transnet for their inputs on this section of the Discussion Document[62]. We have provided inputs below insofar as we have information available to us.

At the time that it was decided to build an inland refinery the South African Railways and Harbours (SAR&H) considered themselves to have the sole right to build pipelines in South Africa; the reason obviously being the fact that pipelines would impact on rail

[60] Documentary proof to this effect may be made available on request
[61] Par 5.7.5.1, p 58 of Discussion Document
[62] Par 5.7.5, p 58 of Discussion Document

transport. Since it was agreed that the SAR&H would construct, own and operate the crude oil pipeline, Natref's lifeline to the coast, the Government gave Total South Africa an undertaking that Natref would (transport-wise) not be worse off than a coastal refinery. SAR&H were adamant that they should receive the same income as if the white products were refined in Durban and transported by rail to inland destinations. This resulted in a mechanism whereby the SAR&H reconciled the Natref crude oil receipts and product despatches on a regular basis and adjusted the crude oil tariffs to ensure that they receive an income equal to what they would have received if the Natref products were railed from the coast. During this period (until 1981) Natref paid for crude oil transportation according to a tariff that was recalculated every six month.

In 1981 the South African Transport Services (SATS) (previously SAR&H) for administrative reasons changed the way in which they ensured that they received the full income that they would have received if the product was refined at the coast. They decided not to levy a crude oil tariff but to invoice Natref for all products despatched by rail or pipeline as if it had originated in Durban. In other words when Natref despatched product to Pretoria they were invoiced the rail tariff from Durban to Pretoria. This tariff mechanism applied from 1981 until 1987.

Both the above tariff mechanisms applied by SAR&H and later SATS resulted in Natref gaining no advantage over a Durban refinery. Natref was therefore "railage neutral" and enjoyed no "locational advantage".

In 1983 SATS introduced a penalty on Natref if product was backhauled to destinations closer than 708 kilometres from Durban.

This impacted negatively on Natref's margin to such an extent that Natref considered reducing throughput to eliminate the backhaul volumes.

In 1987, when SATS started charging different tariffs for pipeline and rail transport, they reneged on the Government undertaking that Natref would not be at a disadvantage relative to a coastal refinery. The Natref partners now had no recourse or guarantee and were at the mercy of SATS, which controlled their sole source of supply.

In 1991 SATS announced a larger percentage pipeline tariff increase for crude oil than for white products. This disproportionate increase in the cost of crude oil transport compared to that of product had a serious negative impact on the Natref margin. It was an untenable situation for the Natref shareholders Total SA and Sasol and resulted in urgent negotiations with Petronet, the pipeline division of SATS. These negotiations culminated in an undertaking that SATS would not increase crude oil pipeline tariffs by a larger percentage than product pipeline tariff increases. Agreement was reached on a formula to be applied during future increases. [63]

As the market demand grew, less product had to be backhauled to destinations closer to the coast. As a result, for the first time Natref started to develop a transport advantage because the transport component in the income from white products exceeded the associated cost of pumping the crude oil required to manufacture these products.

[63] The following documents are attached:

- Letter from Eric Crowley of Petronet dated October 1991 re tariff increases.
- Letter from Sasol and Total SA accepting the Petronet proposal.

In summary:

- Natref had no transport advantage over the coastal refineries until 1987;
- In 1987 SATS reneged on the Government undertaking that Natref would not be worse off than a coastal refinery;
- This resulted in the Natref's partners having to negotiate with SATS for a system that would protect Natref from a transportation penalty;
- This arms length negotiation resulted in Natref concluding a favourable tariff agreement. As the market expanded, this agreement resulted in Natref obtaining a locational advantage and this has resulted in the perception that Natref had been unfairly advantaged in transportation. Unfortunately this created the perception that Natref had from its inception been unfairly advantaged in transportation. This is clearly not the case and no credit is given for the fact that the so-called "locational advantage" that developed in later years resulted from an arms length negotiation with the institution controlling and threatening the lifeline of the refinery.

  The contention in the Discussion Document that Natref did not pay for crude oil transportation for a period of "17 years"[64] is therefore incorrect.

c) Upliftment of Natref production on the same terms as synthetic fuels

[64] Par 5.7.5.1, p 58 of Discussion Document

The undertaking by the OOCs to uplift the production from Natref was the result of negotiations between Sasol, Total South Africa and the OOCs, which were facilitated by the South African Government.

During the negotiations, Sasol and the National Iranian Oil Company (NIOC) requested the right to market their respective shares of Natref's production[65]. The other oil companies resisted this suggestion, as this would have exposed their lucrative marketing profits to competition. Government was careful not to make South Africa an unattractive market for the international oil companies and suggested that a compromise be sought. An agreement that later became known as the Sasol Supply Agreement was eventually reached between Sasol and the OOCs. This agreement restricted Sasol and the NIOC from marketing their product. In return, the OOCs undertook to lift the balance of the production at in bond landed cost (IBLC) prices. [66]

The impression is created in the Discussion Document that Sasol's Natref production was given the same status by the South African Government as that of indigenous synfuels as far as preferential upliftment is concerned. [67] As demonstrated above, this is not correct. Rather, Sasol's and NIOC's marketing rights were constrained in return for having their production share uplifted by the OOCs.

It is correct that crude oil throughput was cut back due to the increased synfuel production, and crude oil refiners were indeed

[65] The other shareholder of Natref, Total SA, of course already had fuel marketing rights and infrastructure.
[66] Relevant documentation in support hereof can be made available on request
[67] Par 5.6.3 (ii), p 48 of Discussion Document

put in the position of "swing producers". [68] Natref was put in exactly the same position as other crude oil refiners. Therefore it is not true to say that Sasol enjoyed the "luxury of being able to sell every litre" it could produce. What is however true is that Sasol's synthetic fuel production was preferentially placed in the market as mutually agreed in terms of the Agreement between Sasol and the OOCs. To call this a "servile relationship" [69] is in our view a biased and one-sided way of looking at it

Like other refineries, Natref also experienced problems in later years to return its capacity to full load. The inference that Natref was treated differently from other crude oil refineries because of the fact that Sasol was a shareholder[70] is therefore incorrect.

d) Indirect advantages to Natref

The Discussion Document enumerates a considerable list of indirect advantages that Natref is said to have enjoyed, creating the impression that these benefits were extended because Sasol was a shareholder[71]. It is important that these incorrect impressions be rectified:

- Natref crude is stored at two different crude oil tank farms in Durban. In the one instance Sasol owns the tanks and the land, and in the other instance Natref owns the tanks and pays a market-related rental to Portnet for the land. Historically, Natref was treated equally with the OOCs for the

[68] Par 5.6.3 (ii), p 49 of Discussion Document
[69]
[70] Par 5.6.3 (ii), p 48 of Discussion Document
[71] Par 5.7.5.2, p 59 of Discussion Document

storage of the crude oil in the Strategic Fuel Fund ("SFF") crude oil tanks

- Natref was treated equally with the OOCs (excluding Shell and Total who imported their own crude oil) for the bulk shipping benefits with SFF cargoes. If Natref enjoyed the bulk shipping benefits of bulk shipping and procurement with SFF cargoes, presumably so did all the other oil companies that, as the Task Team points out, procured their crude oil through the SFF[72].
- Some of the so-called benefits were a consequence of the strategic plans of the Government of the day, for example the routing and sizing of pipelines. Considering these matters as relevant to a retroactive windfall tax seems to be inappropriate.
- The Jet Fuel pipeline from Natref to Johannesburg Airport gave Natref no indirect benefit because:
    - Natref paid fully for the transportation service in accordance with SATS tariffs.
    - All parties agreed that 20% of the Johannesburg Airport demand would be imported from the Durban refineries by rail to ensure that an alternative logistic chain was maintained for emergency situations.
    - It was only early in 2004 that the OOCs wanted to bring their jet fuel via Natref to Johannesburg Airport.
- The repurchase of strategic crude oil stocks by Natref took place as there was no logical alternative. Apart from the fact that the oil was heavily degraded and contaminated, it was not Natref's decision to dispose of these stocks at an supposedly favourable price, but the decision of the regulator of the day. The crude oil purchased from the

[72] Par 5.3, page 43 of Discussion Document

Central Energy Fund ("CEF") mines was sold to Sasol on an arms length basis. Allowance was made for the quality of the remaining oil and an allowance was made for the inland location of the oil. The CEF at certain stages wanted to sell more of the oil and offered an incentive for the additional oil. The co-operation between the CEF and Sasol to consume the remaining oil in the mines was aimed at ensuring a fair deal for both the Government and Sasol. It also needs to be said that large quantities of CEF crude oil ex Milnerton tanks was also sold to OOCs on terms that we assume was beneficial to both parties. But again, incorporating these matters into a discussion on windfall taxes seems to be inappropriate.

- Sasol owned a pipeline from Secunda to Sasolburg that could transfer components between the two factories. SATS prevented Sasol from using this line for the transfer of components on the basis that SATS had an exclusive right to construct and operate pipelines. The result was that SATS transported the components between Secunda and Sasolburg. Background material in this regard will be provided if required.

5.7 Empowerment

Regarding black economic empowerment, we would like to point out that **Sasol was the first company in the oil industry to undertake an empowerment deal** with the formation of Exel early in 1997. Following a change in the approach to BEE as required by the Charter, Sasol unwound the Exel initiative and proceeded to implement a R1,45 billion

BEE transaction with Tswarisano that is substantially compliant with the requirements of the Charter.

5.8 Impact on the Consumer

Sasol is aware that the consumer who has had to bear the brunt of higher fuel prices. As demonstrated above, however, the imposition of a redistributive mechanism to return money from Sasol to the consumer will have a very minor effect on reducing the price at the pump. We sincerely believe that the imposition of windfall taxes will over time not be beneficial to the country or the economy, and will serve to increase South Africa's dependence on imported fuel.

The cost of tariff protection to the synthetic fuels industry was indeed recovered from consumers. However, in exchange, the country benefited from a stronger trade balance and a stronger exchange rate. The economy was relieved of the burden of having to import large volumes of crude oil with all of its associated benefits.

Consumers have also borne the cost of providing the OOCs with a lucrative refining and marketing environment for more than 70 years.

The statement on IBLC pricing is made under the heading of "Government Support for Synthetic Fuels Manufacture [73]" but the maintenance of import parity pricing benefited the entire industry, including the OOCs, as is quite rightly mentioned.

[73] Par 5.7, p 53 of Discussion Document

5.9 Historical inaccuracies

There are a number of historical inaccuracies in the Discussion Document, some of which are addressed, for the sake of completeness, in the following analysis.

- The Retail Price Maintenance (RPM) did not intend to "equalise prices". RPM ensured that rural prices were not above the import parity (delivered cost at that location) level.[74]

- The decision to establish a synthetic fuels manufacturing plant was taken by Government in 1947 and legislation was introduced by Mr Waterson, the then Minister of Trade and Industry, to facilitate this. Anglovaal had originally supposed to have been the lead investor but decided not to go ahead due to the high technical and financial risk involved. Sasol, then wholly owned by the South African Government, was established in 1950 and took over the project from Anglovaal.

- The technology used at Sasol One was both German and American.[75]

- The OOCs were not compelled to purchase their crude oil through the Strategic Fuel Fund (SFF). This was done by choice, since the parent companies of the OOCs could not or would not supply them with crude oil.[76]

[74] Par 5.1, p 41 of Discussion Document
[75] Par 5.4, p 44 of Discussion Document
[76] Par 5.3, p43 of Discussion Document

- The payback arrangement above $28,70/per barrel was not contained in the Pim Goldby report. The payback mechanism was added to the Pim Goldby recommendations by Cabinet.[77]

- Tariff protection applied to the synfuels industry until 2000 and not only until 1995.[78]

- It is our understanding that as a result of the social unrest referred to in the Discussion Document, the oil industry agreed to a lowering of petrol prices. As a result, the synfuels tariff protection level was reduced to $21,40 per barrel. An unintended consequence was that a condition of the loan agreement between CEF and Sasol Three became effective. This condition stated that in the event of a decrease the tariff protection level below $23,00 per barrel, a reduction in the interest rate would become effective. The statement that CEF had to "forgive" Sasol some debt is not correct. [79]

- The Arthur Andersen report did not contain a "claw back" mechanism. There was to our knowledge no trade off between declining floor prices and the "claw back" mechanism. What did occur was that Government gave an undertaking that the transport component of the product pricing would not reduce as assumed by Arthur Andersen and therefore the floor price levels were further reduced from the Arthur Andersen proposal. The Cabinet decision was conveyed to Sasol in a letter dated 15 December 1995 from GPN Venter to P du P Kruger.[80]

- The PAR, and later the MPAR (Marketing-of-Petroleum Activities Return) mechanism, did not and does not guarantee a return on

[77] Par 2, p 11 of Discussion Document
[78] Par 2, p 11 of Discussion Document
[79] Par 5..6.8, p 52 of Discussion Document; Par 5.7.1.2, p 54 of Discussion Document
[80] Par 5.7.2, p 56-57 of Discussion Document; Par 8.1, p 87 of Discussion Document

assets. It was more in the nature of a profit monitoring mechanism that resulted in a Government review of margins outside the range of 10 - 20% return on assets. It should also be noted that the transfer price in the MPAR calculation, set at IBLC, did not guarantee a refining margin, but exposed small South African refineries to the margin trends of large international refineries.[81]

- The Retail Rationalisation Plan (RATPLAN) was established at about the same time that the OOCs requested Government to open single branded service stations. The RATPLAN was used to assist Total and Trek, but at the same time Sasol did not receive any service station quotas. This effectively meant that the RATPLAN was also used to keep Sasol out of the retail market.[82]

[81] Par 7.4.10, p 84 of Discussion Document; Par 7.4.9, p 83 of Discussion Document; Par 5.8.4, p 62 of Discussion Document
[82] Par 5.6.3, p 48 of Discussion Document; Par 5.6.9 p 53; Par 5.6.1, p 46 of Discussion Document; Par 5.1, p41 of Discussion Document; Par 5.3, p 43 of Discussion Document

6. The Liquid Fuels Industry and the Economy

6.1 Introduction

The Discussion Document correctly recognises the importance of the liquid fuels industry in the achievement of economic growth[83]. The Task Team also prudently acknowledges that "movements in the fuel price … are very emotive to the end user". These very considerations impose a duty of care on all participants in the present investigation to exercise regulatory intervention with due and proper consideration of all the facts and all possible consequences, both intended and unintended.

We support the Task Team's sentiments[84] that it is impractical to ring-fence synfuels production when analysing profitability and that it would be more relevant to look at the entire Sasol Group of companies.

Synthetic fuels and alternative fuels can be defined as hydrocarbon fuels from non-conventional sources, namely non-crude oil feedstocks. They are a sub-sector of liquid fuels.

The comparability of Sasol's synfuels value chain with other oil companies is complicated due to:

- The uniqueness of its production process: Sasol produces alternative fuels and is not comparable to international oil majors like Shell, BP, Chevron and Total
- The availability of information on local and international oil companies: Information is only readily available in respect of the group results of

[83] Par 6, p 64 of Discussion Document
[84] Par 6.1 (c), p 68 of the Discussion Document

the integrated oil companies. In an attempt to compare like with like one would have to compare the Sasol synfuels business with the upstream portion of the super major parent companies of the local oil companies. This data is not readily available.

While the Task Team's analysis is thorough and fact-based, a number of important considerations justify further scrutiny. We wish to reflect on these considerations in the following sections.

6.2 The impact of exchange rates on Sasol's cost of production

Figure 2 refers to the "cushioning effect the weakening rand had on the falling crude oil prices in 2000 – 2001"[85]. This reference is particularly apposite, but does not take into account the very detrimental effects that the weakening currency had on inflation rates, and therefore on the cost bases of rand-based producers such as Sasol. The Discussion Document quotes[86] a BJM Report that Sasol Synfuels Division in 2002 stated that "SSF commented that its cash cost is currently less than $10 per barrel of crude equivalent. Its objective is to attain $7 per barrel over the next five years".

At the time that the above statements were made, the rand/dollar exchange rate was materially weaker compared to current levels (in 2002 it fluctuated between R10 to R11 to the dollar). Furthermore, the economic consensus forecast during that time was for a further declining rand. The cost base of Synfuels is predominantly in rand. In a scenario with weak rand dollar exchange rates the dollar price per barrel will, therefore, be

[85] Par 6, p 64 of Discussion Document
[86] Par 6.2.1, p 71 of Discussion Document

very low, and assuming a depreciating currency will result in ever-diminishing dollar-based cash costs.

As we know in hindsight the rand did not weaken as generally expected, but proceeded to strengthen substantially against the dollar since 2001/2. The Discussion Document's analysis of Sasol's cash costs do not take account of this highly relevant factor, which, if it were not for oil prices increasing at the same time, would have had a very significant negative impact on Sasol's earnings.

The cash costs quoted by the Task Team have therefore changed significantly since the BJM report was written. While Sasol is not prepared, for commercial reasons, to share information on its cash costs in a public forum, we can indicate that present cash costs are more than 100% higher than the numbers quoted in the Discussion Document.

6.3 Additional costs

It should also be remembered that the above are **cash** costs only. If provision is made for reinvestment and maintenance, the cost base increases by another $3 - $4 per barrel. These costs are further escalated by the need to invest additional capital for new fuel specifications.

Furthermore, in order to manufacture product, the synthetic crude needs to be refined. The cash refining cost adds another $3,50 - $4,50 per barrel to the production cost, while non-cash costs add another $2 - $3 per barrel. The total margin on synthetic fuels after taking the cash and non-cash costs of manufacturing the products therefore is far more modest than assumed in the Discussion Document. This return is further

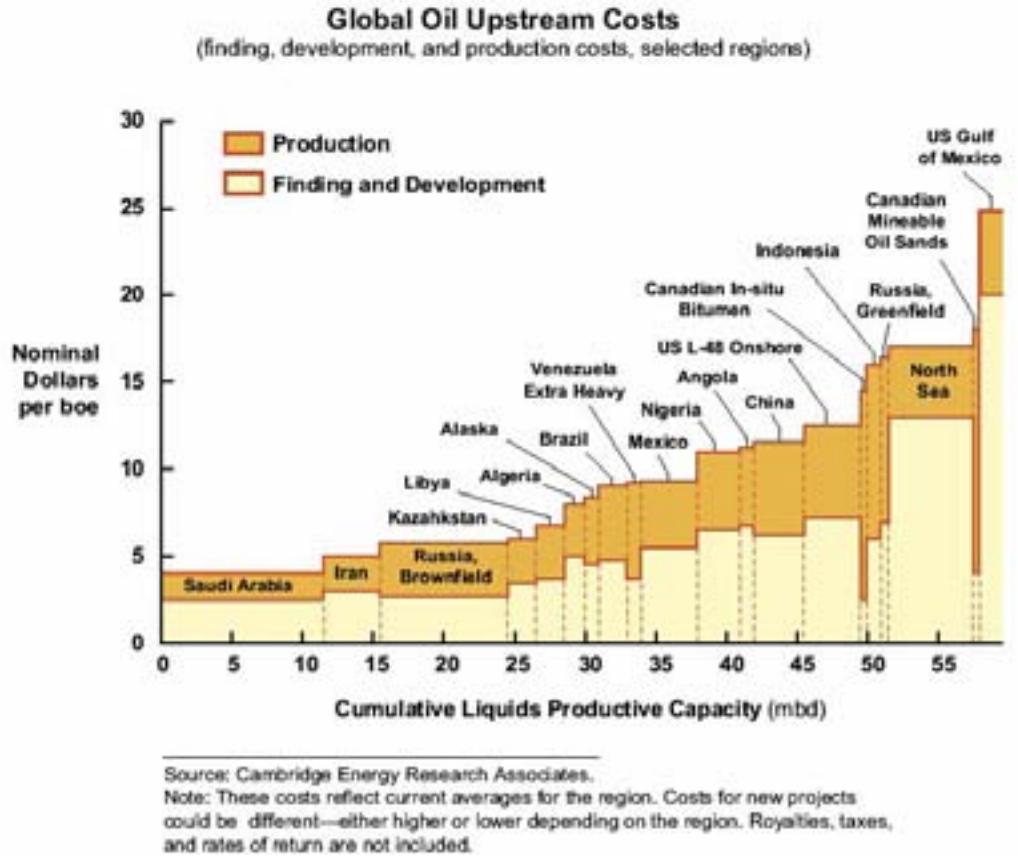
diminished when the rate of return is calculated on revalued assets, instead of on book value[87].

6.4 Comparisons with other jurisdictions and the crude oil industry

Figure 4[88] becomes pertinent when considering the questions raised in par 7.4.2 of the Discussion Document, as it demonstrates that the South African fuel price, excluding tax, is very similar compared to that of other jurisdictions. Sasol submits the same comparison in its comments on paragraph 7.4.2 of the Discussion Document.

The Task Team is quite accurate when it states that "(t)he international upstream operations of the OOCs reap direct and significant benefits from high crude oil and gas prices."[89] The costs that oil companies incur for extracting oil and gas are a fraction of the market prices. According to estimates from Cambridge Energy Research Associates[90], the finding and development cost for crude oil ranges between $2,50 – $20,00 per barrel, depending on the jurisdiction. Cash cost to extract the oil is estimated at some $3,00 – $6,00 per barrel, while transportation cost to a refinery will vary according to the destination, but will typically add some $1,50 - $3,00 per barrel.

[87] To use revalued assets is conceptually the right approach.
[88] Par 6, p 65 of Discussion Document
[89] Par 6, p 66 of Discussion Document
[90] See Graph 3 below

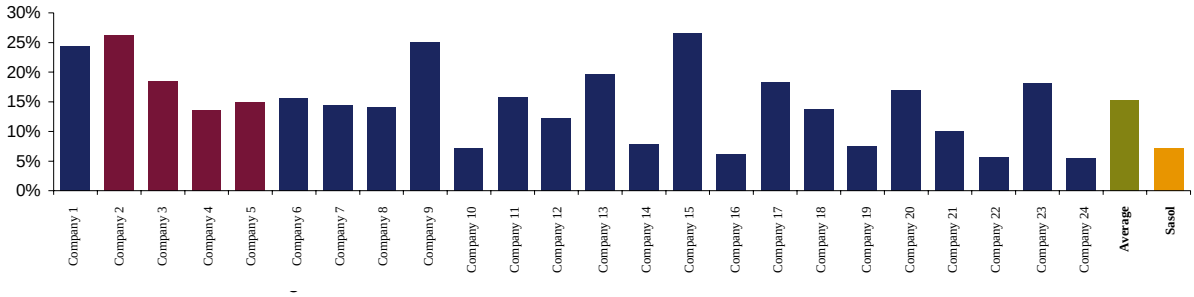


Graph 6: Global Oil Upstream Costs (finding, development and production costs, selected regions)

While it is true that Natref enjoys above-average margins[91], the Discussion Document fails to mention that the Natref shareholders invested very substantially in order to achieve such margins. It is clear, however, that integrated crude oil companies (such as the majority of the OOCs) are making very significant profits in the current crude oil price environment as illustrated in the graph below.

[91] Par 6, p 66 of Discussion Document

Graph 7: Net economic returns after cost of capital – other oil companies



Source: PwC analysis

Integrated oil companies therefore make significantly higher returns than Sasol across their value chains. We cannot comment on the returns proffered by the OOCs to calculate the SAPIA returns, as OOC financial statements are not publicly available. It must, however, be pointed out that the comparison between Sasol and the OOCs cannot be directly made, as the influence of tax is not reflected. It is also not clear to what extent management fees, head office charges and transfer prices may influence the OOC returns.

The approach of the Task Team to this issue is, however, not clear. The Task Team excludes these very significant profits from its purview because of the fact that South Africa is not endowed with crude oil reserves[92]. Instead, it focuses on a domestic industry which makes lesser profits than its competitors in the same business, and which beneficiates a low-grade domestic resource.

[92] Par 6, p 66 of Discussion Document

If Government proceeds to impose windfall taxes on Sasol, it will fundamentally alter the competitive landscape in the liquid fuels industry by allowing the OOCs to capture so-called windfall profits offshore, while penalising the single largest investor in South Africa for being less profitable than its multinational competitors. As Professor Katz states: "will it (the new tax) be applicable to all taxpayer or limited to a specific taxpayer. If the latter is the case will it be constitutionally valid?"[93]

6.5 Contribution of the Synthetic Fuels Industry to the South African Economy - Additional Information

The discussion document highlights a number of important points. Our views in general correspond with these. We nevertheless would like to make a few important additions. The SA synthetic fuel industry has two major players, Sasol and PetroSA. For the purpose of this report we will only be referring to Sasol's contributions.

Sasol consists of various business units, ranging from mining to chemicals and liquid fuels. The synthetic fuel industry is represented by business activities in the following Sasol business units:

- Mining
- Synfuels
- Liquid Fuels Business

The contribution of the synthetic fuels industry to the South African economy is material, covers various aspects and spans over a number of years. The following are the most important contributions:

[93] Prof M Katz, 2006 p 4 par 14.4

a) Security of local energy supplies

Sasol's synfuels value chain consists of a highly integrated production process that includes:

- exploration, mining and extraction of coal or, as a supplementary feedstock, natural gas from Mozambique;
- followed by gasification and reformulation by means of the Fischer-Tropsch process;
- then followed by product work-up and further beneficiation and extraction of various fuel and chemical streams;
- up to the production of a synthetic crude oil;
- which is then refined in a syncrude refinery to produce fuel components
- fuel components are finally blended by the LFB business to saleable fuel products, and sold mainly to OOCs

This synfuels value chain produces:

- approximately 23% of South-Africa's transportation fuels (6 million cubic metres per annum)
- and various chemical streams (4 million cubic metres per annum)
- the environmental drive towards cleaner fuels will result in molecules being transferred from the fuel pool to chemicals in the near future (approximately 0.8 million cubic metres per annum)

Synfuels is planning significant natural gas and coal based investments[94] to expand its capacity by up to 20% over the next 10 years[95]. The expected increase in volumes produced by 2010 would be an additional 9 000 per barrel/day of which 8 000 per barrel/day would be destined for the petrol and middle distillate markets. It should be noted that not one multinational oil company has, as yet, indicated any investment to increase its refining capacity in South Africa.

Further expansions include installing technology to convert the fine coal, currently used to generate electricity, into fuels and petrochemical products. This will enable Sasol Mining to mine more optimally and, as a result, extend the life of the coal reserves around Secunda.

The expansion of refining capacity is especially important considering that South Africa is on the verge of becoming short of refining capacity. This will result in South Africa becoming increasingly dependent on direct fuel imports to meet its transport energy demands[96]. Indications are that South Africa would need to import at least 400 000 m^3 of fuel in 2007, growing to 2.7 million m^3 of fuel in 2014 which, at current prices and exchange rates, will negatively impact the balance of payments by R9,4 billion per annum.

[94] Reference: www.sasol .com Investor Insight, July 2006
[95] A copy of the July edition of the Investor's Insight newsletter is available on the Sasol website as a download
[96] Refer to Graph 1 in Section 3.

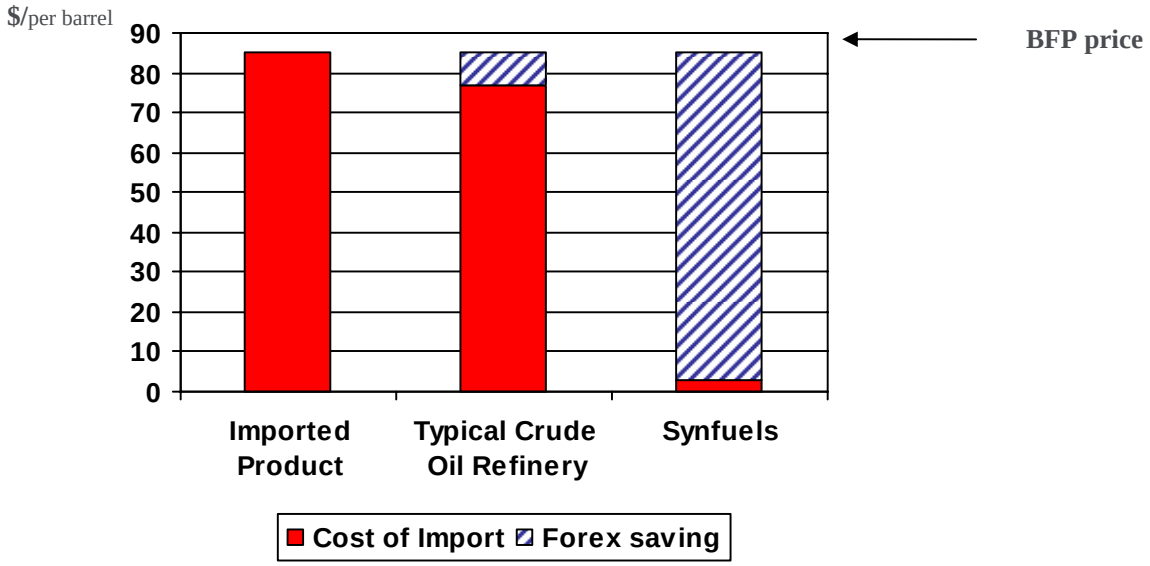
b) Savings in foreign exchange generated from import replacements and exports

In the current economic environment, with oil prices in excess of $60 per barrel, the above products produced by Sasol in South Africa contribute positively to the country's balance of payments by:

- import replacements of petrol and diesel (R18 billion per annum)
- exports of chemicals (R9 billion per annum)

Graph 8 indicates the relative impact on foreign exchange savings of product imports, locally refined crude and synthetic fuel.

Graph 8: Comparison of Imported Product, Crude and Synfuels on Foreign Exchange



Source: Sasol

c) Job creation

Sasol is one of the largest employers in South Africa, employing 26 000 direct employees and creating approximately 140 000 indirect jobs.

The synfuels value chain is by far the largest contributor towards local job creation in the Sasol group. The table below highlights the number of direct employees per business unit:

Business Unit	**Direct employees**
Mining	7 100
Synfuels	6 100
Liquid Fuels Business and Gas	1 800

d) Spending by Sasol in the South African economy:

Capital expenditure – Sasol Group

Sasol is South Africa's largest locally domiciled company by market capitalisation. In six of the last ten years, Sasol's capital investment has exceeded its attributable earnings. Total investment in South Africa has come close to Sasol's total attributable profit for the past three years. **During the financial period 2005 to 2006 capital investment is estimated to amount to around R25,4 billion of which R24,4 billion (80,3%) will be invested in SA alone. Please refer to Graph 2 (Sasol's capital investment in South Africa) for an overview of our capital investment spending**.

Financial Year	Total capital investment	Capital investment in SA	Percentage capital investment in SA
FY2005	R12,4bn	R9,4bn	76%
FY 2006 (estimate)	R13,0bn	R11,0bn	85%
Total	R25,4 bn	R20,4bn	80,3%

Synfuels contribution to the SA economy according to DRI-WEFA study

Sasol commissioned DRI-WEFA, an international firm of consultants, to conduct a study to determine the contribution of the Sasol Group of companies to the South African economy for the calendar year 2000. **The DRI-WEFA report, issued in June 2002, concluded that the Sasol group:**

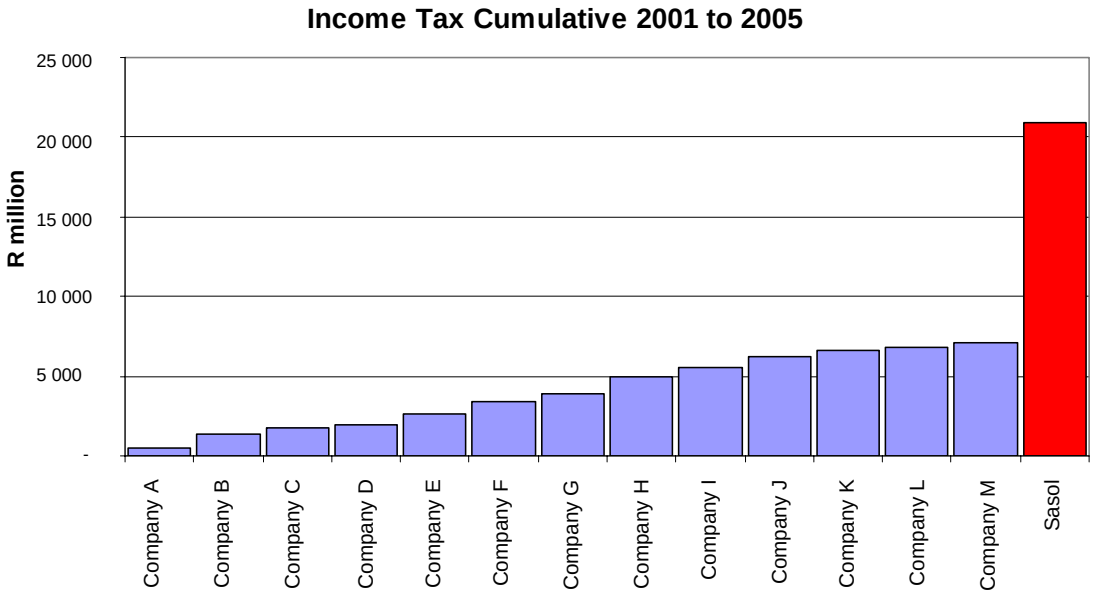
- **Contributes 1;56% of the South African economy's GDP and 2,2% to manufacturing output;**
- **Has an estimated GDP multiplier of 2,9 times;**
- **Has an estimated employment multiplier of 6.4 times;**
- **Including the above multiplier effects, the Sasol Group's direct and indirect contribution to the economy is estimated at 4.4% of GDP.**

e) Biggest taxpayer in South Africa

Sasol is by far the biggest direct taxpayer in South Africa. In the last five years the cumulative income tax paid exceeded R20 billion. The following chart benchmarks Sasol against other major JSE

listed companies (excluding financial services). It is clear from this graph that the tax paid by Sasol to the fiscus represents a very considerable amount. Furthermore, it is obvious that this tax take will increase proportionately as Sasol's profits increase. The fiscus therefore already has a mechanism in place through which it shares in the effects of higher oil prices.

Graph 9: Comparison of Sasol's Income Tax with Other Major JSE Listed Companies (2000 – 2005)



Source: Deutsche Bank (20 April 2006)

f) World-class technology leader

Sasol's strategic intent is to leverage our synfuels technology internationally. This has been, and will increasingly be, to the benefit of South Africa. Reference to Sasol's intellectual property portfolio and research and development activities is made in Section 7 below.

6.6 Conclusion

From the above analysis, it is clear that Sasol is an important contributor to the South African economy. From its origins as a parastatal requiring Government support, the company has a number of years ago reached a point in its development where it is self-funding and independent of the need for downside protection from the South African Government. In comparing Sasol with OOCs, a full value chain comparison makes it clear that the OOCs are significantly more profitable than Sasol, an important consideration when reflecting on the potential imposition of windfall tax treatment.

7. Economic Rent and Windfall Profits in the Liquid Fuels Industry in South Africa

7.1 Introduction

In Chapter 4 of the Discussion Document the Task Team lays out an objective set of criteria for identifying whether windfall profits have been earned by Sasol and whether Sasol should accordingly be subject to special additional taxes. Whereas Sasol's comments on Chapter 4 of the Discussion Document dealt with the conceptual and theoretical issues around these criteria, our comments in this section will seek to apply these to Sasol.

7.2 Applying the Criteria to Sasol

The Discussion Document lists six criteria which may determine potential liability for windfall tax. It then proceeds to use a value chain approach to apply these criteria. However, in view of the complexity of the value chain, it becomes quite difficult to assess when criteria are met and when not. To assist the Task Team in its deliberations, Sasol has prepared a simplified assessment of itself against the criteria proposed by the Task Team. These are:

a) Were economic rents generated in the distant or more recent past?

The Discussion Document defines economic rent as profit exceeding a company's cost of capital. Such profit is then deemed to be to super-normal profit. This definition is then expanded to

define economic rent as profits in excess of profits necessary to attract or keep an entrepreneur to invest or remain invested in an industry. When calculating the returns enjoyed by Sasol Synfuels and Sasol Oil[97] cognisance needs to be taken of the impact of inflation upon the returns. The Return on Assets calculated by Barnard Jacobs Mellet and the Sasol summary of statistics would have been done using a depreciated historic value of assets as a base. Where a plant has been in operation for more than twenty years, the effect of inflation is such that returns on the book value of these assets are very high. However, it is more appropriate to take into account the effect of inflation, as well as continued reinvestment in plant[98]. This approach has been accepted by independent auditors PwC as correct.

The Discussion Document does not propose any method of quantification or method to calculate the return required to persuade investors to remain within an industry or to attract investors to that industry. An appropriate measure would be to consider returns on inflation adjusted assets or capital.

Typically, a company will calculate its cost of capital according to the normal formula[99] for the calculation of a company's weighted averaged cost of capital (WACC) as reflected below:

$WACC = R_e\ E/V + R_d\ (1 - t_d)\ D/V$

where:

R_e = *cost of equity capital*

[97] Par 6.2.1, p 70 – 71 of the Discussion Document
[98] Also see our note on this matter in par 6.3 above.
[99] http://www.med.govt.nz/templates/MultipageDocumentPage____12010.aspx#P6060_92708

R_d	=	*cost of debt*
E	=	*market value of equity*
D	=	*market value of debt*
V	=	*D + E = total value of business*
t_d	=	*investor tax rate on debt.*

It is pertinent to consider the cost of equity capital, as it reflects the cost of shareholding to a company. R_e may be determined using the Capital Asset Pricing Model (CAPM) as:

Re = Rf (1-td) + ße [Rm - Rf (1-td)]

where:

Rf	=	*Risk free rate.*
R_m	=	*Return on the market portfolio of shares post-investor tax.*
R_m-R_f $(1-t_d)$	=	*Equity market risk premium post-investor tax*
$ß_e$	=	*Equity beta (levered).*

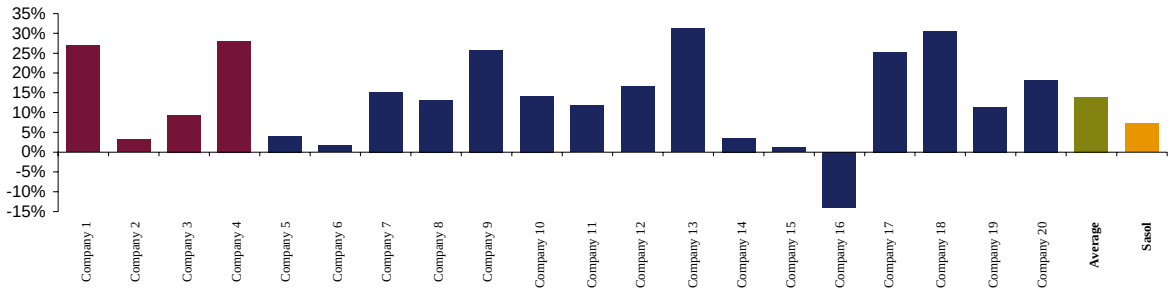
This demonstrates that the cost of equity as reflected in a company's capital structure includes dividends, which can be assumed to be those returns required to attract or keep an entrepreneur to invest or remain invested in an industry.

The cost of capital for investors typically takes into account the risk (uncertainty) of the future returns. Investors and businesses invest exactly because of the risk of the venture. Their ability to manage risk or understand it is a key driver to investing and hence

economic growth. It is the prospect of earning higher returns than the cost of capital which provides this impetus; it is this what gives an entrepreneur the incentive to risk his or her time and money, rather than investing in a portfolio of assets which will reward only the cost of the investment. Adding additional taxes to these profits, over and above those already being paid, will become a disincentive to taking risk, showing initiative and pursuing innovation. Over time, this will reduce the capital available for growth.

On the face of it, this definition would therefore support the contention that profits in excess of WACC are super-normal and therefore subject to potential windfall taxes. **In practice, however, companies that do not seek to exceed their cost of capital are rapidly put out of business as they will only be pursuing projects with a net present value (NPV) of zero. Such firms will not have excess capital to invest in growth projects, and will rapidly wither away as investors withdraw funds because of the lack of growth prospects. This means that as a matter of course all companies will try to exceed their cost of capital (i.e. pursue positive NPV projects), and in fact do so for most of the time.** This can best be illustrated by comparing Sasol to other listed companies on the JSE.

