Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

03-Oct-2001

English text only

CENTRE FOR CO-OPERATION WITH NON-MEMBERS
DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS

CCNM/GF/COMP/WD(2001)11
Unclassified

# OECD Global Forum on Competition

## CONTRIBUTION FROM SOUTH AFRICA

*This contribution was submitted by South Africa as a background material for the first meeting of the Global Forum on Competition to be held on 17 and 18 October 2001.*

JT00113761



English text only

# TABLES OF CONTENTS

# CONTRIBUTION FROM SOUTH AFRICA

By ADV. MENZI SIMELANE
Commissioner : Competition Commission

## I. – COMPETITION LAW AND POLICY IN SOUTH AFRICA

### 1. INTRODUCTION

The Competition Commission (Commission) plays a pivotal role in the development of the South African economy. It creates an environment where an efficient business sector can become internationally competitive and where small businesses can participate more effectively in the economy. Most importantly, it ensures that consumers can obtain the most competitive prices and a greater product choice.

The Competition Act, (Act No. 89 of 1998) was passed by Parliament in September 1998. Certain provisions of the Act came into effect on 30 November 1998 to allow for the establishment of the institutional framework. During the first five months of the financial year, the period from 1 April 1999 to 31 August 1999, the focus of the Commission was on the recruitment and training of staff, the completion and equipping of the building, the development of the necessary systems and the drafting of the procedural rules and necessary regulations. All of these activities ensured that the Commission was ready to commence operations, when the remaining provisions of the Act came into effect.

### 2. PURPOSE OF THE COMPETITION ACT

The purpose of the Competition Act is to promote and maintain competition in the Republic of South Africa in order to:

- promote the efficiency, adaptability and development of the economy,
- provide consumers with competitive prices and product choices,
- promote employment and advance the social and economic welfare of South Africans,
- expand opportunities for South African participation in world markets and recognize the role of foreign competition in the Republic,
- ensure that small and medium-sized enterprises (SMEs) have an equitable opportunity to participate in the economy, and
- promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.

## 3. FUNCTIONS OF THE COMPETITION COMMISSION

The main functions of the Competition Commission are to:

- implement measures to increase market transparency,
- implement measures to develop public awareness of the provisions of the Act,
- investigate and evaluate prohibited trade practices and grant or refuse applications for exemption,
- authorize, with or without conditions, prohibit or refer mergers of which it receives notice,
- negotiate and conclude consent orders, and
- ensure consistent application of the Competition Act across all sectors.

## 4. MERGERS AND ACQUISITIONS

During the period 2000 to 2001, the Commission was notified of 407 mergers, which included 24 large mergers, 387 intermediate mergers and 3 small mergers. The small merger category only came into effect on 1 February 2001 with the amended Competition Act, which accounts for the small number.

An intermediate merger : combined annual turnover or assets of the acquiring firm and the target firm are valued at or above R50 million; and the annual turnover or the asset value of the target value exceeds R5 million.
A large merger : combined annual turnover or assets of the acquiring firm and the target firm are valued at or above R3.5 billion and the annual turnover or the asset value of the target firm exceeds R100 million.

Of a sampling of the 285 merger cases finalised during the period April 2000 to February 2001, it was found that most of these mergers were horizontal, involving firms that competed in identical markets. Conglomerate type mergers constituted 22% of the total. Such mergers are notifiable if they involve a change in ownership and therefore require investigation. As a pure conglomerate merger entails no product overlap or vertical integration, it is not always clear if this type of merger would raise competition concerns. However, conglomerates may diminish competition through their various spheres of influence, and conglomerates might engage in cross-product subsidisation to gain an unfair competitive advantage.

**Table 1: Comparison of merger activity between Sept 1999/Mar 2000 and Apr 2000/Feb 2001**

| SECTOR | % OF TOTAL (SEPT 1999 – MARCH 2000) | % OF TOTAL (APR 2000 – FEB 2001) |
|---|---|---|
| Mining and Construction | 6% | 4% |
| Financial Services | 13% | 6% |
| ICT | 14% | 11% |
| Transport | 10% | 4% |
| Manufacturing | 22% | 33% |
| Food and Beverages | 5% | 2% |
| Chemicals | 5% | 4% |
| Electrical Equipment | 2.5% | 3% |
| Paper and Packaging | 2.5% | 2% |
| Building Materials | 4% | 1% |
| Printing and Publishing | 2.5% | 1% |
| Equipment and Machinery | - | 5% |
| Metal Products | - | 3.5% |
| Transport Equipment | - | 3.5% |
| Textiles and Fabrics | - | 3% |
| Other Manufacturing | - | 5% |
| Services | 13% | 11% |
| Real Estate | 4% | 8% |
| Wholesale [1] | - | 12% |
| Retail | - | 6% |
| Other [2] | 18% | 5% |
| TOTAL | 100% | 100% |

This table reflects a significant increase in the proportion of mergers taking place in the manufacturing sector. Within manufacturing, sub-sectors such as chemicals, electrical equipment, paper, packaging, printing, and publishing have not seen more than a 1% change in merger activity. However, some sub-sectors that did not feature in the previous sample study include equipment and machinery, metal products, transport equipment, textiles and fabrics.

While merger activity increased in manufacturing, it dropped in the Information and Communications Technology (ICT) sector and financial services. These two sectors together contributed more to merger activity than any other sector from September 1999 to March 2000, but have since fallen into second place with manufacturing now leading the way. This renewed interest in manufacturing may be due to waning enthusiasm for information technology on a global level. Nevertheless, ICT and financial services remain an important component of merger activity in South Africa and further consolidation can be expected in future.

1 Note: Finer divisions of wholesale and retail do not show persistent trends in any one sector. In the sample study covering September 1999 – March 2000 wholesale and retail would have been grouped under 'other'.

2 Other includes cases that are not significantly representative of particular sectors.

Due to the nature of case investigations, investigators worked and continue to work on a number of cases simultaneously. However, the average caseload per investigator, indicates that investigators in the Mergers Division had a caseload of approximately twelve and nine cases. This case-load is much higher than in other jurisdictions. For example, the average case-load of an investigator working in the Department of Justice in the United States seldom exceeds two cases at a time.

### *4.1 Case Overview*

During the period under review, the Competition Commission prohibited three intermediate mergers and three large mergers, representing 0.78% of all intermediate and 12.5% of all large mergers finalised. Examples of cases investigated are annotated below:

#### *4.1.1 Glaxo Wellcome (Pty) Ltd and SmithKline Beecham (Pty) Ltd*

The Commission initially prohibited the proposed intermediate merger between Glaxo Wellcome (Pty) Ltd and SmithKline Beecham (Pty) Ltd on competition and public interest grounds. The transaction gave rise to competition concerns in respect of the private sector segments of the relevant markets identified, involving two therapeutic categories. These were Topical Antibiotics (D6A) and Anti-virals (excluding anti- HIV) (J5B).

The Commission's prohibition led to negotiations between the parties, the Commission and the Competition Tribunal. The parties agreed to the out-licensing of Polysporin, Cicatrin and Neosporin, which fell within the Topical Antibiotics (D6A) therapeutic class, on the terms and conditions set out in an undertaking. The parties also agreed to the out licensing of Famir, which fell within the Anti-virals (J5B) therapeutic class.