Graph 10: Net economic returns after deducting cost of capital



Source: PwC analysis

By applying the definition of the Task Team, most companies referred to in the graph above earn excess profit, and on average, do so to a much greater extent than Sasol. This raises a number of important issues:

- Given that economic rent appears to be widely prevalent, is the definition appropriate to defining what constitutes windfall profit?
- If Sasol is subjected to a windfall tax based on the criteria laid down by the Task Team, should not other companies, in accordance with the principles of equality and neutrality, also be subjected to the same taxes?
- Should the fact that one company in the above example does not exceed its cost of capital give rise to Government protection for that company?

Even though the Task Team considers the upstream crude oil industry to be outside its scope, it is instructive to see how Sasol's net economic return after cost of capital compares with some of its peers.

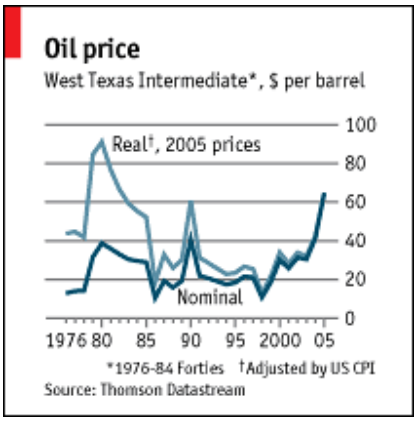
It is clear that Sasol underperforms the returns made by integrated crude oil companies, and that the economic rent that Sasol extracts from its assets is considerably less egregious than its conventional peers.

b) Were these past economic returns windfalls (i.e. not "anticipated in policy")?

We have in Section 3 above indicated that it disagrees that profit levels should be capped by what regulators anticipated or consider appropriate, in particular as this will create doubt for any investor wishing to utilize government incentives in future and hence increase the cost of pursuing government policy initiatives.

However, if for the sake of the argument the test is applied to Sasol, it is difficult to see how regulators could not have anticipated that Sasol would become a profitable enterprise. During the time that much of the regulation (in particular tariff protection) was under consideration, oil prices were in fact higher in real terms than they are today.

Graph 11: Real oil prices



Source: The Economist

Given the fact that any capital project typically generates higher returns later in its life than during its inception (as its capital is amortised), it is reasonable to surmise that regulators should have anticipated that Sasol would eventually generate higher returns than prevailed at the time.

It is also relevant to potential future "claw-back" or margin recovery considerations to point out that the $28.70/per barrel crude oil price ceiling that applied during the Pim Goldby tariff protection dispensation will equate to an equivalent ceiling of about than $50.00/per barrel in today's terms. It is interesting to note that after adjusting Sasol's assets for inflation and accounting for efficiency gains, the total amount of repayment using the 25% clawback mechanism would today amount to a 5c/l reduction in the fuel price.

c) *Is there a reasonable expectation for (continued) generation of economic rents in the future?*

It is generally accepted that the value of a share is equal to the risk-weighted net present value of expected future cash flows. In practice, investors utilise a variety of analyses to determine the value of a share. An indication of expected future earnings is contained in the price: earnings multiple ("P:E"), which is the current share price divided by earnings per share. A higher than average P:E multiple relative to a company's peers may indicate an expectation that a company has better-than-average earnings growth prospects, i.e. that it will return greater than average economic rent.[100]

[100] There are important qualifications to this statement, in particular when companies are in loss-making situations, where their P:E multiples will extend into infinity.

Table 3: Comparison of Earnings Expectations[101]

Company	Forward-looking P:E Multiple
ExxonMobil	10,8
ChevronTexaco	8,2
BP	10,9
Shell	9,7
TotalFinaElf	9,1
Marathon	7,6
Occidental	9,6
ConocoPhillips	6,7
Imperial Oil	15,2
Petrobras	6,5
Mol	9,5
Sasol (South Africa)	11,4
Sector average	10,5

According to this analysis, the market has a better than average future earnings expectation of Sasol compared to its peers. It is Sasol's contention that this difference is at least in part attributable to Sasol's proprietary technology relative to conventional crude oil companies.

d) *Do rents arise, or have they arisen, from natural resource extraction, or infrastructure and essential service or goods provision?*

[101] Source: Bloombergs, Avior Research analysis, 4 August 2006

Although Sasol is engaged in resource extraction, this is mostly low-grade coal with little or no alternative value. Should economic rent be earned from the mining of this coal this would be due to the value added to the coal by the production of synthetic fuel.

Any consideration of economic rents potentially earned from the export of coal by Sasol must be considered at least partly to be the result of Sasol's intellectual property highlighted in paragraph (e) below.

Therefore any argument that Sasol should be subject to windfall taxes on its coal mining activities must be considered tenuous at best. However, on the facts only, as Sasol derives its revenues from the extraction of coal, it is clear that the response to this criterion must be affirmative. The Task Team itself concedes,[102], however, that "only minor rents are assumed to occur in coal mining, and these are expected to be addressed in future by Royalty and Beneficiation Bills". Sasol concurs with this position.

The Task Team's test further revolves around the contention that Sasol is both a basic infrastructure and an essential service to consumers. It appears as though the Task Team's argument seeks to establish Sasol's synthetic fuels plant as being akin to the "essential facility" as defined in the Competition Act.[103] An essential facility is defined in the Act, section 1.1 (viii) as "an infrastructure or resource that cannot reasonably be duplicated and without access to which competitors cannot reasonably provide goods or services to their customers". It is clear that Sasol's competitors can and do provide goods to their customers without access to the synthetic

[102] Par 7.4.1, p 81 of 102
[103] The Competition Act, 89 of 1998.

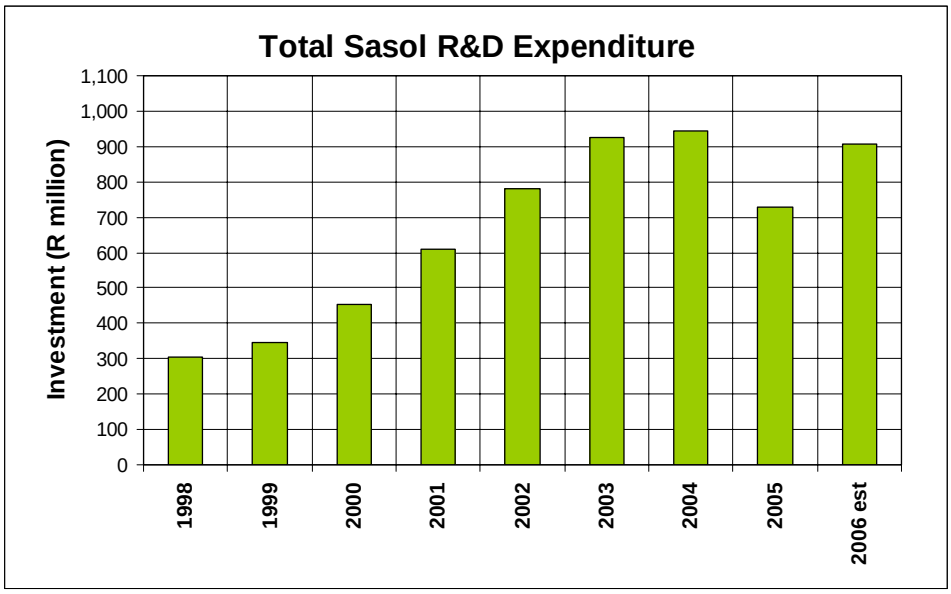
fuels plant. It is less clear why the Task Team chooses to identify only a synthetic fuel plant as an essential facility, and why it does not apply the same criteria to a crude oil refinery, which also produces essential goods through the utilisation of so-called infrastructure. It is also possible to extend this argument to similar facilities, for example a flour mill, which provides both an essential good (food) as well as complying with the Task Team's definition of a basic infrastructure. In view of the food company referred to in Graph 8 above[104] which demonstrates significantly higher economic rent than Sasol, this argument may create undesirable precedents.

e) *Are rents **not** based on efficiency improvements or the creation of valuable intellectual property?*

Since its inception, Sasol has devoted significant resources to research and development in order to enhance its intellectual property. **At present, Sasol spends some R900 million per annum on research and development, making it by far the biggest private research institution in South Africa**.

[104] Par 7.2 (a) of this document

Graph 12: Total Sasol R&D Expenditure

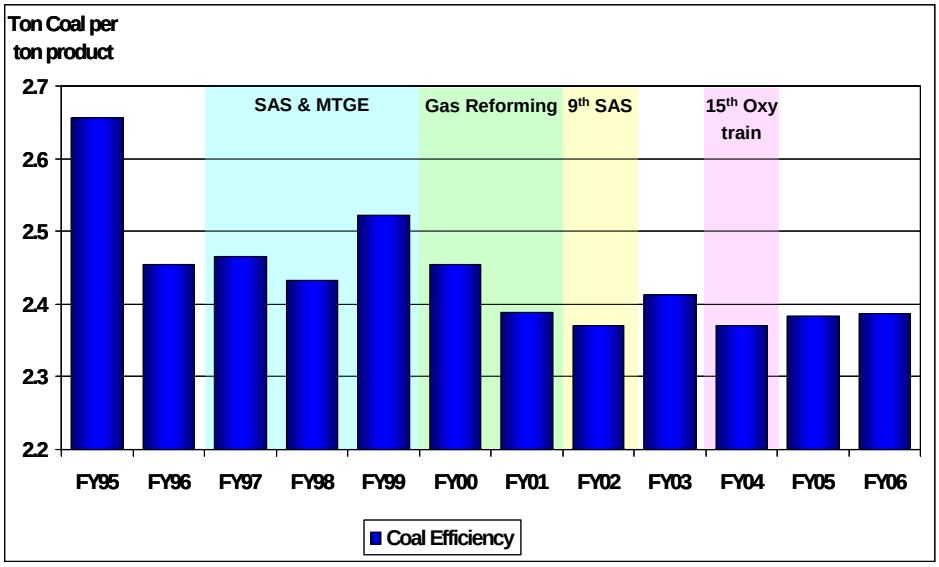


This intellectual property is enshrined in a corpus of patents and trademark registrations, as well as in know-how and trade secrets. While it is difficult to quantify the value of Sasol's intellectual property, its value is demonstrated by the eagerness of large international companies such as Chevron with significant intellectual property portfolios of their own to partner with Sasol in an endeavour to leverage Sasol's unique know-how to manufacture synthetic fuel.

As part of its efforts continuously to improve the efficiency of its operations, Sasol has been successful in significantly increasing its product yield per tonne of coal, as evidenced in Graph 13 below. The improvement indicated in the graph came about through a series of investments in new technologies, including the Sasol Advanced Synthol (SAS^{TM}) reactor, gas refining efficiency improvements and an additional oxygen train. In addition to these initiatives, several large scale business optimisation projects in

addition to normal stringent cost containment measures have been implemented over time. Sasol has also improved its throughput of coal by 1,1 million tonnes per annum[105] as a result of enhanced plant availability and reliability improvement

Graph 13: Improvement in Coal Efficiency at Sasol Synfuels

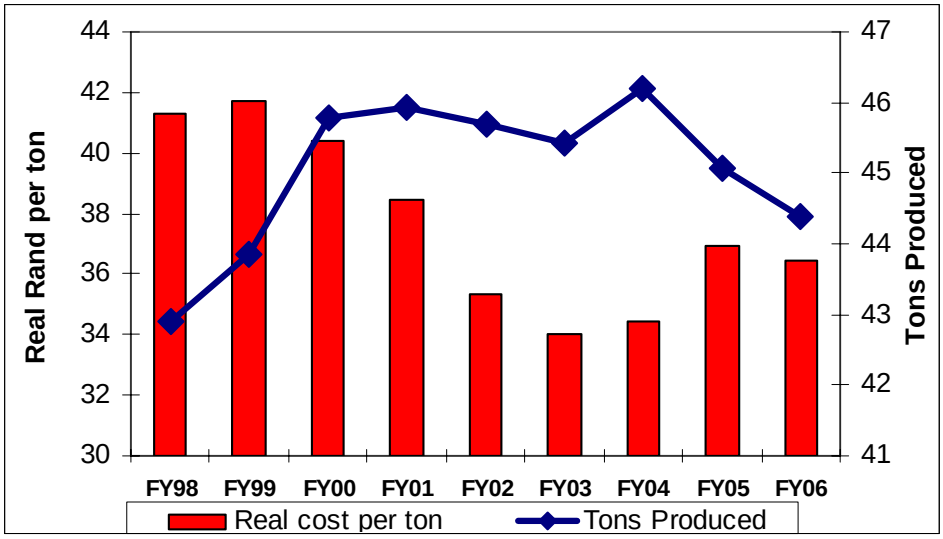


Source: Sasol

Similar efficiency gains have been demonstrated in the upstream equivalent part of Sasol's synthetic fuel value chain. The following graph illustrates the efficiency gains that have been achieved in Sasol's coal mining operations.

[105] As compared with 1995

Graph 14: Improvement in Efficiency at Sasol Mining



Source: Sasol

If a thought experiment were to be conducted to deduce the value of efficiency improvements since 1995 from the economic rent earned by Sasol, the Sasol synthetic fuels value chain annual [**after-tax**] attributable profits would have been reduced by R1,6bn or 26% of the total of the after-tax attributable profits. **It is therefore clear that a significant part of Sasol's economic rent derives from efficiency improvements and the creation of valuable intellectual property.**

f) *Are rents caused by market power, or (possibly combined with) regulatory failure in the case of infrastructure, and essential goods and services?*

To ascertain whether or not Sasol meets the requirements of this criterion, it is necessary to establish if Sasol has market power. As

pointed out by the Task Team[106], the Competition Tribunal[107] spent considerable time assessing this question.

In particular, it considered the difference in market power between Sasol as a stand-alone entity, and Uhambo as a merged entity between Sasol and Engen. It is worthwhile to consider the Chairman of the Tribunal's view on this matter:

> "Several of the key factors that lend themselves to cartelisation are notably absent in the counterfactual, that is, in a market in which Sasol is attempting, on its own, to enter the market. Mr. Reid testified that Sasol's imbalance portended well for the future of competition in South Africa's fuel market.
>
> "Rapid expansion in the retail sector will prove difficult and will rely, the Components Supply Agreement notwithstanding, on the willingness of Sasol Ltd to pass some of the considerable cost and locational advantage enjoyed by its Synfuels subsidiary down to its customer, Uhambo's refining arm, and from there to its wholesale and retail arms. In short, Sasol on its own is a maverick, alone and hungry, and, as Engen would have it, a 'big, bad' wolf..."

While Sasol does not agree with the lycanthropic simile, it is submitted that the above quotation affords strong support for the contention that Sasol does not have market power. It is apparent that Sasol is unlikely to have market power in the absence of a

[106] Par 7.4.7 p83 of 102
[107] The Competition Tribunal of South Africa, decided case between Engen Ltd, Sasol Ltd, Petronas International Corporation Ltd and Sasol Ltd, Engen Ltd - page 179, paragraph index point 527.

significant retail presence. If it were to abuse its inland position to deny the OOCs, who are both its biggest customers and biggest competitors, it will be forced to curtail production at its synthetic fuels plant. This would have such dire financial consequences that it would not be an option that Sasol would contemplate. As a result of the regulatory imposition of onerous marketing constraints on Sasol, the OOCs have very significant countervailing power that creates an uneasy balance that is in neither party's interest to disturb. The fact that the Tribunal considered that a merged entity would have market power, and that Sasol on its own would engage in greater competitive behaviour, leads one to the conclusion that Sasol on its own does not have market power. This does not mean that Sasol agrees with the tribunal's contention that the merged entity would have had market power, but clearly Sasol on its own has no market power.

The matter of possible regulatory failure with regard to infrastructure, as well as perceptions that Sasol was inordinately advantaged by the development of pipeline infrastructure have been exhaustively dealt with in our comments on Chapter 5, and we therefore do not repeat the same arguments here. However, it is worthwhile to record that the historical analysis does not provide compelling evidence of any regulatory failure with regard to the development of infrastructure.

In summary, it is useful to collate the above criteria and apply them to Sasol. In tabular format, the result of such an exercise is presented below:

Table 4: Summary of criteria for windfall profits, as applied to Sasol

Criterion	Does Sasol meet the criterion?	Comment
Were economic rents generated in the distant or more recent past?	Yes	Every company endeavours to create economic rent, and most do. Taxing economic rent (in addition to normal company taxation) may create undesirable precedents by stifling innovation, growth and efficiency.
Were these past economic returns windfalls (i.e. not "anticipated in policy")?	No	Given prevailing real oil prices at significant regulatory junctions, policy-makers should have foreseen economic rent at times in the crude oil price cycle.
Is there a reasonable expectation for (continued) generation of economic rents in the future?	Yes	The management of a company has a fiduciary duty to the company to pursue economic rent. Failure to do so will result in eventual failure of the enterprise itself.
Do rents arise, or have they arisen, from natural	Yes (in respect of natural resource extraction)	Rents are sufficiently low in the coal mining sector not to warrant treatment. Sasol's synthetic fuel

resource extraction, or infrastructure and essential service or goods provision?	No (in respect of infrastructure and essential service or goods)	plant cannot be considered to be of an infrastructural nature, or if it is, it is no different from many other facilities involved in the production of essential goods.
*Are rents **not** based on efficiency improvements or the creation of valuable intellectual property?*	No, rents are based on efficiency improvements or the creation of valuable intellectual property	Sasol has significant and valuable intellectual property, and has invested to create very large efficiency improvements.
Are rents caused by market power, or (possibly combined with) regulatory failure in the case of infrastructure, and essential goods and services?	No	Without sufficient access to retail markets caused by the previous regulatory dispensation, Sasol is exposed to the countervailing power of the OOCs and does not have market power.

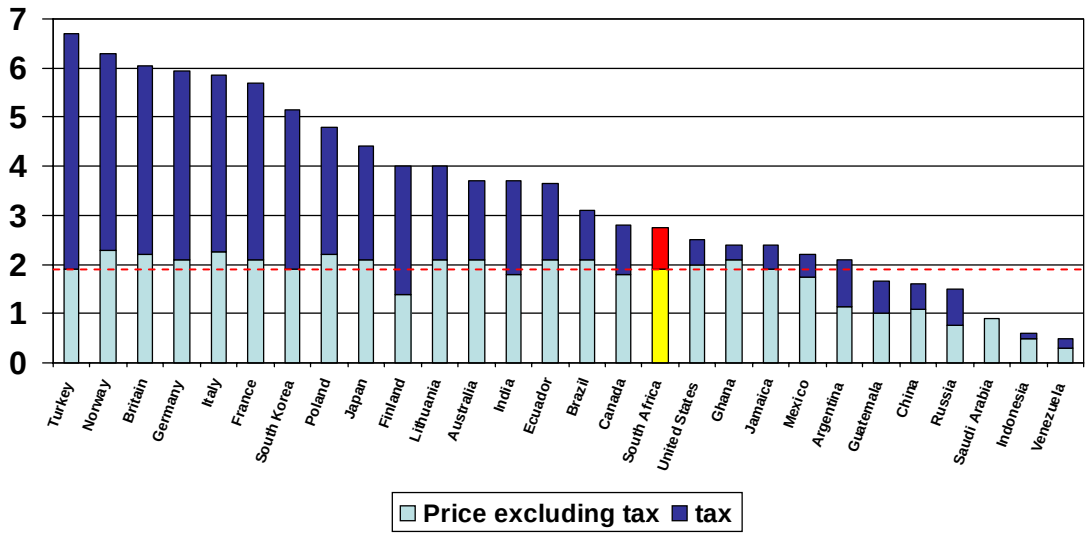
Applying the Task Team's test to Sasol, it is therefore apparent that windfall taxes are not warranted by the facts at hand.

7.3 Price calculation

In the Discussion Document the BFP mechanism is said to create economic rents in two ways.

The first is that the Discussion Document seems to express the view that there could be a difference between the BFP and "true" import parity price. A relatively simple way of establishing if there is such a difference is to benchmark South Africa's product prices excluding tax with other countries. If the local prices are significantly higher, the assumption can be made that economic rent is being extracted through this process.

Graph 15: International pump price comparison (US$/gallon)



Source: The Economist May 6-12, 2006

Graph 15 indicates that the South African pump price (excluding tax), is not out of line with international comparisons, and in fact is reasonably competitive, with the untaxed portion of the pump price in South Africa lower than 13 of the 28 countries in the sample. Given the country's geographic location and dearth of oil reserves, the BFP therefore appears to be a fair proxy for an import parity price.

Secondly the Discussion Document is of the view that the BFP is based on an oil price not reflective of a market-clearing price for crude oil. Two reasons are given for this, one being the existence of an oil cartel and the other the lack of transparent and reliable oil statistics.

The existence of a cartel is not in and of itself an indication of a "crude oil price not reflective of market clearing prices"[108]. The critical question is whether the cartel is in a position to exert sufficient market power to engineer a market price different from one that would be set in a theoretically efficient market. A Sasol analysis using both the Concentration Ratio (CR) and the Herfindahl Hirschman Index indicates that the amount of market concentration caused by OPEC is not excessive, particularly when compared to other commodities such as copper, iron ore, diamonds and uranium. However, the existence of a cartel is a moot point as far as the consideration of windfall taxes on the synthetic fuels industry is concerned, as the effect of the putative cartel operates equally for all players. This is best demonstrated by the fact that South African fuel prices are comparable to the rest of the world.

Sasol is aware of the view that oil statistics are not always considered reliable. While Sasol does not subscribe to this view, it submits that for the purpose of establishing possible liability for windfall taxes, it would

[108] Par 7.4.2 p81 of the Discussion Document

hardly be equitable to impose such taxes on an entity that is neither part of the oil cartel nor is responsible for the accuracy of oil statistics.

It is therefore unlikely that the calculation and use of BFP as a pricing mechanism as described in the discussion paper would give rise to a quantifiable rent.

7.4 Tariff Protection not refunded

The matter of whether or not Sasol is liable for the repayment of tariff protection has been exhaustively addressed in Section 5 of this document. As the arguments raised there appear to be sufficiently conclusive, they are not repeated here. However, it is instructive to consider the following summary of tariff protection received by various industries in South Africa:[109]

Table 5: Tariff Protection enjoyed by various SA industries 1989 - 2005

Incentive	Total
	R 000
Motor industry / MIDP	90 000 000
Motor industry / PAA	410 000
Mining / Mintek	1 152 122
Mining / IDC - Small scale mining	48 800
Defence / Armscor	3 550 947
Defence / Industrial Participation Programme	15 100
Direct grants	200 000 000+
Textile / DCCS	0
Tourism / South African Tourism (SATOUR)	1 623 679
Tourism / SATOUR Grant-in-aid	699 415
Tourism / ITMAS	0
Telecommunication / Telkom	3 800 000
Telecommunication / Telkom shortfall (TBVC)	84 200
Telecommunication / MTN	0
Telecommunication / ICASA	892 185
Telecommunication / SATRA	132 700
Manufacturing / RIDP - Establishment & output	2 216 826

[109] Deloitte Analysis, 4 July 2006 (A full copy of this report is attached hereto as Annexure F)

incentives	
Manufacturing / RIDP - Relocation of factories from abroad	283 469
Manufacturing / RIDP - Small industry development	348 043
Manufacturing / MDP (Manufacturing Dev Prog) Incentives	1 831 015
Manufacturing / SMMDP	1 028 622
Manufacturing / SMMDP - Establishment grant	174 260
Manufacturing / SMMDP - Foreign investment grant	96 750
Manufacturing / Tax Holiday	115 838
Manufacturing / Tax Holiday - Foreign investment grant	140 993
Manufacturing / SMEDP	1 367 130
Manufacturing / SIP	10 769 000
Manufacturing / IDZ	15 768
Manufacturing / CIP	355 075
Manufacturing / GEIS	10 585 093
Manufacturing / SPII	381 100
Manufacturing / PII	72 000
EMIA	599 043
TRHIP	942 378
Competitiveness Fund	151 206
Sector Partnership Fund	60 213
KHULA	333 051
Ntsika Enterprise Promotion Agency	416 576
Total	**334 692 597**

It is apparent from the above table that recovery of past tariff protection in addition to the requirements of the applicable dispensation will create precedents that may affect other industries.

7.5 Downstream – Cost (Saving) Transport costs

The Discussion Document suggests[110] that Secunda enjoyed past windfall profits from a saving on transport costs. It is unclear on what that finding can be based other than the location advantage Secunda enjoys due to its proximity to the inland fuel market in South Africa.

However, the location of a synthetic fuels facility in Secunda was driven by the proximity of large coal reserves to the inland fuel market of South Africa. Hence to the extent that the proximity of Secunda to the inland

[110] Table 13, p 78 of the Discussion Document

market of South Africa gives rise to economic rent this is purely a function of Sasol's technology and the vagaries of where coal deposits are found. In accordance with the definition of a qualifiable economic rent therefore such economic rents cannot be subject to special taxation[111].

7.6 Downstream – Price Zone differential.

As with the point above, any economic rent received by Sasol from the zone differential would be due to its locational advantage, which can largely be ascribed to the intellectual property that allows Sasol to convert a low-grade coal deposit in proximity to the market to liquid fuels. Hence, this cannot be considered to be a quantifiable economic rent.

7.7 Price – Service cost recoveries, wholesale margin, retail margin

The extent to which these give rise to economic rents needs to be evaluated on a return on inflation adjusted asset basis. This is not done in the discussion document.

7.8 Conclusion

Based on the criteria proposed by the Task Team, Sasol did not and does not generate economic rent that would qualify for either a forward-looking or retroactive windfall tax.

[111] Prof. JA du Pisanie, Department of Ecnonmics, UNISA

8. Incentivising Future Investments in the Downstream Liquid Fuel Industry

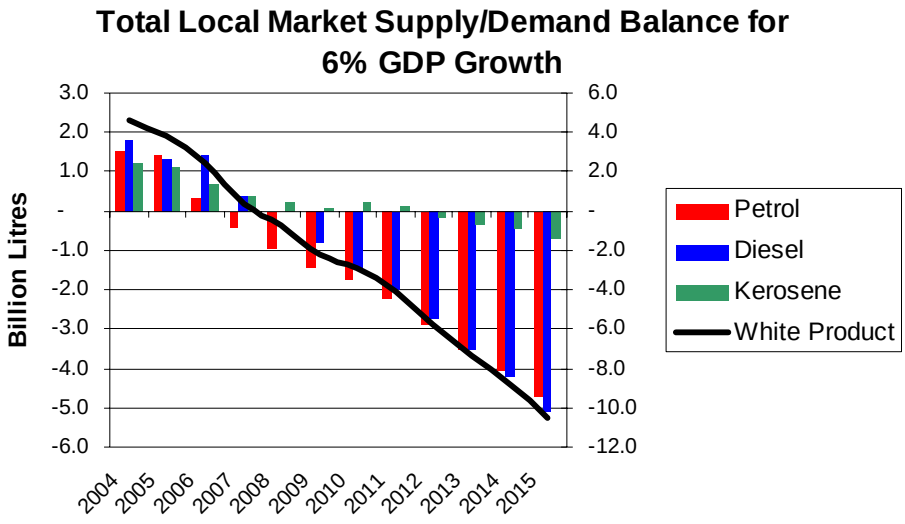
8.1 Introduction

Sasol agrees with the Discussion Document that the supply and demand balance forecast for South Africa highlights the increasing need for securing additional liquid fuels supply capacity. As the Discussion Document points out, this need can either be satisfied from imports of final products or from crude oil imports and greater investment in refinery capacity or from increasing synthetic fuel manufacturing capacity.

8.2 Demand forecast

Sasol is largely in agreement with the SAPIA demand forecast, provided the assumptions are accepted. To answer the question posed by the Task Team, Sasol has performed an analysis of the demand forecast for the total local market (TLM), which consists of the RSA, Botswana, Lesotho, Swaziland and Namibia, for an assumed GDP growth of 6%. This analysis makes it clear that, assuming no refinery closures or significant expansions take place, a new 150 000 barrel per day refinery will be justified by 2011 – 2012. In view of the long lead times for the design and construction of such a facility, it would be sensible to engage in preliminary studies now if supply shortages are to be avoided. **In view of the very substantial risk that either a new crude oil refinery or a new synthetic fuel plant poses to the investor, careful consideration of the prevailing fiscal climate is required to ensure that such investments are encouraged.**

Graph 16



8.3 Meeting the challenges of growth

Sasol intends to meet a portion of the growth in demand through the expansion or the creation of new economically viable production facilities as it does not consider imports of final products to be a preferable option for South Africa. Current forecasts predict a petrol shortfall in 2007 and, therefore, the focus should be on accelerating new fuel capacity investments.

a) Economic benefits of a local fuel industry

There are significant macroeconomic and microeconomic benefits that can be derived from the expansion of domestically produced fuel capacity, as opposed to the importation of final product. It should again be mentioned that developing crude oil refinery capacity only constitutes a marginally better option to the

importation of final product. In contrast the production of fuels from indigenous natural resources contributes complete value-add, foreign exchange savings, job creations and skills development to the benefit of our local economy. **In-country value-add is an important measure of the capacity to beneficiate its natural resources. As pointed out above, there are few, if any, industries in South Africa that can match Sasol for beneficiation.** These arguments are not repeated here.

The Task Team's statement that from an inflationary perspective import parity pricing equates with imported product on the short term does not take account of the effect that imports have on the balance of payments. If money leaves the country to pay for imports, the resulting deficit will, *ceteris paribus*, over time lead to a devaluation of the currency, which will lead to imported inflation. Over the long run, locally produced fuel, even if sold at BFP, is therefore less inflationary than physically imported finished product. The fact that South Africa is progressively becoming a net importer of liquid fuels supports the Government's regulatory pricing regime based on the import parity principle. If any lower price was to be regulated then no liquid fuels would be imported (no one would import products only to then sell them at a loss) and the country would be in short supply.

The coincidence of oil and political uncertainty has been captured as the "curse of oil". In an era where cheap oil seems to have become relatively scarce, new resources are difficult and expensive to find and stable and reliable supplies are at a premium, countries internationally are investing very substantial amounts of money in energy security. The platitude that "supply is infinite" has come under severe pressure from the realities of global political

pressures, disruptions caused by hurricanes and rising costs of finding new supplies of crude oil. Finished products are even more susceptible to such disruptions, as a result of longer value chains, greater logistical challenges and pressures on refinery capacity. In the context of recent developments in the global energy supply, energy security has become an important agenda point for any government.

Local beneficiation also results in the creation of significant numbers of jobs, skills transfer to staff up technologically advanced plants, spin-offs from having hi-tech industries and the possibility of stimulating economic growth in areas away from established urban centres.

8.4 The potential of transfer pricing

The Task Team correctly points out that the SARS is vigilant of the potential abuse of transfer pricing, not only in the cross-border environment. It is submitted that policing this matter will best remain in the sphere of SARS. It must be noted, that Sasol's value chain is highly integrated consisting of several interdependent businesses. It is possible that transfer pricing may be construed to be of a tax-aggressive nature. Sasol feels, however, that this is not the case as extensive and continuous consultations with our auditors and tax consultants on this matter have taken place and we are comfortable that the prices at which products are transferred between the different taxpaying units within the group are appropriate, determined on an arms-length basis and fall within the requirements of normal business practice and tax legislation. Also, as part of the various tariff protection investigations, the matter of transfer pricing was investigated thoroughly, and it was found that Sasol applied

appropriate business and tax practices to the determination of prices between different business units.

We are therefore of the opinion that the Task Team's concern in this regard is not warranted.

9. Conclusions and Issues for Discussion

9.1 Fiscal regime applied to liquid fuel value chain (page 89)

Question: Royalty Bill – Coal: In respect of beneficiation policy objectives, the Bill proposes a 1% reduction in royalties for low-grade coal that will be used to manufacture synfuels and/or electricity. Comment on whether this is a sufficient incentive to encourage further beneficiation of coal.

Comment: Sasol does not consider a 1% reduction (approximately R50 million per annum in the case of Sasol Mining) in royalties for the beneficiation of low-grade coal to be sufficient incentivisation for the benefication of coal through the manufacture of synthetic fuel. International comparisons with other countries such as the US demonstrate that Governments recognise coal as a potentially valuable source of liquid fuels, and that such Governments are putting in place policies to enable this. As an example the US Energy Tax Incentive Act of 2005, provides approximately $14.5 billion in energy tax incentives with approximately $1.6 billion earmarked for oil and gas production and refining incentives. This equates to fiscal support of some $21 per barrel, or the equivalent of some R4.2 billion per annum for a plant half the size of Sasol's Secunda plant.

Question: Royalty Bill/OP26 Fiscal Regime – Gas: In structuring the OP26 fiscal reform and setting royalty levels for offshore gas production, what is the appropriate balance that should be struck between encouraging investment in exploration as against anticipating the potential windfall gains that might arise from a large discovery? Should the Royalty

Bill distinguish between gas used to manufacture petroleum products in RSA and gas for other purposes?

Comment: A significant difference exists between capital employed to utilise gas for heating purposes (low) versus the capital required to manufacture petroleum products (high). Therefore, if this is consistent with Government's strategic intent, any associated royalties should reflect this difference to encourage exploration for gas to supply synthetic fuels facilities. This is consistent with our reasoning on the Royalty Bill on Coal.

9.2 Relationship between fiscal, minerals, energy, industrial and environmental policies (page 89)

Question: The Task Team's brief is to address the fiscal regime applicable to "windfall" profits. We have pointed to the interwoven nature of fiscal, mining, energy and industrial and environmental policies that apply across the liquid fuel value chain. Please comment on the coherence of these policy spheres in South Africa insofar as they apply to windfall profit issues.

Comment: Sasol agrees with the Task Team's observations in this regard. Policy issues cannot be considered in isolation and must be integrated in a holistic manner that seeks to achieve Government's objectives in this regard. A synthetic fuel plant has many interfaces with various regulatory regimes that regulate the chemical, mining, energy and environmental and other related policy spheres. It will be important for Government to ensure that objectives such as greater economic growth, greater domestic beneficiation of mineral, skills development, additional research and

development capability, job creation, protection of the balance of payments, energy security and consumer protection are integrated. We have therefore pointed out that it would be useful for the Task Team formally to consider the possibility of unintended consequences resulting from a possible windfall tax.

It would also be useful for the Task Team to make recommendations on the future needs of the South African liquid fuels market, in particular if the 6% GDP growth target is achieved. Imposing windfall taxes at a time when greater investment in local production capacity appears to be indicated would not, in Sasol's view, take cognisance of the longer term strategic and growth requirements of the country.

The release of the Discussion Document coincided with the release by the DTI of a policy ensuring continued tariff protection for another industry. It is not clear to us that these policy matters have been integrated to ensure that current policy in other areas do not create the possibility of subsequent windfall taxes.

Question: Is there coherence between the policy approach towards proposed environmental taxes and the re-regulation process being applied to the fuels industry? Elaborate on what should be the optimum interlinkage.

Comment:

The draft policy paper released recently by the National Treasury, entitled *A framework for considering market-based instruments to support environmental fiscal reform in SA,* anticipates that any

financial instrument developed by another government department, will be reviewed by National Treasury against this framework.

The paper focuses on the options for environmental fiscal reform and the policies and measures capable of contributing to both revenue requirements and environmental objectives, and therefore seeks to:

- Explore how environmentally-related taxes and charges could assist in progressing towards the achievement of environmental goals and objectives in a cost effective and efficient manner;
- Explore how environmentally-related taxes are able to contribute to revenue-raising requirements;
- Provide a guiding framework and develop a process for considering the use and development of different market-based instruments; and
- Provide a consistent set of criteria for evaluating environmentally-related tax proposals.

In line with international classifications, an environmentally-related tax is classified as "*a tax whose tax base is a physical unit (or proxy of it) that has a proven specific negative impact on the environment"*. Put slightly differently, an environmental tax is a *tax on an environmentally-harmful tax base*. Included in this definition are transport fuels, motor vehicle taxes, emissions taxes, landfill taxes and, more broadly, energy taxes.

The only coherence between the two initiatives currently is the extent to which fuels-related taxes are listed in the following table taken from the draft policy:

Table 6: Overview of environmentally-related taxes and charges in South Africa (2005/2006)

SECTOR	LEVY (charge)	LEVEL	APPLICATION	TAX
Transport fuels	General Fuel Levy	National	Petrol Diesel Biodiesel	116 cent per litre. 100 centre per litre. 60 cent per litre.
	Road Accident Fund Levy	National	Petrol Diesel Biodiesel	36.5 cent per litre.
	Equalisation Fund Levy	National	Petrol Diesel Biodiesel	Currently zero.
	Customs and Excise Levy	National	Petrol Diesel Biodiesel	4 cent per litre.
Vehicle Taxation	*Ad Valorem* Customs & Excise Duty	National	All passenger and light commercial vehicles	Graduated rate based on the vehicle price with an upper ceiling of 20 per cent.
	Road Licensing Fees	Provincial	All registered vehicles	Fees vary between different provinces – usually based on weight.
Aviation Taxes	Aviation Fuel Levy	National	Aviation fuel sales	1,5 cents per litre on all fuel sales excluding foreign operators.
	Airport Charges	National	Landing, parking, and passenger service charge	Charges imposed to fund the operation of the South Africa Civil Aviation Authority (SACAA).
	Air Passenger Departure Tax	National	International air travel from SA	R120 per passenger; R60 per passenger to BLNS countries.
Product Taxes	Plastic shopping bag levy	National	All plastic shopping bags	3 cents per bag.

Electricity	NER Electricity Levy	National	All electricity generated	A levy per kWh is implemented on all electricity generated to fund the National Electricity Regulator.
	Local Government Electricity Surplus	Local	Electricity distributed to end-users by municipalities	Implicit tax rates vary between different municipalities. Total surplus revenue raised is approximately R 1,4 billion.
Water Supply	Water Resource Management Charge	National	All registered water use from DWAF water schemes	Charge rates vary according to different users. The aim is to recover costs associated with water supply and abstraction.
	Water resource development and use of water works charge	National	All registered water use from DWAF water schemes	Charge rates vary according to different users. The charges aim to recover the costs associated with the construction, operation and maintenance of water schemes.
	Water Research Fund Levy	National	All registered water users	This levy is earmarked to fund the operations of the Water Research Commission.
Waste Water	Water Discharge Charge System (proposed)	National Framework	All (DWAF) registered water dischargers	The WDCS is in the process of being developed. Two components are proposed for the system. A cost recovery based charge and a levy/tax on waste effluent.

Question: What liquid fuel investments have been made to date to meet environmental requirements and what investments are still to be made?

Comment:

Sasol's investments made to meet environmental requirements include the following:

FUELS RELATED ACTIVITIES

Sasol Synfuels:

- Clean fuels project: R6,5 billion to be spent by end 2006; additional R1 billion expected to be spent over next 5 years
- Water and utilities related upgrade: R621 million to be spent by end 2006;
- Waste recycling facility: R520 million spent by end 2005
- Black product site remediation: R150 million to be spent over next 10 years
- Energy efficiency projects: R2,7 billion to be spent over next 3 years
- Sulphur recovery: R400 million spent in last 5 years; R800 million to be spent over next 3 years
- Water desalination plant (treat and reuse effluent): R500 million spent in last 5 years

Sasol Oil:

- Natref energy efficiency and emission reduction projects: R120 million spent in last 5 years

- Natref clean fuels; R520 million spent by end 2005; additional R3 billion expected to be spent over next 5 years
- Natref sulphur recovery plant; R120 million to be spent over next 5 years
- Additional Natref emission reduction projects; R150 million to be spent over next 5 years

PROVISION FOR REMEDIATION AND ASSET RETIREMENT –

- R2,6 billion

OPERATING EXPENSES

Environmental components include:

- monitoring (emissions, water and effluent related),
- taxes, charges, levies and license fees (water use, effluent and waste discharge, emissions)

Question: Is it appropriate for RSA to consider a regulatory and fiscal dispensation that would support another round of investment in synfuels or in biofuels or in both? If so, how should it best be done and how should any perceived errors in past attempts be avoided?

Comment:

Given the weight that our Government attaches to matters such as minerals beneficiation, energy security and import replacement, a dispensation that supports further synfuels investment obviously coincides with the national interest. In our view, these matters are of great importance to the country. It would therefore be appropriate for Government to give consideration to such a

regulatory and fiscal dispensation, provided that this is done in a transparent and inclusive manner.

If a fiscal and regulatory dispensation is put in place to support synthetic or biofuels, it would have to be cognisant of the following:

- **Impact on the consumer:** The interests of the consumer need to be carefully considered to ensure that he or she will not have to bear an undue burden in terms of either price or support.
- **Access to market:** Many of the intractable issues that arose during the long period during which the MSA regulated the fuel industry arose out of the onerous marketing restrictions place on synthetic fuel manufacturers. In view of the very large capital investment in, for example, a new CTL plant, it would be essential for any dispensation to ensure market access so that project financing can be procured.
- **Clear roadmap towards maturity:** Any new initiative will in all probability require some sort of Government support, whether it be through floor price protection, tax incentives or infrastructural support. A new dispensation should contain a roadmap that clearly spells out the different phases of the establishment of a new industry, and would have to state exactly what consequences would result when and where, and to what extent. These consequences should then be cast in stone to create investor certainty, and to avoid *ex post facto* Government intervention.
- **Clarification of expectations:** Significant attention should be paid to the intentions and expectations of investors, Government and the consumer. These matters should be

documented and agreed beforehand to ensure that mutual obligations are fully understood.

- **Impact of other regulation and policy:** The impact of other policy initiatives and regulations should be carefully considered to ensure that they are consistent and mutually congruent.
- **Competitive landscape:** A new policy would need to consider the impact of a new synthetic or biofuels facility on the existing players in the market, in order to ensure that their interests will not be compromised, or that their investments are not disincentivised.
- **Competing jurisdictions:** There is at the moment a number of jurisdictions that are incentivising synthetic and biofuels investments. Any dispensation would need to take cognisance of this.

9.3 Methodology for defining windfall (page 90)

Sasol has commented on the matters raised by the Task Team in Section 4. Please refer to our comments in that section.

9.4 History of the liquid fuel industry and synthetic fuel industry – factual accuracy and interpretation of the material analysed (page 90)

Question: Comment on any inaccuracies contained in the history section

Comment: Please refer to our comments in Section 5

Question: Logistics Infrastructure – Are industry participants (crude-based or synfuels) deriving any specific preferential commercial gain through the particular way in which they access nationally owned infrastructure? If so, does this situation continue to prevail? If so, how would you quantify the differential benefit and how can this situation be rectified?

Comment: The liquid fuels infrastructure in South Africa evolved over a long period of time, and in its current state reflects different Government priorities as these changed according to circumstance. Access to, in particular, pipelines has traditionally been governed by transactions in which parties engaged on an arms-length basis, such as the Lilly pipeline agreement. It is important to remove commercial sentiment from the consideration of this matter, as it is entirely conceivable that additional national infrastructure may be created and then used to enhance the bargaining power of one or more parties.

Sasol is of the opinion that no player is deriving any specific preferential commercial gain through access to national infrastructure. These matters are, however, within the purview of the National Energy Regulator, and this entity will in all probability form its own view on this matter. It is important to note that the relevant legislation equips the NER with significant regulatory powers of intervention. To the extent that the NER considers these issues and chooses to intervene, this would be the appropriate mechanism.

Question: Specific Questions to OOCs

Comment: None

9.5 Specific Questions to Government, Sasol, CEF and the IDC (page 91)

Question: What were the terms of the privatisation of Sasol? How many phases of dilution were there by Government and at what price? Who were the main beneficiaries? What was the benefit to shareholders including and excluding tariff protection?

Comment:

The full terms of the privatisation of Sasol are contained in the Prospectus issued by the underwriting banks, attached hereto as Annexure D. A number of 245 000 000 shares were issued at a value of R2.00 per share. According to Sasol's records, when the company was listed on the JSE in 1979, the South African Government received 112,5 million shares in Sasol Limited. A rights issue (two for one) in December 1983, Government (the IDC through the wholly-owned subsidiary Konoil) held 112,5 + 0,5 = 168,75 million shares.

We do not have an accurate record of the IDC shareholding over time for the period 1983 to 1995 and therefore make the assumption that Government's total shareholding for the period 1983 through to 1994 effectively stayed at the 168,5 million level taking cognizance of the fact that this does not consider any share "movement" between the IDC and PIC. Looking at the total PIC and IDC shareholding as of 30 June 1996 (about 156,8 million) it seems to be a reasonable assumption that the total Government shareholding remaining close to the issue share total for the period December 1983 to June 1996. Government's current shareholding

is approximately 103 306 574 (PIC) and 53 266 887 (IDC) at June 2006.

The question regarding the total benefits to shareholders is therefore not entirely clear. However, the table below gives an indication of the value received by an investor had he/she bought 100 Sasol shares at listing:

Total value of shares at time of listing on JSE	***R 200***
Total dividend paid since February 1980	***R 6 129*** *(in nominal terms)*
Total value of shares at 30 June 2006, including 50% added pursuant to Nov 83 rights issue	***R 41 043*** *(net of cost of rights issue)*

On an investment of R200, the shareholder would therefore have earned R47 172.00 since listing.

Question: How was Natref financed through Government and the IDC?

Comment: This matter is more fully addressed in Section 5. No loans or financing for Natref were advanced by Government or the IDC. Natref was instead funded from a combination of shareholder capital and offshore loans. Documentary evidence to this effect can be provided if required.

Question: At what price did Sasol and Total acquire the NIOC share of Natref?

Comment: Sasol and Total SA purchased the NIOC shares on 28 February 1989, pro rata to their previous shareholding after protracted negotiations over many years. The price that Sasol paid for its shareholding was:

• Arrear dividends	$0.75 million
• Purchase price for shares	$1.10 million
• Compensation for use of NIOC's processing rights	$5.56 million
Total amount	$7.5 million

Question: What was the extent of the benefit to Natref from the purchase of Ogies strategic stocks? Was this benefit shared with Total?

Comment: The crude oil purchased from the CEF strategic storage facilities near Ogies was sold to Sasol on an arms length basis. Account was taken of the quality of the oil (severe degradation and contamination had taken place in storage) and an allowance was made for the inland location of the oil (CEF's alternative would have been to pump the oil back to the coast). CEF at stages wanted to sell more of the oil than Natref could accommodate due to processing constraints and offered an incentive for Natref to purchase additional oil. It is fair to point out that the individuals handling the transaction for CEF were experienced international oil traders. The purchase by the OOCs of strategic stocks from the Saldanha crude oil storage facility presumably took place on similar terms.

Further documentation on the crude oil purchases by Natref, including an independent audit report confirming the arms-length nature of the transaction is available upon request.

Question: Why does Natref continue to benefit from location, and other factors enjoyed by synfuels?

Comment: With the decision to build Natref at an inland location, Government gave Total SA an undertaking that Natref would not be worse off than a coastal refinery. At the same time SAR&H was concerned that it should receive the same income as if the white products were refined in Durban and transported by SAR&H to inland destinations. This resulted in SAR&H reconciling the Natref crude oil receipts and product despatches and adjusting the crude oil tariffs to ensure that SAR&H did not lose out. Natref paid for crude oil transportation until 1981.

From 1981 to 1987 SATS changed the way in which it ensured that it received the full income that it would have received if the product had been refined at the coast. SATS did not levy a crude oil tariff but invoiced Natref for all product delivered as if it had originated in Durban. This, in effect, again gave Natref no locational advantage over a coastal refinery. SATS in 1983 introduced a penalty on Natref if product was backhauled to destinations closer than 708 km from Durban. This impacted on Natref's margin to such an extent that Natref considered reducing throughput to eliminate the backhaul volumes.

In 1987 SATS reneged on a Government undertaking that Natref would not be at a disadvantage relative to a coastal refinery. The Natref shareholders now had no recourse or guarantee and were at

the mercy of SATS. In 1991 SATS announced a larger percentage tariff increase for the transportation of crude oil than for the transportation of white products. Sasol and Total SA were now receiving less transport income than before the announcement. Sasol and Total then negotiated with SATS an undertaking that SATS would not increase crude oil tariffs by a larger percentage than white product tariff increases. As the market demand grew this resulted in less product being transported back towards Durban and Natref did get an increasing advantage because the transport component in the income from products exceeded the associated cost of pumping the crude oil required to manufacture the products.

In summary:

- Natref had no transport advantage over coastal refineries until 1987.
- In 1987 SATS reneged on a Government undertaking that Natref would not be worse off than a coastal refinery.
- This resulted in the Natref shareholders having to negotiate with SATS for a system that would protect Natref from a transportation penalty.

The arm's length negotiation resulted in Natref gaining an advantage over the previous system. This advantage also increased over time and has resulted in the perception that Natref has been unfairly advantaged in transportation. Unfortunately the impression is that this has always been the case and no credit is given for the fact that the gains that Natref did receive resulted from an arm's length negotiation, as well as additional investment that increased Natref's white product yield.

Today, when Sasol is not able to sell all its crude derived products to the OOCs at reasonable prices, and has to transport certain volumes to Durban for export purposes, it makes significant locational losses on such products.

Question: What are the break-even synfuel costs before and after capital recovery?

Comment: Sasol is not prepared to divulge this information other than to the extent that we have done so in this submission, as it is commercially confidential.

Question: What has been the cumulative tariff protection, including capital costs incurred by Government over the lifetime of the company?

Comment: The tariff protection received amounted to R7 945 million before tax and R4 353 million after tax and enhanced dividends. The total capital loan, which was repaid in full with interest, amounted to R4 924 million.

Question: The Task Teams understands that the synfuel protection slate was never wiped clean in 1998. Should it have been?

Comment: Please refer to our detailed comments on this matter in Section 5. Sasol complied in full with all its repayment obligations in terms of all the relevant tariff protection dispensations. The only period during which time a repayment obligation existed ran from 1 July 1989 to 31 December 1995. At the end of the tariff protection dispensation on 31 December 1995, an amount of R24 719 646 had been repaid in accordance with the requirements of the then

prevailing dispensation. The subsequent dispensation did not contain any reference to a "slate", nor was a so-called gentlemen's agreement ever reached to the effect that Sasol would repay past tariff protection.

Question: If so, what is the current outstanding amount – assuming the tariff protection system was terminated in 2000?

Comment: There is no current outstanding amount.

Question: And if we assume that it was not terminated but merely suspended while negotiations with the synfuels industry continued, then what amount has built up on the slate since 2000?

- On the basis of the Andersen formula?
- On the basis of the pre-1995 floor and ceiling mechanism?

Comment:

It is not practical to respond to the assumption contemplated in this question, as the Andersen dispensation ceased to exist in 2000 and the pre-1995 floor and ceiling mechanism ceased to exist in 1998. As Sasol has not received any tariff protection since 2000, and since there has been no repayment obligation since 1998, there is no tariff protection slate.

Question: At the time of the 1998 negotiations with Sasol, the Task Team understands that Sasol committed to creating 50 000 jobs in the downstream petrochemical and plastics manufacturing sector (ChemCity initiatives etc.) – What results were achieved and was there any conditionally imposed by Government between this and the suspension of the synfuel tariff protection mechanism?

Comment: According to our recollection, Sasol did not commit itself to the creation of 50 000 jobs. Such a number would be a virtual impossibility to achieve, as Sasol's total staff complement at the moment is some 30 000.

Sasol did, however, commit to the creation of jobs in the downstream petrochemical and plastics manufacturing sector. Apart from the jobs that were created as a matter of course in the growth of Sasol's business, ChemCity was launched as a specific initiative. In clause 3.6 of the initial business plan of ChemCity compiled in 1998 Sasol stated that one of the key objectives was to create between 300 - 500 new businesses, which would employ 3 000 - 5 000 people by the year 2007.

In a letter 16 March 2004 from Mr Trevor Munday (then Sasol executive director) to Mr Alec Erwin (then Minister of Trade and industry) on an update of the development of the downstream chemical industry it was again highlighted that Sasol envisaged to form about 500 businesses over the following five years.

To date a summary of jobs created are as follows:

- Fourteen projects have been implemented with direct job creation of approximately 350 jobs.
- ChemCity 1 (Venco park) has 30 tenants with direct job creation of circa 450 jobs.
- ChemCity, since repositioning (June 2004), has participated in 16 projects with direct job creation of approximately 300 jobs.
- The Chemcity and Sastech new jobs amount to a total job creation of approximately 1 100 jobs.

- Sasol Oil established 215 plus petrol station franchises with an average of 25 jobs per petrol station. This amounts to an additional approximate 5 325 jobs.

From the above it can be seen that by 2006 Sasol created more than 6 425 new jobs against our target of 5 000 by 2007.

To the best of our knowledge, and as far as our records show, there never existed a link, nor was there ever any conditions/conditionally imposed by Government between job creation and the suspension of the synfuel tariff protection mechanism.

Question: Specific Questions to PetroSA

Comment: None

9.6 Value chain approach to the liquid fuel industry (page 92)

Question: Transfer pricing. Please comment on whether the Task Team's concern about the potential for transfer pricing of windfall gains across the value chain is valid or not. If so, how do you suggest the transfer pricing risk could be mitigated?

Comment: Sasol shares the concern expressed in the Discussion Document regarding transfer pricing between local and international entities in a back-integrated value chain. Therefore, the discussion document's proposal to look at the profitability of an entire company will be more relevant.

The Task Team correctly points out that the South African Revenue Services is vigilant against the potential abuse of transfer pricing. It is submitted that policing this matter will best remain in the sphere of SARS. It must be noted, that Sasol's value chain is extremely integrated, consisting of several interdependent businesses. It is possible that transfer pricing may be construed to be of a tax-aggressive nature. Sasol feels, however, that this is not the case as extensive and continuous consultations with our auditors and tax consultants on this matter have taken place and we are comfortable that the prices at which products are handed over between its different business units are appropriate and within the requirements of normal business practice and tax law. Also as part of the various tariff protection investigations, the matter of transfer pricing was investigated thoroughly, and it was found that Sasol applied appropriate business and tax practices to the determination of prices between different business units.

We are therefore of the opinion that the Task Team's concern in this regard is not warranted.

9.7 Applying windfall methodology on the liquid fuel value chain to identify economic rent streams (page 92)

Comment: Kindly refer to our comments made in section 7 of this submission

9.8 Request for comment on the fiscal measures identified in the TOR that the Task Team has been requested to consider (page 93)

Comment:

Revised subsidy regime: Floor price protection is typically extended to an immature industry to ensure its viability during times of low prices. In some instances, a cap is added to ensure that the risk/reward equation is balanced during times of high prices. However, when an industry reaches maturity, the need for protection significantly decreases. Any revised subsidy would need to take note of the stage of maturity of the relevant business.

Sasol's synfuels plant at Secunda has reached a level of efficiency and maturity where Sasol no longer requires a formally institutionalised system of tariff protection. In the event that Government wished to extend tariff protection at derived crude oil prices similar to those applicable in the Arthur Andersen dispensation, the level of protection offered by this proposal would be inadequate compensation for the mitigation of risk of low oil prices compared to the sacrifice of revenue during times when the derived crude oil price exceeds the new ceiling price.

The imposition of such a protection mechanism would in all probability amount to the imposition of a windfall tax simply by other means. A precedent for such payments could have significant economic consequences for other companies that receive protection through tariffs and may negatively impact on investment in other industries.

In addition, a highly efficient derivatives market exists, which Sasol can and does use to reduce its exposure to negative oil price

fluctuations. Sasol believes that a new tariff protection regime would effectively transfer the risk of low oil prices from our counterparties in the derivatives market to the South African taxpayer. We believe this to be a disproportionate burden to place upon the taxpayer for what is a mature industry in SA. A targeted incentive scheme, on the other hand, (for example the Strategic Investment Programme) would have a place in the synthetic fuels industry, by promoting further investment in a strategic industry such as energy.

9.9 Cost based administered price regime

In its analogy to explain this potential fiscal measure, the Task Team treats the refining operations of the integrated supermajors as standalone entities. This position fails to take account of the very substantial profits that supermajors make in their upstream crude oil production business, and would therefore disincentivise local minerals beneficiation. We believe that such a regime will have a significantly negative outcome not only for Sasol and its investors but also in the long run for the country's motorists and the nation as a whole for the following reasons:

- It would set a precedent for Government intervention in the free market pricing of goods and services. Such interventions create the danger of significant market distortions.
- Historically it has proven extremely difficult to set such formulas to achieve a price that does not lead to either over- or under-investment.
- A cost plus formula could remove incentives to strive for efficiency and optimisation, as returns would be fixed.

- Such formulae remain open to abuse and will require significant administrative resources to enforce.

9.10 Progressive formula tax & investment linked tax and subsidy options

There are precedents for a progressive tax formula in the South African tax system, for example the tax regime that applies to gold mining. Under such a regime, tax is levied on a formula basis, which takes into account the profitability of each mine. When commodity prices are high, the profits are higher and the consequent tax payments are higher. The proviso to this type of formula is that it allows capital expenditure to be deducted in full (in year one), against the mining income.

Sasol considers a combination of the progressive formula tax and the investment linked tax options above to be of potential interest for new investment in the synthetic fuels industry, for the following reasons:

- Such a formula does not remove the elements of commercial risk and reward that are fundamental to a functioning market economy.
- Such a formula can act to encourage investment in the synthetic fuels industry while limiting the potential for economically distorting over-investment.
- Such a regime will be in keeping with the precedent in other jurisdictions providing fiscal incentives for investment in synthetic fuels in recognition of the strategic importance of synthetic fuels for many fuel importers, and the capital-intensive nature of such investments.

Government may also wish to give consideration to policy measures that will operate for the benefit of the larger fuel industry, in particular to secure

South Africa's self-sufficiency in fuel manufacture, and to encourage foreign direct investment in new clean fuels capacity. A revised tariff protection mechanism or a windfall tax will not achieve these goals, but will burden the indigenous synfuels industry with a loss of profits during periods when our competitors, the integrated multinational oil companies enjoy high profits as a result of high oil prices.

Sufficient mechanisms are already available to enable Government to support the local fuel industry. These mechanisms include import control, import duties, anti-dumping measures and other WTO-compliant actions. An import duty on fuel would be more appropriate, and concerns regarding any cost-raising impact could be laid to rest by excluding this element from the Basic Fuel Price. Failure to protect local investors against overseas marginal refining capacity that was built with tax support (which has not been extended to local investors) puts the strategic local industry at risk.

10. List of Tables

11. Table of Graphs and Charts

12. Annexures

Annexure A

QUESTIONS OF TAX POLICY AND TAX DESIGN ARISING FROM ANY CONTEMPLATION TO IMPOSE A NEW TAX

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1. When there is a contemplation to impose a new tax a number of fundamental questions arise. Some of these are set out hereunder.

2. In the first instance what is the philosophical justification for the contemplation of the proposed tax? What is sought to achieve by its imposition? Is it, for instance, designed to alter economic behaviour or economic activity or is it designed to raise revenue? The answers to these questions will be relevant to, and inform, many of the subsequent questions that arise.

3. Secondly, what will be the design of the proposed tax? What activities will fall within the net? Which taxpayers will fall within the net? How general will be its application? The answer to these questions will also be relevant to, and inform, many of the subsequent questions that arise.

4. Thirdly, the design of the proposed tax must be structurally sound.

5. Fourthly, not only must the design of the proposed tax be structurally sound but it must also be compatible with the existing tax structure. Furthermore, it must be compatible with the structure of the economy.

6. Fifthly, the question arises as to how much the proposed tax will increase the total tax burden of the economy. Conventional wisdom is to the effect that there must be a sensible relationship between the total tax burden and gross domestic product. This ratio is of considerable importance. The question then arises as to how this ratio will be affected by the proposed imposition of a new tax and what the consequences thereof will be.

7. Sixthly, what will be the incidence of the proposed tax and who will effectively bear it. Conventional wisdom is that ultimately the burden of all taxes falls on households. The initial incidence may be on the company on which it is directly imposed; however, experience is that the burden of taxes is often

pushed backwards or sideways to employees or consumers. The burden of those taxes which the company does not deflect backwards, sideways or forwards is borne by the shareholder. When a new tax is proposed careful studies are required to be undertaken as to where the burden of the tax will be felt and what impact it will have economically and sociologically.

8. Seventhly, the question arises as to what other economic impacts are likely to arise. Two examples in this regard will indicate some of the possible economic consequences :-

8.1. first, taxes, apart from their revenue raising capacity, can fundamentally affect economic behaviour. Incentives, for example, can distort the allocation of resources. So too can the imposition of a tax. Resources may flow away from a particular activity that is subject to a specific (i.e. not general) tax. If the activity is important to the economic division of resources from that activity may have far reaching consequences;

8.2. secondly, taxes may disturb the level playing fields as between competitors by subjecting one party to a competitive disadvantage. For example, in South Africa, most of Sasol's competitors import crude from their offshore parents where the production is done.

9. Eighthly, when a new tax is being contemplated careful consideration must be given to :-

9.1. the cost of administration of the proposed tax. How will the new tax be collected, what is the capacity to do so and is it compatible with existing tax collecting structures;

9.2. the cost of compliance with the proposed tax.

10. Ninthly, an important issue that arises when the imposition of a new tax is being contemplated is how the net proceeds of the tax will be spent.

11. The aforegoing observations indicate that considerable research is required both in respect of principles and the application of those principles in the context of the South African economy. Foreign precedent and experience may provide useful guidance provided always that care is taken to contextualise the foreign experience for the purposes of the South African economy.

12. Having regard to the fact that South Africa is classified as a developing economy it should be borne in mind that certain tax writers point out that in taxing the revenue of natural resources and minerals it is important not to cause distortions in economically optional production levels.

13. Dr Vito Tanzi, Director, Fiscal Affairs Dept., International Monetary Fund, Washington DC points out as follows in his contribution entitled "Forces That Shape Tax Policy" to a book "Tax Policy In The 21st Century" edited by Herb Stein :-

"In recent years, economists have had little interest in the question of whether or not a relationship exists between structural changes in a country's economy and changes in the structure, and perhaps, the level of taxation. This question did attract some attention about 20 years ago, especially in connection with the tax systems of developing countries. At that time, a small group of fiscal economists, including Prof. Richard Musgrave, attempted to determine the extent to which various structural characteristics of national economies influence both the level an the structure of tax systems. The results of these attempts were used by tax experts to advise policy makers on changes that they could bring to the tax systems of their countries.

However, the relationship between economic structures and taxation is an important element of any forecast about the future of taxation. The main question is : How might future structural changes influence tax systems."

Energy issues and particularly efforts to achieve conservation have been the subject matter of tax studies in a number of OECO countries.

In “World Tax Reform” by Michael J Boskin and Charles E McLure Jnr., the authors (Andrerw W Dilnot and J A Kay) who evaluate the United Kingdom’s tax system point out that the tax reforms there are somewhat incoherent :-

“The primary reason for this mixed record has been the absence in British Reform of any cohesive view of the tax structure as a whole of the kind that motivated more effective reform proposals in other countries such as the United States and New Zealand.”

This could be regarded as a warning against the *ad hoc* imposition of new taxes without taking cognisance of where any such new tax fits into the entirety of the tax system.

The conventional wisdom of tax commentators today is a strong preference for neutrality in the tax system.

14. Additionally, from a design or mechanical point of view a number of questions arise :-

14.1. how will the tax be calculated, will it be on a part of turnover or profit and in the latter case how will the profit be calculated?

14.2. will it be once-off or ongoing?

14.3. will it be deductible in the calculation of taxable income for income tax purposes?

14.4. will it be applicable to all taxpayers or limited to a specific taxpayer. If the latter is the case will it be constitutionally valid?

14.5. will the tax apply to old or new investments or both?

14.6. what will the equity be between domestic and foreign production?

14.7. how will the proposed tax interact with the pre-existing tax regime?

15. Finally, any new tax must comply with the traditional canons or principles of tax policy :-

15.1. fairness and equity;

15.2. certainty and transparency;

15.3. efficiency;

15.4. ease of administration.

M Katz

4 August 2006

Annexure B

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Memo

Date: May 30, 2006

To: George Trollope and Ray Eskinazi, Sasol (South Africa)

From: Gary Hecimovich, Clint Stretch, Elias Hinckley and Debbie Klis

Subject: Windfall Profit Tax Regimes

I. Introduction

This document examines the historical and current applications of various windfall profit taxes imposed by governments around the world, as well as the current debate over the potential application of such a regime in the US on oil and energy profits. The analysis will consider the rationales cited for the imposition of these taxes, the mechanical operation of the tax structures and finally the impacts, measured and perceived that these taxes have had, or are expected to have.

a. Windfalls taxes

i. Windfall taxes and the economic rationale for windfall taxes

The concept of a windfall tax is to redistribute a profit that is seen as unearned by the party receiving it. Such a tax is intended to apply to proceeds that are the result of events that the taxpayer neither influenced nor anticipated. In theory, the tax will cause no distortion in behavior since no behavior on the part of the taxpayer gave rise to the windfall. In a complex economy, no political process can precisely identify the amount, or recipients, of windfall profits that arise from various events nor can it impose a tax on those profits and only those profits. Any windfall tax is an attempt to redistribute wealth in a manner that either does not distort the taxpayers' (or the non-taxpayers' for that matter) behavior or at worst only insignificantly modifies behavior.

As a general concept, windfall taxes (or the proposals thereof) have had both political and economic motivators. Politically, windfall profit taxes respond to constituent concern (or anger) at the perception that someone or group of persons has received something for nothing or something that they did not earn. The citizenry may see imposing a tax on such persons as restoring fairness. Similarly, windfalls that arise from unexpected price increases may simply engender anger in constituents who then demand a windfall tax in retribution for the perceived injury of higher prices. Lastly, windfall taxes may be seen as painless taxes by politicians in that they can create a revenue source for additional spending or offsetting tax cuts that benefit a broad class at the expense of a few. Economically, windfall taxes may be seen as desirable by politicians who could believe that a properly designed tax would bring with it only minimal economic distortion. A less sophisticated

analysis might argue that a windfall tax targets those with the greatest ability to pay so that, even if it affects their decision-making, they have the greatest flexibility.

ii. Basic types of windfall taxes

In its purest form, a windfall tax is a one-time tax levied against one fortuitous income or wealth-producing event. In its practical application, however, the term and concept of a windfall tax has transformed over time to include multi-year excess profit, excise and special income taxes. This analysis will approach the concept of windfall taxes as a broad and generic concept, encompassing each of these sorts of tax structures.

There are two basic methods for levying a windfall tax. One method is a tax based on an element of gross receipts that is presumed to produce a windfall profit. This type of gross receipts or production-based tax is often an ongoing tax structured as an excise or transactional tax. The other method is to levy a tax on a portion of financial profits determined by reference to historical profits or a rolling calculation of annual profits. This type of tax is often structured as a form of special income tax.

This paper will examine the applications of each of these forms of taxation, examining the politics leading to the imposition of the tax and the mechanics of how each of these taxes has been structured. The paper will also look at the perceived impact of these taxes with a focus on examining the behavior changes the taxes have or may cause in the affected taxpayers.

iii. Other issues discussed

While this discussion of windfall taxes will focus on the political and economical policies and perceptions that define the windfall tax arguments, there are other considerations, which are necessary for a complete understanding of these tax regimes. This paper will touch upon an analysis of alternatives to windfall taxes that have been implemented or considered around the world, whether the imposition of windfall taxes against alternative fuels has ever been considered and how the tax correlates to other taxing regimes. It concludes with a discussion of how classic measures of an acceptable tax system might be applied in the analysis of a windfall profit tax.

II. The gross receipts based tax as a windfall tax

a. 1980 tax on US oil production

Enacted in 1980 on profits from domestic oil production, the Windfall Profit Tax was an excise, or severance, tax on US domestic extraction of crude oil. The tax did not tax profits derived by US companies from interests in foreign oil wells or production nor did it tax profits derived from refinery or distribution activities.

i. Triggering events and politics

Windfall profit tax proposals had been advanced by the Nixon and Carter administrations as part of potential compromises leading to the decontrol of the price of oil in the US. Oil prices had been

under the control of the US Government since 1971 pursuant to President Nixon's Economic Stabilization Act of 1970. In the House Committee Report, Congress expressly detailed the influence of the decontrol of prices on oil profits as part of its explanation for the legislation enacting the windfall profit tax.[1] The Committee Report also noted that during the negotiation period to end price controls, the OPEC oil cartel had taken a series of actions causing a sharp increase in world oil prices. These official explanations, however, only provide a window into the larger policy debate, and the shift in US energy policy that was central to the institution of the windfall tax.

President Carter was deeply concerned with energy independence and saw decontrol of oil prices as an essential element of his strategy to strengthen the US economy. At the same time, dramatically higher energy prices coupled with recent memories of oil shortages created significant hostility toward the oil industry in many parts of the American electorate.

ii. Mechanics

The tax was a highly complex mechanism that distinguished between types of oil production depending on its treatment under price control, ownership, and other characteristics. The tax was imposed on the excess of the sales price over an inflation adjusted base price. Essentially, it was an excise tax of 15 to 70% on the difference between the market price of oil and a predetermined, adjustable base price. The base price varied with the status of oil under former price controls, the size of the producer, and the production processes used.

The dramatic declines in world oil prices that occurred after enactment of the tax, combined with inflation, caused the tax to cease producing significant revenue. By 1988, the tax was generating only approximately $10 million per year. The tax was administratively burdensome for both the taxpayers and the government to maintain, so by 1988 the repeal of the tax, while contested, was generally a non-controversial move.

iii. Politics of proceeds

Funds from the tax were treated like other tax revenues. The dollars collected through the tax were used as a general source of funds by the government. The debate and discussion around the enactment of the tax pre-dated the Reagan revolution when tax increases became an anathema to many in the US Congress. In 1979 and 1980, the "no-new-tax" pledge had not yet been invented. Therefore, at the time that the tax was enacted the notion that a special tax could be used as a general source of revenue, rather than requiring the funds to be specially earmarked, was still a notion available for reasonable debate. This no-new-tax position in Congress (as well as the White House), while not decisive in the current debate clearly affected the debate during the past year over whether to reinstitute a windfall tax on oil in the US, and will continue to do so as the debate continues.

b. Oil production taxes in the UK—the SCT and PRT taxes

[1] H.R. Rep. No. 96-304; 96th Cong., 1st Sess. at pages 4-8.

The recently implemented Supplementary Charge to Corporation Tax ("SCT") is an annual charge levied on profits from oil and gas production. The Petroleum Revenue Tax ("PRT"), which was introduced in 1975, is an annual charge to tax the profits from winning oil and gas exploration rights under a UK license.

i. Triggering events and politics

In 2002, the UK Government introduced the SCT at a rate of 10%, supposedly, to create a stable regime for the future of the North Sea, raising a fair share of revenues while also promoting long-term investment. In 2006, the Government increased SCT rates to strike a balance between producers and consumers quoting very high returns by the oil and gas sector as justifying the increase. Companies, however, dispute the claims made by the government regarding the high levels of returns made by oil and gas companies, in particular when the long investment cycle of the industry is taken into account.

The PRT was introduced to capture a 'fair share' of the profits arising for oil and gas companies for extracting oil and gas, which effectively belonged to the State. Though it is common with many regimes around the globe to recover some costs for the rights to extract natural resources, the PRT stands out because it was not designed as fees or royalties, as is typical practice, but as a tax on the profits of the extractor.

ii. Mechanics

The SCT is charged in addition to corporation tax, which effectively means that oil companies operating in the North Sea now pay corporation tax and SCT at a combined rate of 50% for new fields as compared to corporation tax rate of 30% for other businesses. The effective rate is 75% for old fields, which are also subject to the PRT. The SCT is computed at 20% (previously 10%) of the 'ring fence' profits of oil companies, and takes effect on accounting periods from January 1, 2006 (with adjustments for straddling periods). The tax charge has no deduction for financing costs, which gives rise to foreign tax creditability issues.

The PRT is a field-based tax that is applicable to fields given development consent before March 1993 and has been abolished for new fields, where development consent was given after March 15, 1993. Since 1993, the rate of the PRT has been 50% of the net profit of sales of North Sea crude oil and gas after taking account of associated expenditure. Profits are taxed for six-month chargeable periods ending in June and December, irrespective of the licensee's accounting periods. Prior to the 1993 changes, the rates had been substantially higher. From January 1, 2004, income arising from new tariff business is exempt from the PRT. The PRT is computed in addition to corporation tax and SCT and is deductible against corporation tax and SCT. Combined with corporation tax and the increase in SCT, this brings the old field chargeable to PRT to an effective tax rate of 75%. Each field is treated as a separate taxable unit and each participator is taxed on their share of profits (*i.e.,* it is not an entity-based tax). There is no distinction between capital and revenue expenditure and relief is given for most expenditure after it has been claimed and allowed by Inland Revenue.

iii. Politics of proceeds

The SCT imposition came at a time when the UK Government was looking to raise money for various public and infrastructure spending. The oil companies had allegedly enjoyed record profits in the prior few years due to soaring oil prices; additionally the industry was an easy target from a political perspective—there had been protests in the UK in 2001 regarding high petrol prices. A tax on the industry was viewed as an easy method to increase Government revenues. The Government also justified the increase on the high returns on capital enjoyed by the oil companies. A previous review of the UK upstream regime in 1997-1998 was shelved because of low commodity prices at that time.

c. Issues presented by production tax

i. Treatment of old vs. new investment

One of the most common criticisms of windfall tax regimes is that the taxes suppress new investment. To the extent that a tax applies to gross proceeds or net income derived from new investments that tax would lower the after-tax rate of return for those investments. At the margin, this would influence new investment dollars to seek different opportunities. A windfall tax would seem to have less potential impact on activity related to existing investment since the investment decisions would be made before the tax was imposed. Nonetheless, existing production facilities require operating, maintenance and repair investments. At some point, a windfall tax can render marginal investment in the facility less attractive than alternative investments. In the US, the 1980 windfall profit tax had special provisions to limit or lift the tax on new or high-cost investments blunting these impacts. The PRT and SCT in the UK have similarly been adapted or designed to give more favorable treatment to new investment. The PRT phases out entirely on certain new investment and the SCT sets lower rates on new investments.

ii. Equity between domestic and foreign production

There is a well-developed position that the windfall profit tax enacted in 1980 had a measurable, negative impact on US domestic oil production.[2] Since the actual market price for a barrel of oil was based on global markets, the added cost to a domestically produced barrel of oil was not a factor in the price of imported oil, while the domestic producer could not recover the cost of the additional tax through higher prices. The incremental cost of production for domestic oil increased because an oil producer would treat the tax as an increase in the marginal production cost of oil. The price to produce and import oil remained constant. The price for selling oil into the market was the same whether the oil was imported or domestically produced. The argument is that to the extent that imported oil was less expensive to produce some amount of production was not pursued within the US. That is, multi-national investors in oil production had incentives to invest outside rather than inside the US.

The result, it is asserted, was either a reduction in the rate of capital investment into the assets used to produce domestic oil or an unnatural increase in the demand for oil imports. This imbalance, the analysis concluded, had a negative effect on both near and long-term capital investment in US

[2] Salvatore Lazzari, The Crude Oil Windfall Profit Tax of the 1980s: Implications for Current Energy Policy, CRS Report for Congress, RL33305 (March 9, 2006).

production. The rudimentary hypothesis of this theory is that anything that reduces the growth of domestic supply (*i.e.*, windfall taxes) or increases demand for oil (which also occurred) increases the amount of oil imported.

In the UK, the companies affected by the SCT tax increases argue that they necessarily will reduce investment in the UK controlled North Sea fields due to resources being diverted elsewhere globally where overall returns are better, as well as to the risk created by the perceived and actual lack of stability in the UK's tax regime. This argument continues that because of reduced investment, less oil and gas will be discovered and produced in the UK North Sea fields leading to a loss of jobs, skills and resources in the sector, which will be impossible to bring back to the UK once diverted. The ultimate result will be a greater reduction in overall taxation revenues than would have been the case if the SCT had not been introduced.

iii. Potential for behavioral responses by taxpayers

The exact impact of the tax on US oil production is neither obvious, nor easy to measure. There have been studies that correlate the windfall profit tax to a drop in US production.[3] Fundamentally, unless a windfall tax is truly a one-time event, affecting only an amount that is truly a windfall, there exists the potential for a taxpayer to modify its behavior because of the tax. Because the tax as imposed in the US spanned several years, affected taxpayers continually modified their behavior in response to the tax. This extended period for oil companies to react was critical, because oil prices and capital expansion for oil production are relatively inelastic. That is, price changes do not have an immediate impact on industry behavior. The industry, however, was not so inelastic that it could not react. The longer a period it had to do so, the greater the reaction. Opponents of windfall profit taxation argue that by limiting the profit available to certain types of domestic production, the windfall tax spurred the industry to direct capital to those markets where profit could be maximized, which resulted, to some degree, in the flow of capital to non-domestic production activities. This change in capital flow may not have made an enormous impact on domestic production activities, but the change did, according to several critics, have a measurable effect on capital spending for domestic production activities.

A similar set of concerns has been expressed with respect to the UK SCT and PRT regimes. The common criticisms suggesting that the tax structure leads to less domestic oil production spending, which reduces overall production in the UK, mirror the criticisms of the windfall profit tax in the US. The critical difference between the impact on the industry in the UK and the impact on the industry in the US is the level of importance now placed on a reliance on imported oil given the current instability in the oil producing Middle East. As an oil independent nation, the UK does not suffer the same set of vulnerabilities, real or perceived that an import dependent nation like the US does by virtue of reduced domestic oil production. The uncertainty that these taxes cause in the UK oil industry is also often cited as problematic for planning within the industry. Uncertainty increases the risk associated with an investment, and mitigating that risk has a cost.

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[3] The most often cited of these studies was done by the Congressional Research Service and showed a drop in production of 3% to 6% and an increase of dependence on foreign exports of between 8% and 16% due to the windfall profit tax.

III. The Financial Profits based taxes as a windfall tax

a. Wartime excess profits tax

Both the US and the UK assessed excess profits taxes during World War I and World War II,[4] and the US again enacted an excess profits tax during the Korean War. Both governments sought some level of government control over industries seen as critical to the war effort, and to generate income for the government's wartime needs, while at the same time leaving the majority of the wartime economy in private hands. The tax was generally preferable to a government takeover of the relevant industries. In addition to the political issues associated with a government take over of private industry, this approach was expected to allow for an easier transition in peace time when private ownership, and its perceived efficiencies, would be ceded back by the government.[5]

i. Triggering events and politics

In addition to the obvious need for substantial increases in government revenues, the US and UK instituted the taxes in the earliest stages of World War I due to the unprecedented profits by certain companies and individuals from unusual and expanding industry demands. In addition to addressing the economic concerns of profiteering, the taxes were a political device to counter public perception that unscrupulous businesses were reaping huge profits while the public sacrificed and served the war effort.[6]

ii. Mechanics

Excess profits were defined in two general ways, either as any return on capital over a fixed percent or as net income in excess of prewar levels. The governments each allowed a taxpayer to choose its preferred methodology.[7] This description oversimplifies the actual mechanical complexities inherent in levying this sort of tax. There were multiple challenges that the taxing authority faced in coordinating this sort of tax with preexisting tax regimes. Capitalization, interest allocation, transfer pricing and countless other issues needed to be reconciled with this tax, because all of these factors, in addition to the more obvious issues, had implications on how profits would be measured.

iii. Politics of proceeds

These were special wartime taxes, designed to generate necessary additional capital for the taxing government to use in meeting wartime expenses.

b. 1997 UK privatization tax

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[4] Sweden and Denmark actually imposed the first special profits tax during World War I, in reaction to the spectacular profits of traders and shippers who, due to the allied blockade of the North Sea, possessed the sole remaining trade routes into Germany, through the Baltic Sea. Carl C. Plehn, *War Profits and Excess Profits Taxes*, 10 Am. Econ. Rev. 283 (1920).

[5] See Eric Kades, Windfalls, 108 Yale L.J. 1489 (May 1999).

[6] Id.

[7] See Second Revenue Act of 1940, Pub. L. No. 76-801, tit. II, 54 Stat. 974, 975-98 (1940).