These two undertakings addressed the competition concerns. The parties also provided the Commission with an undertaking that addressed the Commission's concerns regarding public interest issues. The Commission recommended approval of the merger once the necessary remedies were effected. The Tribunal approved the merger once satisfied with the undertakings.

#### *4.1.2 Tongaat-Hulett Group Ltd (THG) and Transvaal Suiker Beperk (TSB)*

This merger posed special challenges for the Commission. The sugar industry is heavily regulated with limited competition and limited incentives for competition.

##### 4.1.2.1 The Current Regulatory Framework

The South African industry is regulated in terms of the Sugar Act, 1978, and the Sugar Industry Agreement 2000.

The Sugar Act allows for the incorporation of the South African Sugar Association (SASA). SASA administers the partnership between its two members, the South African Cane Growers Association and the South African Sugar Millers Association. It is an autonomous organisation and operates in terms of the Sugar Act and the Sugar Industry Agreement, first promulgated in 1936. The 22 members on the council of SASA represent the interests of both growers and millers. 11 SASA council members represent the 53 000 registered cane growers (Industry Directory 2000/2001) and another 11 SASA council members represent the 4 millers (which will become three). The four millers are Tongaat, TSB, Illovo Sugar Ltd and

Union Co-op Ltd. Union Co-op Ltd owns one mill and sells its sugar production through Illovo. Thus there are only three South African sugar producers actually selling to the domestic market.

In terms of the Sugar Act, the Minister of Trade and Industry may, after consultation with SASA, determine the terms of the Sugar Industry Agreement (Agreement). The Agreement shall provide for matters relating to the Sugar Industry, which are in the interest of the industry but not against the public interest.

The Minister may provide for and deal with, inter alia, the following issues in the Agreement:

- The regulation and control of the production, marketing and exportation of Sugar Industry Products;
- The prohibition of the production, marketing and exportation of Sugar Industry Products;
- A formulae for determining the price to be paid by millers to growers;
- The functions to be performed by the Association;
- The imposition of levies, etc.

The Act also allows for the determination of a maximum industrial price by SASA, at which any sugar product, other than specialty sugar, may be sold. The maximum price is also part of the formulae utilised in calculating the current import tariff.

The prominent feature of the Sugar Industry Agreement, 2000, Government Gazette No 21139, Vol. 419, is the division of proceeds. It is a formula through which revenue accruing from the sugar industry is allocated to the millers and growers as part of the partnership arrangement. Revenue is based on a notional calculation reflecting anticipated industry income, not real income. The notional price (the price attributed to brown sugar, refined sugar (white) and molasses) is determined from time to time by SASA. Net proceeds from both domestic sales and exports are calculated and allow for the allocation of net divisible proceeds between millers and growers in a specific ratio (63% for growers and 37% for millers).

SASA also determines the quantities of sugar required for the local market and the export market. This entails allocating a quota to each mill, which states the amount of sugar that can be sold domestically and the amount that must be exported. Millers are allowed to sell more than the allocated quota on the domestic market. However, if they do, they must pay back to SASA an amount equal to the difference between the profit from selling on the domestic market and the profit from selling to the export market for redistribution amongst those mills, which have sold less than their allocated quotas.

The provisions of the Sugar Act are further supported by the tariff regime adopted by the Department of Trade and Industry through the Board on Tariffs and Trade. The tariff adjusts automatically to the world sugar price in order to maintain the maximum tariff allowable under the GATT rules. In interviews with the parties, reference was made to the “two pillars” of the tariff policy – a “reasonable” tariff to keep out sugar at the distorted world market price (“distorted” because of the subsidies to the exporters of sugar), and the equitable sharing of the benefits of the tariff. The maximum domestic price for sugar also automatically adjusts with the tariff, so as to remain just below the price of sugar imports.

The net effect of the policy instruments is that the tariff essentially operates as a price-setting mechanism, and the “equitable sharing” essentially operates as a volume allocation mechanism. As there is

little incentive for millers to increase the amount that they sell in the domestic market, there is little incentive for them to initiate price competition with each other and the "maximum" price, set by SASA, therefore essentially becomes a minimum price. The current regulatory framework thus creates very few incentives for competition between sugar producers.

During its investigation the Commission received written assurances from the Department of Trade and Industry (DTI) that it did intend to revise the Sugar Act of 1978, to implement measures which would promote rivalry in the domestic sugar industry. The Commission considered the effect the merger would have on competition in the existing relevant market as well as potential future competition and recommended to the Competition Tribunal that the proposed merger be prohibited for the following reasons:

The market was already concentrated and concentration levels would increase further.
The proposed merger would have also facilitated a split between THG (direct consumption) and Illovo (industrial sales).

Although there was limited price and non-price competition, the Commission was of the opinion that the merger would substantially lessen any competition that existed at that stage. This was largely in respect of non-price competition but significantly contributed to competition.

The high levels of concentration and possible negative effects thereof on competition would not be offset by any balancing factors such as competition from imported sugar, low barriers to entry, or significant countervailing power.

Customers perceived TSB to be the "maverick" in the industry, and that an effective competitor would be removed, especially considering the DTI's endeavours to make the domestic industry more competitive.

*4.1.3. Joint Venture between Shell SA (Pty) Ltd, BP Southern Africa (Pty) Ltd, Caltex Oil (SA) (Pty) Ltd and Trident Logistics (Pty) Ltd*

On 15 December 2000, the Commission submitted its recommendation to the Tribunal to prohibit the proposed supply and distribution joint venture between Shell SA (Proprietary) Limited (Shell), BP Southern Africa (Proprietary) Limited (BP), Caltex Oil (SA) (Proprietary) Limited (Caltex) and Trident Logistics Proprietary) Limited (Trident). On 22 January 2001 the parties withdrew their application from the Tribunal. In light of this withdrawal, the Competition Commission's recommendation to prohibit the proposed joint venture remains in force.

The proposed transaction involved the consolidation of certain services and assets of three major oil companies in South Africa, i.e. Shell, Caltex, and BP. Through the joint venture, the three parties would form Trident, to manage, contract, and provide logistical services on their behalf. Trident would provide these services with respect to supply and distribution, including services associated with refining, storage, and handling at depots, pipeline, rail, ship, and road transportation.

The proposed merger would substantially have lessened competition between the parties. More specifically, the Commission believed that it would have had the effect of substantially lessening competition in the markets for product exchange and hospitality services.

Refiners enter into agreements with other refiners, called product exchange agreements, as an alternative to producing the product themselves. Through the agreements, the refiners may exchange product or pay cash for product. However, the majority of transactions, both by volume and value, are

settled in product rather than in cash. These agreements allow them to receive product in areas where they may have shortfalls and give product in areas where they have surpluses. This helps cut down on uneconomical and unnecessary transportation throughout the country.