The windfall tax on privatized companies was a one-time tax imposed by the UK Government in 1997 on the profits of a variety of privatized companies, which had been under Government control. The companies that were subject to the tax included regional electricity companies, electricity generators, waste and sewage companies, as well as some other companies in the telecoms, rail and energy sectors. The Labour party had proposed the tax as early as 1992 before it came to power, and the imposition of the tax was therefore not a surprise when it was introduced in 1997 after the Labour party had come to power. The expectation of the tax was such a certainty that the tax had been reflected in the share prices of many of the companies in question.

i. Triggering events and politics

The tax was imposed on companies that had been privatized by flotation in the period from 1984 to 1996. The companies in question operated in a regulated environment where their return was largely determined by the regulator. The tax was levied on the 'excess profits' of the privatized companies, which the Government claimed arose because the companies had been sold off too cheaply and regulated too lightly in their early years of private ownership, enabling them to earn supernormal profits.

ii. Mechanics

The profits subject to the tax were assessed as the difference between the value that was placed on a company at privatization and a 'more realistic' valuation based on its after-tax profits up to the first four years after privatization. The tax rate of 23% was payable by the company in two installments on or before December 1, 1997 and December 1, 1998. An interesting note to the calculation was that due to the manner in which the tax was calculated, the tax created an issue over US tax creditability, the key question being whether it was in fact a tax on profits. [8]

iii. Politics of proceeds

The Government's primary stated objective was for the cash raised through the tax to fund the Government's £3.5 billion Welfare-to-Work program, which was designed to provide employment and to help single parents and the disabled.

c. The impacts of a excess profits tax

i. Definition of tax base

The primary challenge with applying the excess profit taxes is how to define profit. The most common methodology has been to rely on historical profits as a measure against current profits. Another approach has been to establish a board or panel to review profits, and define reasonable and unreasonable profits. The challenge in defining an accurate and equitable measure of profits is significant. Profitability is not static; certain markets are cyclical and profits vacillate based on where in the cycle the industry happens to be. Other markets have higher levels of risk and profits

[8] The concern is that the tax may be viewed as a tax on capital rather than a tax on income, thereby calling into question its creditability for foreign income tax purposes.

can be very volatile. Taxing either of these types of markets based on a fixed set of criteria for measuring profits can produce inequitable results.

ii. Treatment of old vs. new investment

In some ways, it can be more difficult to mitigate the impact of a profit-based tax on new investment. Taxing new investments at different rates than preexisting investment becomes an administrative impossibility. This problem has been largely avoided in the case of a single event tax that is focused on historical windfall profits, as was the case with the privatization windfall tax in the UK.[9] In the case of an ongoing tax like the wartime profit taxes the problem could have been more acute because there was no mechanism to offset the impact that the tax has on the rate of return on new capital investment.

iii. Potential for behavioral responses by taxpayers

In the wartime excess profit taxes, rates were structured to go so high that either it became economically efficient for the market to manipulate production and profitability to avoid the tax or the tax worked as a disincentive to push production to its absolute capacity. While the market manipulations represented inefficiencies, the disincentive to maximize production or absorb risk by the private markets was exactly contrary to the need to stimulate production during war times. The politics of the time gave the reasons for the excess profits taxes more weight than the flaws in the systems. Further, the patriotism and increased public support for the war effort mitigated the economic inefficiencies. In hindsight, a strictly economic analysis of these taxes would likely conclude that they lacked the neutrality, predictability and ease of administration that are commonly understood to be characteristic of an economically desirable tax.

The one-time privatization windfall tax has faired better in the eyes of critics with respect to minimal impact on taxpayer behavior. In fact, many commentators within the EU refer to the tax as a successful model for windfall tax structures in the future. That this particular windfall tax was received well is of little surprise; this tax provided an example of a one-time tax on income that could reasonably be the result of a windfall. This is not to suggest that there are no critics of this tax, there have been many but the tax's impact on industry behavior is not cited among those criticisms.[10] Because the tax was a one-time event, and because it was based on past profits, the implications for a taxpayer's future business decisions were meant to be insignificant. That there has not been a great deal of study dedicated to the behavioral impacts of the tax may be the best endorsement of the taxes economic efficiencies and lack of impact on behavior. The one area cited with respect to behavior modification was the potential that the tax was not truly going to be a one-time event created a risk and, thus, a cost to mitigate that risk for the potentially affected taxpayers.[11]

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[9] As explained subsequently in III.c.iv., there are some behavioral impacts that could affect new investments, but these are limited.

[10] There is arguably some impact because the money used to pay the tax cannot be used for capital spending, but this impact on behavior is typically seen to be minimal. Lucy Chennells, *The Windfall Tax*, Fiscal Studies vol. 18, no. 3, pp 279-291 (1997).

[11] Id.

IV. US windfall taxes redux—2006, the current debate

a. Triggering events and politics

Due in part to record high prices per barrel of oil, several companies in the oil production chain have recorded unprecedented profits over the past year. These high prices, and profits, are widely expected to continue for the near future as global demand outstrips increases in conventional and alternative supplies. These profits have led to several calls by members of Congress to institute a new windfall profit tax in the US on the oil industry.[12] As of this writing, the passage of such tax appears unlikely. Proponents of windfall profit taxation today face numerous hurdles compared to the 1979 – 1980 experience.

This current debate is not the first time policymakers have proposed a renewed windfall tax on oil companies. During the summer of 1990 oil prices nearly doubled, increasing from roughly $16 per barrel to nearly $32 per barrel. This jump, caused in large part by the first Gulf War, prompted some members of Congress to call for reinstatement of the 1980 windfall profit tax. While the speed with which a call to reinstate the tax may have been partially due to how recent the repeal of the windfall profit tax had been, it is also evidence of an important theme that is common to every discussion of windfall taxes. Political expediency alone would be enough to prompt calls to tax an industry that appears to be profiting off the misfortunes of voters facing high prices to fuel their cars and heat their homes.

b. *The proposals*

Currently, the House and Senate have proposed several bills[13] to impose some form of tax that could be described as a windfall profit tax on oil profits. These bills generally propose one of two tax structures: either an excise tax, which is a type of production tax, or a special income tax, which is a profit based tax.

The income type of windfall tax would impose a tax on the excess of the adjusted taxable income of a taxpayer for that tax year over an average taxable income based on some pre-defined period. The tax would apply to crude producers, as well as integrated oil companies and in some cases to sellers of petroleum products, with large gross receipts.[14] Another variation of an income based windfall tax would impose a 100% tax on any profit above a 15% rate of return from the sale of crude oil, natural gas or products of crude oil and natural gas.[15]

The excise tax based windfall tax would impose a set tax rate on windfall profits not reinvested in certain identified manners: oil/gas exploration and drilling, refineries, renewable electricity property or facilities for producing alcohol fuels or bio-diesel. Windfall profit would generally be defined as

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[12] Calls for a windfall tax have, certainly not been limited to elected officials. Countless commentators outside of the government have made similar arguments.

[13] S. 1631, H.R. 3752, H.R. 4203, H.R. 4248, H.R. 4449, H.R. 4263, S. 1981, S. 2103, H.R. 2070, H.R. 3664, H.R. 3544, S. 1809, H.R.4276, H.R. 3712.

[14] S. 1809, H.R.4276

[15] H.R. 3712

the difference between the market price of oil and some base price (typically $40/barrel), adjusted for inflation.[16] Other bills attempt to create a hybrid approach - a graduated excise tax with the rates, from 50 to as much as 100% depending on the amount that a specially created board or commission deems as profits exceeding reasonable levels.[17]

As discussed above there is a strong contingent in Congress that is fundamentally opposed to levying new taxes. The notion of a new tax, which would be used as general government funds, is likely to crystallize opposition to the imposition of any new tax. Because of this culture, many of the new windfall proposals provide specific uses for the revenues such as additional aid to hurricane victims or to the highway trust fund to offset lost motor fuel excise taxes. Some bills would direct the proceeds to the Low- Income Home Energy Assistance Program, to help the poor pay high energy bills or to fund a gas stamp program, similar to the Federal food stamp program. What is clear from this diverse use of projected funds is that the sponsors see a windfall tax as special source of revenue to fund special initiatives.

c. The hurdles

For all of the windfall tax proposals, however, there are numerous reasons why the likelihood of the passage of such a tax remains remote. The energy market of today is much different from the one that existed in 1980. Currently, no *quid-pro-quo* exists as it did in the past to attract support of the industry or its closely aligned constituents. The imposition of the windfall tax was part of the compromise to decontrol oil prices in the 1970s that attracted this support. Further, critics of a tax on domestic production claim it would hinder US energy independence by discouraging exploration. This argument is far more compelling in today's geopolitical and economic world than in was in 1980.

The political climate is different as well. Political support for the oils industry is high. Many Republicans (who control Congress) have taken a "no-new-taxes" pledge; they would imperil their political careers if they were to support windfall taxation. Additionally, public anger, to the extent it exists, seems focused on the major oil companies and on suspicions of undue profit in the refining and distribution portions of the business. The 1980 tax did not address profits in those sectors.

Energy markets and energy policy today, and the oil industry specifically, differ from the late 1970s. The US imposed the windfall tax in 1980 as part of compromise to decontrol crude oil prices. The removal of these controls resulted in oil prices in the US rising from the controlled level of $6 per barrel to market prices of $24 per barrel (*albeit* an OPEC influenced market price). In the US today, competitive (arguably) global markets determine prices. The run-up in oil prices during the past two years has been for significantly different reasons than the increases during the 1970s, and increases caused by market changes receive different treatment than increases that are linked to government policy.

Furthermore, dependence on foreign oil has become a critical issue, and the possibility that any initiative could increase dependence on imported oil has become political poison. The concern according to critics is that oil producers would view the tax as an increase in the marginal cost of oil

[16] S. 1631, H.R. 3752, H.R. 4203, H.R. 4248, H.R. 4449, H.R. 4263, S. 1981, and S. 2103.
[17] H.R. 2070, H.R. 3664, H.R. 3544

production; this incremental cost of producing an after windfall tax barrel of oil would push some amount of production out of the US. The affordability of petroleum products is also a decisive political issue, even the possibility that a tax like this could curtail domestic exploration and thereby increase consumer costs would concern proponents.

The political landscape is far different as well. On August 8, 2005, President Bush signed The Energy Tax Incentive Act of 2005,[18] which provided approximately $14.5 billion in energy tax incentives with approximately $1.6 billion earmarked for oil and gas production and refining incentives. While the wisdom of these tax breaks has been questioned, the enactment of this law provides at least two important insights into the debate over the probability of the enactment of a windfall tax on domestic oil companies. First, the passage of an Act with tax breaks for the oil industry during a period of significant profit can reasonably be seen as an indication of the current administration's disposition towards taxation of the industry. Second, it provides a much easier mechanism, *i.e.*, the repeal of those tax incentives, for the collection of additional tax receipts from domestic oil companies. At a minimum, the discussion of a repeal of these incentives acts to divide the debate over how best to increase collections from the oil industry.

One other important observation that can be made about these legislative proposals is that the proposed taxes are not limited to oil production. Many of the proposals would also tax the "windfalls" of upstream activities as well as some natural gas production. As the taxes move farther from the speculative markets like that for oil, the taxes become less and less about windfalls. Large profits in upstream activities represent a changing supply and demand equation, rather than easily isolated fortuitous events. The farther these taxes reach into the basic structure of the US economy the less palatable the prospect of the tax becomes to the powerful political center.

The cost of compliance and administration of the tax was one of the rationales for the repeal of the windfall tax in 1988. Critics of the proposals to enact a new windfall tax have also pointed to the compliance and administration costs as economic inefficiencies that are unpalatable and unacceptable.

d. The debate

The extent to which recent profits are true windfalls, and whether profits in the petroleum products industry are similarly generating windfall profits, is critical to the debate over whether windfall taxes are an appropriate course of action. The answer, of course, depends on who has posed the question. To the extent that the sharp increases in prices produce similar accelerations in profits, which were unforeseeable or unanticipated, proponents of a tax will see these as windfalls. Under this argument, the profits are essentially unearned—virtually no incremental cost is incurred to produce these extra profits. On the other side, the argument would be that in a free market, there must be rewards for taking risks and for having the foresight to build a profitable business. These current profits are nothing more than that reward for taking those risks and having that foresight.

This debate continues to develop. As it does, economic arguments to support high consumer prices may not soften anger at oil companies for reaping "unreasonable" or "windfall" profits. Crude

[18] P.L. 109-58

prices have increased steadily since 2004 when prices averaged $37 per barrel to $55 per barrel in October 2004, $60 per barrel during the summer of 2005 and on up to more than $70 per barrel as of this writing in May 2006. Prices for petroleum have similarly undergone remarkable increases. These dramatic price increases may create their own dramatic and unpredictable political consequences.

V. Other issues

a. Application to other conventional energy producers or suppliers

In various forms, taxes that have been called windfall profit taxes have been levied by other nations. In addition, there are other instances of the tax being proposed but never enacted. The industry targeted by these special taxes has, with the exception of the wartime excess profits taxes most commonly been oil production, though taxes have been levied against industries as diverse as banking and coffee bean farming. The 1997 windfall tax levied by the UK on privatized companies had a substantial impact on electricity distribution and generation companies.

b. Application to alternative fuels

Based on the research done thus far, and going back approximately thirty years, this sort of taxing regime has never been levied against producers or users of alternative fuels. It is common for taxing jurisdictions to provide tax incentives to taxpayers that engage in the production of alternative fuels. In the US, there is a mixture of investment and production based tax credits designed to stimulate capital investment in the alternative and renewable fuels industries. The most important of these were introduced as part of the original Windfall Profit Tax legislation. These incentives exist due to the consensus that these technologies are not economically competitive with conventional fuel sources, but that there is a social benefit to the pursuit of these technologies.

The US legislature has recently expanded and extended tax credits and initiatives as part of an effort to reduce dependency on imported fuel supplies as well as to promote environmentally sound alternatives to conventional fuels. These credits include production-based credits for renewable and alternative energy sources including wind, geothermal, biomass, the production of synthetic coal, and the gasification of coal among others, and investment based credits for capital investment in many of these types of properties as well. The credits were designed to level the economics for alternative and renewable fuels.[19] In addition to the US, most other petroleum producing counties in the world provide similar economic and/or tax incentives for the production or investment in alternative and renewable fuels. This includes the UK, China, India, Indonesia, Russia, and Australia. See Appendix II below for a table summarizing these incentives by country.

c. Correlation to existing tax regimes

Some windfall taxes are designed as a separate and distinct tax with no correlation to the other taxes collected, other windfall tax structures either reduce regular corporate tax by the windfall tax or the

[19] Because the primary driver for these incentives is economic parity, certain of these credits were designed with funding limitations or phase-out provisions based on prevailing energy prices.

windfall tax by the amount of regular corporate tax. In the US, during its application in the 1980s, the windfall tax was treated as a deductible expense, which reduced taxable income. In the UK, the 1997 privatization windfall tax was similarly imposed on after-tax profits. China's new tax follows this structure; windfall taxes are treated as an expense that reduces taxable income. Alternatively, the SCT and PRT taxes in the UK are both calculated based on pre-tax profits and cannot be used as an offset against regular corporate tax. See Appendix I below for a table summarizing the various windfall profit tax regimes by country.

d. Alternatives to windfall taxes

There are alternatives available to enacting a windfall tax. What these potential alternatives are, to some degree, will be dependent upon the motivation for enacting the windfall tax. Obviously if the issue is primarily one of revenue generation by the taxing government, then any other taxing regime could be added or modified to collect those additional tax dollars. The chance that a government would look to a windfall tax primarily because it is a revenue source might seem remote, but given the taxes enacted in Ecuador, Bolivia and Venezuela on foreign oil companies, some governments are willing to enact these taxes for little reason other than to generate revenue.[20] In those situations where the windfall tax will affect domestic based taxpayers, it is a near certainty that there is more driving the dialogue than government revenues. As explained above, the notion of fairness, and through fairness, redistribution of good fortune, are regular themes behind windfall taxes. The consideration of these factors is critical in analyzing alternatives to windfall taxes.

A progressive corporate income tax can achieve, to some extent, the same result as a windfall tax. By accelerating the progression of tax rates at higher levels of profitability the progressive income tax would operate like a windfall tax to redistribute more of the windfall-like profits. A progressive income tax as an alternative to a windfall tax though may produce unintended results. The same issues that have been raised with respect to inefficiency and behavioral change by taxpayers subject to a windfall tax may well apply to taxpayers subject to this sort of progressive income tax, and because such a tax would be levied against all industries, those inefficiencies and behavioral changes could potentially affect every domestic industry. Therefore, the challenge to levying this sort of tax would be how best to administrate the tax[21] to focus the impact only on those industries that the government deemed a focal point of this targeted redistribution.

In a system where there are incentives or subsidies for an industry that is the target of a windfall tax discussion, capping, reducing or eliminating these incentives or subsidies may be a viable (and palatable) alternative to a windfall tax. Alternatively, applicable incentives could be limited so that they do not apply to activities undertaken in the targeted industry. If the two principles driving the windfall tax are a fair redistribution of the windfall proceeds and increased government revenues, then the removal of all or part of these allowances can accomplish both of these goals. Specifically, smaller or eliminated subsidies create additional government revenue, and the taxpayers reaping the windfalls are effectively paying higher taxes against the unacceptably high profits they have earned.

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[20] The newly levied taxes in South America do not really fit within the context of this analysis. Strictly revenue motivated tax structures should be considered in light of that fact.

[21] In order to target actual windfalls rather than just the size of a taxpayer's profits the tax would need to be based on profits as a percentage of capital, or revenue, otherwise the tax would only act to tax larger companies, with commensurate larger profits at the higher rates.

The benefit, from an economic perspective, is that in a free market the subsidies represented an economic inefficiency. Removing the subsidy and avoiding the windfall tax enables the affected industry to operate in an economically cleaner environment. There are, of course, challenges to this approach as well. It generally favors larger more established taxpayers in the targeted industry, which may not comport with preferred policy. This approach also may not produce the same potential for quantity of revenue, or the same level of redistribution that the taxing government aspires to obtain because the amounts are fixed by the value of the subsidy or incentive, while amounts subject to the windfall tax may be more open-ended because of the potential for increasing profits.

A government can target a specific industry for a special tax or equivalent in countless other ways. One example is the Italian compromise on the windfall tax proposal there. Rather than enacting a windfall tax, the government elected to increase the tax recovery period for capital assets used by the energy industry. While this course of action could cause its own set of behavioral changes in the impacted taxpayers (the US uses accelerated recovery periods as an incentive in both the broad markets and in targeted industries to stimulate investment), it may not present the same level of economic inefficiency as a windfall tax. It seems likely however, that most of the affected taxpayers would view this as a positive compromise, as the potential for profits in the current markets likely exceeds the measurable effect of the change in recovery periods.

VI. Conclusion

Widely accepted criteria for good tax policy include the following four general concepts: (1) fairness and equity; (2) certainty and transparency, (3) efficiency; and (4) ease of administration.[22] The satisfaction of these criteria should be an important consideration in any debate over whether to impose a windfall tax, and how to design such a tax.

A tax should be levied in a fair and equitable manner. Fairness is usually measured in terms of both "vertical equity" and "horizontal equity." A tax possesses vertical equity when it appropriately (in the eyes of those judging it) accounts for differences in wealth or ability to pay. A tax possesses horizontal equity when it taxes similarly situated taxpayers in the same way. The notion of vertical equity often supports arguments that a windfall tax would be appropriate. That is, the redistribution of windfall proceeds by the government to socially desirable programs, or otherwise across a wider cross section of the population is thought to be more equitable than all of the benefits of the windfall being reaped by a select few lucky taxpayers.

In contrast, a windfall profit tax is often subject to criticism if it lacks horizontal equity. That is, in a relatively open economic system, the events that would give rise to a windfall for one taxpayer will have ramifications, both negative and positive, on other taxpayers in other industries.[23] By

[22] The AICPA published guidance on the principles of good tax policy, enumerating ten factors to consider in determining whether a tax proposal is good tax policy. Those factors were equity and fairness, certainty, convenience of payment, economy in collection, simplicity, neutrality, economic growth and efficiency, transparency and visibility, minimum tax gap, and appropriate government revenues. AICPA, Tax Policy Concept Statement, *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*, 2001.

[23] For example, when the price of oil spikes it is obvious that the oil producers benefit (hence the current debate over whether to levy a windfall tax against them) and oil consumers suffer a detriment in the form of higher prices. There

targeting only a single industry, a windfall tax could result in the potential inequity of taxpayers in different industries reaping similar windfall type benefits yet receiving disparate tax treatment.

Closely related to fairness is the notion that a tax should be both transparent and attain some level of certainty. Taxpayers need to be aware of how a tax operates, how the tax interacts with the preexisting tax regime and how the tax affects the taxpayer compared with other similarly situated taxpayers. A tax that fails to have this sort of transparency, even if it is applied fairly and equitably, can be perceived as unfair. Moreover, the less clear the mechanics and application of the tax the greater the potential that the affected taxpayers will be able to find ways to manipulate the mechanics of the tax, limiting compliance. Similarly, a tax must carry some level of certainty. Regular changes to the structure or rates of a tax, or even the perceived potential for changes can foster a perception of inequity and hinder a taxpayer's ability to manage liability within lawful bounds. Certainty is also important because uncertainty can cause behavioral distortions just like an actual tax, with a taxpayer reacting to the perceived potential changes, just as it would react and modify its behavior in reaction to actual changes to the tax.

A tax should be efficient. An efficient tax minimizes economic distortions and even handedly encourages productive activity. The potential for economic inefficiency is an oft-cited principle in the argument against the imposition of a windfall tax. In order for a tax to be economically efficient, it should cause minimal distortion of taxpayer behavior. The distortion most often cited is the suppression of investment by the affected taxpayer. The most common form of this suppression is decreased capital spending, but a tax can also suppress other types of expenditures such as ordinary operating expenditures or labor expenditures depending on the structure of the tax. It is also important to consider the potential for behavioral distortions with respect to consumption. Suppressed consumption or the shifting of consumption are both undesirable behavioral distortions that can arise from the imposition of a tax. As discussed above in the analysis of previously enacted windfall taxes, implementing a windfall tax in an economically neutral manner requires a great deal of finesse.

Finally, a tax must be administrable from both the taxing authority's and the taxpayers' perspectives. Excessive administrative costs, which become more common as tax regimes are made more complex (and avoiding excess complexity becomes increasingly more difficult as a tax is designed to satisfy all of the other criteria of good tax policy), can create potential challenges for the successful operation of a tax. A lack of administrative ease can cause two potential problems. The first is the potential for noncompliance. The greater the administrative burdens the greater is the likelihood that some taxpayers will fail to comply with the tax. The second problem is the potential for manipulation. Much like the problem with transparency, an overly complex tax lends itself to abuse through the manipulation of the mechanics or inputs used in calculating the tax.

The successful implementation of any tax, including a windfall tax, depends on the satisfactory integration of all of these criteria of good tax policy, in at least some manner. Neither the gross receipts based, nor the profit based windfall taxes that have been previously enacted have been free

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are other taxpayers, in other industries that similarly reap benefits if oil prices are high. For example, producers of other fuels such as coal or natural gas also see price increases, manufacturers of fuel efficient autos and other energy saving equipment will likely see increased demand, and certain types of mass transportation operators will see increased rider-ship far in excess of increased fuel costs, etc.

of criticism. Those criticisms, nearly universally, have as their origin the failure of these taxes to satisfy one or more of these criteria.

VII. Appendix I: Table of Windfall Profit Taxes by Country

Name	Type of Tax	Tax Rates[24]	Period	Mechanics	Comments
			United States		
1980 Windfall Profit Tax	Gross Receipts	15% - 70%	1980-1988	Assessed on excess of sale price over inflation indexed base price, several other variables (*e.g.*, type of production, age of well, etc.)	Only levied on domestic production; special treatment for new investments; part of compromise to decontrol oil prices
			United Kingdom		
Petroleum Revenue Tax	Gross Receipts	50%	1975 – ongoing	Charged on net profit of North Sea crude oil and gas after associated expenditure	Only applies to wells permitted before March 1993; designed to act as tax for winning exploration/development rights in the North Sea
1997 Privatization Tax	Excess Profits	23%	1997	Assessed as the difference between the value at privatization and valuation based on after-tax profits up through four years after privatization	One time tax; tax caused by backlash over perceived/real excess value caused by privatizing industries; levied against a range of industries
Supplementary Charge to Corporation Tax	Gross Receipts	20%	2002 - ongoing	Annual charge levied on profits from oil and gas production	Charged in addition to regular corporate tax; rate bumped from 10% to 20% in 2006
			China		
Petroleum Special Revenue Charge	Gross Receipts	20% -40%	Effective March 26, 2006	This charge is levied whenever the weighted average price of crude oil sold in any month exceeds US$40 per barrel	China enacted the tax for revenue generation. With the March 26, 2006 effective date, it is too soon to measure the pros and cons of the tax in China

[24] Exclusive of company taxes.

Russia					
Taxes on Oil and Gas Companies	Export Duties; Mineral Extraction Tax (equivalent of a royalty) plus corporate tax	20% - 50%	January 1, 2005	The tax regime operates on a sliding scale and the rates are adjusted annually, which, when added to corporate tax can place companies at a 90% rate	Since the January 2005 enactment, domestic oil production in Russia has decreased significantly, which has caused as much concern
Norway					
"Special Tax"	Corporate Profits	50%	1975 - ongoing	Annual tax levied on corporate profits. Companies may deduct financial costs and expenses against both the corporation tax and this special tax	An "uplift" is available (*i.e.,* an additional depreciation (amortization)) when calculating the basis for the corporate tax and special tax
Bolivia					
Company Profits Tax and Direct Hydrocarbons Tax (IDH)	The royalty tax is based on the Company Profits Tax; IDH is based on production	18% royalty plus 32% IDH	January 1, 2005	18% in royalties under the Companies Profit Tax plus 32% under the Hydrocarbon Law, plus corporate tax of 50%; taxpayers can deduct the profits and the IDH tax from the company tax	The IDH has forced twelve foreign energy companies to renegotiate exploration and production contracts. Growth in GDP could shrink substantially as foreign oil and gas companies invest elsewhere

Ecuador					
Extraordinary Profits Tax	At least 50% of the revenue when oil prices exceed a benchmark	50-60%	May 1, 2006	The enactment of this tax will generate for the government at least 50% of the revenue when oil prices rise above a benchmark price	Ecuador's Congress enacted the tax to generate revenue to capitalize on the recent fuel prices; recent Congressional estimates suggest raising $500 million in 2006 alone and more in the future.
Venezuela					
Hydrocarbons Law	The royalty rate is based on profits; the surface tax is based on per square kilometer surface granted; the consumption tax is based on fuel price	50 to 65%. (Plus a recently announced a new windfall tax tariff)	Enacted in 1999; amended in 2001 and increased rates in January 1, 2006	A royalty rate of 30%; surface tax of 2% for the first 5 years and 5% for each following year; and an enterprise consumption tax of 10% of the product price to the final consumer	The Hydrocarbons Law and the forcible imposition of the New Regime, if adequate compensation is not provided, may be an unlawful expropriation according to many foreign oil and gas companies doing business in Venezuela.
Canada					
Resource Royalty Regime (RRR)	Royalty Tax is based on profits above a certain level	On average, 25% can exceed 60% however.	1974 with amendments since then	Specification of a threshold return representing normal profits, no tax on returns up to the threshold, and a relatively high tax on returns in excess of it	Rates vary in the country. Royalties are payable to provincial governments as a percentage of production. The rates vary depending upon factors such as well production volumes, selling prices, method of recovery, location of production and date of discovery

Australia					
Petroleum Resource Rent Tax (PRRT)	Tied directly to profit: the net cash flow above a specified rate	40% plus excises on petroleum products and crude oil	1984	PRRT is levied on offshore projects to net cash flow *after* projects have achieved a threshold rate	The PRRT compounds pre-tax losses at the threshold rate; unsuccessful projects are denied full loss offsets
Malaysia					
Petroleum Income Tax Act of 1967	Chargeable on profits based on a formula	38%	1967 (this amount has decreased from 45% to 40% and then 38% in 1998	Petroleum income tax is assessed on the profits from operations; the 38% can be deducted when computing Company Tax (28% rate)	Every company must deliver a copy of its accounts of the profits arising from petroleum operations within three months from the closing date of the accounts. The rate reduction in the 1990s was enacted to stimulate production.

VIII. Table of Renewable and Alternative Fuel Tax Credits and Financial Incentives by Country

Type of Tax Credit/Incentive	Amount of Incentive/ Credit	Applicable Period	Mechanics	Comments
United States				
Investment Tax Credit for Advanced Coal and Gasification Projects	15-20% of investment	Enacted 2005, certification period 2006-2008	A 15 or 20% tax credit applies to investments in a clean coal facility. The credit is taken in the year the facility is placed in service.	This credit is available on a competitive basis following approval by the Department of Energy and an award of credits from the Internal Revenue Service.
Election to Expense Certain Refinery Costs	50% Accelerated Cost Recovery	Available for property placed in service before January 1, 2012	Taxpayers may elect to treat 50% of the cost of property considered "qualified refinery property" as an expense in the tax year such property is placed in service.	Applies to refineries that process liquid fuel from crude oil or qualified fuels (*i.e.,* oil from shale and tar sands; gas from geo-pressured brine, shale, coal seams, or biomass; and syn-fuels produced from coal).
Production Credit for Renewable Fuels	1.9 cents per kilowatt hour sold (adjusted for inflation)	The credit expires 5 or 10 years from the placed in service date of the facilities according to the resources used	The electricity must be produced from a qualified energy resource (QER), owned by the taxpayer and sold to an unrelated person.	QERs include wind, closed-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, refined coal, hydropower production and Indian coal.
Production Credit for Refined Coal	$5.679 per ton (indexed for inflation)	10 years from the facilities' placed in service date	Refined coal is a liquid, gaseous or solid synthetic fuel produced from coal sold to produce steam.	A qualified refined coal facility is one that is placed in service after August 8, 2005 and before January 1, 2009.

Production Credit for Non-Conventional Fuels	$6.56 per barrel currently (indexed for inflation)	Applicable for Coke Gas Sold before January 1, 2008	Facilities producing coke or coke gas placed in service before Jan. 1, 1993 or after June 30, 1998 and before Jan. 1, 2010 can qualify.	This credit applies to the sale to an unrelated person of qualified fuels (*i.e.,* liquid, gaseous, or solid synthetic fuels produced from coal) produced in the U.S.
Excise Tax Credits for Alternative Fuels And Alternative Fuel Mixtures	50 cents per gallon	Expires September 30, 2009 (or 2014 for liquefied hydrogen)	Facilities can offset excise tax levied on the removals and sales of fuel when used to produce alternative fuel or an alternative fuel mixture for sale (or used in its business).	An alternative fuel mixture is a mixture of alternative fuel (*i.e.,* LPG, LNG, benzol, benzene, naphtha, any liquid fuel from coal through Fischer-Tropsch process) and taxable fuel (*i.e.,* gasoline, diesel fuel, kerosene) sold by the taxpayer
United Kingdom				
Capital Allowances for Expenditures on: **i. New energy saving plant or machinery ("P&M")** **ii. P&M for gas refueling station** **iii. New environmentally beneficial P&M** **iv. Cars with low carbon dioxide emissions**	Immediate 100% tax deduction on capital expenditure	 On/after April 2001 On/after 17 April 2002 or on/before 31 March 2008 On/after 1 April 2003 On/after 17 April 2002 or	The company can claim first year allowances (FYA) (100% tax depreciation or 24% for assets with a useful economic life of 25 years or more) in the chargeable period the expense was incurred when computing profits chargeable for purposes of corporation tax. The company may claim the whole or part of the allowance that it is entitled to receive in the given year.	This compares to tax depreciation rates of 25% reducing balance (6% for long life assets) for other types of capital expenditure. FYAs may be claimed irrespective of whether the company is profit making. Claiming FYAs can increase a loss position. If the company is in a losses group for UK tax purposes the losses may be surrendered to other companies in the group.

		on/before 31 March 2008		
Research & Development Allowance	100% of capital expenditure incurred	On or after November 1962	The company will receive an allowance equal to the value of the expenditure incurred on research and development (R&D) when computing its profits for the corporation tax for the period the expenditure was incurred.	The allowance covers expenditure incurred for carrying out R&D, or providing facilities for research, but not that incurred on the acquisition of rights in, or arising out of, R&D.
Research & Development Tax Credit	12.5% for North Sea Oil Companies 7.5% for other companies	On or after 1 April 2002	The company may claim a tax deduction equal to 125% of the revenue expenditure incurred on qualifying R&D. For companies paying corporation tax at 30% this equates to a 7.5% tax credit. For companies paying tax at 50% (North Sea Oil companies) this equates to a tax credit of 12.5%.	An activity qualifies as R&D for tax purposes if it would be treated as R&D under normal accounting practice for companies in the UK. Expenditure for carrying out R&D, or providing facilities for such research, but not that incurred on the acquisition of rights in, or arising out of, R&D. The minimum cost incurred must be £10,000.
Climate Change Levies: **i. Exemption for supplies of energy for use in recycling process**	100% exemption	Exemption available until certificate issued by customer is no longer valid.	For supplies of energy for use in recycling. Supplier must receive a certificate that the energy will be used for such purposes.	Paragraphs 18A and 19 of Finance Act 2000 Schedule 6.
ii. Supplies of electricity exempt from CCL if produced from	100% exemption	Exemption available until certificate issued	For supplies of electricity produced from renewable sources, the supplier must issue	Paragraphs 18A and 19 of Finance Act 2000 Schedule 6.

renewable sources		by customer is no longer valid.	a 'renewable source declaration'	
Reduced-rate VAT	5% VAT on services (standard rate of 17.5% would otherwise apply)		Reduced VAT applies to supplies of services of installing energy-saving materials for use in residential accommodation and 'charitable buildings'	Group 2, Schedule 7A, VAT Act 1994 The benefit also only applies to the installation of such materials, not merely the supply to another person.
Exemption from Aggregates Levy on the supply of industrial and commercial waste	100% exemption (otherwise subject to charge of £1.60 per tonne).		Exemption from Aggregates Levy on the supply of industrial and commercial waste as fuel to boilers which produce steam to drive steam turbine generators. The electricity is sold for distribution on the national grid.	HMRC Notice AGL2, paragraph 3.6 Industrial and commercial waste is shredded and separated, with metals, for example aluminum, recovered from waste. The resultant electricity is sold to utilities for distribution on the national grid.
Excise Duty Reduction	50.19 for unleaded petrol, 56.20 for leaded petrol		Excise duty on unleaded petrol is lower than on leaded petrol.	
Excise Duties	Bioethanol + Biodiesel: £0.20 per litre below the rate for sulphur-free petrol (27pence/litre)		The full rate of excise duty must be paid and a reclaim lodged with the tax authorities.	
Customs Duties Reduced	The customs duty rates for biofuels/biomass are likely to be lower than the duties for normal fuels or nil.		The customs duty rates applicable depend on the classification of the import goods.	Biofuels have a reduced rate of excise duty, based on the ratio of normal fuel to biofuel. Bioethanol is reduced below the prevailing rate of duty for sulphur-free petrol.

Vehicle Excise Duty Reduced	Rates can vary from £0 to £200. Vehicles on alternative fuels always benefit from lower rates compared to classic fuels		The alternative fuel category will be extended to include cars that are capable of running on bioethanol (at least 85%, *i.e.,* E85 or Flex Fuel)	Vehicle excise duty tax is based on CO2 emissions
China				
Research of Renewable Energy	Assisted Government Funding (specific terms in the Code not yet defined)	Enacted in 2005, the Renewable Energy Law	Scientific and technological research for the development and utilization of renewable energy	China has the goal of generating 30 gigawatts of installed power generation capacity using renewable sources in the next 15 years.
Independent Renewable Power Systems	Assisted Government Funding	2005	Construction of independent renewable power systems in remote areas and islands	The terms of the following programs below are not defined yet.
Renewable Energy Resources	Assisted Government Funding	2005	Surveys and assessments of renewable energy resources, and the construction of relevant information systems	
Utilization of Renewable Energy	Assisted Government Funding	2005	Localized production of the equipment for the development and utilization of renewable energy	
Construction of Renewable Energy Projects	Assisted Government Funding	2005	Construction of renewable energy projects for domestic use in rural and pasturing areas	
Tax Benefits for Renewable Energy Projects	Investment Tax Credits ranging from 10-40%	2005	Tax benefits for renewable energy development and utilization projects for the renewable energy industry.	

Preferential Loan Subsidies	Interest Rate Subsidies in varying amounts	Enacted February 28, 2005	Financial institutions provide preferential loans with interest subsidies to renewable energy development and utilization projects.	This government subsidized bank loan program requires borrowers to comply with the requirements for bank credit.
India				
Village Energy Security Programs	Investment credits and income tax holidays for seven years.	2004 and the Finance Act of 2005	Renewable energy program for the electrification of remote villages through renewable energy sources (solar, biomass and bio-fuels) for energy needs.	Achievement in wind power is likely to exceed targets. The target set includes the 140 MW Integrated Solar Combined Cycle (ISCC) power plant in Rajasthan.
Biomass Gasification	Investment credits and income tax holidays for seven years	2003	Biomass Energy Systems have been successfully demonstrated. The local community is involved in biomass collection.	The operation of the energy supply systems is done through locally available manpower. The electricity is used to provide drinking water supply and lighting.
Cogeneration Program	Investment tax credits and financial incentives from the Government	2004	The cogeneration in sugar mills using bagasse as the fuel can generate 3500 MW of exportable surplus power	Sugar mills hardly require 20-30% of their power generating capacity for internal consumption. The balance power is available for feeding into the grid.
Income Tax Deduction	100% income tax deduction of expenses over 7 years	Finance Act of 2005	This accelerated depreciation applies to equipment	

Biomass Program	Significant tax credits	Started in 1981 and ongoing to day	The credits apply to technologies developed for using tree-based organic substrates such as leaf litter, starch, vegetable & kitchen waste	Biogas has traditionally been produced in India from cow dung (gobar gas); dung is not adequately and equitably available in villages.
Alternative Fuels	$4 million of project funding	N/A	The Indian government to support research in three areas of alternative energy created a special fund of US$4 million.	Applies to solar power, wind turbines and hydrogen fuels.
Indonesia				
Biodiesel Plants	$33 million funding assistance plus significant investment tax credits	Enacted 2006	The government has earmarked $33 million to build four pilot bio-diesel plants, meant to serve as national models for alternative-energy production.	The plants in Kalimantan and Sumatra, with a combined annual capacity of 6,000 tons, will reportedly be operative by the end of this year.
Bio Coal Briquette as An Alternative Fuel	20-50% Investment Tax Credit	2006	The Indonesian government has enacted an innovative financing regime to promote Bio Coal Briquette as an Alternative Fuel	This program is expected to reduce or eliminate significant market barriers to such a program. This program is expected to attract investment.
Sustainable Cement Production	Undisclosed Sums of Financial Assistance and Tax Credits - partnered with the World Bank's Carbon Finance Unit	2006	The program is geared to improving cement production that accounts for about 3-4% of total human-induced greenhouse gas emissions.	Developing countries must reduce such emissions by adopting new technologies in cement production.

Tax Consolidation/ Improvement of Fiscal Terms for Oil And Gas Production	Undefined thus far, still pending	Pending	Current discussion of potential amendments to the tax system to create further incentives for O&G production are in the early planning stages.	
Plants to Build Synthetic Diesel	Undisclosed financial and tax incentives		The financial incentives will assist foreign oil companies to build pilot plants for synthetic Fischer-Tropsch diesel fuels.	
Russia				
Current incentive: **Favorable Mineral Extraction Tax Rate**	0%	Effective from 2002 The Government has not enacted many incentives for clean or renewable fuels.	Extraction of associated gas from oil wells is exempt from Mineral Extraction Tax (equivalent of a royalty). Direct application of zero tax rates to the whole volume of associated gas produced.	The establishment of a zero tax rate for O&G companies is to stimulate them to use the associated gas rather than flare it. In the current tax law this is the only example, which may fall under the incentive definition.
Proposed Incentive: **Lower Excise Tax Rates For Higher Quality Petrol**	To be defined	No earlier than 2008	New differentiating excise tax rates to be set. The principle of differentiation is the quality of petrol.	Currently excise tax rates are set in a way that the higher the octane number of petrol, the higher the tax rate. Such situation does not induce companies to produce high quality fuel in the Russia.

Recently Expired Incentive: **Favorable Excise Tax Rate**	0%	Abolished in 2006	Previously there was 0% excise tax rate on "straight-run" petrol (*i.e.*, petrol obtained from processing gas condensate, petroleum gas, natural gas, coal)	This exemption is abolished from 2006 and now "straight-run" petrol is taxed at the rate established for petrol with an octane number of up to "0"
Australia				
Petroleum Resource Rent Tax Deduction	100-150% deduction	Enacted 2004	The government has increased the value of pre-appraisal exploration deductions in designated frontier areas from 100% to 150% for determination of Petroleum Resource Rent Tax	Petroleum resource rent tax—providing an immediate uplift for exploration expenditure in designated offshore frontier areas.
Core Petroleum Program	$36 million	2003-2007	The government is providing $36 mil between 2003-04 & 2006-07 to continue with the existing pre-competitive oil exploration program	The Government developed protocols to guide collection of comprehensive, consistent pre-competitive data for energy resources, covering mineral and renewable energy sources
Alternative Fuels	0%	July 1, 2006	Diesel and fuel oil used for power generation will be effectively excise-free from 1 July 2006. There will be no excise introduced on currently untaxed fuels used for power generation	These measures include excise tax concessions costing $840 million a year in forgone excise revenue mostly from LPG sales and a $1000 grant for LPG vehicles delivered new between 1 July 2011 and 30 June 2014

Biofuels Capital Grants Program	Cost $37.6 million in first year from 2004-2005	2004-2008	The government established a $37.6 mil capital fund annually to fund one-off capital grants for projects that provide new or expanded biofuels production capacity	Grants will be provided at a rate of 16 cents per liter to projects producing a minimum of 5 million liters of biofuels per year, up to a maximum of $10 million per project.
Fuel Excise Reform/ **Business Credits**	50% excise tax credit on amounts levied Program cost: $100 mil in 2006-07, $350 mil in 2008-09, $310 mil in 2012-13, totaling $1.5 billion	1 July 2006 with additional phase in through July 1, 2012	A full excise credit is available for all business use of fuel off-road. Diesel and fuel oil used for power generation will be effectively excise-free. There is no excise introduced on untaxed fuels used for power generation.	This measure is expected to reduce the excise collections from businesses by $320 mil in 2008-09, increasing to $650 mil in 2012-13 (in addition to the grants provided for electricity generation).
Single Business Credit for Alternative Fuels	0% excise tax credit	2006	The measure will ensure that alternative fuels that are effectively untaxed under the current excise regime remain until July 2011. After that, a 50% credit is available.	All fuels will be grouped into three bands based on their energy content, with different rates for high, medium and low energy fuels. Excise on petrol and diesel will remain unchanged.

Annexure C

REPORT

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The Relationship among Economic Rents, Windfalls and Taxation

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1. INTRODUCTION

This report addresses the issues raised in Sections 4 and 7 of the Discussion Document (DD) on the relationship between the theoretical concept of economic rents and the rationale for the taxation of such rents. More broadly, it addresses the role of economic rents in a competitive market economy and demonstrates why, as a practical matter, governments do not attempt to tax pure economic rents – both because they are very difficult to identify and measure properly, and because the existence of such rents is what gives signals to investors regarding where to allocate their capital in a market economy. The paper also addresses the concept of windfall profits and their use as a justification for taxation.

It is recommended that before any proposed mechanism to tax windfall profits on synthetic fuel production is implemented, the economic impact of such a mechanism be studied in detail.

2. ECONOMIC RENTS

2.1. ECONOMIC RENTS IN A MARKET ECONOMY

We accept the basic definition of economic rents provided in the DD, although the provision of three separate definitions is somewhat confusing. The basic principle is that the economic rent (which is also known as, inter alia, residual income, abnormal earnings and economic value added ®) for a particular period represents the excess of profit over the appropriate cost of capital. Moreover, there is a close relationship between the economic rents generated by a given investment and the added value created by that investment. Hence, we disagree with the impression given in the DD that economic rents are unnecessary to the functioning of a healthy competitive market economy or that they are profits that are not needed by firms to stimulate efficiency-seeking, value-creating, and employment generating behaviour.

Consider the role that economic rents play in a competitive market economy. Firms seek to create wealth for their owners and they do this by seeking out investments that generate income that exceeds the associated costs when calculated, again using the appropriate cost of capital, on a net present value (NPV) basis. If the NPV of an investment is zero, then it is simply a breakeven investment, i.e. it creates no added value for the owners of the firm who consequently have no incentive to make that particular investment. In addition, as illustrated by the example in Appendix A to this paper, in this instance there are no economic rents (more precisely, the present value of the economic rents over the life of the investment is zero). This is not the kind of investment that investors will seek out. It is investments with positive NPVs (equivalently positive economic rents) that firms are seeking since these are the investments that create value. This is an essential incentive for efficient investment, value creation and economic growth.

The example in Appendix A highlights another important point that seems to be missing from the DD. Investments typically have a lifespan of many years. This is certainly true in the case of a synthetic fuel plant. Projects will be attractive to potential investors when the NPV of the project *over its lifespan* is positive. In any given year of its operating life, the project may earn positive or negative economic rents. The existence of the former is essential to balance the losses incurred by the latter. Indeed, many businesses expect to lose money in their initial years hoping that these losses will be recovered as the business grows. In this way too, economic rents are crucial to a well functioning economy.

On the other hand, suppose there is a real shortage of some economic good and that prices are high. Under these conditions, investors will be able to earn high returns with a NPV significantly greater than zero by investing in the production of this commodity. As a result, capital will flow into this industry, the supply will increase and supply and demand will reach a new equilibrium. The fact is that it is the existence of economic rents that motivates investment in any industry. Over time, as long as the potential for earning economic rents exists in an industry, there will be expansion and new entrants that will cause an increase in supply to the point at which economic rents are minimal.

In summary, in a competitive economy, the existence of economic rents is an essential driver of investment to areas of the economy that produce the greatest value for the investor and the economy as a whole.

We can consider some concrete examples. It should be noted of course, that economic rents could be derived from any commodity subject to cyclical pricing. In the case of a producer of synthetic fuels, economic rent might temporarily result from the following factors:

1. The impact of high global oil prices, over which Sasol and the South African economy have no control;

2. Temporary constraints in global crude oil supplies, triggering higher prices; and

3. A delay in the normal economic adjustment for higher prices (new entrants), caused by a combination of the nature of the investment (it requires a large up front investment, not small incremental investments) and potential regulatory barriers (Government permits etc).

For Sasol, any economic rent would be enhanced by the Government's price regulation mechanism, which bases inland wholesale prices on import parity plus pipeline transportation costs. Actual product transport cost (i.e. by road) are approximately three times higher than the regulated pipelines tariff, so Sasol's transportation advantage is trivial compared to the impact of high crude prices.

There is thus a danger in confusing a short term market advantage, to do with locational factors and infrastructure constraints, with long term market power. An efficient, deregulated economy will produce competitors to erode any advantage, in this case by building more infrastructure (e.g. more pipelines or refinery expansions).

There is an issue of Government influence here, since major fuel infrastructure investment requires both substantial permitting and high potential risk, which Government can help or hinder. Whilst utilities such as gas and power distribution are effectively monopolies, since it is uneconomic to build parallel networks, the same is not the case for the downstream oil industry. The issue is more one of scale – there must be a sufficient market deficit to justify the large investment required in a new pipeline and/or refinery, but once that stage is reached then competitors will be interested in making such an investment (e.g. UK interconnectors, new US refineries).

We consider the specific supply demand balance of South Africa in Appendix B

A similar issue arises when power prices in a deregulated market achieve high peaks. Many commentators talk about abuse of market power. However, the generators are simply taking advantage of a movement in demand where supply can only change over a long lead time. Without the price peaks, there would be no signal to other market operators that supply is restricted and that there are opportunities to build new generation capacity. EU regulatory studies into possible means of capping price peaks have come to the conclusion that any such mechanisms would be counterproductive, since they would hinder the building of new capacity.

2.2. ECONOMIC RENTS AND TAXATION

Even in long-run equilibrium, some firms in the industry may still earn economic rents because of greater efficiency. Only the marginal firm will earn zero economic rent. The more efficient firms may earn these rents, as was noted in the DD, because of better technology, management, intellectual property, etc. The DD stated that these economic rents were not normally considered as a target for taxation [DD, at p. 29] but mentions two other situations in which taxation of economic rent may be appropriate. These include the case of the extraction of natural resources, which are considered to belong to society, and the excessive pricing of essential goods and services for which consumers have no alternatives and have little choice but to consume.

The DD often adopts the relatively simple economics of a static one-period world at the expense of the more nuanced and more realistic economics of a dynamic multi-period world. Put another way, when economists adjust their simple one-period models to instead account for the fact that economic decisions take place over time, many of the insights of the static models are no longer valid. Nowhere is this more apparent than in a discussion of investment - a point that arose in the above discussion of economic rents. What looks like a rent in one period may, over the course of the lifetime of a project, be countervailing a loss in another period or compensating investors for the higher-than-normal level of risk involved in the project. The idea of profits and losses over multiple years and the notion of a risky future are both ideas that only arise in a dynamic context. And their inclusion is key to a realistic view of the economy.

2.2.1. Natural resource rents

In the case of natural resource endowments that are being exploited by a firm, the government may consider this to be a target for taxation on the grounds that the profits

should in part go to society – just as one might tax property, income, or any other asset as a way of raising revenue. However, seldom is such a natural resource tax designed in such a way that it is levied only on the economic rents themselves (i.e., profits over time that are over and above a normal rate of return on capital). In addition to severe difficulties of implementing a tax on economic rents rather than profits, such a tax would also provide a disincentive to efficiency. A more normal approach would be to levy a tax on all profits or to charge a tax on sales arising from the extraction of the resource. Obviously the tax cannot be so high that the after-tax return is below the cost of capital, or the firm would not (had it known that the tax would be imposed at the time of the investment) have made the investment in the first place. If, however, the tax were imposed after the investment took place and did drive the return below the cost of capital, this would amount to a confiscation of capital.

It is interesting to note that if the tax could be levied on the economic rent alone then the problem of confiscating capital would not arise. For this reason, economists have been fascinated by the possibility of taxes based only on economic rent, as they would cause less distortion than taxes on all profits. Unfortunately, it is impractical to calculate taxes on this basis, as they would have to be calculated or adjusted over the life of the investment. We would have to know the appropriate cost of capital, and we would have to calculate these rents for the firm as a whole, which in general would have a portfolio of investments. In Appendix A we discuss the problems with identifying and measuring economic rents earned by a firm. As we show, it cannot be done by looking at one year or a few years over the life of a project, even if profits appear very high in those years. Furthermore, even if Government could somehow do the appropriate calculation over the course of the entire lifetime of the project, such a tax would still have disincentive effects on future employment generating investments in risky ventures.

Taxation of natural resource rents is common in the oil industry, where governments enter into various fiscal arrangements with oil exploration and production companies. The UK 2002 & 2006 “Supplementary Corporate Taxes on Oil Producing Corporations” are adjustments to the UK fiscal regime rather than “windfall” taxes, as acknowledged in the DD. However, these taxes have had unintended adverse effects on the economy, in reducing the incentive for investment and exploration in the North Sea (UKOOA 28 November 2005). As a result, the UK Government had to introduce additional complex measures to try to incentivise investment whilst still keeping tax levels high (the Exploration Expenditure Supplement in 2004, replaced by the Ring Fence Exploration Supplement in 2006). Ultimately, however, investors will spend marginal investment funds in the area where costs, including taxes, are lowest. The UK tax increases pushed the UK gross tax take over that charged by the US in the Gulf of Mexico, [and as a result exploration and development activity in off-shore oil has been growing in the US at the expense of the UK].

2.2.2. Rents from substantial market power

The other justification for taxing economic rents that was mentioned in the DD is where there is the potential for the exercise of substantial market power to raise prices. Generally, where this situation exists, there are two preferred solutions. The first is to introduce sufficient competition to eliminate or greatly reduce this pricing power. Certainly

competition in fuel product markets has been introduced successfully in much of the developed world. The second approach is price regulation, but that entails all the incentive problems associated with such regulation as well as the analytical problems of establishing what the appropriate price is that will eliminate economic rents. The DD mentions possible taxes to claw back economic rents that were made because of regulatory error. On the other hand, this should also include the possibility of payments to companies where prices were set too low. If this were done, then the firm would be guaranteed to earn its cost of capital regardless of its performance; this, however, would create strong disincentives for efficiency.

The primary goal of policy makers should not be the elimination of economic rents per se, but rather the promotion of the healthy functioning of a competitive market economy. Competition will erode transitional situations where firms earn high economic rents. Where significant monopoly power exists, this can be dealt with through competition policy or through regulation. However, taxation initiatives that are directed at eliminating economic rents is seldom an option that is used as part of either of these options.

CRA understands that a supply deficit of fuel product is expected to emerge in South Africa over the next few years. In the absence of full deregulation, the existing regulatory pricing mechanism is based on an import parity derived price. This is consistent with normal industry practice and is a reasonable basis absent full deregulation.

For example, few regulatory systems provide for retrospective clawback of abnormal profits, even when these are considerable (and could thus be deemed to be a result of regulatory failure rather than economic gains). The UK utility regulatory systems adjust their price control every 5 years, based on the five year history but with future impact. Thus firms can make surplus profits for a certain length of time before being stopped. This encourages efficiency and innovation.

In UK utility regulation, there are certain “windfall” provisions which have retrospective effect (e.g. property asset disposal gains), but these rules are set out and understood in advance of the period to which they apply – the retrospective nature is purely for ease of calculation. In addition, these gains are not passed on to Government as an additional tax, but are pushed down to customers in the form of lower future prices. Similarly, in a recent case against Thames Water, fines for failure to deliver regulatory targets were waived in return for a binding commitment to make additional investments in the network, above and beyond what was allowed for in the price determination, again waiving Government revenues in favour of customer benefits.

An example of the EU approach to energy monopoly regulation is discussed at Appendix C.

3. WINDFALL PROFITS

3.1. WINDFALL PROFITS AND TAXATION

Windfall profit, unlike economic rent, is not a well-defined or widely used concept in economics. Windfall profits are generally said to occur when changes in the economic environment are such that firms in certain industries get large increases in profits from some economic shift and, therefore, are felt to be unjustly enriched. The case of high oil prices is a typical example. As a result of an increase in worldwide demand relative to supply, prices have surged. Consequently consumers are paying higher gasoline prices than ever, while oil companies are recording record profits. In these situations, there is always a call for windfall profits taxes to take some of the profits from those firms and individuals who have been enriched and to redistribute them to the public coffers. This call for windfall taxes is seldom accompanied by a careful analysis of whether, in fact, these companies have earned any economic rents over the life of their invested capital, let alone rents that are greater than are found on average in highly competitive industries.

The standard approach is to observe a rise in profits due to something like a rise in oil prices and to conclude that these prices are excessive and should be subjected to a special windfall profits tax. The concept and implementation of a windfall profits tax is more of a political creation and phenomenon than the result of economic analysis. Considerations of revenue generation and fairness are the primary driving forces, rather than the attainment of economic efficiency and growth. In fact, efforts are more likely to be devoted to elimination of so-called windfall profits because they impede economic efficiency and growth. This is demonstrated most strongly by the absence of windfall profits taxes being implemented by governments. Although commodity prices have been subject to many positive and unanticipated increases over the past quarter century, one has to search hard for examples of windfall profits taxes. Furthermore, as noted in the DD, these few examples are typically prospective taxes, not the retrospective tax that appears to be on the table in the DD. Finally, there is little evidence that the windfall profit taxes that were implemented enhanced economic growth and employment.

We believe that defining “windfalls” as being events outside the range of contingencies considered by regulation is not particularly helpful. If we look at the relatively small number of examples in which windfall profits taxes have been levied, the main guiding principle is that the government felt some industry or group was unjustly enriched and that the size and importance of this enrichment justified a special tax. If that is the main criterion, then the critical analysis is to demonstrate unjust enrichment of such magnitude that legislation of a special tax is necessary. As noted above, there have been many shifts in commodity prices that have been unanticipated and of a magnitude to significantly enrich firms or individuals. Yet, in very few cases have windfall profits taxes been legislated in response. Certainly, the evidence that Sasol has benefited on a scale that would justify consideration of a windfall profits tax has not been demonstrated.

The UK utility windfall tax was a highly political measure made against a soft target, whose management had been heavily criticised in the media as “fat cats”. As stated in the DD, it was justified by reference to the large increase in market value in the four years

following flotation, thus allowing the Government to argue that the share price at the time of privatisation was incorrect. This was less a regulatory failure than an alleged failure by a previous Government to maximise the value of its assets. It was also clearly a means of raising revenue to meet spending promises after an election whilst appearing to remain fiscally responsible.

3.2. VOLATILITY FOR SASOL AND OTHERS

Much of the argument for additional taxes upon Sasol arises from the view that the company benefits disproportionately from oil price volatility. In a climate of $70/bbl oil, the synthetic fuels industry is perceived to be making substantial profits from an activity whose costs are considered to be quite static, regardless of the price of oil. It is worth noting that profitability creates benefits for both synfuel producers and the Government of South Africa. In addition, while the alternative value of the coal at Secunda may be low, and many operating costs are relatively static, Sasol incurs cost with both local and international components. In recent years the company has expended significant amounts of capital in order to meet environmental requirements and tighter product specifications. Furthermore, Sasol is subject to both South African inflation and Rand foreign exchange rate fluctuation.

The contrast with the refining industry is clear. A refiner buys crude oil and sells product at prices which often move in tandem with crude, but the two are not perfectly linked. Refiners' margins tend be higher whenever crude prices rise, due to the inelastic nature of fuel product demand, but the correlation is far from perfect. At times refining margins may not be sufficient to cover costs, for example when either crude prices or refinery utilisation is low.

Nonetheless, in either case the driver of revenue is not the technology in use but external forces which set the market price of what Sasol and the conventional refiner produce. The current high profitability of synthetic fuels is largely due to high global crude prices, which are determined by external factors over which South Africa has no control.

Conversely, this fact can result in prices that are uneconomic to a CTL / GTL producer. The commercial challenge to potential CTL / GTL producers lies in the fact that the technology and its operation cost a fixed amount per tonne of output, but the revenue from that output may vary below what is required to turn a profit. This volatility has a leveraged effect in any event.

Any part of the oil, gas or petrochemical industry with a high fixed cost base (e.g. the North Sea, CTL and GTL producers, etc.) will have a greater risk of low profitability because of the inherent possibility of a downturn in global crude oil and product prices. Many of Sasol's competitors, whether they be independent refiners or integrated oil companies with crude oil production, have lower fixed costs and therefore can operate profitably at lower crude prices.

Because the integrated oil companies typically can attain breakeven at lower oil price levels, and Sasol must compete with them in the international capital markets, any

attempt by the South African Government to place a windfall profits tax on synthetic fuels would make Sasol less attractive to investors in these same capital markets.

3.2.1. Supply security: price volatility is beneficial

Supply security is no longer the major issue that it once was, due to structural changes in global oil markets.

When the oil-price shocks of the 1970s occurred, price markers, hedging and the use of derivatives were virtually unknown. Most of the world's supplies were provided under term contracts from OPEC into systems controlled by the integrated major oil companies. In many consuming countries, wholesale and retail fuel prices, as well as physical supplies, were rigidly regulated by governments (including that of the US).

An inflexible supply system and government interference, combined with a lack of price transparency, virtually assured that if a physical dislocation of the oil supply took place, the available remaining supplies could not be quickly reallocated. There was no point in traders selling into tight markets because there was little price transparency and thus little prospect of economic reward.

This contrasts significantly with recent experience. There has been turbulence recently in global markets – the guerrilla war in Iraq, instability in Nigeria and political uncertainty in Iran, for example – but this has not been accompanied by physical shortages. Anxiety about supply translates into higher bids to buy oil, with the most anxious – or most structurally short – countries bidding highest.

Modern oil trading markets respond to the bids by sourcing oil from areas where supply is less critical and thus the price is lower. This has ensured continued availability, albeit at higher prices.

Supply interruptions are far less probable now, because of the ability to arbitrage physical cargoes. Oil-price shocks are unlikely to threaten supply of oil everywhere in the world simultaneously, so even when supply is constrained, certain regions are better supplied than others. The least-threatened markets can be incentivised by price to sell their surpluses or reduce their stocks. Markets have thus become highly adept at arbitraging between regions to ensure continuity of supply. Both the physical means to do this – ships, shore tanks and pipelines – and the financial means – liquidly-traded, transparent spot markets in oil and its derivatives – exist to support this activity. If anything, aggregate price volatility has increased simultaneously with improved supply security, because the former provides economic rewards to suppliers which prevent the latter.

The most striking recent example of this corrective mechanism at work was in the aftermath of Hurricane Katrina in 2005, in the US Gulf of Mexico. The disruption to US supply caused by the hurricane briefly pushed the price of gasoline above $800 a tonne – a more than 70% rise over the previous week – providing European refiners with an economic incentive to ship their plentiful inventories to the US to redress the imbalance.

This was possible because the Mideast Gulf states and other OPEC producers lost control of the price of oil when there was a supply surplus. This meant they always had

excess cargoes to sell, the price of which was determined by the marginal customer. The transparency this brought to pricing made spot and forward trading possible, and encouraged the development of commoditised core petroleum grades, with other grades traded at quality differentials to marker-grade crudes. In turn, this enabled the development of futures markets. The resultant forward curves continue to support traders in their goal of arbitraging between shortage and surplus.

When oil markets experience a threat to supply, their intrinsic flexibility and transparency enables the price to fluctuate in a way that rewards market participants who move to correct the interregional supply imbalance. Gas, in contrast, has no such mechanism. If supply is threatened sufficiently, it will be cut off, because arbitrage arrangements do not exist on the necessary scale. There is no point in a Ukrainian gas buyer raising his bid for a gas supply in the event of a shortage, because nobody can supply him; the infrastructure to support global gas arbitrage does not exist.

Put simply, price volatility is beneficial to countries which are net short of fuel because volatility offers market participants an economic incentive to sell into those markets and solve their problem for them. There is no reason to think this is about to change.

3.2.2. Volatility and returns on capital

It follows from the above that while volatility may periodically produce attractive returns for a group such as Sasol, the volatility is useful in itself to countries with concerns about strategic fuel supply. Price volatility is often perceived as a problem, but in the case of supply security volatility actually solves a problem by ensuring security of supply.

A side effect of price volatility is that it will cause the returns earned by an asset to fluctuate. Sasol needs to retain some element of the return available from high prices to offset the impact of the opposite. In general, it is the case that these high prices, while they produce attractive returns, also confer a strategic benefit on countries as a whole.

Oil price volatility will continue to exist regardless of the absolute level of prices. High volatility and high price levels, however, may help encourage development of alternative fuels. In turn, this will confer strategic benefits to countries having the capability to produce alternative fuels, in like fashion to producers of oil and gas.

3.2.3. Case Study: the downstream oil industry of Turkey

Tupras in Turkey represents an example of how a protection mechanism intended to safeguard the value of a state owned enterprise produced unintended side effects which eventually destabilized it and jeopardized the country's fuel supply.

Tupras was the state-owned refining company of Turkey, operating four refineries. Throughout the 1990s, successive Turkish governments prepared to privatize Tupras, and in order to protect its revenues they operated a regime called "the 60:40 Rule". This stipulated that all local retailers and wholesalers had to source 60% of their sales from Tupras, at a price which was also regulated. Taken together, the effect of these measures was to protect Tupras' revenues and hence its value ahead of privatisation.

Problems arose because the pricing climate made fuel expensive regardless of how it was sourced, and meant it cost the same everywhere, even inland. This provided an incentive for the import of contraband fuel via land routes from Iraq. This material undercut Tupras' prices and hence its margins, but the rogue product could not be policed out of the market because after a few years, if it had been, Tupras would have been unable to meet 60% of local demand and a supply crisis would have resulted.

The problem was dealt with by allowing Tupras to invest in hardware that upgraded its ouput to exportable standards, and by relaxing the 60:40 Rule. This allowed Tupras to sell its production without needing a captive market and allowed importers to bring in cargoes at more economic rates. The result of this has been that although it now operates in a largely liberalized market Tupras was still able to be sold last year for 150% of replacement cost, and there have been no adverse consequences in the form of steep price rises for customers. Tupras' loss of its preferential position provided an incentive for importers to replace their Tupras supply with volumes bought at market rates and transported inland.

4. THE POTENTIAL EFFECTS OF FISCAL POLICY ON THE SYNTHETIC FUELS INDUSTRY AND THE SOUTH AFRICAN ECONOMY

The impact of South African fiscal policy on the future growth of the CTL industry and its effects on the overall economy could be extremely significant, particularly on the upside, and should be carefully explored before changing the current policy. The technical possibilities of using this technology to substitute liquid hydrocarbons, derived from relatively abundant coal, for constrained and insecure sources of oil has always been a possibility, but one not developed significantly because of its cost relative to oil extraction. South Africa, because of its unique history, is one of the few countries that has extensive experience with this technology at production volumes. . Its synthetic fuel industry possesses knowledge and experience that is unique in the oil and gas industry.

The recent rise in oil prices has now put oil prices in a range where coal liquification appears to be an economical alternative to oil for the first time. Given that South Africa has ample supplies of coal and experience with this technology, the potential for expanding CTL production in the country, and perhaps exporting technology and/or product, is significant. The impact of such future development could have a considerable impact on economic growth in South Africa as well as on its balance of payments related to the use of oil. South Africa is uniquely situated to exploit its comparative advantage in a new and potentially export-oriented technology. Success, though, is not assured.

The fiscal policy adopted by the South African Government could have a great influence on whether this materialises. First, while the rise in oil prices to just below $80 a barrel puts oil prices at a level that makes CTL competitive, there is the very real potential for the price to drop to levels – say, below $60 a barrel – where it would no longer be competitive. As a result, any investor in large scale CTL facilities may need some risk sharing arrangement to make it prudent to undertake such investments. This is where a well-reasoned and forward-looking fiscal policy by the South African Government may have a role to play, and any policy changes should not be made before the potential for a private sector and governmental collaboration effort for future development of CTL in South Africa has been fully explored.

As stated before, the potential new investment and growth of the South African economy could be substantial, depending on the scale of the expansion of this industry and its multiplier effect on the economy. The exact implications for investment, employment growth, balance of payments, and other economic measures would have to be studied in the context of a specific plan. However, the preconditions are certainly in place to make significant expansion of CTL in South Africa, with its attendant effects on economic growth, a very real option.

Given that potential, we believe that the focus of changes in South African fiscal policy in this sector of the economy should be forward-looking and focused on the potential for economic growth based on the foreseeable growth of this sector. Because of the large

sunk investments that are required, some risk sharing may be essential; but even with this risk sharing, investors will still face considerable risk and need the possibility for commensurate rewards if the investments turn out to be successful.

Because of this, investors are not likely to undertake these investments in a fiscal climate that is based on a philosophy of eliminating economic rents through retroactive windfall profits taxes. Therefore, it is critical to any future development in this sector, and the potential growth it could generate, that the present effort at fiscal reform be forward-looking and focus on this potential for growth and not focus on trying to recapture past rents that have not been demonstrated to exist. Furthermore, the costs in terms of decreased future investment resulting from retrospective taxation are not limited to the liquid fuels sector of the economy. Rather, potential investors in many other industries, some of which may be the hard-to-predict drivers of future economic growth, are likely to take pause in the event of retrospective profit taxation. We believe that the rise in oil prices presents some unique opportunities for South African economic development, because of its resource endowments and its special CTL knowledge and experience. Making this opportunity for growth materialise should be the focus of Government's economic policy.

5. SUMMARY

5.1. RESPONSES TO QUESTIONS

We believe that the concept of economic rent is well defined in the economic literature and that natural resources can have an economic value that is captured as economic rent. We believe that the definition of windfall profits is not helpful for the reasons described above. We do not agree that economic rents necessarily justify special taxation. In fact, because of the practical difficulties of taxing pure economic rents, it is seldom attempted. Instead, corporate taxes are generally based on accounting profitability, and are not set on the basis of a firm's economic rent. Also, in cases of monopoly power, these can best be handled by competition policy or regulations, not taxation.

We agree that there is an important distinction between forward-looking and backward-looking approaches to regulation, and strongly believe in the position of the "South African fiscal authorities – in support of fiscal certainty and against retrospectivity and its possible consequential adverse impact on investor confidence" [DD at p. 38]. We see nothing in the nature of the CTL business that would change the conclusion that forward-looking regulations or fiscal rules should be preferred.

With regard to the analysis of windfall losses, the fact that the government might step in if a company were in danger of failing by no means fully protects investors from the effects of windfall losses. These losses can significantly affect shareholders' wealth short of causing a company with significant sunk costs to shut down. A recent example is British Energy, owner of most of the UK's nuclear generation capacity, where a Government-sponsored bail out left the operations continuing but the shareholders significantly diluted. Thus investors will give no value to an implied government underwriting.

5.2. CONCLUSIONS ABOUT THE APPROACH SET FORTH IN SECTION 4

In conclusion, the case for basing corporate taxation on the existence and the level of economic rents generated by firms appears unfeasible and is essentially unprecedented. To the extent that the unwarranted economic rents are created by monopoly pricing power, this should be dealt with by competition policy or prospective regulation, not by retrospective taxes on profits. This is standard procedure in much of the developed economies of the world. Finally, there is little evidence developed to suggest the gains to Sasol from higher commodity prices are of a magnitude that would cause inequities sufficient to justify the special legislation of windfall taxes for the liquid fuels industry.

5.3. IMPLICATIONS OF OUR CONCLUSIONS FOR THE ANALYSIS OF ECONOMIC RENTS AND WINDFALL PROFITS

From what has been said, it is clear that we believe that focusing on possible economic rents and windfall profits both conceptually and practically is the wrong way to manage the liquid fuels sector of the South African economy. To the extent that economic rents are thought to be generated by market power, one should deal with these issues through competition policy or regulation designed to provide the incentives necessary to promote a health and potentially growing CTL industry or a combination of both policies to promote competition but to provide fiscal incentives to facilitate growth for the sector.

We believe that the value chain approach with its focus on where rents might be created and efforts to identify and to tax apparent windfall profits is conceptually flawed, which will almost certainly impair the performance of the industry at a time when CTL technologies are becoming more economically attractive. The focus should be on policy to create a competitive and productive liquid fuels industry going forward, not on a backward-looking attempt to identify possible economic rents and capture them with retroactive taxes as discussed in Section 7 of the DD.

The objective of the government policy should be to ensure that the South African consumer can obtain liquid fuel products at competitive world prices, and that, to the extent that it is economically viable, its CTL and GTL technologies be developed. If incentives are required to attract investment in these sectors, they should be designed to do so at minimum cost to the taxpayer, but be forward looking so investors can assess the risks and prospects facing them. The focus should be on the creation of economic value and growth in South Africa. Companies that participate in this sector of the economy should be subject to the same profits taxes as other companies and not be subject to retroactive attempts to claw back any possible economic rents. This will serve only to be counter-productive and to reduce incentives for investment growth in this industry.

The development of the CTL and GTL industries has the potential for being a continued driver of growth in the South African economy. The adoption early on of an ill-conceived program to identify and tax past economic rents as windfall profits can only set back this potential.

APPENDIX A: EXAMPLE OF ECONOMIC RENTS AND NPV

In this Appendix, we provide a simple example that illustrates the relationship between economic rents and value creation, and clarifies some of the practical issues that need to be addressed when using economic rents to assess the extent of value creation in a given setting.

Consider a project that requires an initial investment in capital equipment of $600. The equipment will generate cash flows for six years, at the end of which it will be scrapped. The equipment is to be depreciated for accounting purposes on a straight line basis whilst the expected revenues are as follows:

Year 1 $130
2 $150
3 $300
4 $400
5 $600
6 $250

- costs are 50% of revenues, whilst the required working capital is 10% of the following years sales. Finally, the cost of capital is 10.65%.

As can be seen from the following table, the project has a zero NPV:

Table 1: Project NPV

Year		0	1	2	3	4	5	6
Revenues			130	150	300	400	600	250
Costs			(65)	(75)	(150)	(200)	(300)	(125)
Investment		(600)						
Working capital	Opening	0	13	15	30	40	60	25
	Closing	13	15	30	40	60	25	0
	Change	(13)	(2)	(15)	(10)	(20)	35	25
Cash flows		(613)	63	60	140	180	335	150
PV		(613)	57	49	103	120	202	82
NPV		0						

However, economic rents are expected to be negative in the first two years and positive thereafter (equivalently, return on invested capital is expected to be below the cost of capital for the two years and above it thereafter):

Table 2: Economic Rent/Return on Invested Capital – Historic Cost

Year		0	1	2	3	4	5	6
Revenues			130	150	300	400	600	250
Costs			(65)	(75)	(150)	(200)	(300)	(125)
Depreciation			(100)	(100)	(100)	(100)	(100)	(100)
Earnings			(35)	(25)	50	100	200	25
Book value	Opening		600	500	400	300	200	100
	Depreciation		(100)	(100)	(100)	(100)	(100)	(100)
	Closing	600	500	400	300	200	100	0
Working capital		13	15	30	40	60	25	0
Invested capital (IC)		613	515	430	340	260	125	0
Capital charge			65	55	46	36	28	13
Economic rent			(100)	(80)	4	64	172	12
Return on invested capital (ROIC)			-5.7%	-4.9%	11.6%	29.4%	76.9%	20.0%

Now compute the NPV of the economic rents generated by the project:

Table 3: NPV of Economic Rents

Year	1	2	3	4	5	6
Economic rent	(100)	(80)	4	64	172	12
PV	(91)	(65)	3	43	104	6
NPV	0					

This result (that the NPV of the expected economic rents is equal to the NPV of the project) is no coincidence and is true irrespective of the details of the project's expected cash flows. As a result, it is completely valid to assess the value that the project is expected to create by computing the NPV of the economic rents it is expected to generate. What is **invalid** is to focus on the expected economic rents of some sub-period. For example, if we look only at year 4, this will appear to be a project that is expected to generate substantial economic rents whereas in reality it is (over its life as a whole) merely expected to break even (has zero NPV).

Whilst the above example has adopted an ex-ante approach that uses expected cash flows, its translation to an ex-post analysis of whether a project did indeed create value is straightforward – simply replace expected cash flows and economic rents with actual realised cash flows and economic rents. Only if the NPV of the realised economic rents over the entire life of the project is positive can we conclude that the project has created value. No matter how large they may be, we cannot conclude anything from the fact that economic rents in one or more years were positive.

Of course, in practice we are not dealing with an isolated project with a finite life but rather are concerned with an entire company. As a result, any period that we look at is by definition only a sub-period of the life of the company. Given this fact, does the analysis of economic rents and/or return on invested capital continue to be valid? The answer is yes but with an important caveat, namely that rather than using the depreciated original cost of the capital equipment, we use the replacement cost. The rationale is that in a competitive market, the replacement cost at a given point in time will simply equal the present value of all expected future cash flows (including the necessary working capital injection) at that point in time. Further, depreciation is defined as the change in replacement cost.

Then, as shown by Table 4, the ROIC is constant and equal to the cost of capital in every year whilst the economic rent in each year is zero:

Table 4: Economic Rent/Return on Invested Capital – Replacement Cost

Year	0	1	2	3	4	5	6
Replacement cost	600	600	591	507	365	111	0
Working capital	13	15	30	40	60	25	0
Invested capital (IC)	613	615	621	547	425	136	0
Historic cost earnings		(35)	(25)	50	100	200	25
Add back historic cost depreciation		100	100	100	100	100	100
Replacement cost depreciation		0	(9)	(84)	(142)	(255)	(111)
Replacement cost earnings		65	66	66	58	45	14
Capital charge		65	66	66	58	45	14
Economic rent		0	0	0	0	0	0
ROIC		10.65%	10.65%	10.65%	10.65%	10.65%	10.65%

The reason why the economic rent is zero in each period is that we have defined replacement cost from the perspective of an owner of the capital equipment for whom an investment in this equipment is a zero NPV proposition. In practice, such investment will be zero NPV only for the marginal firm – for infra-marginal firms, the NPV will be positive with a corresponding change to the economic rent and ROIC.

Suppose that at the outset, revenues in each year were expected to be 20 higher than shown above so that the project now has a positive NPV. It is easy to show that the ROIC is still equal to the cost of capital and economic rent is still zero in each of years 1 to 6 – the positive NPV is actually reflected in an immediate gain (i.e. year 0) when the project is undertaken. In other words, a positive expected NPV will not lead to a sustained boost to ROIC or economic rent over the life of the project but rather a one-off gain. However, a better than expected outcome in a particular year will lead to an increase of ROIC above the cost of capital and a positive economic rent.

The bottom line, therefore, is that if invested capital and depreciation are expressed in terms of replacement cost, ROIC will equal the cost of capital unless either (i) the project

has a non-zero NPV or (ii) the outcome in a particular year is better or worse than anticipated.

To apply these basic ideas to Sasol, we would need to do the following:

- Identify the time period that we are interested in investigating
- At the beginning of that time period, rather than initial investment include the opportunity cost of not exiting the business at that point – this may well simply be the replacement cost of the assets
- At the end of the time period, include as a cash "inflow" the ongoing value of the business at that point – again, this will probably equate to asset replacement cost
- Estimate the evolution of replacement cost over the time period, and restate earnings accordingly to reflect the change in depreciation

- whilst this may require data that is difficult to obtain, it does a least set out a road-map for how the analysis should (in an ideal world) be carried out. Note that the cash flows we are using in this analysis are the actual realised cash flows that incorporate the effects of government regulation.

One final point that we may need to address is that if the market is not competitive, then replacement cost may well impound anticipated market power profits – as such, zero economic rents would not then be an indication of a lack of market power.

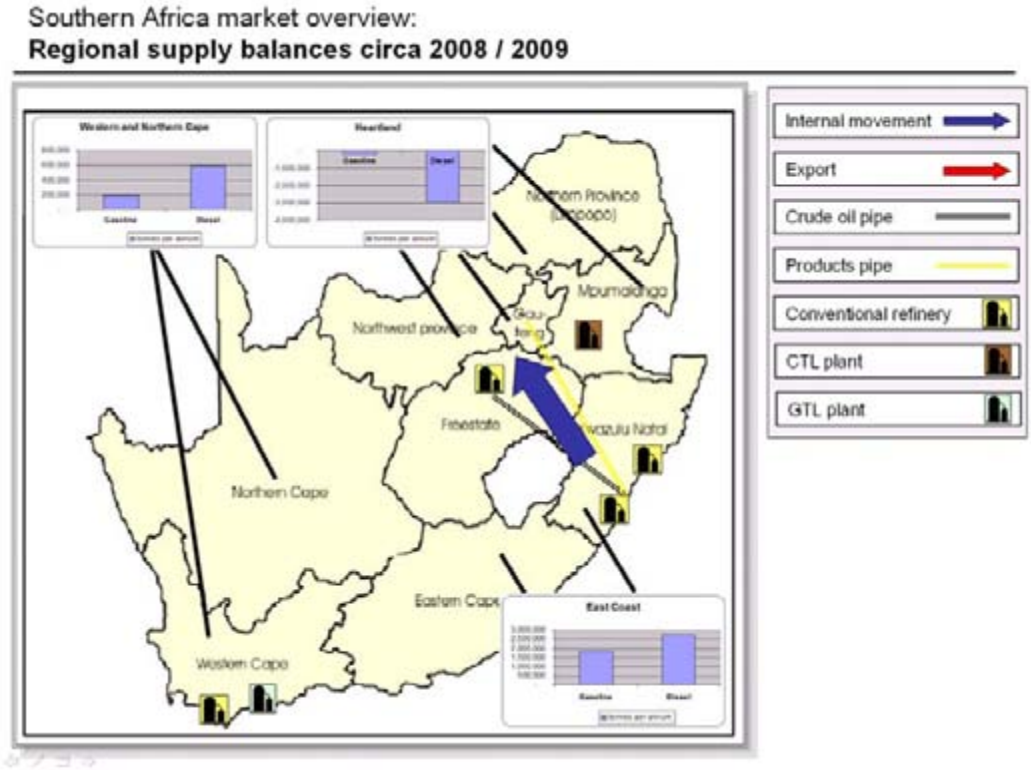
APPENDIX B: SUPPLY BALANCE IN SOUTH AFRICA

South Africa's current supply position is balanced to long, but this is likely to change within the next few years. SAPIA expects demand for gasoline and diesel to grow by some 4.0 million tonnes per year by 2012, which would put the country into deficit. (http://www.sapia.org.za/pubs/2005_ARep/Sapia_2005_Facts_Figures.pdf)

This has different implications for different regions. The south-western and west part of the country, i.e. Western Cape and Northern Cape, is currently adequately supplied and likely to remain so.