The owners of the crude refiners have longstanding product exchange agreements with each other, essentially *to reduce the cost of product transportation.* These exchange agreements are between the four crude oil refineries in Durban (Shell/ BP and Engen), Cape Town (Caltex) and Sasolburg (Sasol/Total).

For example, there is a Durban/Cape Town product exchange agreement between Caltex, Shell, BP and Engen. In terms of that agreement, the parties communicate their requirements for products in the Cape Town and Durban product markets. As far as possible, Caltex supplies the Cape Town market requirements of Shell, BP and Engen. These parties deliver equivalent products to Caltex in Durban to meet Caltex's requirements for the Durban area and the hinterland. The effect is that each party saves the transportation cost of delivering the product volume in question between Durban and Cape Town. That saving is shared equally between the two parties having exchanged products.

Like product exchange agreements, hospitality agreements are mainly entered into for efficiency reasons. The main savings resulting from hospitality agreements are:

i) A reduction in depot numbers, and

ii) The transport cost savings.

These services are thus offered both for convenience and to save costs. To minimise distribution costs, the major marketers of petroleum products have entered into hospitality agreements on a case-by-case basis at various depots. These arrangements are common worldwide and have been in place for decades. Hospitality arrangements are willingly entered into between oil companies.

Invariably hospitality agreements are recorded in writing. Generally these agreements have six months or greater notice of termination periods.

The essence of a hospitality agreement is that a depot operator (e.g. Shell – the operator) agrees to provide another oil company (e.g. BP – the guest) with product at a Shell depot (e.g. Ladysmith). The purpose of these negotiated agreements is to save the cost of duplicating facilities in the same vicinity. Both host and guest benefit from economies of scale.

Insofar as hospitality involves a product exchange (i.e. it is not settled in cash) this is referred to as a *"borrow/loan" arrangement*. In the above example Shell is deemed to have loaned Shell product to BP and BP is deemed to have borrowed that Shell product from Shell. The borrow/loan balances are settled either by the guest placing product into the depot in advance or by repaying in product, either at the depot or at the coast.

In addition to settling the loan with product the guest would pay the host:

- The primary transport cost of delivery from coastal refinery to the depot (normally the zone differential), if applicable; and

- An agreed rate for storage and handling; and

- An agreed rate for delivery to customer, if applicable.

The requirements for participation in hospitality and product exchange arrangements are:

- Storage facilities;
- Transport facilities; and
- A supply of product.

The joint venture, in the Commission's view, would also essentially reduce the incentives for vigorous future competition, once momentum was given to the deregulation of the industry. Furthermore, no efficiency, technology or other pro-competitive gains would result from the joint venture that would outweigh or offset the potentially anti-competitive effects. The Commission found that the parties had failed to demonstrate which efficiencies were unique to the merger as opposed to gains that the parties would achieve without the joint venture. More importantly, they had failed to convincingly show that the efficiencies would benefit consumers in any manner. The Commission, therefore, was of the view that the parties had failed to demonstrate that efficiency gains that arose from the proposed venture outweigh the potential anti-competitive effects of the proposed venture.

The proposed joint venture also raised certain public interest concerns, specifically regarding employment and empowerment issues, within the context of the oil industry and the overall restructuring vision of Government. While the merger would benefit the parties in terms of one time cost savings, it would not contribute to the overall competitiveness of the South African oil industry.

One of the eleven cornerstones of future government policy on the liquid fuels industry is that black economic empowerment should be reflected in the composition of the industry at all levels, and significant domestic black ownership, or control, in all facets of the industry.

The aim of competition legislation is not to protect competitors, but the competitive process. The effect of the proposed transaction on empowerment firms in the liquid fuel industry raised concerns within the context of the broader aims of the legislation, i.e. ensuring small and medium-sized enterprises have an *equitable opportunity* to participate in the economy, and the promotion of a greater spread of ownership, in particular the ownership stakes of historically disadvantaged persons.

The oil industry needs storage facilities to facilitate the economic movement of product from refinery to end consumer. Access to these facilities is particularly important to the BEE companies. The smaller, empowerment firms in the liquid fuels market are dependant on the other industry participants for both product exchange services and hospitality services, since they do not own any refineries or depots themselves. Similarly, access to these facilities and services would be crucial to any future new entrant into the industry. Within this context, the Commission found that the proposed joint venture would not facilitate the achievement of the proposed empowerment goals of Government and, furthermore, would not contribute to an overall competitive industry.

After due consideration the Commission concluded that there were no mitigating factors that would lessen the anti-competitive effects of the joint venture and also no public interest grounds on which the venture could be approved.

## 5. ENFORCEMENT AND EXEMPTIONS

The Competition Commission is required to investigate alleged contraventions of Chapter 2 of the Competition Act. Chapter 2 of the Act deals with restrictive horizontal and vertical practices and the abuse of dominance. The Commission must investigate all complaints submitted to it, and may initiate a complaint in cases where a reasonable suspicion of an alleged contravention exists.

During the period 1 April 2000 to 31 March 2001, the Commission dealt with about 176 complaints, of which 123 (69.9%) were resolved and 53 (30.1%) are still being investigated. Twenty-eight of the cases under investigation involved complaints alleging more than one contravention of the Act. Although there are only five cases with complaints pertaining only to contraventions of Section 5, Section 5(1) features in 18 of the cases involving multiple contraventions. Section 8(c), which relates to exclusionary acts by a dominant firm, features in nine of the 28 alleged multiple contravention cases. Section 4(1)(b)(i), regarding price fixing, arose in ten different cases.

The Act also makes provision in section 10 that a firm may apply to the Commission to be exempted from the application of Chapter 2 (the horizontal, vertical, and abuse of dominance provisions). This applies when either an agreement, or practice, or category of agreements or practices meet the requirements laid down in section 10(3) of the Act.

It is incumbent on the applicant to show that any restriction or restrictions thus imposed on the firm(s) concerned is/are required to attain to any of the following objectives:

- the maintenance or promotion of exports;
- the promotion of the ability of small businesses or firms controlled or owned by historically disadvantaged persons to become competitive a change in productive capacity necessary to stop decline in an industry or the economic stability of any industry designated by the Minister of Trade and Industry after consulting the Minister responsible for that industry.

During the period 1 April 2000 to 31 March 2001, nine applications for exemption were lodged, all relating primarily to restrictive horizontal practices. Three applications pertain to activities of pharmaceutical manufacturers, two relate to healthcare services sector, and the remaining four applications are derived from companies involved in the manufacture of transport equipment, cement products, liquid fuels, and shipping lines. Four exemption applications were concluded by March 2001. Examples of cases investigated are annotated below:

### *5.1. Case Overview - Exemptions*

#### *5.1.1. South African Airways Limited (SAA) and Qantas Airways Limited (Qantas)*

SAA and Qantas filed an application with the Commission for an exemption. The Department of Transport (Department) and the International Air Services Council (Council) are responsible for the regulation of international air services to and from the Republic of South Africa. The International Air Services Council has been created in terms of Section 3 of the International Air Services Act, 1993 (Act No. 60 of 1993). It is clear that the Department and Council have the responsibility to promote competition between air service providers. To this end, the Department endeavours to create bilateral air service

frameworks that provide for the designation of more than one airline, negotiate sufficient capacity to enable further airlines to introduce services, and to establish a flexible tariff filing system to encourage price competition between airlines.