The industrial heartland (Northwest Province, Freestate, Gauteng, Mpumalanga and Northern Province) is short and depends on supplies transshipped inland via pipeline. The source of this supply is the coastal region (Eastern Cape and KwaZulu Natal), which is long and currently exports excess products not required inland.

Currently Sasol receives preferential access to this heartland market, inasmuch it is effectively guaranteed offtake, with the additional volume supplied by the conventional refineries. By 2008 / 2009, this situation will change. As economic growth drives consumption up, demand will rise, but the coastal refiners' ability to meet this demand is constrained by the capacity of the pipeline. Once that capacity is exceeded, demand would normally be met by product brought in through other means such as road or rail and sold at a higher price. Since prices are controlled inside South Africa, this cannot happen, so one would expect fuel shortages to result - there is no incremental reward available to anyone who meets that demand because they cannot charge more for having done so.



This will not happen if Petronet's planned additional product pipeline from Durban inland goes ahead.

The above scenario does suggest that the economic rents from having an inland facility to produce fuel arise from the limitations of the logistical infrastructure and associated transportation costs, combined with the regulated price climate that may reduce incentives for investment.

In a deregulated market, the existence of a rent would rapidly be noticed by other players, who would invest to secure some of it and consequently supply it out of existence. This in turn suggests that rather than tax the presumed actual and potential beneficiary of the temporary rent, they should be allowed to collect it so as to finance the investments that will remove the rent and lower net prices to the benefit of end-users. Rents are inherently ephemeral and can persist only as long as the conditions in which they arise – a technology advantage, preferential access to a resource, or regulatory prescription – persist and discourage other entrants to the market in which they are being earned.

APPENDIX C: FRENCH ENERGY REGULATION

Prior to a law introduced in 2000, electricity activities in France were carried out solely by Electricité de France (EdF), the vertically-integrated national electricity company. Edf had a monopoly over generation, transmission and distribution. The 2000 and subsequent laws have been introduced to modernise and develop the electricity sector and bring France in line with EU energy market directives, which seek to create fully competitive markets.

The 2000 law introduced the independence of the electricity transmission operator and created a regulatory body. This was the first step towards the opening of the electricity sector. The 2003 law brought some amendments to the 2000 law, such as reinforcing the separation of the management of the transmission system. In the 2004 law, the EU 2003/54/EC Electricity Directive was incorporated into French Law. This stipulates legal and functional separation of transmission activities and functional separation of distribution activities.

The generation, transmission and distribution activities in the French electricity sector are currently organised as:

- Electricity Generation: EdF is the main electricity generator in France, producing 90% of the total electricity generated. EdF undertook to open up the generation market through the auction of 6,000 MW of generation capacity by November 2003.

- Transmission: Transmission infrastructure was originally owned by EdF, but is now a public company following the creation of RTE. RTE has the exclusive right to operate the transmission networks. EdF owns RTE's capital, but the independence of RTE is guaranteed by the Electricity Law providing that the transmission system operator has its own budget. RTE has implemented codes of conduct to ensure its independence. Regulated access to the network is granted to third parties through a contract between RTE and the operator requiring access.

- Distribution: There are between 160 and 170 electricity distributors in France. The majority are controlled by the State or public entities (there are a few very small private sector operators who are only locally active, accounting for 5% of consumers). Following the implementation of EU directives (through 9th August 2004 Act), distribution activities have to be managed within a specific division of the company when distribution activities serve more than 100,000 clients and the company concerned is active in other activities in the electricity sector (e.g. generation). Only five distributors meet this threshold of having more than 100,000 clients. Effectively, France has postponed the implementation of distribution sector unbundling. A system of regulated network access to the grid is in operation.

- Retail market (power supply): there are two types of electricity customer

    1) non-eligible: must purchase electricity from EdF and the specific distributors partly owned or fully operated by local governments or from other very specific entities

2) eligible: are free to choose from any electricity producer or supplier

Eligible customers are defined as non-domestic customers. The retail market for domestic consumers will open in 2007.

In June 2005 the Commission launched an Energy sector inquiry. Following the result of the inquiry, France has been issued with a letter of formal notice (the first step in the legal procedure which ultimately could lead to the commission bringing the matter before the European Court of Justice to ask for penalties to be paid). The issues were identified as:

- absence of, or insufficient legal unbundling of distribution system operators in order to guarantee their independence
- existence of regulated prices which block the arrival of new suppliers
- preferential access for certain contracts in the electricity market
- non-publication of commercial conditions for access to storage

EdF remains the dominant company in France's electricity sector. Market concentration continues to be one of the main barriers to effective competition in European power markets. Yet there is no question of additional taxation on monopoly profits. The EU competition authorities instead continue to look to reform the matter by continued deregulation.

Annexure D

SASOL LIMITED

(Incorporated in the Republic of South Africa)

Prospectus in respect of an
offer of 245 000 000 ordinary shares
of no par value in Sasol Limited
at a subscription price of R2,00 each.

Consulting merchant bank
Finansbank Limited
(Registered Merchant Bank)

Issuing houses
Volkskas Merchant Bank Limited
(Registered Merchant Bank)
Barclays National Merchant Bank Limited
(Registered Merchant Bank)
Central Merchant Bank Limited
(Registered Merchant Bank)
Standard Merchant Bank Limited
(Registered Merchant Bank)
Union Acceptances Limited
(Registered Merchant Bank)

A copy of this prospectus, accompanied by the documents specified in Part II paragraph 10.10 of this prospectus, has been registered in terms of the Companies Act, 1973, as amended.

Date of issue: 15 August 1979

SASOL LIMITED

(Incorporated in the Republic of South Africa)

Address:
1 Klasie Havenga Road, Sasolburg, 9570,
P.O. Box 1, Sasolburg, 9570

Directors:
D. P. de Villiers (Chairman), J. A. Stegmann (Managing Director), G. A. Macmillan, A. J. Marais, J. K. Mitchell, P. E. Rousseau, A. J. van den Berg

CONSULTING MERCHANT BANK

Finansbank Limited
(Registered Merchant Bank)
20 Anderson Street
Johannesburg, 2001
P.O. Box 62343
Marshalltown, 2107

SPONSORING BROKERS

Simpson, Frankel, Hern, Kruger Incorporated
(Successors to Sidney Isaacs Incorporated, Simpson, Frater, Melrose and Stein Incorporated and Ed Hern, Kruger Incorporated)
(Member of The Johannesburg Stock Exchange)
4th Floor
The Stock Exchange
Diagonal Street
Johannesburg, 2001
P.O. Box 299
Johannesburg, 2000

Max Pollak & Freemantle
(Incorporating: Morris Lipschitz & Co, Allen Hesselberger & Co, and L. Bowman & Michel)
(Members of The Johannesburg Stock Exchange)
201 The Stock Exchange
Diagonal Street
Johannesburg, 2001
P.O. Box 512
Johannesburg, 2000

BANKER

Volkskas Limited
(Registered Commercial Bank)
Volkskas Building
Pretorius Street
Pretoria, 0002
P.O. Box 578
Pretoria, 0001

CONSULTING ACCOUNTANTS

Alex. Aiken & Carter
(Chartered Accountants (SA))
Marshall Place
66 Marshall Street
Johannesburg, 2001
P.O. Box 61975
Marshalltown, 2107

TRANSFER SECRETARIES

Central Registrars Limited
28 Harrison Street
Johannesburg, 2001
P.O. Box 61042
Marshalltown, 2107

ATTORNEY

Couzyn, Hertzog & Horak Incorporated
Trust Bank Centre
56 Eloff Street
Johannesburg, 2001
P.O. Box 2242
Johannesburg, 2000

ISSUING HOUSES

Volkskas Merchant Bank Limited
(Registered Merchant Bank)
40th Floor
Carlton Centre
Commissioner Street
Johannesburg, 2001
P.O. Box 8054
Johannesburg, 2000

Barclays National Merchant Bank Limited
(Registered Merchant Bank)
6th Floor
National Bank Building
84 Market Street
Johannesburg, 2001
P.O. Box 7761
Johannesburg, 2000

Central Merchant Bank Limited
(Registered Merchant Bank)
31st Floor
Sanlamsentrum
Jeppe Street
Johannesburg, 2001
P.O. Box 2683
Johannesburg, 2000

Standard Merchant Bank Limited
(Registered Merchant Bank)
15th Floor
Standard Bank Centre
78 Fox Street
Johannesburg, 2001
P.O. Box 61344
Marshalltown, 2107

Union Acceptances Limited
(Registered Merchant Bank)
42nd Floor
Carlton Centre
Commissioner Street
Johannesburg, 2001
P.O. Box 582
Johannesburg, 2000

CONTENTS

SASOL LIMITED

(Incorporated in the Republic of South Africa) ("Sasol")

MAIN FEATURES OF THE OFFER

Please note:

The offer in terms of this prospectus is made by way of a private placing and may be accepted only by investors who are invited to participate. Members of the public who have not been specifically invited may not apply in terms of this offer.

The following is a summary of the main features of the offer contained in this prospectus. The entire prospectus should be read for full information.

THE OFFER

Sasol hereby offers for subscription, subject to the terms and conditions of this prospectus, 245 000 000 ordinary shares of no par value in Sasol at a subscription price of R2,00 each ("the shares") by way of a private placing ("the offer" and/or "the private placing").

Application may be made only in units of R10 000 each, with a minimum of 10 units. Each unit consists of 5 000 shares. See Part II paragraph 3.4.

The subscription price is payable as follows: a first payment of R4 000 per unit on application; on 2 January 1980 a second payment of R1 000 per unit; on 1 July 1980 a third payment of R3 000 per unit; on 2 January 1981 a final payment of R2 000 per unit. Payment may not be effected in a different manner or order. See Part II paragraph 3.5.1.

The shares will be issued as indicated in Part II paragraph 3.6.

Dividends will be paid as indicated in Part II paragraph 3.8.

After the private placing a public issue of 17 500 000 ordinary shares of no par value in Sasol at a subscription price of R2,00 per share will be made which will be directed at the smaller investor and the general public. See Part I paragraph 1.

OTHER PARTICULARS

Issued share capital

Issued ordinary shares after the offer, the public issue and the issue to the IDC/Konoil referred to in Part I paragraph 1	375 000 000

Financial information

	June 1979 (Estimated)	June 1980 (Estimated)
Earnings per share*	22 cents	25 cents
Dividend per share		11,5 cents
Dividend yield on issue price**		7% per annum
Dividend cover*		2,2 times
Net asset value per share*	152 cents	167 cents

*On the assumption that 375 000 000 ordinary shares are in issue throughout the financial period.

**Calculated from the closing date of the offer up to 28 June 1980.

Sasol will aim at a dividend growth in the region of 12,5% per annum from a base rate of 7% per annum. The board of Sasol regards it as sound policy to aim at a dividend cover of approximately twice.

Listing

Application has been made to The Johannesburg Stock Exchange for the listing of the shares under the name "Sasol" in the "Chemicals and Oil" section. See Part II paragraph 5.

Salient dates

Offer opens at 08h00 on	Wednesday, 15 August 1979
Offer closes at 12h00 on	Wednesday, 5 September 1979
Listing commences at 10h00 on	Wednesday, 31 October 1979

Requirements of the Companies Act, 1973

The information set out in this prospectus in connection with the offer, is furnished in accordance with the requirements of section 148 of the Companies Act, 1973, as amended. The numbers of the paragraphs of Schedule 3 of that act applicable to the prospectus, are given in brackets after the relevant headings contained in the prospectus.

SASOL LIMITED

(Incorporated in the Republic of South Africa) ("Sasol")

Application form

№ . . 1271

Application form in respect of the offer of 245 000 000 ordinary shares of no par value in Sasol at a subscription price of R2,00 each ("the shares").

Please note:

The offer in terms of the accompanying prospectus is made by way of a private placing and may be accepted only by investors who are invited to participate. Members of the public who have not been specifically invited may not apply in terms of this offer.

Applications may only be made in units of R10 000 each, with a minimum of 10 units. Each unit consists of 5 000 shares. **All applicants must complete blocks A, B and D of this application form. Please read the instructions overleaf before completing the form.**

Offer opens: Application lists open at 08h00 on Wednesday, 15 August 1979.

Offer closes: Application lists close at 12h00 on Wednesday, 5 September 1979, or at such later date as the directors of Sasol may determine in their discretion, but not later than three months after the date of registration of this prospectus.

The prospectus to which this application form is attached was registered in terms of the provisions of the Companies Act, 1973, as amended, on 10 August 1979.

BLOCK A

Name of applicant	
Postal address (Preferably a P.O. Box number)	**Postal code** .....
Language preference (mark with an X)	**English** | | **Afrikaans** |
Surname, initials and telephone number of person who may be telephoned in connection with the application	

BLOCK B

In this block details are to be filled in of the number of units applied for and the first payment in respect thereof. Please fill in figures only.

	Number of units (minimum of 10 units)	Value of the units (minimum R100 000)	Amount payable on application * (minimum R40 000)
Number and value of units, each consisting of 5 000 shares at R10 000 per unit		R	R
Add bank commission where applicable (0,1%)			R
Total amount paid by the attached cheque or banker's draft dated not later than 5 September 1979†			R
Amount which will be paid by telegraphic transfer not later than 12h00 on 5 September 1979†			R

Notes

*A first payment of R4 000 per unit must be paid on application (see Part II, paragraph 3.5.1 of the prospectus).

†Delete whichever is not applicable.

BLOCK C

Instruction regarding dividend payments: Dividends will be paid by cheque and will be forwarded to the registered address shown in Block A unless otherwise requested in this block.

Address ..... Postal code.....

Bank account .....

BLOCK D

The Directors
Sasol Limited
Sasolburg

Dear Sirs

I, the undersigned, warrant to Sasol that I have full legal capacity to contract and hereby irrevocably apply for the number of units indicated in Block B overleaf. This application is subject to the terms and conditions contained in this application form and the accompanying prospectus.

You are hereby authorised to enter my name in Sasol's register of members, subject to Sasol's memorandum and articles of association, as the holder of the number of shares ensuing from the units applied for and to mail to my address, as set out in Block A, by certified mail at my risk on the appropriate dates the appropriate number of share certificates.

I undertake to Sasol to pay, as indicated in Block B overleaf, for the number of units applied for, including bank commission where applicable.

I undertake to pay the balance of the amount due by me in terms of this application and your acceptance thereof, in three further payments as follows: R1 000 per unit on 2 January 1980; R3 000 per unit on 1 July 1980; R2 000 per unit on 2 January 1981.

I confirm that the lodging of this application form by me and the acceptance of this application by Sasol will constitute a binding agreement between Sasol and myself with regard to the units in respect of which my application is accepted and that I will be bound to perform in terms of such agreement in accordance with the conditions set out in this application form and the accompanying prospectus.

Signature of authorised signatory

.....

Date .....

Official stamp and name of institution/body corporate on whose behalf this form is signed

.....

Applicants who are not sure how to complete the application form should consult one of the issuing houses, a stockbroker, banker or other financial adviser.

INSTRUCTIONS

1. **Payment**

   Payment in terms of this application form must be made as follows:

   1.1 By cheque or banker's draft, dated not later than 5 September 1979, crossed and marked "not negotiable", made out to "Central Registrars Limited – Sasol Offer". The relevant cheque or banker's draft must be lodged together with the application form;

   or

   1.2 by means of telegraphic transfer, not later than 12h00 on 5 September 1979, to the credit of "Central Registrars Limited – Sasol Account Number 100-741-075", Volkskas Limited, Market Street, Johannesburg. If you pay by telegraphic transfer, you should forthwith take the steps set out in Part II paragraph 3.5.1 of the prospectus. The application form must be lodged before the relevant telegraphic transfer is made.

   1.3 Further payments must be made not later than 12h00 on the days indicated, in accordance with the provisions of Part II paragraph 3.5.1 of the prospectus.

2. **Address where application form must be lodged**

   The completed application form together with the relevant cheque or banker's draft, must be mailed or delivered to be received not later than 12h00 on Wednesday, 5 September 1979, at:

   Central Registrars Limited
   30th Floor
   Sanlamsentrum
   Jeppe Street
   Johannesburg
   2001

   or

   P.O. Box 8980
   Johannesburg
   2000

3. **Powers of attorney and documents**

   Sasol is entitled to request powers of attorney or supporting documents in connection with the application from any applicant at any time.

4. **Joint applicants**

   The application form must be signed by all joint applicants.

5. **Alterations**

   All alterations made on the application form, excluding the deletion of alternatives, must be authenticated by a full signature.

6. **Receipts**

   No receipts will be issued for applications or payments.

7. **Address**

   The address furnished in Block A will, except if requested otherwise in Block C in respect of dividend cheques, be used for the purposes of transmitting all correspondence including share certificates and dividend cheques. Post office box numbers will be preferred if furnished. All transmissions through the post will be at the risk of the applicant. Share certificates will be sent by certified mail.

8. **Currency**

   Only South African rand may be used to subscribe for shares in terms of the offer.

9. **Nominees**

   Application may only be made in the name of a principal. Applications by nominees will not be accepted.

10. **Interpretation**

    In this application form references to natural persons include corporate bodies, the singular includes the plural and the male includes the female.

SASOL LIMITED

(Incorporated in the Republic of South Africa)

PART I

The directors of Sasol have been authorised by the State to declare that the sections of this prospectus in Part I paragraphs 2, 3, 4, and 6, printed in italics, are published with the consent of the State and are conditions of the offer.

In this prospectus the following terms have the meanings appearing opposite each of them:

"Sasol"	Sasol Limited.
"Sasol One"	Sasol One (Proprietary) Limited, formerly known as South African Coal, Oil and Gas Corporation Limited.
"Sasol Two"	Sasol Two (Proprietary) Limited, formerly known as Sasol (Transvaal) Limited.
"Sasol Three"	Sasol Three (Proprietary) Limited, formerly known as Sasol (Overvaal) Limited.
"Sasol group"	Sasol, Sasol One, Sasol Two, Sasol Three and their subsidiaries.
"IDC"	The Industrial Development Corporation of South Africa Limited.
"Konoil"	Konoil (Proprietary) Limited, a wholly-owned subsidiary of the IDC, which has the function of holding shares in Sasol and, together with SOF (Proprietary) Limited and associated companies of Konoil, serves as a channel for the financing of Sasol Two and Sasol Three by the State. A reference to Konoil includes, where appropriate, a reference to SOF (Proprietary) Limited and Konoil's associated companies.
"the State" or "the Government"	The Republic of South Africa.
"the Act"	The Companies Act, 1973, as amended, of the Republic of South Africa.

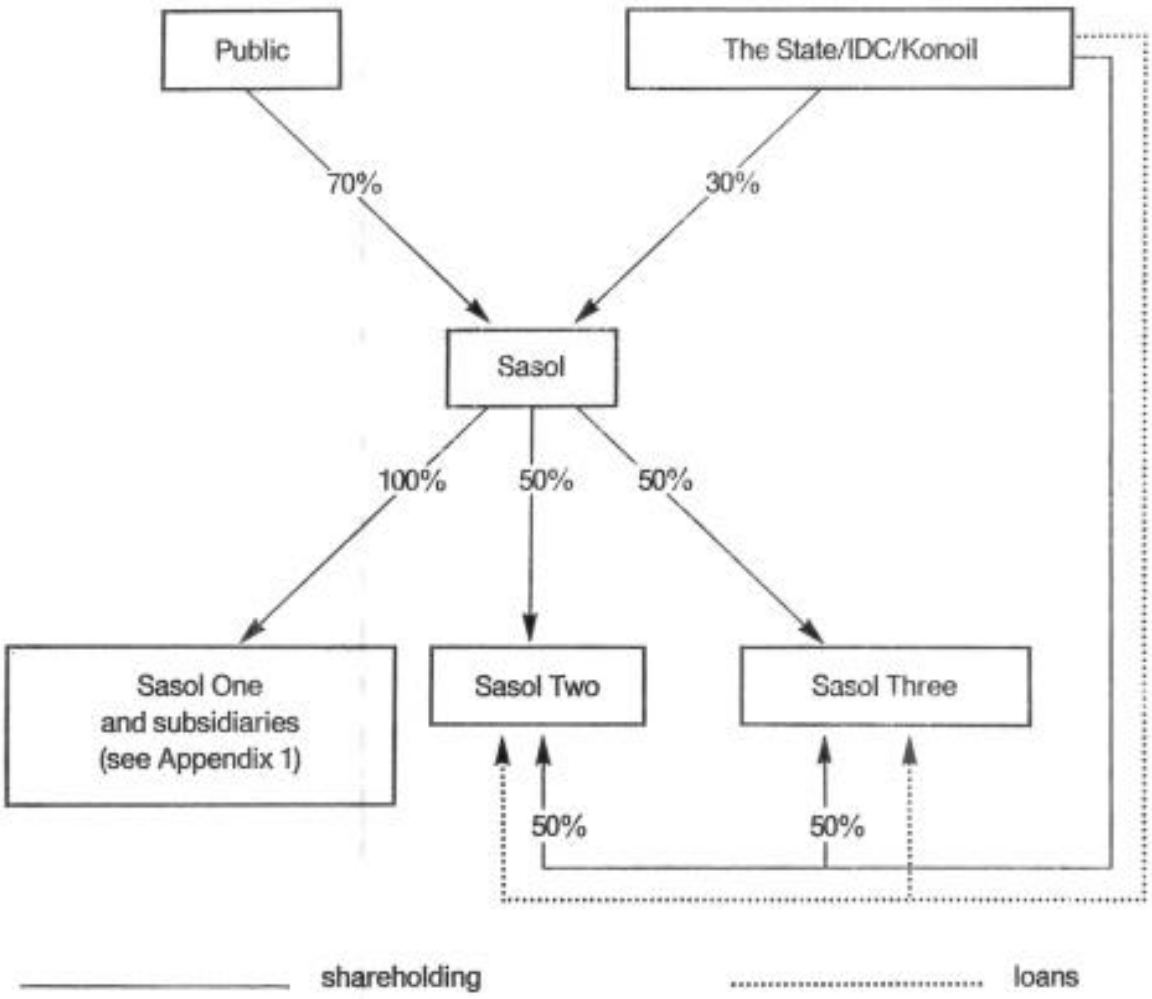
1. PURPOSE AND EFFECT OF THE OFFER (7)

The public will be invited in two successive issues to acquire equity participation in the Sasol group. The first issue comprises the offer contained in this prospectus and is aimed at institutional investors ("the private placing"). The private placing may be accepted only by investors who are invited to participate. Members of the public who have not been specifically so invited, may not apply in terms of this offer.

Immediately after the completion of the private placing a further offer will be made to the general public by way of a public issue directed at the smaller investor ("the public issue").

The purpose of the private placing is to raise R490 million by way of the issue of 245 000 000 ordinary shares of no par value in Sasol at a subscription price of R2,00 each ("the shares"). The purpose of the public issue is to raise R35 million by issuing a further 17 500 000 ordinary shares of no par value. 112 500 000 ordinary shares of no par value in Sasol will also be issued to the IDC/Konoil (see Part I paragraph 5). After completion of the private placing and public issue as well as the issue to the IDC/Konoil, the public will hold 70% of the issued shares and the State, via the

IDC/Konoil, 30% of the issued shares in Sasol. The Sasol group structure can then be illustrated diagrammatically as follows:



2. PRIVATE SECTOR OPERATION OF THE SASOL GROUP

Since its inception in 1950, Sasol One has been registered under the Companies Act as an ordinary company, which emphasises its commercial approach and concomitant profit motive.

The question may however arise among investors whether the State would impose unreasonable restrictions on the profitability of Sasol and the operating companies in the group, which would inhibit the growth of Sasol and reduce returns. This matter was referred to the Government.

The State decided that the assurance may be given that the companies in the Sasol group will operate as companies in the private sector and that any State control applicable to the Sasol group will not be more restrictive than in other sectors of industry and specifically the chemical and petroleum industry in South Africa.

3. CONTROL OF SASOL

While Sasol Two and Sasol Three are not fully commissioned and Sasol has not acquired all the shares in Sasol Two and Sasol Three, the State and the IDC will exercise control over the Sasol group by controlling the composition of the board of directors. In this connection Sasol's articles of association provide that, for as long as the abovementioned state of affairs continues, the Minister will appoint four and the IDC three directors, which seven directors may invite two others to join the board.

The State has decided that when Sasol Two and also when Sasol Three are wholly-owned subsidiaries, further shares will, from time to time, be offered to the public and that the State's representation on the board of directors of Sasol will be reduced in line with the proportional reduction of the State's investment.

According to current indications and expectations Sasol Two will not become a wholly-owned subsidiary of Sasol before 1984 and Sasol Three not before 1986.

The shares referred to above, which will be offered to the public from time to time, will be offered by way of rights issues or rights offers.

4. GENERAL BACKGROUND

With the announcement of the establishment of a third Sasol it was made known that the public would be afforded ample opportunity to contribute to the financing of the project by way of a share-holding in the Sasol group.

The Sasol group developed from the incorporation of Sasol One in 1950. The incorporation resulted from the State's decision to establish an industry in South Africa for the manufacture and marketing of liquid fuels, pipeline gas and chemical products from coal. The Sasol group today operates a highly developed and integrated series of plants, while further significant extensions are under construction. After more than 25 years of the commercial application of oil-from-coal technology, the Sasol group is the world leader in this field. A more complete review of the history of the Sasol group is given in Part II paragraph 2 and an exposition of its products, activities and subsidiaries is furnished in Appendix 1.

Sasol was incorporated on 26 June 1979 as the holding company of the Sasol group. Sasol presently holds a 100% share interest in Sasol One and a 50% share interest in each of Sasol Two and Sasol Three. The State indirectly holds, through the IDC/Konoil, the other 50% share interests in Sasol Two and Sasol Three but supplies the major portion of the initial and construction financing of Sasol Two and Sasol Three through Konoil.

Sasol One is situated at Sasolburg and operates the only factory complex in full production, while the factory complexes of Sasol Two and Sasol Three are still under construction. The financial achievements and strength of Sasol One form the basis of this offer to the public. In addition to the large scale processing of coal, Sasol One also uses crude oil and petroleum naphtha as important raw materials. Particulars concerning Sasol One's subsidiaries and its influence on the chemical industry in South Africa appear in Appendix 1 and Part II paragraph 2.2 respectively.

Sasol Two was established in 1975, after the State and the board of Sasol One had decided that an additional oil-from-coal plant was an economically viable project, particularly in the light of the rising prices which have characterised the crude oil markets of the world since November 1973. The plant, which is situated at Secunda in the Eastern Transvaal, is presently under construction and is already more than 80% complete. Certain units have already been commissioned. It is expected that the first oil products will be produced early in 1980 and that full production will be achieved by 1982. Sasol Two will concentrate mainly on the manufacture of liquid fuels such as petrol, diesel, liquid petroleum gas and kerosene, including jet fuel.

The world is facing an increasing shortage of fossil fuel, especially oil. At present South Africa is less vulnerable in this respect than most of the industrialised countries, as South Africa depends on indigenous coal for almost 80% of its energy requirements. Oil, nevertheless, remains the most important fuel for mobile propulsion.

The effects of the latest oil crisis arising from the unrest in Iran resulted in the State initiating an investigation into the further expansion of South Africa's production of liquid fuels from indigenous sources. The study showed that such an expansion would indeed be economically viable and in February 1979 the State announced that the establishment of a third oil-from-coal plant, Sasol Three, adjoining the site of Sasol Two at Secunda, was to proceed immediately. Sasol Three is to a large extent a duplication of Sasol Two and will also concentrate mainly on the manufacture of liquid fuels. Sasol Three will more than double the production potential at Secunda and production is expected to commence during the second half of 1982.

All three plants are directly dependent on the availability of coal. Sasol One operates the two coal mines of the group, namely the Sigma Colliery at Sasolburg, supplying Sasol One, as well as the Bosjesspruit Colliery at Secunda, which will supply Sasol Two and Sasol Three and which has already reached a production rate of 170 000 tons per month. Both collieries have extensive coal reserves at their disposal which can meet the foreseeable needs of the Sasol group for a minimum period of 40 years in the case of Sigma and 70 years in the case of Bosjesspruit. Further coal rights are being acquired for both mines on a continuous basis. Sigma presently produces 5,5 million tons of coal per annum. Bosjesspruit will produce about 27 million tons of coal per annum at full production, by far the largest colliery in South Africa. Full particulars of the Sasol group's mining activities are contained in Appendix 3.

The products of the Sasol group are marketed by the group itself. Certain products are, however, supplied in bulk to other organisations for distribution.

Sasol One's current operations require no further shareholders' funds at this stage and are financially self-sufficient. The estimated direct cost of completion of the Sasol Two and Sasol Three projects, including the mining operations at Bosjesspruit and a provision for cost escalation, amounts to R2 503 million and R3 276 million respectively.

The financing of the Sasol Two project has been fully provided for in accordance with the following programme already approved by the State:

Export credits	*492 million*
State oil fund ("SOF")	*1 711 million*
Parliamentary grants	*300 million*
Total	*R2 503 million*

With regard to the financing of the Sasol Three project the following arrangements have been made:

Of the estimated cost on completion of R3 276 million approximately 20%, that is R655 million, will be provided by means of export credit financing and the accompanying loan facilities. This financing has already been arranged.

The proceeds of the two present issues, which are estimated at R525 million, will, after deduction of costs, be employed for the financing of the Sasol Three project.

The Government has undertaken to provide the remaining financing requirements of the project, presently estimated at R2 096 million, by way of parliamentary grants and out of the SOF.

The financing of the Sasol Three project has therefore been provided for.

The "two present issues" referred to above, refer to the private placing and public issue mentioned in Part I paragraph 1.

After the abovementioned position had been confirmed by the State, it was decided to amend the specific allocation of certain of the abovementioned funds. The amounts concerned are not substantial, however, and the total in respect of the two projects remains unchanged. The cost of the issues will now also be paid out of internal resources of Sasol One and not out of the proceeds of the issues.

The remaining costs for the completion of the Bosjesspruit Colliery, estimated at R355 million, will be financed from the cash on hand and the expected cash flow of Sasol One. On the other hand the State will contribute, as part of the financing programme of Sasol Two and Sasol Three, the costs of township development and housing at Secunda, operating capital and initial cash shortages of Sasol Two and Sasol Three, estimated at R388 million, which would have been provided for by Sasol One's cash flow under the previous financing programme.

No further funds are required from Sasol and Sasol One for the development of Sasol Two and Sasol Three.

At Sasol Two and Sasol Three the aim is to achieve a position where share capital and non-interest-bearing shareholders' loans will amount to approximately 80% of all funds required. During later years, when the plants are in operation, the ratio of share capital to interest-free and interest-bearing loan capital may be adjusted to the prevailing requirements of the industry. As applied very successfully by Sasol One, the aim will be to optimise production through relatively smaller capital investments in each of the new plants.

Sasol will, subject to certain conditions, eventually acquire the IDC/Konoil's interest in Sasol Two and Sasol Three (see Part I paragraph 5).

5. MATERIAL CONTRACTS (16)

Sasol has entered into three written agreements which are of fundamental importance for the composition of the Sasol group in its present form and the further progress of the Sasol projects (see Part II paragraph 10.9).

On 20 July 1979 Sasol entered into an agreement with the IDC/Konoil in terms of which Sasol bought 100% of the issued share capital of Sasol One from the IDC/Konoil for a consideration of R400 million in cash and 112 500 000 ordinary shares in Sasol. The cash consideration will be paid by Sasol from the proceeds of the private placing and public issue and the shares will be issued to the IDC/Konoil not later than 17 October 1979. The transaction became effective on 1 July 1979. The IDC/Konoil will make the R400 million available to Sasol Three.

A further agreement was entered into on 20 July 1979 between Sasol, the IDC/Konoil and Sasol One in terms of which Sasol purchased 50% of the issued share capital of Sasol Two and 50% of the issued share capital of Sasol Three from Sasol One (see Appendix 2 paragraph 7.2). The agreement also governs certain other related matters and became effective on 29 June 1979.

An agreement was concluded on 20 July 1979 which provides for the future acquisitions by Sasol of Konoil's interest in Sasol Two and Sasol Three which includes a 50% shareholding and substantial loans in each of the companies. The loans will be free of interest initially, but one half thereof will bear interest, up to a rate not exceeding that applicable to 10-year Government Stock, once Sasol Two and later Sasol Three each exceeds a profit level of R100 million per annum after taxation.

The price and terms of the acquisitions will be negotiated by Sasol and the IDC/Konoil and their agreement will become effective after experts (which must be either merchant banks or firms of auditors, with the proviso that one party must be a firm of auditors) appointed by Sasol and the IDC/Konoil respectively, have confirmed that in their opinion, the transactions are fair and reasonable.

In the absence of agreement on the price and terms, a mutually binding procedure for determining the price and terms will be put into effect, in which case the experts and, if necessary, a majority of the experts and an impartial third expert will determine the price and terms.

The acquisitions can take place at the request of either Sasol or the IDC/Konoil at a time when the profitability of Sasol and the company concerned has reached an acceptable level, at a price and on terms which as far as possible, will not result in a decrease in the attributable earnings per Sasol share and will not unreasonably affect the dividend growth prospects of the holders of shares in Sasol. The consideration to be offered and the nature of and ratios between the various forms of compensation to be applied in settlement of the acquisitions, will at that stage be determined by the parties with due consideration to, inter alia:

- Sasol and Sasol Two or Sasol Three's profit prospects and Sasol's consolidated financial structure and cash flow after acquiring the company concerned;
- prevailing economic and financial conditions in the Republic and the industry in which the Sasol group operates;
- the historical growth rate in attributable earnings and dividends of the holders of shares in Sasol;
- the reasonable expectations of holders of shares in Sasol in respect of dividend growth;
- the fact that the State, as its contribution to the success of Sasol Two and Sasol Three, will have made funds available on favourable terms, but on the other hand, that Sasol as its contribution to the success of the two companies, will have made expertise and management available to the companies on favourable terms.

The agreement contains provisions to ensure as far as possible, that subject to the final dates referred to below, no acquisition takes place at an inopportune time when the application of the above factors would result in a transaction unfair to Sasol or the IDC/Konoil.

Should the acquisitions, in the case of Sasol Two not have taken place before 1 July 1989, and in the case of Sasol Three before 1 July 1993, the transactions will in any case take place on these dates, unless such a transaction would be extremely unfair to one or other of the parties.

Each of the abovementioned acquisitions will have the effect of substantially increasing the interest of the IDC/Konoil in Sasol.

6. GOVERNMENT SUPPORT FOR PRODUCTION OF LIQUID FUELS FROM INDIGENOUS RAW MATERIALS

The oil-from-coal industry is highly capital intensive. This means that once the construction of a new project has been completed, profitability will increase when the prices of its products subsequently increase.

The selling prices of petroleum products in South Africa are determined from time to time on the basis of the ruling official crude-oil selling prices of the oil producing countries. In considering the economic viability of the Sasol group once the Sasol Two project has been completed, the State agreed that for the commercial success of the undertaking in which the public is now being invited to participate, the State will have to meet two requirements to achieve the desired financial results, namely:

(a) An additional protection of 3,6 cents per litre will have to be granted on all white products, namely liquid petroleum gas, petrol, diesel, kerosene, including jet fuel, produced from indigenous raw materials;

(b) This industry must have the assurance that as international oil prices increase in future, the prices of its products will also increase.

These principles have been considered and accepted by the State with the reservation that should the ratio between the rise in general cost factors and the rise in the prices of petroleum products materially deviate from the assumptions made for the purpose of the economic evaluation of the Sasol undertaking, the additional protection of 3,6 cents per litre may be adjusted upwards or downwards by the State. The additional protection for the domestic industry has been in force as from 1 July 1979.

As is generally known, South Africa does not at present obtain all its oil requirements at the official selling prices of the oil producing countries and the Government is therefore compelled to increase the selling prices of all petroleum products with equalisation fund levies which are applied mainly to meet the premiums which have to be paid for acquiring crude oil. The income of the oil industry (including Sasol), therefore, does not benefit as a result of the premiums paid at present. For as long as purchasing costs which are higher than the official selling prices of the producer countries are levied on the buying public by way of equalisation fund levies, the oil-from-coal industry will continue to benefit by the additional protection of 3,6 cents per litre. Should the purchases at high premium prices prove more permanent and should the Government decide to consolidate the equalisation fund levies in the producing prices accruing to the oil industry in view of those higher purchasing costs, the oil-from-coal industry will be able to afford that the additional protection of 3,6 cents per litre falls away in whole or in part.

Sasol therefore enjoys the above protection of 3,6 cents per litre at present, but this amount is markedly lower than the amounts per litre applied out of the equalisation fund to settle the current premiums on imported crude oil and therefore the protection will not result in higher fuel prices to the public.

7. IMPORTANT ASSUMPTIONS

The future financial requirements and prospects of the Sasol group have been planned on the basis of, inter alia, a number of assumptions. Due to the gigantic size of the project, and in view of the times in which the oil industry finds itself, care has been taken to ensure that the assumptions are realistic and conservative. Some of the more important assumptions which have financial implications are stated below.

Provision has been made for an expected decrease in fuel consumption as a result of the recent fuel-saving measures.

The operating costs of the Sasol group are based on budgeted figures up to June 1980.

Increases in the product prices of the Sasol group have been estimated with due regard to market conditions and other factors which affect the marketing of its various products.

The price at which coal will be supplied by Sasol One to Sasol Two and Sasol Three will incorporate a yield acceptable to Sasol on the capital employed for the Bosjesspruit Colliery. No income from this source has been taken into account for the 1980 financial year.

It is assumed that the quantities of crude oil and naphtha taken into account in the estimates will be available and that the level of stock valued on the last-in-first-out basis will not fluctuate materially.

The commissioning of Sasol Two and Sasol Three will take place over a period of about three years and full production will be attained in 1982 and 1984 respectively. A change in the expected commissioning rate could have a substantial effect on production and initial profitability of Sasol Two and Sasol Three. These are probably the most sensitive assumptions from a financial viewpoint as far as Sasol Two and Sasol Three are concerned and for this reason are made on a conservative basis. These assumptions will, however, have no effect on the estimated profits of Sasol for the 1980 financial year.

8. PROFITS AND PROSPECTS (6)

The corner-stone of the Sasol group's commercial success is the strong emphasis that has been placed on productivity and efficiency since its early years.

Profitability has shown a sharp increase over the past five years and, in addition to the contribution of increased productivity and extensions to existing plants, the world-wide increases in the prices of crude oil and related products have further contributed to increased profitability. There was not, however, a proportional increase in the physical volume of production. In summarised form the consolidated profit history of Sasol One, and therefore in essence of Sasol, is as follows:

Sasol One

Financial year-end June	1975 R million	1976 R million	1977 R million	1978 R million	1979* R million
Turnover	400	571	693	833	903
Profit before tax	40	49	83	115	140
Profit after tax	23	28	56	73	83

*Estimated

The investor is afforded an opportunity to share immediately in the profit of Sasol One with its proven record of commercial success and profitability. At the same time the investor is assured of participation in Sasol Two and Sasol Three, which are expected to provide a major portion of the growth in the yield on his investment in years to come.

The Sasol board of directors expects a further increase in the profit of Sasol over the next few years, but initially at a slower rate than that of Sasol One during the past five years. When Sasol Two and, subsequently, Sasol Three are in operation and have become profitable, Sasol's profit should grow at a faster rate, initially as a result of dividend receipts on its 50% shareholding in Sasol Two and Sasol Three and subsequently through the acquisition of Sasol Two and later Sasol Three.

For the financial year up to June 1980 a profit after tax of approximately R94 million is projected.

The profits of Sasol One are derived not only from fuel but also from a wide variety of chemical products and pipeline gas which are described in greater detail in Appendix 1. Coal and crude oil (including petroleum naphtha), as basic raw materials, respectively contribute about two thirds and one third of the above estimated profit. The relative contribution of crude oil and naphtha to profits of Sasol will decrease sharply in future as Sasol Two and Sasol Three come into operation. Profit and dividend growth over the medium-term is also dependent upon the rate of commissioning and profit levels of Sasol Two and Sasol Three.