The South African and Australian Governments have since 18 July 1985 discussed and agreed to arrangements in respect of the air services between the two countries. A code share agreement is currently in place, specifically regarding routes to be flown and their frequency.

The agreement also provides for block sharing and code sharing between the two airlines. "The designated airline(s) of South Africa may terminate services at Perth or Sydney, and may, at its option, serve any point or points of choice in Australia through joint service, blocked space, or code share arrangements with any Australian carrier; (while) the designated airline(s) of Australia may terminate services at Johannesburg or at other nominated points in South Africa, and may, at its option, serve any point or points of choice in South Africa through joint service, blocked space, or code share arrangements with any South African carrier."

The parties raised the question of jurisdiction, especially in relation to the Competition Act 1998, prior to the 2000 amendments coming into force on 1 February 2001. Since this exemption is granted for a period encompassing a period after 1 February 2001 and taking the comments above into account, the Competition Commission has concurrent jurisdiction. Both the Department of Transport and its minister support the agreement, clearly as being consistent with the objects of the IAS Act.

The application related to the granting of an exemption from Section 4(1)(b)(ii) of the Competition Act 1998 (the Act). The applicants specifically requested that their code sharing agreement on the South Africa-Australia route and other commercial agreements be exempted from the prohibition(s) contained in the Act. The agreement relates to a market sharing agreement between the parties.

The applicants indicated that there was a serious chance that SAA might exit the market, having made significant losses on the route due to, *inter alia*, fuel price hikes. It also pointed out that export earnings would be generated from the carrier's continued presence on this route.

Exemption was granted until 30 June 2002. This mirrors the period permitted by the Australian transport authorities. The approval of the application is subject to the following conditions that the parties need to comply with:

- During the period of the exemption, both parties to the agreements must independently submit quarterly reports, detailing the following:
- the actual highest and lowest fare charged over the period for all classes;
- the number of code share seats sold by each party on the other's services;
- the volumes of cargo, rates charged for cargo, and the revenue derived from cargo as well as any increase and/or decrease in the said value, sales, and revenue.
- The parties to the agreements shall not share or pool revenues with each other under the code share or commercial agreements.
- The parties to the agreements must each independently establish and determine their own tariffs and fares on the code share flights, and market these flights separately.

- The parties to the agreements must show how exports have been promoted or maintained in terms of both seat and cargo volumes during the period for which the exemption has been granted, before any new agreement or extension of the existing agreement will be considered by the Commission.

- Any amendment to the agreement shall not be of force and effect until approved by the Commission.

- Parties must add a clause to their agreements stating that the agreements are subject to the above-mentioned conditions, and in so far as there is a conflict on any term of the agreement between the parties on the one hand and these conditions on the other hand, the conditions shall prevail.

- Nothing in this exemption shall preclude the Competition Commission from initiating action against any party for implementing the various agreements prior to the issue of the exemption.

## *5.2 Case Overview - Enforcement*

### *5.2.1 Scotprop complaint against Property Network*

Scotprop a new estate agency filed a complaint against Property Network, an estate agents association in Kwazulu Natal. Scotprop alleged new entrants to the real estate market struggled to establish themselves as a viable alternative to the well-established market participants being members of Property Network. In order to survive as an estate agent, an estate agent has to be a well-established independent estate agent or a member of Property Network.

The CC accepted the submission and found the membership criteria of the participants in the Property Network to be restrictive.

The Commission submitted a recommendation to the Tribunal for the approval of a consent order and it was agreed that the existing membership criteria of the Property Network Participation agreement have to be expunged and substituted with a new membership criteria agreed to by the Competition Commission. These new criteria would not be restrictive and allow for easy membership to the Property Network.

### *5.2.2 D.J. Mine Services Pty Ltd complaint against Palabora Mining Company*

In practically the first complaint lodged with the Competition Commission after it started operating on 1 September 1999, a small converter of vermiculite, D J Mine Services (Pty) Limited (D J Mine) objected to a sole distribution agreement that existed at that time between Palabora Mining Company Limited (Palabora), the only manufacturer of crude vermiculite in this country and Chemserve Perlite (Pty) Limited (Chemserve) a subsidiary of the publicly quoted company Chemserve Limited and a large converter of vermiculite. In particular the complainant objected to the fact that it had to purchase raw materials from its competitor. Moreover, the agreement permitted Chemserve to add on an allegedly large mark-up in its sales to smaller converters such as D J Mine. It was averred that the agreement contravened both sections 8(c) and 9(1) of the Competition Act 1998. During its investigation the Commission found that Palabora was dominant as defined in sections 6 and 7 of the Act and that it contravened the sections

referred to above. In terms of section 6 a firm is dominant if its assets or turnover exceed. Palabora agreed that it was in contravention of the Act and negotiated a consent order with the Commission to address the prohibited practice. The agreement was terminated which had the effect that all converters were able to source product directly from Palabora on a non-discriminatory basis. This consent order was confirmed by the Competition Tribunal on 18 May 2000.

*5.2.3 Competition Commission complaint against Nutri-Health*

During this year the Commission initiated an investigation into resale price maintenance by Nutri-Health International (Nutri-Health). Nutri-Health is an international company that specializes in weight management and nutritional products. It operates its business through network marketing and direct selling It employs independent distributors to sell its products.

In terms of section 5(2) of the Competition Act 1998 the practice of minimum resale price maintenance is prohibited. A suppliers or producer may recommend a minimum selling price to the reseller of a good or a service provided the supplier or producer makes it clear that the recommendation is not binding and if the product has its price stated on it, the words "recommended price" appear next to the stated price.

"Formula 2001" a weight management drug distributed by Nutri-Health stated the following on the package label: "Minimum selling price R91,00 per bottle". Although this price did not seem to be enforced in practice, the wording contravened the Act. Labels were changed and consent order negotiated with Nutri-Health.

## 6. COMPLIANCE

The Competition Act requires the Commission to implement measures to ensure market transparency and to develop public awareness of the provisions of the Act. Despite efforts to educate and inform the specific stakeholders and the general public about the provisions of the Competition Act, the levels of awareness and understanding are still low. To address the information needs of stakeholders, the education and information activities of the Commission aims to meet the following three objectives :

- promote voluntary compliance with the provisions of the Act by public and private enterprises;
- promote participation by public interest groups recognised in the Act in competition proceedings;
- build a public profile for the Commission.

In addition, the Compliance division provides advisory opinions to outside stakeholders to clarify the provisions of the Act and to provide guidance to business on the position the Commission is likely to take in respect of certain agreements, transactions or practices.

The Division aims to encourage and facilitate voluntary compliance with the provisions of the Act through education and information programmes. In addition, to facilitate compliance by businesses with the provisions of the Act, the Commission provides non-binding advisory opinions on matters which constitute clarifications of the Act. The Commission may also provide non-binding opinions as to whether the implementation of a proposed business plan or practice would comply with the Act.

Initially, the Commission received 125 written requests for clarification on various sections of the Act but this figure has dropped and has indicated that the provision of the Act have become clearer to practitioners and businesses.

In addition, the Compliance division has conducted presentations, workshops and meetings with business, both public and private, to promote voluntary compliance.

In terms of the Competition Act, it is compulsory for companies to notify trade unions of their intention to merge. Trade unions may participate in the merger proceedings and may file a Notice of Intention to Participate with the Commission. To facilitate their participation in cases, the Compliance division conducts training and presentations to trade union officials on the Competition Act and proceedings.

## 7. LEGAL SERVICES

The other critical area of the Commission is the Legal Services Division, which is responsible for providing legal opinions on all cases in the Commission. It is also responsible for the litigation of cases in the Tribunal. In addition, it is responsible for all litigation in the High Courts and other administrative bodies.

The Division was initially conceived on the basis that it would provide second opinions on legal issues in the Commission and then deal with matters referred to the Tribunal. The workload of the Division is very high due to the increase in the Commission's enforcement activities in particular cases referred to the Tribunal. In addition, the parties have also adopted a strategy of engaging the Commission in litigation. The strategy is to refer matters to the High Courts to avoid them being heard in the Tribunal. This is expected to continue in the short - medium term. However the cases referred to the Tribunal and the litigation therein, is expected to increase in the medium - long term.

## 8. CONCLUSION

The Commission has in the short space of its existence, helped to preserve and restore competition on markets. Certain key industries have not yet been exposed to competition, because of the dominance of state-owned enterprises in sectors that were previously regarded as natural monopolies. However, the Commission will try to play an important role in the deregulation of these sectors and the restructuring of state assets. Because, not only will the introduction of competition make these organisations more responsive to the needs of the market, bust South African businesses using their products and services will also benefit and become more globally competitive.

## II. - ANNUAL REPORT OF THE COMPETITION TRIBUNAL FOR THE PERIOD 1 APRIL 2000 TO 31 MARCH 2001

**Contents**

## 1. Chairperson's introduction

South Africa's competition authorities are now fully up and running. The Competition Appeal Court, the third in the trio of institutions created by the Competition Act, was established in September 2000, with Judge Dennis Davis as its Judge President. The court has already commenced functioning. The Tribunal staff provides registry and other administrative services to the court.

For its part, the Tribunal continues to perform its functions effectively. Indeed, the overall functioning of the Tribunal has, if anything, become more streamlined, as the staff and members of the Tribunal acquire experience of the act and the rules.

In the year under review, a number of significant decisions have been taken, particularly in the area of merger regulation. However, while we continue to hear a steady stream of applications for interim relief, we have only recently received the first full complaint referral from the Commission. The time taken to bring restrictive practices complaints to full trial has clearly been underestimated. While this mirrors experience in other jurisdictions and reflects the immense complexity of these matters, it is clear that the task of implementing new legislation in a relatively new and untested constitutional environment adds an unforeseen element of delay and complexity. There are currently several High Court reviews of aspects of our legislation pending, reviews that stem directly from restrictive practice complaints submitted to the Commission. Our expectation is that once the High Court clarifies certain basic interpretations of our legislation, restrictive practice matters will begin finding their way to the Tribunal.

The work of the Tribunal impacts significantly on important commercial decisions and is, accordingly, subject to close scrutiny by the business and investment community and the media. The South African business community clearly has some way to go before it fully accepts the reality of a robust competition regime in South Africa. Although South Africa has had competition legislation for decades, this legislation was characterised by weak substantive and enforcement provisions. Weak competition law partly accounts for the high levels of concentrations in our economy and for the existence of business practices out of step with the requirements of a competitive economy. Because the Competition Act and the authorities responsible for its implementation, inevitably, question these long-established anti-competitive, though highly lucrative, practices, there has been some measure of resistance to our work in parts of the business community.

I am confident, however, that the South African government's decision to install an effective competition statute reflects international best practice. The past two decades have witnessed a significant extension of market relations, both globally and within individual nations. Markets, like any institution, require clear rules if they are to function effectively. The Competition Act represents an important component of these rules. We will inevitably brush up against those who have benefited from a lax set of rules in the past and we must expect, even welcome, criticism from these quarters. Certainly, we are encouraged by the growing sophistication of media analysis of our work and by the developing professional and academic interest in this critically important branch of law and economics.

Maintaining accounting and other records and an effective system of internal control is my responsibility as chairperson. I believe this requirement has been fulfilled and that the financial statements prepared fairly present the results of the Tribunal for the 12 months to 31 March 2001.

The Tribunal's annual financial statements are prepared on the historical cost basis and relevant accounting policies. These policies have continually been complied with. I approved the annual financial statements set out on pages …to (see printed version of the official brochure).

No material facts or circumstances have arisen between the date of the balance sheet and the date of approval which affect the financial position of the Competition Tribunal as reflected in these financial statements. I believe the Competition Tribunal is financially sound and operates as a going concern.

It remains for me to thank the members and staff of the Tribunal for their outstanding contribution.

**David Lewis**

## 2. The Competition Authorities

The Competition Act provides for the establishment of three institutions. These are:

- The Competition Commission investigates mergers and complaints of anti-competitive practices and grants exemptions;
- The Competition Tribunal is the court of first instance: it adjudicates cases referred to it by the Competition Commission or brought directly to it by an aggrieved party;
- The Competition Appeal Court has the status of the High Court, hears appeals and reviews decisions of the Competition Tribunal.

(diagram on the relationships between the institutions goes here) (see printed version of the official brochure)

## 3. The Functions of the Competition Tribunal

The Competition Tribunal adjudicates competition matters, in accordance with the Competition Act No 89 of 1998. It has jurisdiction throughout South Africa. The Competition Tribunal is independent and is subject to the constitution and the law. It must be impartial and perform its functions without fear, favour or prejudice.

When a matter is referred to it in terms of the Competition Act, the Tribunal must:

- authorise or prohibit a large merger, with or without conditions
- adjudicate appeals from the Competition Commission's decisions on intermediate mergers and exemptions
- adjudicate complaints of prohibited conduct in terms of the act by determining whether prohibited conduct has occurred, and if so, impose a remedy provided for in the act
- grant or deny an order for interim relief
- grant or deny an order for costs

## 4. The Competition Act

Section 2 of the Competition Act specifies that its purpose is to promote and maintain competition in the Republic to:

- Promote the efficiency, adaptability and development of the economy
- Provide consumers with competitive prices and product choices
- Promote employment and advance the social and economic welfare of all South Africans
- Expand opportunities for South Africa to participate in world markets and to recognise the role of foreign competition in the Republic
- Ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy
- Promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged people.

The Competition Act:

- Prohibits anti-competitive practices between firms in vertical and horizontal relationships
- Prohibits abuse of a dominant position
- Provides for restrictive practices to be exempted on specified grounds
- Requires notification of merger transactions above a specified threshold and for the regulation thereof.

## 5. Changes to the Competition Act

On 1 February 2001, the Competition Second Amendment Act came into operation. At the same time, new rules for the Competition Tribunal and Commission came into effect, as did new thresholds for the notification of mergers.