On the assumption that all the shares offered in terms of the private placing and the subsequent public issue are issued and taking into consideration the shares that will be issued to the IDC/Konoil, the estimated attributable earnings per share for the 1979 financial year are 22 cents, and are estimated at 25 cents per share for the 1980 financial year. As only shares actually in issue at a

specific point in time will be taken into account, the earnings per share for the 1980 financial year should be higher than 25 cents. The latter earnings per share are, however, of no value for comparative purposes.

A dividend growth in the region of 12,5% per annum will be aimed at. This is a reasonable figure in the light of the strong balance sheet, future profit expectations and the attendant positive cash flow. The Sasol board of directors regards it as sound policy to aim for a dividend cover of approximately twice. It is also policy that dividend distributions should grow at a rate commensurate with the normal income expectations of investors in ordinary shares.

Against the above background the board of directors foresees that, should Sasol's indicated profitability be achieved, it will declare an interim dividend of 4,5 cents per share for the period up to 31 December 1979 and a final dividend of 7 cents per share for the period to June 1980. Only shares already issued on the relevant dates will qualify for the appropriate dividend. On the issue price of R2,00 per share and calculated over the period from the closing date of the offer up to 28 June 1980, the expected dividend represents a yield of 7% per annum. Future dividend growth will be from this base rate. It is expected that the interim dividend will be paid during February 1980 and the final dividend during September 1980. See Part II paragraph 3.8 for further information regarding dividends.

9. BALANCE SHEET AND FUNDING

The consolidated financial statements of Sasol One form the basis of this prospectus as Sasol has only recently been established and Sasol One and its subsidiaries constitute its main assets. The consolidated balance sheets of Sasol One may be summarised as follows:

Sasol One

Financial year-end June	1975 R million	1976 R million	1977 R million	1978 R million	1979* R million
Fixed assets	173	209	268	283	269
Investments, loans and long-term debtors	11	23	47	112	185
Net current assets	67	48	78	70	139
– Current assets	171	196	216	276	296
– Current liabilities	104	148	138	206	157
	251	280	393	465	593
Financed by:					
Shareholders' and minority shareholders' interest	160	181	224	342	465
Deferred taxation	17	15	38	47	51
Long-term liabilities	74	84	131	76	77
	251	280	393	465	593

*Estimated

A full report on the financial position of the Sasol group, compiled by the consulting accountants and auditors, appears in Appendix 2.

The above balance sheets indicate that Sasol One is well funded. The major capital requirements of Sasol One and therefore of Sasol are in respect of the development of the Bosjesspruit Colliery, on which R103 million has already been spent as at 30 June 1979 and approximately a further R115 million will be spent during the financial year ending June 1980. It is estimated that Bosjesspruit will cost R458 million on completion. Present cash on hand and the expected cash flow will be adequate to meet these requirements from internal resources. The remaining capital expenditure at Sasol One will be on a relatively small scale and will be similarly financed from internal resources.

Sasol Two and Sasol Three, from an accounting point of view, have been isolated from Sasol during the construction and commissioning periods, but when each of these projects has been put into successful commercial operation, the investor will start reaping benefits from them. Sasol has no obligation to make further contributions towards the financing of Sasol Two and Sasol Three. Because Sasol Two and Sasol Three have been so isolated from Sasol until they become wholly-owned subsidiaries, the risk of the public investor during the establishment of these two projects is limited to Sasol's initial investment of R100 million by way of share capital of R50 million in each of those companies.

Taking into account the private placing and the transactions set out in this prospectus as well as the proceeds of the public issue, the pro-forma consolidated balance sheet of Sasol was as follows at 1 July 1979:

Sasol

1 July 1979	R million
Fixed assets	269
Share investment in Sasol Two and Sasol Three	100
Other investments, loans and long-term debtors	180
Net current assets	156
– Current assets	313
– Current liabilities	157
	705
Financed by:	
Shareholders' interest	577
– Ordinary shareholders' interest	569
– Minority shareholders' interest	8
Deferred taxation	51
Long-term liabilities	77
	705

On the assumption that all the shares offered in terms of the private placing and the public issue are issued and taking into consideration the shares to be issued to the IDC/Konoil (a total of 375 000 000 shares), the estimated net asset value per share based on the above pro-forma consolidated balance sheet is 152 cents. This figure takes into account the historic cost less accumulated depreciation of fixed assets and the fact that a large part of the stock is valued on a last-in-first-out basis.

The proceeds of the private placing and public issue will be applied as a contribution to the purchase price of Sasol One, which will be paid to the IDC/Konoil, to a maximum contribution of R400 million. The IDC/Konoil will apply this amount for the financing of Sasol Three. Should the proceeds of the private placing and public issue be more than R400 million, the excess over R400 million will be applied as a contribution to Sasol's 50% share investments of approximately R100 million in Sasol Two and Sasol Three. The proceeds of the private placing and public issue will therefore be mainly employed in Sasol Three. Sasol will, however, be able to acquire all the abovementioned amounts from alternative sources and it is therefore not a requirement that the abovementioned amounts must be provided for out of the proceeds of the private placing and public issue.

10. MANAGEMENT (2)

The Sasol group is managed by a team of highly trained and experienced staff. The senior positions are held by persons who have acquired extensive experience both within the Sasol group and in similar industries elsewhere.

A competent core of technical, financial, commercial and marketing staff has been built up at Sasol One through a policy of selection and development of personnel which has been implemented for more than two decades. The Sasol group has more than 400 scientists and graduates in its service at present.

The expertise of Sasol's technical and research personnel has secured for Sasol and South Africa a leading position in the world in the field of coal liquefaction. Sasol is frequently asked to act as advisers in the field of coal beneficiation and is actively engaged in the research and development of further processes which may find commercial application within 10 to 15 years.

It has been possible to select the key managers for the construction and operation of the new plants at Secunda out of the Sasol group's reservoir of experienced and trained personnel. The various plants of Sasol Two are therefore under the control of persons who have had many years experience in the operation of similar plants at Sasolburg. Moreover, a large number of other operating personnel have already been trained at Sasolburg and Secunda and large-scale training is being continued with a view to the needs of both Sasol Two and Sasol Three.

It would not be possible anywhere else today to start such a specialised oil-from-coal industry with as technically an experienced team as that which Sasol Two and Sasol Three have at their disposal.

Particulars of senior personnel are set out in Part II paragraph 8.1.

OTHER STATUTORY INFORMATION IN CONNECTION WITH THE OFFER

1. NAME, ADDRESS AND INCORPORATION (1(a))

The name of the company is **Sasol Limited** (referred to elsewhere in this prospectus as "Sasol"). Sasol was incorporated in terms of the Act on 26 June 1979. The company's registered office is situated at 1 Klasie Havenga Road, Sasolburg and its transfer office at Central Registrars Limited, 28 Harrison Street, Johannesburg.

2. HISTORY, STATE OF AFFAIRS AND PROSPECTS OF SASOL (6)

2.1 History and background of the Sasol group

The establishment of Sasol One was the result of years of research into the production of oil from coal.

Legislation was passed in 1947 for the establishment of an industry producing oil from coal and in 1950 Sasol One was registered in terms of the provisions of the Companies Act as an ordinary company with a profit motive. The State provided the capital investment required for the establishment of the industry in the form of share capital through the IDC.

Since the completion of the first plant at Sasolburg in 1955 several improvement and expansion programmes have been implemented. The coal for this plant is mined by the Sigma Colliery of Sasol One. In 1964 Sasol One started producing butadiene and styrene for the manufacture of synthetic rubber. The same year saw the start of the synthetic manufacturing of ammonia for the large-scale production of nitrogenous fertilisers. In 1965 the first naphtha cracker of Sasol One was put into operation to produce ethylene, one of the most important raw materials in the chemical industry.

Sasol One has kept pace with the increasing demand for its products through the years and in 1964 established the South African Gas Distribution Corporation Limited ("Gascor") for the distribution of industrial gas to industries in Southern Transvaal (see Appendix 1). In this way Sasol One with its wide range of products developed into the pivot of the chemical industry of South Africa which resulted in the establishment of an extensive petrochemical complex of related industries at Sasolburg.

A new milestone was reached in 1966 when it was decided that Sasol One was to undertake the refining of petroleum. This decision resulted in the establishment in 1969, in partnership with the French Total group and the National Iranian Oil Company ("NIOC"), of National Petroleum Refiners of South Africa (Proprietary) Limited ("Natref"). The refinery was built at Sasolburg (see Appendix 1).

In November 1973, after the start of the OPEC oil crisis, a study in connection with the technical and economic feasibility of an extensive second installation for the large-scale production of fuel from coal was undertaken on the initiative of the then Prime Minister and the Minister of Economic Affairs and the board of Sasol One. Towards the end of 1974 the Minister of Economic Affairs announced that a second installation (Sasol Two) would be developed. In November 1975, a start was made with shaft-sinking at Bosjesspruit and the construction of the Sasol Two factory at Secunda was started in October 1976.

At present the Sasol Two factory is more than 80% complete and certain units have already been commissioned. The Bosjesspruit Colliery is already producing 170 000 tons of coal per month, which are mainly stockpiled in anticipation of the commissioning of Sasol Two.

During February 1979, the Minister of Economic Affairs announced that the construction of a third installation, Sasol Three, adjoining the second installation at Secunda, would go ahead. The development of a third installation at this stage will result in substantial savings in time and establishment costs. Civil construction work at the factory site of Sasol Three has already started. The two new plants at Secunda will employ Sasol's proven oil-from-coal technology and will incorporate the latest improvements and developments.

The Bosjesspruit Colliery is being developed on a four-shaft system and will eventually produce more than 27 million tons of coal per annum. This tonnage represents about 30% of the present total annual coal production of South Africa.

Apart from the coal mined at the Sigma and Bosjesspruit collieries of the Sasol group, the group also has other extensive coal reserves at its disposal which will not be mined in the foreseeable future and which are regarded as not having any significance for the purposes of this prospectus.

A report by Sasol's mining experts on the mining activities of the Sasol group is contained in Appendix 3 in accordance with the requirements of Schedule 3 of the Act. Particulars of the most important immovable properties of Sasol and its subsidiaries are contained in Appendix 5.

2.2 Stimulation of other industries

The manufacture of a wide range of intermediary chemical products by Sasol One brought about the establishment of several satellite industries at Sasolburg resulting in it becoming the most important centre in the South African chemical industry. Feed stocks such as ethylene, propylene, butadiene and styrene, of which Sasol One is the only manufacturer in the country, are supplied to these satellite industries.

AECI Limited has already established two large factories, Coalplex (in association with Sentrachem Limited) and Midland, at Sasolburg for the manufacture of plastics and other chemical products. These factories make use of a variety of feed stocks acquired from Sasol One.

Karbochem (Proprietary) Limited, a wholly-owned subsidiary of the Sentrachem group, manufactures a wide range of products by processing feed stocks which are mainly supplied by Sasol One. Synthetic rubber, for example, is manufactured from styrene and butadiene produced by Sasol One.

Safripol (Proprietary) Limited, owned by Sentrachem Limited and Hoechst SA (Proprietary) Limited, uses the ethylene and propylene supplied by Sasol One for the manufacture of high-density polyethylene and polypropylene respectively for the plastics industry.

The manufacture of nitrogenous feed stocks such as sulphate of ammonia, ammonia, ammonium nitrate, limestone ammonium nitrate, nitric acid and sulphur by Sasol One resulted in the establishment of fertiliser factories at Sasolburg by Federale Kunsmis Limited and Omnia Fertilisers Limited.

In addition to the feed stocks which are supplied to the neighbouring industries, Sasol One also provides utilities such as steam and fuel gas to almost all the industries established in Sasolburg.

In the foreseeable future the development of satellite industries which make use of chemical feed stocks of the Sasol group will still take place mainly at Sasolburg. Ethylene, which will be one of the most important feed stocks supplied by Sasol Two, will be transported to Sasolburg from Secunda by means of a gas pipeline which has almost been completed.

2.3 Prospects of Sasol

For particulars of the prospects of Sasol, see Part I paragraph 8 and paragraph 9.

3. PARTICULARS OF THE OFFER (18)

3.1 The offer (18(a))

See "Main features of the offer" on page 2.

3.2 Time and date of opening and closing of the offer (19)

The offer and subscription lists open at 08h00 on Wednesday, 15 August 1979 and close at 12h00 on Wednesday, 5 September 1979. The directors of Sasol may, however, in their discretion close the offer and subscription lists later, but not later than three months after the date of registration of this prospectus.

3.3 Purpose of the offer (7)

The purpose of the offer is to secure equity participation by the public in Sasol. The funds obtained by the offer will be applied as set out in Part I paragraph 9.

3.4 Manner in which application is to be made

3.4.1 *The application*

Application may be made only for units of R10 000 each, with a minimum of 10 units. Each unit consists of 5 000 shares.

3.4.2 *The application form and submission*

Application may be made only on the application form attached to this prospectus and is to be completed and submitted in accordance with the instructions contained therein and in accordance with the terms of this prospectus and is irrevocable. The terms and conditions which appear in the application form, constitute part of the terms and conditions of this prospectus.

The duly completed application form as well as the first payment, whether the first

payment is made by means of cheque, banker's draft or telegraphic transfer, must be received not later than 12h00 on Wednesday, 5 September 1979, at:

Central Registrars Limited

30th Floor Sanlamsentrum Jeppe Street Johannesburg 2001	or	P.O. Box 8980 Johannesburg 2000

3.4.3 *Multiple applications*

In case an applicant submits more than one application form, the total number of units applied for under the same name may be regarded by Sasol's directors, in their discretion, as a single application. Every other application will be regarded as a single application.

3.4.4 *Condonation of defects and acceptance of applications*

Sasol's directors retain the right to condone in their discretion any defect in an application, or to accept applications after the closing date (but not later than three months after the date of registration of this prospectus), or to refuse any application, or to accept some applications in full and others in part, or to reduce all or any applications in such a manner as they may determine. Applicants will be informed as soon as possible after the closing date of the offer of the number of units in respect of which their applications were accepted.

3.4.5 *Nominees*

Application may only be made in the name of a principal. Applications by nominees will not be accepted.

3.5 Method of payment

3.5.1 *Payment on application and subsequent payments*

Payment must be made as follows not later than 12h00 on the undermentioned dates, and may not be made in any other manner:

- on application a first payment of R4 000 per unit, being the full subscription price of 2 000 shares per unit applied for;
- on 2 January 1980 a second payment of R1 000 per unit, being the full subscription price of 500 shares per unit in respect of which an application is accepted;
- on 1 July 1980 a third payment of R3 000 per unit, being the full subscription price of 1 500 shares per unit in respect of which an application is accepted;
- on 2 January 1981 a final payment of R2 000 per unit, being the full subscription price of 1 000 shares per unit in respect of which an application is accepted.

The second, third and last payments must be sent to Central Registrars Limited, 28 Harrison Street, Johannesburg, 2001 or P.O. Box 61042, Marshalltown, 2107.

The lodging of the application form and the acceptance thereof by Sasol create a binding agreement between Sasol and an applicant in respect of the units for which an application is accepted. An applicant is bound to perform pursuant to such agreement in accordance with the conditions set out in this prospectus and the application form attached hereto.

An applicant remains responsible for all payments in connection with units in respect of which his application has been accepted, irrespective of whether he has alienated any shares already allocated to him. Failing any payment on the due date thereof, Sasol's directors shall take such steps as they may deem fit.

Unless payment is effected by means of telegraphic transfer, each application must be accompanied by a cheque or banker's draft for the relevant amount, drawn in favour of "Central Registrars Limited – Sasol Offer", crossed and marked "not negotiable".

The cheque or banker's draft accompanying an application form in accordance with the terms hereof, may bear the date of the application or a date not later than the closing date of the offer (5 September 1979). A postdated cheque or banker's draft will be presented for payment on the date appearing on it.

An applicant may, if thus indicated on his application form, telegraphically transfer the payment which should accompany his application form to the credit of "Central Registrars Limited – Sasol Account No. 100-741-075", Volkskas Limited, Market Street, Johannesburg, by not later than 12h00 on 5 September 1979. Particulars of all telegraphic transfers must be furnished by telex by not later than 12h00 on 5 September 1979 to Central Registrars Limited, for the attention of Mr H. J. A. Boonzaaier (Telex number 8-7659 SA).

This information must include particulars of the amount transferred, date of transfer, name of the transferor's and transferee's banks as well as the account number of the transferor. A copy of the telegraphic transfer form must be sent to the address of Central Registrars Limited in Johannesburg, for attention of Mr H. J. A. Boonzaaier. If any cheque or

banker's draft is dishonoured, or a telegraphic transfer has not been received by 12h00 on 5 September 1979, as the case may be, Sasol's directors may at their discretion regard the relevant application as invalid or take such other steps as they may deem fit.

3.5.2 *Application of payments*

Payments made will be applied as stated in Part II paragraph 3.5.1 in settlement of the subscription price of the shares applicable to each unit.

3.5.3 *Bank commission*

Bank commission at a rate of 0,1% of the amount of any payment must be added to all payments where cheques are drawn on branches of banks outside the Johannesburg clearing area.

3.5.4 *Currency*

Only South African rand may be used to subscribe for shares in terms of the offer.

3.5.5 *Oversubscription and repayment*

If any application is refused, or if it is accepted for a smaller number of units than the number applied for, the total amount paid on application or the balance thereof will, at the risk of the applicant concerned, be refunded by Sasol, by cheque accompanied by an advice, together with bank commission at a rate of 0,1% where applicable, in the currency of the Republic of South Africa, within seven days after the closing date of the offer. No interest shall be paid on application moneys.

Advices informing applicants of the acceptance of their applications, as well as cheques in repayment of the full amount or the amount of the balance, as the case may be, may be retained pending payment of the applicant's cheque or draft.

3.6 Allotment, issue and certificates

3.6.1 *On application and thereafter*

The shares applicable to units in respect of which an application is accepted and which are paid for in full by applying the first payment, will be allotted and issued on 10 September 1979. The relevant share certificates will be posted on 17 September 1979.

Allotment and issue of shares (as the case may be) which are paid for in full on the respective consecutive payment dates, will take place within 90 days of each payment date concerned, but these shares will not rank for dividends which are paid within six months of any of the relevant payment dates. The relevant share certificates will be mailed on the dates on which these shares are listed on The Johannesburg Stock Exchange. See Part II paragraph 5.

3.6.2 *Block certificates*

Sasol will make use of certified transfer procedures and will therefore issue only block certificates in respect of shares allotted and issued pursuant to this prospectus.

3.7 Receipts

No receipts will be issued for applications or payments.

3.8 Dividends (6)

See Part I paragraph 8 for particulars of the expected declaration and payment of the first two dividends in respect of the shares. Thereafter Sasol proposes to pay dividends half-yearly, during April and October of each year. This paragraph should be read in conjunction with Part II paragraph 3.6.1, which deals with the allotment and issue of shares pursuant to this prospectus.

3.9 Transmission by post

Sasol will despatch all correspondence, letters informing applicants of the acceptance or non-acceptance of their applications, letters of allocation, share certificates, dividend cheques and cheques in respect of application moneys which are being refunded, to the address of an applicant as furnished by him on the application form, at the risk of the applicant. Preference will be given to a P.O. Box address. Share certificates will be sent by certified mail.

4. MINIMUM SUBSCRIPTION (21)

There is no minimum amount which, in the opinion of the directors, must be obtained by means of the offer contained in this prospectus in respect of any of the matters mentioned in paragraph 21 of Schedule 3 of the Act.

5. STATEMENT AS TO LISTINGS ON THE STOCK EXCHANGE (23)

Application has been made to The Johannesburg Stock Exchange for listings in respect of the following shares:

Shares	From
210 500 000 shares	31 October 1979
24 500 000 shares	14 April 1980
73 500 000 shares	13 October 1980
49 000 000 shares	16 April 1981

6. PARTICULARS REGARDING THE SHARE CAPITAL OF SASOL (8)

6.1 Nature of share capital

Sasol has no shares with a par value. The share capital of Sasol consists of one class of ordinary shares of no par value, the particulars of which are as follows:

6.1.1 *Authorised*

1 175 000 000 ordinary shares constitute the authorised capital of Sasol.

6.1.2 *Issued*

7 ordinary shares were issued at 50 cents per share to the directors of the company as founders' shares (see Part II paragraph 6.4). These shares will be transferred and will form part of the 112 500 000 ordinary shares mentioned hereafter.

6.1.3 *To be issued*

In terms of the agreement as set out in Part I paragraph 5, 112 500 000 ordinary shares will be issued to the IDC/Konoil as fully paid shares not later than 17 October 1979. 245 000 000 shares will be issued at an issue price of R2,00 per share pursuant to the offer contained in this prospectus. 17 500 000 ordinary shares will be issued at an issue price of R2,00 per share in terms of a further offer to the public by way of a public issue at the end of September 1979. Application will also be made to The Johannesburg Stock Exchange for the listing of the last mentioned shares.

6.1.4 *To be held in reserve*

800 000 000 ordinary shares are being held in reserve to provide partially for the acquisition of Sasol Two and Sasol Three and future rights issues and/or rights offers to shareholders (see Part I paragraph 3). In terms of a resolution passed at a general meeting of the members of Sasol on 24 July 1979, the directors of Sasol are empowered to issue the unissued shares of Sasol solely for the purposes set out in this paragraph.

6.1.5 *Stated capital*

On the date of this prospectus Sasol has a stated capital of R3,50.

6.1.6 *Shares issued or to be issued otherwise than for cash* (11)

112 500 000 ordinary shares will be issued to the IDC/Konoil as part of the purchase price of the total issued share capital of Sasol One. The balance of R400 million of the purchase price is payable in cash. Sasol's directors are of the opinion that the value of the Sasol One shares is at least equal to the value of the consideration which the IDC/Konoil will receive. Purely for the purpose of Sasol's stated capital a value of 50 cents per share will be attributed to these shares.

6.1.7 *Issue price* (20)

Apart from the 112 500 000 ordinary shares referred to in the previous paragraph, all the issues of shares in terms of the private placing and public issue described in this prospectus will take place at an issue price of R2,00 per share. This price is higher than the price mentioned in paragraph 6.1.6 above on account of the expected profitability of Sasol's investments in Sasol One, Sasol Two and Sasol Three.

6.2 Further issues

All shares in the present authorised capital of Sasol to be issued pursuant to further increases of share capital will rank pari passu with the existing issued shares of Sasol.

6.3 Voting rights

At all general meetings of Sasol a member who is personally present (or in the case of a corporate body, represented) and is entitled to vote, will on a show of hands have one vote. On a poll such member, or a duly appointed proxy, will have one vote in respect of each ordinary share held.

6.4 Founders' shares (8(d))

7 ordinary shares at an issue price of 50 cents per share have been issued to the directors of Sasol as founders' shares. Each director received one share. These shares rank pari passu with all the other shares of Sasol and will in due course be transferred to the IDC/Konoil.

6.5 Options (10)

Except as set out in this prospectus:

- no shares of Sasol are under option, or are by agreement conditionally or unconditionally subject to being placed under option;
- no shares have been issued for cash or otherwise and no shares will be so issued;
- no commissions, discounts, brokerage or other special conditions have been granted in connection with the issue or sale of Sasol's shares.

7. STATEMENT REGARDING THE ADEQUACY OF CAPITAL (22)

Sasol's directors are of the opinion that the issued share capital of Sasol, including the amount being raised pursuant to this offer and the public issue referred to in Part I paragraph 1, will be adequate for the purposes of the business of the company and its subsidiaries.

8. PARTICULARS REGARDING DIRECTORS, MANAGEMENT AND SECRETARY

8.1 Directors and management (2(a))

The directors of Sasol are:

David Pieter de Villiers
Goedvertrouw
Stanford
7210

Industrialist and Chairman of the board of directors of Sasol

Johannes Augustus Stegmann
15 Kromellenboog
Sasolburg
9570

Managing Director of Sasol

George Alistair Macmillan
23 Victoria Avenue
Melrose
Johannesburg
2196

Chairman and Chief Executive of the Rio Tinto Group of South Africa

Albert Jacobus Marais
255 Smith Street
Muckleneuk
Pretoria
0002

Managing Director of Saambou National Building Society

John Kirkman Mitchell
34 Kloof Road
Bedfordview
2008

General Manager, IDC

Pierre Etienne Rousseau
Pure Vuur
9 Sixth Avenue
Voëlklip
7203

Industrialist

Abie Johannes van den Berg
Stand 75
Dolweni Avenue
Boskruin Extension
Randburg
2194

Managing Director, IDC

All the directors are citizens of the Republic of South Africa.

The management of the Sasol group is:

Name	Designation	Age	Years of service	Academic qualifications	Career with Sasol
J. A. Stegmann	Managing Director	52	26	BSc (Eng) MCom (B&A)	Commercial and administrative/Financial/ General company management
Dr A. H. Stander	Senior General Manager, Sasol	57	28	PhD BCom	Technical services/ Research and development/Project management
J. L. J. Bezuidenhout	Senior General Manager, Sasol	52	28	BCom	Administrative/ Marketing/Personnel function/Company secretary/Commercial and financial general management
H. R. Wiggett	General Manager, Sasol	57	24	BCom	Marketing/Crude oil acquisition and refining
T. A. Conradie	General Manager, Sasol	53	22	BSc (Eng)	Factory maintenance/ Works study/Works engineering/Management services/Personnel function/General management
J. C. Hoogendoorn	Deputy General Manager, Sasol	58	24	MTS (Amsterdam)	Chemical engineering services/Research and development
Dr D. F. Mostert	Deputy General Manager, Sasol	42	5	BA, LLD	Company secretary/ Commercial/Legal services/Administrative
W. F. Reyneke	General Manager (Operations), Sasol One	55	25	BSc BSc (Eng)	Production management/ Project management/ General manager: Natref
B. H. L. Leach	General Manager (Mining), Sasol One	53	14	BSc (Eng) MSc (Eng)	Mine manager/General management: Sasolburg works and mine
P. R. Barker	Manager: Financial Department, Sasol One	54	26	BCom CMA	Accounting and financial
P. V. Cox	Assistant General Manager (Mining), Sasol One	35	8	BSc (Metal. Eng) BSc (Mining Eng)	Mining/Mine project management/Mining management
P. du P. Kruger	General Manager (Operations), Sasol Two	42	15	BSc (Eng) MBL	Mining/Mine management/General management: Secunda operations
W. P. de Waal	Assistant General Manager (Operations), Sasol Two	47	24	BSc (Eng), AMI	Laboratory/Plant operations/Production management/General factory management
C. J. Uys	Managing Director, Sasol Marketing Company	52	23	BSc	Marketing

8.2 Service contracts (2(b))

There are no existing or proposed service contracts with any of Sasol's directors.

8.3 Directors' remuneration (2(c))

The remuneration of the directors of Sasol and Sasol One is determined by the directors of Sasol and Sasol One respectively from time to time. The relevant provisions of Sasol's articles of association are quoted in Appendix 4. The remuneration of directors of all other subsidiaries is determined by way of a general meeting, except in the case of Allied Tar Acid Refinery (Proprietary) Limited, where remuneration is determined by the directors or a general meeting and National Petroleum Refiners of South Africa (Proprietary) Limited, where remuneration is determined by the company in general meeting, to be confirmed by the holders of A, B and C ordinary shares.

8.4 Directors and management (2(b), (c) and (e))

The provisions of Sasol's articles of association with regard to the directors and management of Sasol are set out in Appendix 4 and further information appears in Part I paragraph 10 and Part II paragraph 8.1.

8.5 Secretary (5)

The secretary of Sasol is:

Anton Kruger Roodt, MA
1 Klasie Havenga Road
Sasolburg
9570

9. BANKERS, SPONSORING BROKERS, ATTORNEY AND AUDITORS (3 and 4)

9.1 Banker

Volkskas Limited
(Registered Commercial Bank)
Volkskas Building
Pretorius Street
Pretoria
0002
P.O. Box 578
Pretoria
0001

9.2 Consulting merchant bank

Finansbank Limited
(Registered Merchant Bank)
4th Floor
20 Anderson Street
Johannesburg
2001
P.O. Box 62343
Marshalltown
2107

9.3 Sponsoring brokers

Simpson, Frankel, Hern, Kruger Incorporated
(Successors to Sidney Isaacs Incorporated, Simpson, Frater, Melrose and Stein Incorporated and Ed Hern, Kruger Incorporated)
(Member of The Johannesburg Stock Exchange)

Johannesburg	*Cape Town*	*Benoni*
4th Floor	17th Floor	50 Cranbourne Avenue
The Stock Exchange	Cartwright's Corner House	Benoni
Diagonal Street	Adderley Street	1501
Johannesburg	Cape Town	
2001	8001	
P.O. Box 299	P.O. Box 4805	P.O. Box 285
Johannesburg	Cape Town	Benoni
2000	8000	1500

and

Max Pollak & Freemantle
(Incorporating: Morris Lipschitz & Co., Allen Hesselberger & Co. and L. Bowman & Michel)
(Members of The Johannesburg Stock Exchange)

Johannesburg

201 The Stock Exchange
Diagonal Street
Johannesburg
2001

P.O. Box 512
Johannesburg
2000

Cape Town

1st Floor
Colonial Mutual Building
97 St. George's Street
Cape Town
8001

P.O. Box 512
Cape Town
8000

Durban

1st Floor
Hill Samuel House
17/23 Field Street
Durban
4001

P.O. Box 1558
Durban
4000

9.4 Attorney

Couzyn, Hertzog & Horak Incorporated

26th Floor
Trust Bank Centre
56 Eloff Street
Johannesburg
2001

9.5 Auditors

Alex. Aiken & Carter
(Chartered Accountants (SA))

Marshall Place
66 Marshall Street
Johannesburg
2001

9.6 Issuing houses

Volkskas Merchant Bank Limited
(Registered Merchant Bank)

40th Floor
Carlton Centre
Commissioner Street
Johannesburg
2001

P.O. Box 8054
Johannesburg
2000

Barclays National Merchant Bank Limited
(Registered Merchant Bank)

6th Floor
National Bank Building
84 Market Street
Johannesburg
2001

P.O. Box 7761
Johannesburg
2000

Central Merchant Bank Limited
(Registered Merchant Bank)

31st Floor
Sanlamsentrum
Jeppe Street
Johannesburg
2001

P.O. Box 2683
Johannesburg
2000

Standard Merchant Bank Limited
(Registered Merchant Bank)

15th Floor
Standard Bank Centre
78 Fox Street
Johannesburg
2001

P.O. Box 61344
Marshalltown
2107

Union Acceptances Limited
(Registered Merchant Bank)

42nd Floor
Carlton Centre
Commissioner Street
Johannesburg
2001

P.O. Box 582
Johannesburg
2000

10. GENERAL PARTICULARS

10.1 Loans (9)

There are no material loans by Sasol or its subsidiaries to any party which were not granted in the ordinary course of business of Sasol or its subsidiaries. A table with particulars of loans to Sasol and its subsidiaries is furnished in Appendix 5. Details of loans by Sasol and its subsidiaries to other parties are available for inspection as stated in Part II paragraph 10.9.

10.2 Borrowing powers (2(e))

The provisions of Sasol's articles of association with regard to the borrowing powers of Sasol's directors are set out in Appendix 4.

10.3 Property acquired or to be acquired (12)

Particulars of fixed assets acquired by Sasol One are set out in Appendix 3 and Appendix 5. In addition, Sasol has purchased shares in terms of the contracts set out in Part I paragraph 5.

10.4 Material contracts (16)

The contracts set out in Part I paragraph 5 (being contracts not entered into in the ordinary course of business of Sasol or its subsidiaries) which may or may not be material, have been entered into.

10.5 Preliminary expenses and issue expenses (15)

It is estimated that the preliminary expenses and the expenses in connection with the issue will amount to approximately R12 million. This amount includes listing fees of R5 000 payable to The Johannesburg Stock Exchange. The above preliminary costs and expenses will be paid by Sasol out of internal resources.

10.6 Reports of the auditors of Sasol (25 and 27 read in conjunction with 29 and 30)

The reports of the consulting accountants and auditors appear in Appendix 2.

10.7 Report by directors on material changes (31)

The material changes in the assets and liabilities of the subsidiaries of Sasol since the date of the latest audited annual financial statements of the subsidiaries, namely 24 June 1978, are contained in the report of the consulting accountants included in this prospectus.

10.8 Requirements for prospectus of mining company (24)

The relevant information required in terms of paragraph 24 of Schedule 3 of the Act is set out in the mining experts' report contained in Appendix 3 hereto.

10.9 Documents for inspection

Copies of the following documents will be open for inspection at Sasol's registered address and at that of the transfer secretaries, during normal business hours for the duration of the issue:

- Memoranda and articles of association, as well as the documents of incorporation, of Sasol and its subsidiaries;
- Audited financial statements of Sasol and its subsidiaries which are referred to in this prospectus;
- The material contracts mentioned in Part I paragraph 5 and Part II paragraph 10.4;
- The documents mentioned in Part II paragraph 10.10;
- A schedule containing details of loans by Sasol and its subsidiaries to other parties.

10.10 Registration of this prospectus and supporting documents

A copy of this prospectus has been registered with the Registrar of Companies, Pretoria, in terms of section 155 of the Act. The copy so registered was accompanied by the written consent of Sasol's mining experts, consulting accountants and auditors, attorney, banker, brokers, issuing houses and consulting merchant bank to act as such and to be mentioned in this prospectus, as well as by copies of the material contracts as mentioned in Part I paragraph 5 and required under sections 152 and 153 of the Act, and the written consent of both the mining experts and the consulting accountants and auditors of Sasol to issue this prospectus, as well as to publish their reports in the form and context in which they appear herein. The latter consents were granted before this prospectus was lodged for registration and have not since been withdrawn.

11. ACCEPTANCE OF RESPONSIBILITY

The directors, having made all reasonable enquiries, jointly and severally accept full responsibility for the correctness of the information in this prospectus and confirm that, to the best of their knowledge and belief, there are no other facts (including facts which may not be published in terms of section 15A of the Act) which have been concealed whereby any information which is given herein is rendered misleading. The directors furthermore confirm that the omission of facts which may not be published in terms of section 15A of the Act can in no way prejudice the assessment of the state of affairs and prospects of Sasol or render the information given in this connection misleading.

12. PARAGRAPHS OF SCHEDULE 3 WHICH ARE NOT APPLICABLE

Paragraphs 1(b), 2(d), 6(d), 6(e)(ii), 6(h), 8(a), 13, 14, 16(b), 17, 18(b), 20(a), 26, 28 and 32 to 48 of Schedule 3 of the Act do not apply to this prospectus.

Signed by the directors of Sasol at Johannesburg on 2 August 1979

D. P. de Villiers

J. A. Stegmann

G. A. Macmillan

A. J. Marais

J. K. Mitchell

P. E. Rousseau

A. J. van den Berg

PRODUCTS, ACTIVITIES AND SUBSIDIARIES OF THE SASOL GROUP

Sasol's main activities

Sasol's oil-from-coal technology is based on more than 25 years' experience and skill in the development of what is today known as the Sasol process. One of the first steps of this process entails the production of synthesis gas, a mixture of hydrogen and carbon monoxide in a specific ratio. This is done by burning coal in an atmosphere of steam and oxygen in pressure gasifiers. These gasifiers simultaneously produce various other products such as ammonia and tar products.

The unpurified synthesis gas is then fed into a gas purification unit where impurities are removed. The purified gas mixture is the raw material for the Sasol synthol synthesis process. This process mainly produces products such as petrol, diesel, kerosene, liquefied petroleum gas and various chemicals.

Continued research is still increasing the range of industrial products and consumer goods resulting from the above reactions. Sasol is today the world leader in the field of commercial application of oil-from-coal technology.

Coal

Information in connection with Sasol's collieries is provided in Part I and Appendix 3 of this prospectus.

Gas

A considerable portion of Sasol's gas production is used as industrial gas which is distributed over a large area by pipeline. This gas also serves as a substitute for fuels manufactured from imported crude oil and therefore results in a saving of foreign exchange. See particulars of Gascor below.

Oil

Apart from playing a leading part in oil-from-coal technology, Sasol One has taken important decisions in the field of crude oil through the establishment of Natref in collaboration with Total and NIOC. See particulars of Natref below.

Chemicals

With the founding of Sasol One the South African petro-chemical industry became firmly established.

The gasification of coal produces various by-products, including tars and tar acids. Alcohols, ketones and organic acids are recovered from the aqueous streams flowing from the synthesis reactors.

Various waxes are also produced which are employed in the manufacture of matches, candles, polishes, beauty preparations, plastics and other end products. These waxes are exported to a number of overseas countries.

A range of nitrogenous products, including liquid ammonia, ammonium nitrate and sulphate of ammonia is mainly used in the South African agricultural industry.

Petroleum naphtha is cracked into chemical products such as ethylene and propylene, which are among the most important raw materials for the plastics industry. Butadiene, which is used for the manufacture of artificial rubber, is also recovered in the process. Styrene, the other basic raw material of synthetic rubber, is manufactured from ethylene and from benzene obtained from the neighbouring steel industry.

Subsidiaries and other important companies of the Sasol group

The main functions of the subsidiaries of Sasol (excluding Sasol One) and the other important companies of the Sasol group (excluding Sasol Two and Sasol Three), as well as the Sasol group's shareholding in each one, are as follows:

– Sasol Marketing Company Limited ("SMC") was incorporated in South Africa on 15 November 1952 and markets petroleum products of the Sasol group, excluding road binder material, tar and bitumen. Sasol One has held all the issued shares of SMC since November 1952. SMC's issued share capital amounts to R300 000;

- South African Gas Distribution Corporation Limited ("Gascor") was established in 1964 to distribute industrial gas by pipeline from Sasol One to South Africa's most important industrial complex consisting of the entire Witwatersrand and the Vaal Triangle. Gascor has already replaced 95% of the petroleum fuels used for industrial heating in its marketing area. In terms of its articles of association Gascor may not pay dividends to its shareholders and distributes the gas produced by Sasol One on a basis of recovery of all distribution costs. Gascor has also been designated to distribute any natural gas that may be discovered in South Africa. Gascor's total issued share capital of R1 000 is held equally by Sasol One and the IDC. The funds for the financing of Gascor's assets were raised on the South African capital market by means of long-term loans;

- National Petroleum Refiners of South Africa (Proprietary) Limited ("Natref") was incorporated in South Africa on 8 December 1967 and refines crude oil against payment of a process fee for its shareholders. Since December 1967 Sasol One has had a 52,5% interest in Natref's issued share capital of R15 million. In terms of an agreement with NIOC, which has a 17,5% interest in Natref, Sasol One has the right to utilise their 17,5% of the refining capacity of Natref which, together with Sasol One's own 52,5%, gives Sasol One a total right to 70% of Natref's refining capacity. The Natref refinery therefore processes crude oil for Sasol One into petrol, diesel oil, kerosene, jet fuel and various other products. The crude oil is pumped by pipeline from the coast to Sasolburg;

- Sasol Dorpsgebiede Limited ("SDB") was incorporated in South Africa on 29 February 1952. It undertakes township development at Sasolburg and provides housing for the Sasol group's employees. SDB has an issued share capital of R100 000 which has been held in total by Sasol One since February 1952;

- Inspan Beleggings (Proprietary) Limited ("Inspan") was incorporated in South Africa on 1 July 1966 and holds the major portion of the coal rights of Bosjesspruit's coal field. Sasol One has the right to mine the coal concerned on conditions which are determined from time to time. Inspan's entire issued share capital of R2,00 has been held in total by Sasol One since July 1977;

- Leslie Coal Development Company (Proprietary) Limited ("Leslie Coal") was incorporated in South Africa on 20 November 1968 and holds Sasol One's longer-term coal rights. Sasol One has, as in the case of Inspan, the right to mine the coal reserves concerned. Leslie Coal's total issued share capital of R152 has been held by Sasol One since November 1968;

- Inspan Bedryf (Proprietary) Limited (incorporated in South Africa on 13 January 1971), Sasol Konstruksiemaatskappy (Proprietary) Limited (incorporated in South Africa on 20 January 1966) and Naftachem (Proprietary) Limited (incorporated in South Africa on 26 September 1962) each has an issued capital of R2,00 which is held in total by Sasol One. The companies are dormant;

- Allied Tar Acid Refiners (Proprietary) Limited ("Atar") was incorporated in South Africa on 30 August 1974 and refines tar acids in one of Sasol One's factories. Atar also markets phenols and cresylic acid through SMC. Atar's issued share capital amounts to R500 000, of which 75% has been held by Sasol One since August 1974;

- Tosas (Proprietary) Limited ("Tosas") was incorporated in South Africa on 25 October 1971. Its only asset is an interest of 50% in FTS Binders (Proprietary) Limited ("FTS"). Sasol One has held 70% of the total issued share capital of Tosas, amounting to R100, since October 1971. FTS markets road binder material;

- Southern Oil Exploration Corporation (Proprietary) Limited ("Soekor") undertakes oil exploration. The investment by Sasol One in Soekor represents a 50% shareholding in the company. Soekor was established to lead and co-ordinate the search for oil in South Africa on behalf of the Government and is financed with State funds. Should oil or gas be discovered in the future it would not result in any automatic rights or commitments for Sasol. Such rights or commitments can under such circumstances only be created through negotiation with the State;

- Fedgas (Proprietary) Limited ("Fedgas") markets industrial gases such as oxygen, nitrogen and argon and compositions thereof, as well as welding equipment and welding services. Sasol One has a 20% interest in the issued capital of Fedgas, amounting to R5,5 million. Sasol One supplies certain industrial gases to Fedgas.