Although the amendments were wide ranging, touching on aspects of jurisdiction, procedural rights and institutional reform, they did not affect the core provisions of the act, which, with one minor change, remain the same.

The most prominent of these amendments was to delete a section of the act that excluded jurisdiction over “acts subject to or authorised by public regulation”. The ambit of this exclusion had led to conflicting interpretations in the high courts. The object of the provision, as has been observed by one judgment in the Supreme Court of Appeal, was to avoid a situation of double jeopardy so that a firm was not faced with having to defend itself twice under different regulations for the same conduct. What emerged in practice was that the exclusion was being interpreted too broadly so that firms in regulated

industries escaped the Competition Act's jurisdiction without being subject to equivalent regulation in their sector in respect of anti-competitive behaviour.

There will now be concurrent jurisdiction with sector regulators where the same conduct is the subject of the jurisdiction of both the Competition Act and the sector regulation. The difficulties this may lead to are ameliorated by a requirement in the act for sector regulators and the Competition Commission to enter into agreements to manage concurrent jurisdiction.

From the Tribunal's point of view, the most important impact of the changes has been at the level of procedure. Prior to the amendment, procedures in the act and rules were asymmetrical - for certain procedures, one had to look to the act to see how they were to be regulated while for others, one had to look to rules. All procedures are now treated on the same footing. Issues of standing and procedural rights are now uniform and are found in the act. Where rules are more detailed or differ in relation to specific procedures, these can be found in the respective rules of the Commission and the Tribunal.

The amendments have made merger regulation simpler, more focused and less onerous on business. In addition, the threshold for notification has been raised while fees have been reduced. These reforms have been well received by the business community. Labour, too, has benefited from the reforms. Unions can now appeal to the Tribunal against a decision of the Competition Commission in relation to an intermediate merger. Amendments to the rules now require merging firms to provide employees with a summary of the employment effects of the merger.

**The amended act, new rules and thresholds can be found on the Tribunal's website.**

**Changes to merger thresholds and filing fees**

It is compulsory for mergers above a certain threshold to be notified. Since 1 February 2001, the threshold for compulsory notification was raised from R50m to R200m of combined assets and/or turnover, and for the target firm from R5m to R30m of turnover or assets. As a consequence, fewer mergers will require compulsory notification.

As from 1 February 2001, the filing fees for large mergers have been reduced from R500 000 to R250 000; and for intermediate mergers from a maximum of R125 000 to R75 000.

## 6. The Competition Tribunal's members

The President, on recommendation from the Minister of Trade and Industry, appointed the chairperson and nine other members of the Tribunal with effect from 1 August 1999. Terms of appointment are for five years. Two of the members (including the chairperson) are full-time executive members and eight (including the deputy chairperson) are part-time non-executive members. The members of the Tribunal constitute the pool from which the chairperson appoints adjudicative panels comprising three members.

The act specifies that, viewed collectively, the membership of the Tribunal should represent a broad cross-section of the population of South Africa and that each member should be a citizen of the Republic and should have suitable qualifications and experience in economics, law, commerce, industry or public affairs. Six of the current Tribunal members have a legal background, three are economists and one is a chartered accountant.

**Members of the Competition Tribunal**

**Chairperson**
David Lewis (BCom, MA)

**Deputy Chairperson**
Advocate Marumo Moerane (BSc, BCom, LLB)

**Full-time member**
Norman Manoim (BA, LLB)

**Part-time members**
Urmila Bhoola (BA Hons, LLB, LLM)
Professor Frederick Fourie (BA Hons, MA, Ph.D)
Professor Merle Holden (BCom Hons, MA, PhD)
Phatudi Maponya (BProc, LLB, H Dip Company Law, LLM)
Christine Qunta (BA, LLB)
Diane Terblanche (BA, LLB, LLM)
Sindi Zilwa (BCompt Hons)

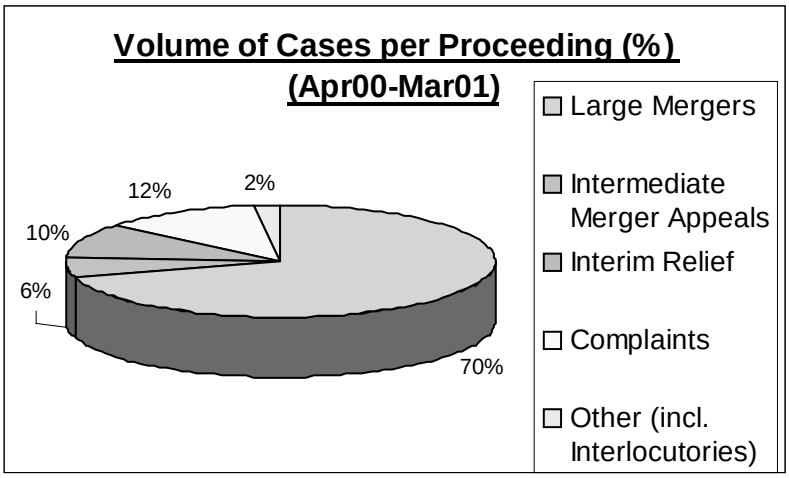
Tribunal members have met three times in the year to review their work and to keep abreast with specific aspects of competition economics and law. A two-day workshop on adjudication held in March 2001 was facilitated by Sir Christopher Bellamy, president of the UK Competition Appeals Tribunal, and Prof Richard Whish, Professor of Law at Kings College, London.

Tribunal members are also kept informed of cases through a quarterly newsletter, *The Tribunal Tribune*, which carries briefing articles on topical issues.

## 7. Competition Tribunal cases

### *7.1 Introduction*

The Competition Tribunal issued 50 orders in this period, up from 14 for the seven months to 31 March 2000. They were distributed as follows:



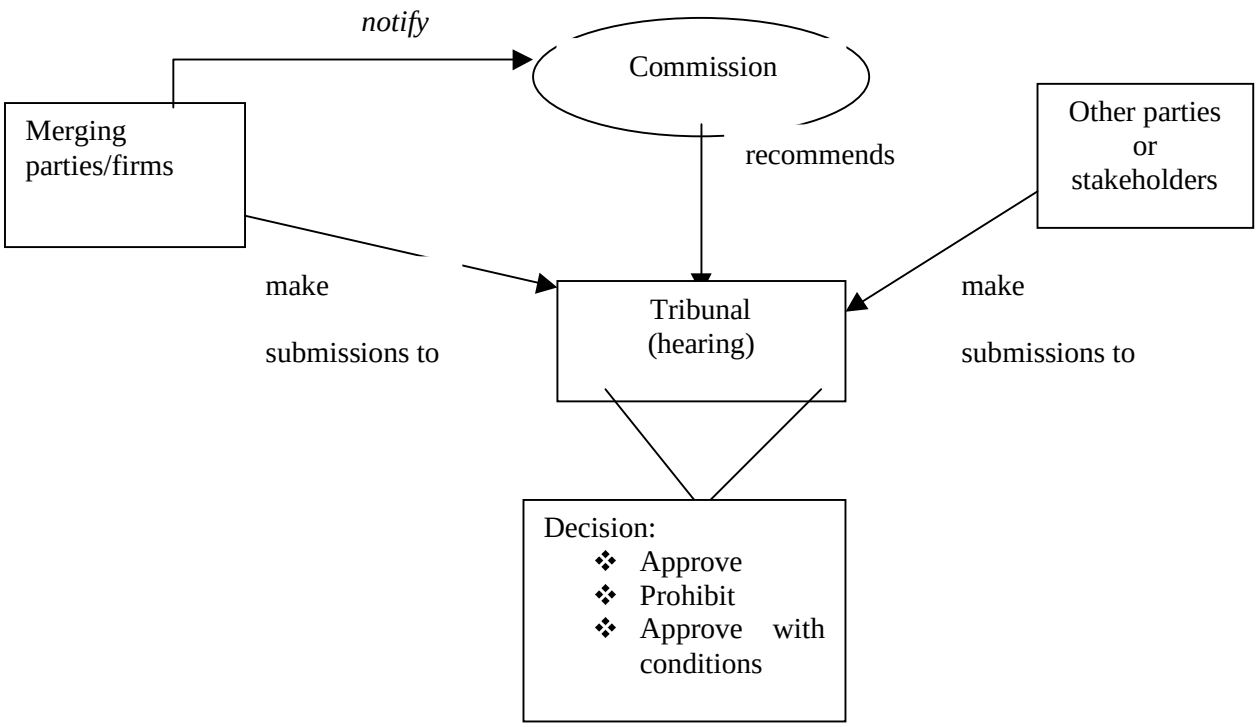
The vast majority of cases were in respect of merger transactions. It is difficult, however, to compare time expended on different types of proceedings, with some requiring greater scrutiny than others. In practical terms, cases differ in terms of volume of documentation, hearing time and writing time. These are generally substantial with complaint and interim relief applications and vary in relation to mergers.

The Tribunal publishes written reasons for all its decisions and provides considerable detail in cases where there are competition concerns. Even where there are no competition concerns, the Tribunal delivers reasons for its decisions in order to maintain an accurate record of the transaction and to promote an understanding of the factors considered in adjudication.

### *7.2 Large Mergers*

All large mergers having an effect within the Republic of South Africa have to be approved by the Competition Tribunal. The merger is considered large if the combined turnover or combined assets of target and acquiring firms exceeds R3.5bn; and the assets or turnover of target firm exceed R100m.

#### *7.2.1 Procedure for Assessing Mergers*



*7.2.2 The cases*

The tribunal decided 35 large mergers between 1 April 2000 and 31 March 2001.

***(List cases here – see annexure)***

*7.2.3 Decisions*

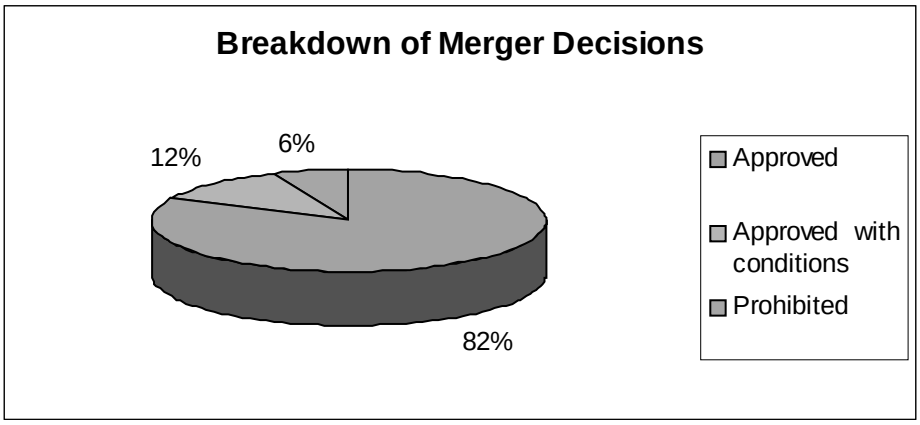
In the period under review, the Tribunal decided 35 large mergers. Of these, 29 were approved without conditions, four were approved with conditions and two were prohibited. Two notified matters were withdrawn.

*7.2.4 Turnaround times*

In its second year of operation, the Tribunal has continued to process its consideration of large merger transactions efficiently and swiftly.

Of the 35 merger transactions considered, the Tribunal released an order on the same day of the hearing in 24 (72%) of the cases, and in all but two of the remaining instances, an order was released within a week of the hearing.

Twenty-one (60%) were set down for hearing within 15 days of the Tribunal receiving a recommendation from the Commission.




*7.2.5 Types of mergers*

The Tribunal has considered transactions in varied product markets including consumer goods, chemicals and minerals, services and distribution. The majority comprised horizontal mergers (mergers between competing firms selling the same products or providing the same services), some conglomerate mergers (mergers between firms conducting unrelated business activities) and a small percentage comprised vertical mergers (mergers between firms operating at different stages of production)

The following shows the types of merger transactions according to the relationship of the parties pre-merger:

**International mergers**

23% of the mergers adjudicated during the review period formed part of multinational mergers, which were notified with several competition authorities worldwide. All were approved by the Tribunal.

*7.2.6 Defences*

The Competition Act allows parties to justify an otherwise anti-competitive merger with defences specified in the act. Frequently-invoked defences relate to efficiencies arising from the merger transaction and public interest arguments. In reality, there has been a tendency to combine these defences. Specifically, arguments that the merger would result in a "national champion" for a particular industry or sector is often incorporated with an efficiency defence.

None of the mergers considered in this period have been decided solely on public interest grounds. In one landmark decision, however (*Trident Steel (Pty) Ltd and Baldwins Steel*), the Tribunal allowed the efficiency defence to prevail over an otherwise anti-competitive merger.

"The efficiencies claimed are so overwhelming, especially in relation to the plant re-organisation that is entailed and the reduction of the scrap rate they suggest, that they will dwarf the anti-competitive effects."

Tribunal decision in the merger between Trident Steel (Pty) Ltd and Baldwins Steel

*7.2.7 Public interest considerations*

In addition to its core function to preserve and promote competition and consumer welfare, the Competition Tribunal is obliged to consider the public impact of transactions and how they prejudice the rights of less powerful interest groups. The Tribunal has maintained transparency and flexibility in allowing the participation of trade unions and other interested parties in its proceedings Public interest concerns have been considered in a number of decisions and featured prominently in the *JD/Ellerines* and *Tongaat-Hulett/TSB* transactions, although they were not in themselves decisive to the outcome in these cases.

***In the merger between JD Group Limited and Ellerines Holding Limited, the Tribunal's major concern was consumer interests and their vulnerability* vis-à-vis *the merging of two large retail groups:***

"…the interests directly affected by this merger are represented by millions of atomised, disorganised individuals incapable of defending their economic interests except to the extent that they are able to exercise a preference for one retail outlet over another… the real competition significance of this transaction is to be found in the direct links between the parties and South African consumers."