REPORTS OF CONSULTING ACCOUNTANTS AND AUDITORS ON PROFITS, ASSETS AND LIABILITIES (25 and 27 read together with 29 and 30)

2 August 1979

The Directors
Sasol Limited
1 Klasie Havenga Road
Sasolburg
9570

Gentlemen

1. We have acted as auditors to Sasol Limited ("Sasol") since its incorporation on 26 June 1979 and as auditors to Sasol One (Proprietary) Limited ("Sasol One") and its subsidiary companies (collectively referred to as "the Sasol One group"), with the exception of National Petroleum Refiners of South Africa (Proprietary) Limited which was audited by another firm, during the period covered by this report.

2. We have examined the financial records of Sasol as at 26 June 1979 and the audited financial statements of the companies comprising the Sasol One group for the five financial years ended on 24 June 1978.

3. We report for the purposes of a private placing and a public issue of ordinary shares in Sasol.

SASOL

4. Sasol was incorporated on 26 June 1979 and has an authorised share capital of 1 175 000 000 ordinary shares of no par value. At the date of this report and before taking into account the shares to be issued in terms of this prospectus the issued capital was R3,50, comprising 7 ordinary shares of no par value issued at 50 cents per share.

5. PROFITS AND DIVIDENDS (25(2)(a), 29)

Sasol did not carry on business and incurred only minimal expenses on the date of its incorporation. Consequently it neither earned any profits nor declared any dividends.

6. ASSETS AND LIABILITIES (25(2)(b))

The assets and liabilities of Sasol at 26 June 1979 were:

Source of capital

Stated capital

Authorised

1 175 000 000 ordinary shares of no par value

Issued

7 ordinary shares of no par value	R3,50

Employment of capital

Amount due by subscribers to memorandum of association	R3,50

7. MATERIAL CHANGES IN ASSETS, LIABILITIES AND CAPITAL STRUCTURE SINCE 26 JUNE 1979 (25(4))

The following events have taken place since 26 June 1979:

7.1 In terms of an agreement dated 20 July 1979 Sasol acquired, with effect from 1 July 1979, the entire issued share capital of Sasol One for 112 500 000 ordinary shares of no par value in Sasol to be issued not later than 17 October 1979 and R400 000 000 free of interest payable on or before 31 December 1980. The 7 ordinary shares issued to the subscribers to the memorandum will be transferred as part of the 112 500 000 ordinary shares and all these shares will, when issued, rank pari passu in all respects with the shares to be issued in terms of this prospectus. Details of the companies comprising the Sasol One group, their profits for the five financial years ended 24 June 1978 and their assets and liabilities at that date are set out below.

7.2 In terms of an agreement dated 20 July 1979 Sasol acquired, with effect from 29 June 1979, 5 000 000 ordinary shares of R1,00 each (50% of the issued capital) in Sasol Two (Proprietary) Limited ("Sasol Two") and 700 ordinary shares of R1,00 each (50% of the issued capital) in Sasol Three (Proprietary) Limited ("Sasol Three"), at par payable in cash.

Furthermore, Sasol subscribed during July 1979 for an additional 45 000 000 ordinary shares of R1,00 each in Sasol Two at par and for an additional 49 999 300 ordinary shares of R1,00 each in Sasol Three at par. The other 50% shareholder in Sasol Two and Sasol Three subscribed at the same time for the same number of shares in Sasol Two and Sasol Three at par.

THE SASOL ONE GROUP (27)

8. COMPOSITION OF SASOL ONE GROUP

The companies comprising the Sasol One group are:

Company/Subsidiary company	Nature of business	Issued share capital at 24 June 1978	Percentage interest of Sasol One in issued share capital
Sasol One (Proprietary) Limited	Holding company and production of liquid fuels, gases and chemical products	Ordinary R102 750 000 Preference R12 000 000	
National Petroleum Refiners of South Africa (Proprietary) Limited	Refining of petroleum products	R15 000 000	52,5%
Sasol Marketing Company Limited	Marketing of liquid fuels and chemical products	R300 000	100,0%
Sasol Dorpsgebiede Limited	Development, sales and letting of land and residential buildings	R100 000	100,0%
Allied Tar Acid Refiners (Proprietary) Limited	Tar acid refiners	R500 000	75,0%
Leslie Coal Development Company (Proprietary) Limited	Holder of coal rights	R152	100,0%
Tosas (Proprietary) Limited	Holds 50% interest in FTS Binders (Proprietary) Limited	R100	70,0%
Inspan Beleggings (Proprietary) Limited	Holder of coal rights	R2	100,0%
Inspan Bedryf (Proprietary) Limited	Dormant	R2	100,0%
Naftachem (Proprietary) Limited	Dormant	R2	100,0%
Sasol Konstruksiemaatskappy (Proprietary) Limited	Dormant	R2	100,0%

9. ACCOUNTING POLICIES

The principal accounting policies of the Sasol One group, which have been consistently applied throughout the five financial years ended in June 1978, except as stated in paragraph 10.2 of this report, are:

9.1 Accounting convention

The statements of profits and assets and liabilities are, subject to the items noted in paragraph 10.2, presented according to the historical cost convention.

9.2 Basis of consolidation

The statements of group profits and assets and liabilities set out later in this report incorporate the results and assets and liabilities of Sasol One and its subsidiary companies.

9.3 Deferred tax

Deferred tax is calculated at current tax rates and represents the future liability for tax in respect of items of income and expenditure, including depreciation, which are recognised for tax purposes in periods different to those during which they are brought to account in the income statement.

9.4 Fixed assets and depreciation

Fixed assets are stated at cost. Expenditure on prospecting for coal is capitalised.

Fixed assets are written off on the straight-line method over their expected useful lives and additional depreciation is charged against fixed assets from time to time. Additional amounts of R12 500 000 per annum have been written off in the last four financial years (see paragraph 10.2).

Expenditure on certain minor assets is charged against income.

9.5 Undeveloped and developed land and residential buildings

Land is stated at cost. Residential buildings are stated at cost and are written off on the straight-line method over their expected useful lives.

The net income from the sale of land and buildings on instalments is accounted for as the instalments are received.

9.6 Stock

Crude oil and naphtha are valued at purchase price on the last-in-first-out method. Other materials are valued at average purchase price. Redundant stocks are written off and provision is made in respect of slow-moving items. Finished products are valued at the lower of production cost, excluding administration overheads, calculated on the last-in-first-out method, or net realisable value (see paragraph 10.2).

9.7 Debtors

Known bad debts are written off and provision is made for doubtful debts.

9.8 Plant turn-around

Provision is made to eliminate the effect on income of periodic planned plant turn-around.

9.9 Exchange rates

Assets and liabilities of the group in foreign currencies are converted to South African currency at the approximate rates of exchange ruling at the balance sheet date except for certain liabilities which are converted at forward contract rates. Differences arising from changes in conversion rates are credited to or written off against income unless the liabilities relate to major capital projects.

10. PROFITS (27(1) and (2))

10.1 The consolidated results of the Sasol One group and the results of Sasol One, after making such adjustments to the audited financial statements as we considered appropriate, are:

Fifty-two weeks ended	29 June 1974 R000	28 June 1975 R000	26 June 1976 R000	25 June 1977 R000	24 June 1978 R000
Sasol One group					
Turnover	306 570	400 134	571 060	692 776	832 866
Income before taking the following items into account	51 583	74 402	80 988	117 027	151 122
Add:					
Dividends received	10	78	120	189	170
Interest received	2 500	3 401	3 054	5 065	8 312
	54 093	77 881	84 162	122 281	159 604
Less:					
Depreciation of fixed assets					
– Normal	20 610	20 469	18 465	20 177	25 118
– Additional	—	12 500	12 500	12 500	12 500
Interest paid	5 494	4 831	4 505	7 030	7 334
	26 104	37 800	35 470	39 707	44 952
Net income before taxation	27 989	40 081	48 692	82 574	114 652
Taxation, including deferred taxation	11 748	16 677	19 878	26 129	40 733
Net income after taxation	16 241	23 404	28 814	56 445	73 919
Outside shareholders' interest	3	10	590	585	585
Net income attributable to shareholders of Sasol One	16 238	23 394	28 224	55 860	73 334
Sasol One					
Income before taking the following items into account	34 771	56 191	60 778	96 059	128 789
Add:					
Dividends, interest and fees from subsidiary companies	5 909	7 068	8 374	9 573	11 677
Other dividends received	—	—	—	45	—
Other interest received	2 106	2 936	2 133	4 180	7 705
	42 786	66 195	71 285	109 857	148 171
Less:					
Depreciation of fixed assets					
– Normal	12 627	12 322	10 118	11 531	16 275
– Additional	—	12 500	12 500	12 500	12 500
Interest paid	3 046	2 594	2 483	5 370	5 995
	15 673	27 416	25 101	29 401	34 770
Net income before taxation	27 113	38 779	46 184	80 456	113 401
Taxation, including deferred taxation	11 565	16 519	19 630	25 858	40 560
Net income attributable to shareholders of Sasol One	15 548	22 260	26 554	54 598	72 841

10.2 Changes in the basis of accounting

10.2.1 With effect from 29 June 1975, that is the beginning of the financial year ended 26 June 1976, the Sasol One group changed its basis of valuing crude oil, naphtha and finished goods from the first-in-first-out to the last-in-first-out method of valuation. The effect of this change on the profits for the year ended 26 June 1976 was calculated at the time and the effect on the profits for the subsequent two years, ended 24 June 1978, has now been calculated.

10.2.2 With effect from 30 June 1974, that is the beginning of the financial year ended 28 June 1975, in the absence of general agreement concerning the method of dealing in financial statements with the effects of inflation, additional depreciation amounting to R12 500 000 per annum was written off fixed assets.

10.2.3

	1974 R000	1975 R000	1976 R000	1977 R000	1978 R000
The consolidated net income for the five years to 24 June 1978 attributable to shareholders of Sasol One is set out in paragraph 10.1 after charging the following amounts, after taxation, against profits as a result of the changes stated in paragraphs 10.2.1 and 10.2.2	—	7 741	20 777	12 258	8 471

10.3 The charge for taxation in each of the five financial years ended 24 June 1978 has been reduced by investment and export sales allowances.

10.4 No subsidiary company incurred a loss in any of the five financial years ended 24 June 1978.

11. ASSETS AND LIABILITIES (27(1) and (2))

11.1 The assets and liabilities of the Sasol One group and Sasol One at 24 June 1978, based on the audited balance sheets at that date, were:

	Notes	Sasol One group R000	Sasol One R000
Source of capital			
Share capital	1	114 750	114 750
Distributable reserves	2	170 013	163 288
Amount received in respect of shares issued on 30 June 1978		50 000	50 000
Shareholders' interest		334 763	328 038
Interest of outside shareholders in subsidiary companies		7 663	
Long-term liabilities	3	75 974	64 799
Deferred tax		46 734	46 506
Capital employed		465 134	439 343
Employment of capital			
Fixed assets	4	275 108	217 489
Undeveloped and developed land and residential buildings	5	7 904	245
Interest in subsidiary companies	6		57 096
Investments	7	6 522	5 902
Long-term loans and debtors	8	105 654	99 207
Current assets			
– Stock	9	108 165	94 957
– Subsidiary company			72 597
– Debtors and prepaid expenditure		85 714	3 940
– Funds on deposit		81 300	81 300
– Bank balances and cash		1 197	1 178
		276 376	253 972
Deduct: Current liabilities			
– Creditors		150 905	143 711
– Tax		34 815	35 022
– Loans		7 044	2 750
– Bank overdraft		442	453
– Dividends – Preference shares		360	360
– Ordinary shares		9 775	9 775
		203 341	192 071
Net current assets		73 035	61 901
Deduct: Provisions	10	3 089	2 497
		69 946	59 404
		465 134	439 343

11.2 Notes to the statement of assets and liabilities

		Sasol One group R000	Sasol One R000
1. Share capital			
Authorised and issued			
12 000 000 6% cumulative preference shares of R1,00 each		12 000	12 000
102 750 000 ordinary shares of R1,00 each		102 750	102 750
		114 750	114 750
2. Distributable reserves			
General		85 000	85 000
Retained income		85 013	78 288
		170 013	163 288
3. Long-term liabilities			
Dates of repayment	Rates of interest per annum		
Loans			
December 1987	7,94%	3 100	3 100
March 1981 (Sw Fr 20 000 000)	7,75%	6 795	6 795
Five equal half-yearly instalments commencing November 1978 (Sw Fr 1 806 000)	8,75%	482	482
May 1981 (DM 50 000 000)	9,75%	17 215	17 215
Twenty six half-yearly instalments commencing July 1978	13,00%	3 500	3 500
Two equal half-yearly instalments commencing October 1978 (DM 6 002 000)	3,5% above German Bundesbank rate	1 092	—
January 1979 (DM 13 998 000)	3,5% above German Bundesbank rate	2 547	—
Undetermined	8,0%	11 172	—
Undetermined	3,0% above South African Reserve Bank rate	3	—
Other loans	Various	22 125	22 125
		68 031	53 217
Guaranteed registered notes			
December 1987	7,5%	10 000	10 000
Export credit			
Six equal half-yearly instalments commencing July 1978 (DM 5 513 000)	4,0% above German Bundesbank rate	2 170	2 170
Six equal half-yearly instalments commencing November 1978 (F Fr 3 479 000)	7,25%	542	542
		80 743	65 929
Less: Amount repayable within one year included in loans under current liabilities		4 769	1 130
		75 974	64 799

4. Fixed assets

(a) *Schedule of fixed assets*

	Sasol One group			Sasol One		
	Cost R000	Depreciation R000	Net book value R000	Cost R000	Depreciation R000	Net book value R000
Land, buildings and improvements	13 996	4 079	9 917	8 877	2 398	6 479
Plant, equipment and vehicles	399 449	248 279	151 170	300 784	192 706	108 078
Coal rights	7 616	344	7 272	894	342	552
Expenditure on prospecting	8 200	5	8 195	8 200	5	8 195
Mine development	99 550	12 068	87 482	99 551	12 068	87 483
	528 811	264 775	264 036	418 306	207 519	210 787
Capital work in progress			11 072			6 702
Patents – at nominal value of R2,00 (Sasol One group) and R1,00 (Sasol One)						
			275 108			217 489

(b) Assets to the value of approximately R4 million have been erected by an associated company on land owned by a subsidiary company. In accordance with an agreement, the subsidiary company has the right, against payment of compensation, to use the assets and has an option to acquire, against payment of further compensation, permanent and unencumbered rights over the assets.

	Sasol One group R000	Sasol One R000
5. Undeveloped and developed land and residential buildings		
Undeveloped and developed land	1 931	245
Residential buildings	7 787	
Less: Amount written off	1 814	
	5 973	—
	7 904	245
6. Interest in subsidiary companies		
Shares at cost		8 650
Loans		49 327
		57 977
Less: Provision for losses incurred prior to 1974 by the housing subsidiary company and for diminution in value of certain assets owned by another subsidiary company		881
Interest in subsidiary companies per balance sheet		57 096
Current account		72 597
Total interest		129 693
7. Investments		
(a) Unlisted shares – at cost	5 912	5 902
Building societies – shares at cost	299	—
– deposits	311	—
	6 522	5 902

			Sasol One group R000	Sasol One R000
(b) *Unlisted share investments consist of:*				
	Number of shares held			
	Sasol One group	Sasol One		
Fedgas (Proprietary) Limited	900 000	900 000	900	900
FTS Binders (Proprietary) Limited	10 000	—	10	—
Sasol (Transvaal) Limited (now Sasol Two)	5 000 000	5 000 000	5 000	5 000
Sasol (Transvaal) Dorpsgebiede Limited	1 000	1 000	1	1
The South African Gas Distribution Corporation Limited	500	500	1	1
Suidelike Olie-Eksplorasiekorporasie Limited	50 000	50 000		
Total book value			5 912	5 902
Directors' valuation			6 517	6 167

(c) The shares and deposits in building societies have been pledged to the building societies as security for housing loans granted to employees of the group and associated companies.

8. Long-term loans and debtors

Sales of land and residential buildings	10 396	1 088
Deduct: Provision for unrealised income	3 872	354
	6 524	734
Loans	88 549	88 549
Mortgage loans	237	—
Loan portion of tax	10 017	9 924
Land development	327	—
	105 654	99 207

9. Stock

Process material		
– Valued on last-in-first-out method	53 372	53 372
– Valued at average purchase price	9 596	5 677
Maintenance and other material	21 498	15 416
Finished products	23 699	20 492
	108 165	94 957

10. Provisions

Mine equipment	387	387
Plant turn-around	1 930	1 930
Land development	596	4
Sundry	176	176
	3 089	2 497

11. Contingent liabilities

(a) Guarantees for the repayment of capital and payment of interest in respect of loans raised by a subsidiary company and an associated company	21 000	24 639
(b) Guarantee jointly and severally with the Industrial Development Corporation of South Africa Limited for the repayment of capital and payment of interest in respect of a loan raised by an associated company	400	400
(c) Guarantees on behalf of subsidiary company acquiring coal rights		363

	Sasol One group R000	Sasol One R000
(d) Guarantees in favour of building societies for housing loans granted to employees of the group and associated companies	723	723
(e) Other guarantees	790	790
12. Capital expenditure		
Capital expenditure authorised *less* expenditure incurred to 24 June 1978 amounted to approximately	121 059	111 568

12. OTHER MATTERS

We have satisfied ourselves in relation to the assets and liabilities at 24 June 1978 that:

12.1 the debtors and creditors do not include any material accounts other than those arising in the normal course of business;

12.2 the provisions for doubtful debts are adequate;

12.3 adequate provision has been made for obsolete, damaged and defective goods and for any supplies purchased at prices in excess of current market prices; and that

12.4 all inter-company profits in the group have been eliminated.

13. MATERIAL CHANGES IN ASSETS, LIABILITIES AND CAPITAL STRUCTURE SINCE 24 JUNE 1978

13.1 On 27 June 1978 the authorised share capital of Sasol One was increased to R214 750 000 by the creation of 100 000 000 ordinary shares of R1,00 each. Of the newly created shares 85 000 000 were issued at par on 30 June 1978 and 15 000 000 at par on 1 September 1978.

13.2 The bulk of the proceeds of the above share issues has since been utilised mainly in increasing long-term loans made by Sasol One to associated companies and others, including loans made in respect of the Sasol Two project.

13.3 Further capital expenditure amounting to approximately R20 100 000 has been incurred in respect of the Bosjesspruit Colliery which is being developed for Sasol Two and Sasol Three.

13.4 On 29 June 1979 Sasol One's 50% shareholding in Sasol Two, Sasol Three and Sasol (Transvaal) Dorpsgebiede Limited was sold at its book value of R5 001 700.

Apart from the above matters there have been no material changes in the assets, liabilities and capital structure of the Sasol One group between 25 June 1978 and the date of this report, other than in the normal course of business.

Yours faithfully

Alex. Aiken & Carter

Chartered Accountants (SA)

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2 August 1979

The Directors
Sasol Limited
1 Klasie Havenga Road
Sasolburg
9570

Gentlemen

We have reviewed the accounting bases and calculations of the profit forecasts, as set out in this prospectus and for which you as directors are solely responsible, for Sasol One (Proprietary) Limited and its subsidiary companies for the financial year ended 30 June 1979 and for Sasol Limited and Sasol One (Proprietary) Limited and its subsidiary companies for the financial year ending 28 June 1980. The forecast for the financial year ended 30 June 1979 includes the actual results for the forty-four weeks ended 28 April 1979 as reflected in unaudited financial statements.

In our opinion the forecasts, so far as the accounting bases and calculations are concerned, have been properly compiled on the basis of the assumptions (some of which are set out in Part I paragraph 7 of this prospectus) made by the directors and explanations given to us and are presented on a basis consistent with the accounting policies normally adopted by the group.

Yours faithfully

Alex. Aiken & Carter

Chartered Accountants (SA)

Appendix 3

REPORT BY MINING EXPERTS (24)

The expert information was prepared by the chief of Sasol's geological services (Mr P. P. A. Steyn) and the Bosjesspruit mine manager (Mr P. V. Cox).

Mr P. P. A. Steyn (BSc Geology 1970, MSc 1977) gained experience as coal geologist at General Mining and Finance Corporation Limited from 1971 to 1977 and has been attached to Sasol's coal-geological department since 1977.

Mr P. V. Cox (BSc (Metal. Eng) 1966, BSc (Mining Eng) 1968) was formerly associated with the gold-mining industry and has since 1971 been in the employ of Sasol where he has gained extensive practical experience in coal mining at Sasol's Sigma and Bosjesspruit collieries.

1. INTRODUCTION

The mining activities of the Sasol group are geared to supply coal to the two factory complexes, namely Sasol One at Sasolburg and Sasol Two and Sasol Three at Secunda. For this purpose two mines have been established, namely the Sigma Colliery at Sasolburg, which has been successfully supplying coal to the Sasol One factory complex for more than 25 years at a rate of approximately 5,5 million tons per year, and the Bosjesspruit Colliery which will meet the coal requirements of Sasol Two and Sasol Three. The latter mine is already producing at a rate of 170 000 tons per month and the production will be systematically stepped up in line with the needs of the Sasol Two and Sasol Three plants which will require 27 million tons per year when in full operation.

2. SIGMA COLLIERY

2.1 Geology

The Sigma Colliery is situated in the Sigma Sector of the Vereeniging/Sasolburg coalfield. The coal occurs in the Vryheid Formation of the Ecca Group and is separated from the pre-Karoo rock formations by the Dwyka Group. Both the Dwyka and Ecca Groups form part of the Karoo Sequence. The Karoo Sequence is deposited in a broad valley stretching north-south, in which further irregularities in the form of smaller valleys and ridges occur.

The coal-bearing zone is up to 30 m thick and three coal units are present. Coal unit 1, which is the most basal coal unit, occurs directly upon or very near to the Dwyka tillite. This coal unit occurs only in the deeper valleys and is consequently not present over the entire coalfield. The coal unit is often divided by sandstone or grit-beds into two or three coal seams. Normally only one of the seams is mineable. The mineable seam varies in thickness from 0 m to 5 m with an average thickness of 3 m. Coal unit 1 is overlain by sandstone, grit and/or conglomerate which form the separation between coal unit 1 and coal unit 2. The separation varies in thickness between 0 m and 2,2 m. The remaining portion of the Ecca Group consists, apart from the coal seams, of shale and sandstone in more or less equal proportions with sandstone sometimes predominant and a little carboniferous shale above coal unit 3.

Coal unit 2 is often divided into two by a layer of brown mudstone or shale up to 0,8 m thick. The two coal seams thus formed are known as seams 2A and 2B, each of which can be up to 8 m thick. The average thickness of seam 2A is 3,6 m while seam 2B has an average thickness of 4,2 m, but neither seam is developed over the entire area. The separation between seam 2B and coal unit 3 consists of consecutive layers of shale, sandy mudstone and sandstone and its average thickness is 13 m.

Coal unit 3 consists of only one seam which is from 0 m to 5,81 m thick, with an average of 3 m. It is developed over a large area and is, on average, overlain by 130 m of sandstone, shale and dolerite. The overlying strata varies in thickness from 60 m in the northern part of the field to 200 m in the southern part.

Generally the coal deposits in the Sigma Basin are of a low grade but suitable for the production of liquid fuels and petrochemicals.

The average quality of the Sigma Colliery coal can, on a moisture-free basis, be expressed as follows:

Ash content	29,8%
Volatile content	21,5%
Fixed carbon content	48,7%
Heating value	20,1 mJ/kg

The weighted average percentages indicated here have been determined with due observance of the borehole information in respect of all the coal seams in the Sigma coalfield and the mining methods which are to be applied.

The reserves and geology of the Sigma Colliery were thoroughly investigated by means of core analysis of 470 boreholes which were drilled in the area. All coal samples were analysed by the Fuel Research Institute of South Africa. Sufficient reserves have been proven in the Sigma coalfield to meet the needs of the Sasolburg works for at least 40 years at the present consumption rate of 5,5 million tons per annum.

2.2 Mining methods

The mining methods used are well known and proven techniques which are successfully being applied in South Africa, namely longwall mining, conventional board and pillar mining and continuous mining methods.

2.3 Rights

The coal rights located in the Sasolburg and Heilbron districts are summarised in paragraph 6.

3. BOSJESSPRUIT COLLIERY

3.1 Geology

The Bosjesspruit Colliery is situated in the Highveld coalfield. The coal seams in the area occur in the Vryheid Formation of the Ecca Group of the Karoo Sequence. Sandstone is the predominant rock type occurring in the Vryheid Formation with subsidiary shale beds. Dolerite sills which have penetrated into the Karoo Sequence occur generally while a few dolerite dykes are also known to exist.

Four coal seams, namely seams 2, 4 lower, 4 upper and 5 are present in the area. The 4 lower coal seam is the main seam in the area and is mineable over the major portion of the area. It varies in thickness from 0 m to 5 m with an average of 3 m. The depth at which the 4 lower coal seam occurs under the surface, varies between 120 m and 180 m.

Seam 2, which occurs about 40 m underneath seam 4 lower, is the second most important seam and is sufficiently well developed in some areas to be mineable. Seams 4 upper and 5 are poorly developed and do not attain a mineable thickness.

The reserves of the Bosjesspruit Colliery are divided into two reserve areas which are respectively known as the main reserve area and reserve area 2. The two areas are separated from each other by a 2 km wide area in which no coal occurs. In the main reserve area only the 4 lower coal seam is well developed while both seam 4 lower and seam 2 in reserve area 2 are well developed and mineable. In the latter area the average thickness of seam 2 is approximately 3,7 m.

The total Bosjesspruit Colliery reserve area has been geologically well explored. A total of 2 000 boreholes were drilled in the area and the coal cores were analysed by the Fuel Research Institute of South Africa.

The average quality of the Bosjesspruit Colliery coal can, on a moisture-free basis, be expressed as follows:

Ash content	22,5%
Volatile content	24,8%
Fixed carbon content	52,7%
Heating value	24,5 mJ/kg

Sufficient exploitable reserves are present in the two reserve areas to supply the Sasol Two and Sasol Three factory complexes with coal for a period of 70 years at a rate of 27,5 million tons per annum.

3.2 Mining methods

The mining methods to be applied are longwall mining, conventional board and pillar mining and continuous mining methods. All these methods are proven mining techniques which are successfully being employed in South Africa.

3.3 Rights

The coal rights in the districts of Bethal and Standerton, which are controlled by Sasol One through two wholly-owned subsidiaries, Inspan Beleggings (Proprietary) Limited and Leslie Coal Development Company (Proprietary) Limited, are summarised in paragraph 6.

4. LONG-TERM COAL RIGHTS

Sasol One also holds other long-term coal rights in other areas of the country.

5. STATEMENT BY DIRECTORS

The Sigma Colliery has been in production for 25 years and is satisfactorily supplying the needs of the Sasol One plant. It will therefore not be necessary to incur any further capital expenditure to maintain the present production level. The total development expenditure through the years at actual cost has amounted to R26,8 million.

The Bosjesspruit Colliery is also in production. The development costs up to 30 June 1979, including the cost of sinking two shaft systems, amount to R103 million. Additional production equipment will have to be acquired and further underground preproduction development will have to be undertaken at an additional estimated cost of R104 million, to raise the production level in order that the full needs of the Sasol Two factory can be supplied.

To be able to meet the needs of the Sasol Three factory, a further two shaft systems will have to be sunk, production equipment will have to be purchased and further underground preproduction development will have to be undertaken at a total estimated cost of R251 million. The cost estimates are based on the cost on completion and include escalation costs.

6. SUMMARY OF COAL RIGHTS

6.1 Sigma Colliery

Sasol One owns the coal rights to 19483,6743 hectares which were purchased at a total purchase price of R894 190 and holds options to purchase a further 3289,3193 hectares at a total purchase price of R152 831. Furthermore, a mining lease is held in respect of 1248,8 hectares.

The farms in respect of which coal rights are held, are situated in the Sasolburg, Heilbron and Parys districts.

6.2 Bosjesspruit Colliery

6.2.1 *Bosjesspruit coal field: Main reserve area*

Sasol One holds the following coal rights in the names of wholly-owned subsidiaries:

– *Coal rights registered in the names of wholly-owned subsidiaries*

Leslie Coal Development Company (Proprietary) Limited
4261,9117 hectares purchased at R509 430

Inspan Beleggings (Proprietary) Limited
66545,3015 hectares purchased at R4 864 120

– *Coal rights in respect of which options have been exercised and which are in the process of being registered in the names of wholly-owned subsidiaries*

Inspan Beleggings (Proprietary) Limited
6382,7753 hectares – total purchase price R802 505

– *Coal rights held under option in terms of prospecting contracts*

Leslie Coal Development Company (Proprietary) Limited
842,4419 hectares – total option price R91 539

Inspan Beleggings (Proprietary) Limited
5580,1304 hectares – total option price R661 896

– *Mining leases in favour of wholly-owned subsidiaries*

Inspan Beleggings (Proprietary) Limited
1625,3920 hectares.

6.2.2 *Bosjesspruit coal field: Reserve area 2*

Sasol One holds the following rights in the names of wholly-owned subsidiaries:

– *Coal rights registered in the names of wholly-owned subsidiaries*

Leslie Coal Development Company (Proprietary) Limited
25920,9019 hectares – total purchase price R1 554 496

– *Coal rights in respect of which options have been exercised and which are in the process of being registered in the names of wholly-owned subsidiaries*

Leslie Coal Development Company (Proprietary) Limited
2036,3251 hectares – total purchase price R159 275

– *Coal rights held under option in terms of prospecting contracts*

Leslie Coal Development Company (Proprietary) Limited
1055,9820 hectares – total option price R78 081

Inspan Beleggings (Proprietary) Limited
1926,7702 hectares – total option price R423 890.

The farms in respect of which coal rights are held, are situated in the Bethal and Standerton districts.

CERTAIN PROVISIONS OF THE MEMORANDUM AND ARTICLES OF ASSOCIATION OF SASOL

The following important provisions, preceded by the number of the relevant provision are, inter alia, contained in the memorandum and articles of association of Sasol:

The appointment of directors

75 The board of directors of the company shall consist of not less than seven and not more than nine members, of whom the Minister shall appoint four (4) directors, including the chairman, and the Industrial Development Corporation of South Africa Limited (the "IDC") three (3) directors. The directors shall be entitled (but shall not be obliged) to appoint two (2) additional directors for such period as the directors may decide. The first directors of the company, whose consent to act as directors is filed with these presents, are:

David Pieter de Villiers – chairman – appointed by the Minister;

George Alistair Macmillan – appointed by the Minister:

Albert Jacobus Marais – appointed by the Minister;

Pierre Etienne Rousseau – appointed by the IDC;

John Kirkman Mitchell – appointed by the IDC;

Johannes Augustus Stegmann – appointed by the Minister;

Abie Johannes van den Berg – appointed by the IDC.

76 A director (including the chairman) appointed by the Minister in terms of this article, shall hold office as such for such period as indicated by the Minister at the time when he is appointed as a director. A director appointed by the IDC in terms of this article shall hold office as such for such period as the IDC indicates at the time when he is appointed as a director.

77 Notwithstanding any provisions to the contrary elsewhere contained in these articles, the Minister and the IDC respectively shall be entitled to remove any directors appointed by them respectively from their office at any time and to appoint other directors in their stead.

78 Any removal or appointment of a director and/or chairman by the Minister and/or the IDC shall take place by way of a letter to that effect by the Minister or the IDC (as the case may be), to the secretary.

82 A director of the company shall not be obliged to hold any shares in the capital of the company to qualify as a director.

The remuneration of directors

84 The remuneration of the directors shall be determined by the directors from time to time.

85 All reasonable travelling expenses to and from meetings of the board of directors may be paid to the directors. Should a director who is prepared to do so be required to perform extra services for any of the purposes of the company or to make a special effort by travelling or residing abroad or otherwise, the directors may remunerate the director or directors who does/do so out of the funds of the company and such remuneration may be either in addition to or in substitution for his or their share of the remuneration provided for in these presents. The directors may also reimburse such director or directors for all reasonable expenses incurred by him or them on behalf of the company's business out of the funds of the company.

94 The remuneration of a managing director or of a director who is an employee of the company in any other capacity shall be determined from time to time by a disinterested quorum of the directors.

104 A director who serves on any management or other committee or who devotes special attention to the company's business or who otherwise performs services which, in the opinion of the directors, are outside the scope of the ordinary duties of a director, may receive, by way of a salary or otherwise, such extra remuneration (in addition to the remuneration to which he is entitled as a director) as is determined by the directors.

106 A director may, in conjunction with his directorship, hold any other office of profit (other than that of auditor of the company) with the company on such terms as to remuneration and otherwise as determined by the directors. Any appointment and the remuneration of such director shall be determined by a disinterested quorum of the directors subject to the requirements of article 90 of these presents.

Powers of directors

87 The management of the business and the control of the company shall be vested in the directors who, in addition to the powers and authority by these articles of association expressly conferred upon them, may exercise all the powers and do all the acts and things as may be exercised or done by the company. Without prejudice to the general tenor of the above, the directors shall have the power at their discretion to grant or withhold confirmation as intended in article 89. The general powers conferred by this article shall not be restricted or limited by any special authority or power conferred on the directors by any other article. It is hereby declared that although the directors, subject to the provisions of section 228 of the Acts, shall have the power to enter into a provisional contract for the sale or alienation of the whole or the major portion of the property and assets of the company and the rights vested therein or attaching thereto, such provisional contract shall only become binding on the company if it is ratified and confirmed by a resolution passed by a majority of the votes of the members who are present personally or by proxy at a general meeting convened for that purpose. All the provisions of these articles of association in regard to general meetings shall apply mutatis mutandis to meetings convened pursuant to this article.

88 The directors may take all steps necessary or appropriate to put into circulation the shares, debentures and other securities of the company in any country, colony or state and to ensure that they are recognised by and specially listed on any stock exchange or exchanges in any country, colony or state and may on behalf of the company accept responsibility for and pay and settle all taxes, rights, fees, expenses or other amounts payable in respect of any of the aforementioned matters and may comply with the laws and regulations of such country, colony or state and the rules and regulations of such exchange or exchanges.

89 Notwithstanding any provision to the contrary and irrespective of the wording and/or meaning of any of these articles of association, no resolution passed by the company and/or its members and which shall be passed as a special resolution pursuant to these articles of association or by virtue of any other provision and/or which relates to the allotment or issuing of shares in the share capital of the company, shall be of any force or value unless and until such time as it has been confirmed by the directors.

90 The directors may exercise the voting rights attaching to the shares in any other company held or owned by the company in all respects as they think fit, including the exercise thereof in favour of a resolution appointing them and/or any one of their number and/or any other person as directors or officials of such other company or providing for the payment of remuneration to the directors or officials of such other company. A director may vote in favour of the exercise of such voting rights in the aforesaid manner notwithstanding that he is or will shortly become a director or official of such other company and as such or in any other way has or may have an interest in the exercise of such voting rights in the aforesaid manner.

Borrowing powers

39 The directors may at their discretion exercise all the powers of the company to borrow money and to encumber by mortgage bond or bind its undertaking and property or any portion thereof, whether as security for a debt commitment or obligation of the company or a third party : provided that the directors shall ensure (in regard to subsidiaries, insofar as they can ensure this by exercising voting and/or other rights of the company) that the total amount then still owing in respect of money borrowed and/or secured by the company and its subsidiaries (excluding any money borrowed by any of the said companies which will be utilised within 90 days of taking up the relevant loan to repay other loans), will not at any time without the prior approval of the company in general meeting amount to more than R500 million or twice the total of the following, whichever amount is the greater :

(a) The amount of the issued capital of the company (if any) ; plus

(b) The amount of the share premium account (if any) ; plus

(c) The stated capital ; plus

(d) The reserves of the company and its subsidiaries as shown in the latest consolidated balance sheet of the company.

Dividends

117 Dividends shall be declared by the directors. The directors may from time to time pay to members on account of the forthcoming dividend such interim dividend as in their opinion the profits of the company justify.

GENERAL INFORMATION

The major immovable properties of Sasol and its subsidiaries (6(c) and 12(a))

Information concerning certain major immovable properties of Sasol and its subsidiaries appears in Appendix 3 to the prospectus.

During the past two years Sasol One and its subsidiaries also purchased the following immovable properties:

- Purchased by Sasol One from Julian le Rock Muller, 801 21st Avenue, Rietfontein, Pretoria, 0002, an unsurveyed piece of land, approximately 45 hectares in extent, being portion of Portion 19 of the farm Goedehoop 290 I.S. shown on the map attached to the purchase contract, at a price of R9 000 to be paid in full to the seller;
- Purchased by Sasol One from J. H. Hanekom, Goedehoop, Trichardt, 2300, an unsurveyed piece of land, approximately 13 hectares in extent, being portions of Portions 1 and 6 of the farm Goedehoop 290 I.S. shown on the map attached to the purchase contract, at a price of R6 149 to be paid in full to the seller;
- As a result of the transfer of certain personnel from Sasol One to Secunda, Sasol Dorpsgebiede Limited, a wholly-owned subsidiary of Sasol One, purchased the houses from the staff members concerned at Sasolburg. Altogether 238 houses were purchased for a total purchase price of R4 800 984;
- 187 erven situated in the township of Secunda were purchased by Sasol One from Sasol (Transvaal) Dorpsgebiede Limited, a wholly-owned subsidiary of Sasol Two, at a total purchase price of R1 140 243 to house staff at Sasol One's Bosjesspruit Colliery.

Sasol One's major immovable property is the property on which its factory complex at Sasolburg was erected. The area of the property is 730 hectares and comprises portions of the farms Herewarde 409, Antrim 923, Saltberry Plain 137, Roseberry Plain 250, Donkerhoek 323, Driefontein 2 and Montrose 213.

Loans to the Sasol group (9)

See Part II paragraph 10.1 of the prospectus for general particulars. Particulars of material loans, including debentures, all of which are unsecured, to Sasol One and its subsidiaries as at 30 June 1979 are shown in the table below:

Dates of repayment	Rate of interest per annum	Amount R000
Loans		
December 1987	7,94%	3 100
March 1981 (Sw Fr 20 000 000)	7,75%	6 795
Three equal half-yearly instalments from November 1979 (Sw Fr 1 025 000)	8,75%	274
May 1981 (DM 50 000 000)	9,75%	17 215
Twenty five half-yearly instalments from December 1979	13,00%	3 444
Twenty three half-yearly instalments from December 1979	13,00%	3 320
Undetermined	8,00%	10 621
Other loans	Various	22 125
		66 894
Guaranteed registered notes		
December 1987	7,50%	10 000
Export credit		
Four equal half-yearly instalments from July 1979 (DM 3 675 000)	4,00% above German Bundesbank rate	1 693
Four equal half-yearly instalments from November 1979 (F Fr 2 320 000)	7,25%	362
		78 949