Reasons for Tribunal decision in the merger between JD Group Limited and Ellerines Holdings Limited

*In* Naspers Limited/The Education Investment Corporation Limited, *the Tribunal considered the impact of the merger on the education sector and on small business enterprises through onerous franchise agreements.*

*"The potentially pervasive economic and social consequences of monopolistic structures and conduct in the education sector demand that the Tribunal pays particularly close attention to its public interest mandate*."
"…there is no question that the impact of monopolistic practices in the private education sector will reverberate more powerfully on the economy and society than would similar practices in most other sectors."

*The Tribunal approved this merger in the secondary and higher education sector, but imposed certain remedies designed to ameliorate the potentially negative consequences of the transaction for the public interest.*

*The merged company was ordered to collaborate with the Department of Education in building capacity in public education and to consult with franchisees if it were to alter the terms of the franchise agreement. The Tribunal also imposed a postponed divestiture remedy – a non-core brand may be divested in two years depending on the outcome of an investigation by the Competition Commission on the competitive impact of the transaction in the relevant markets. The Tribunal said in its decision:* "The objective of a divestiture remedy is not punitive but it is rather to ensure the basis for continued competition".

The Tribunal has in certain instances (JD/Ellerines and Tongaat/TSB) employed its inquisitorial powers to allow an expansive scrutiny of particular mergers. It is within the ambit of the Tribunal to demand additional evidence, expert or otherwise, from both merging parties and the Competition Commission. Representation at Tribunal hearings from government departments and policy experts has provided information to contextualise merger transactions within broader public policy objectives and sector regulation.

The Tribunal's consideration of the proposed merger between Tongaat-Hulett Group Ltd and Transvaal Suiker Bpk exposed the tension between excessive regulation and preserving a competitive market. The proposed transaction would have occurred in a highly-regulated sector affected by government policy in a state of flux. In its decision to prohibit this transaction, the Tribunal considered the general tenure of regulatory policy and prospects for a liberalised market.

" In evaluating this merger considerable attention has been given to the interplay between regulation and competition, between regulation in the rest of the world and regulation in South Africa, and between competition in the rest of the world and competition in South Africa. ….the regulatory regime has undoubtedly undermined the extent of competition. In essence the tariff holds international competition at bay while the equitable proceeds arrangement eliminates the incentive to compete for domestic market share."

The Tribunal endeavours to ensure that the potential for competition and countervailing factors are not disregarded. In *Santam Ltd and Guardian National Insurance Company Ltd,* a merger in the short-term insurance industry, the Tribunal approved the transaction despite the merged entity having high market shares in most short-term insurance products.

*"The broker's role as intermediary between the customer and insurer effectively consolidates the buying power of customers and should therefore contribute significantly towards countervailing the potential market power established by moderate to high concentration levels on the supply side of the markets*."

Despite the Tribunal's due consideration of public interest submissions, it applies a flexible, case-by-case approach to evaluating them. It avoids, for example, taking an overly expansive view on long-term employment effects. Accordingly, a merger which could hypothetically create unemployment in unrelated industries in the distant future, will generally not deter the Tribunal from approving the immediate transaction under its consideration, provided of course the merger would not otherwise prevent or substantially lessen competition. However, the Tribunal will, in appropriate cases, seek undertakings from parties to allay public interest concerns.

In its decision on *TPI Investment (Pty) Ltd, Praysa 1062 (Pty) Ltd and Telkom SA Ltd*, a merger involving a restructuring of state assets by Telkom, the Tribunal acknowledged that the dynamic nature of the telecommunications industry warranted certain guarantees on employment. It included in its order voluntary undertakings from the parties to refrain from retrenching employees as a consequence of the transaction.

### 7.3 Intermediate Mergers

The Tribunal's role in intermediate mergers is to hear appeals on the decisions of the Competition Commission.

***(List intermediate mergers here – see annexure)***

Three decisions by the Competition Commission on intermediate mergers were appealed to the Tribunal in the period. In one of these, which was separately appealed by the parties to the merger, the Commission had not taken its decision within the requisite time period, necessitating the Tribunal's approval of the merger by default.

In another case involving pharmaceutical companies, *Glaxo Wellcome plc and Smithkline Beecham*, the Tribunal approved the merger conditional on the merged entity out-licensing the production of drugs in each of the three therapeutic categories where it would have had a significant market share. One of the cases, *Food & Allied Workers Union versus Heinz Frozen Foods and McCain Foods*, was not heard in the period.

## 7.4. Restrictive Practices

### *7.4.1 Complaint Referrals*

Any person can lodge a complaint to the Commission about anti-competitive practices prohibited by the Competition Act. The Commission has one year to investigate such complaints. Investigations may also be initiated by the Competition Commissioner.

On completing its investigation, the Commission will either refer the matter to the Tribunal for adjudication or issue a notice of non-referral if it did not find that a prohibited practice had occurred. Complainants may make direct representation to the Tribunal when the Commission issues a notice of non-referral.

***(List complaint referrals here – see annexure)***

Of the 19 complaint referrals notified to the Tribunal in the period, 11 were referred by the Commission. Of these, six were settled by consent orders and five are pending. Eight complaint referrals were filed by complainants, following a non-referral by the Commission. These are pending.

Consent orders are issued by the Tribunal when the Commission and the respondent agree on the nature of the contravention and the appropriate remedy. The six consent orders agreed in the period related to agreements between parties in a vertical relationship (section 5(1)), minimum resale price maintenance (section 5(2)), engaging in an exclusionary act by a dominant firm (section 8(c)) and price discrimination by a dominant firm (section 9(1)). The respondents' willingness to make concessions to complainants by way of consent order further illustrates that the prohibited practices defined in the act are well understood and are effective in securing relief for complainants.

### *7.4.2 Interim Relief*

Since complaint referrals take some time to investigate, a person is entitled to apply to the Competition Tribunal for interim relief, pending the outcome of the Commission's investigation. The Tribunal will grant interim relief if it is satisfied that the complainant may suffer irreparable harm during the period in which the investigation is taking place and having regard to the balance of convenience. The life of such interim relief orders are six months after issue (unless the Commission's enquiry is completed before this), extendable on good cause shown for a further six-month period.

***(List interim relief applications here – see annexure)***

During the period, there were 17 applications for interim relief, of which six were withdrawn, three were taken off the roll, two were granted, three were denied and three are pending.

In one of those granted, *Jakobus P Bezuidenhout vs Patensie Sitrus Beherend Limited*, the Tribunal ordered PSB to refrain from enforcing its option to purchase the claimant's citrus crop in accordance with its articles of association. This was the second application for interim relief brought before the Tribunal in which the provisions of the articles of association of a company converted from an agricultural co-operative were alleged to be anti-competitive.

In *National Association of Pharmaceutical Wholesalers & Others vs Glaxo Welcome SA (Pty) Ltd & Others*, the Tribunal granted the relief, ordering the manufacturers to continue to supply their products directly to the wholesalers on the same terms before the formation of a joint exclusive distribution agency. This decision has since been taken on review to the Competition Appeal Court.

Interim relief applications require less stringent proof than would be the case when the final complaint referral is heard. Nevertheless, the act still requires evidence of a prohibited practice and certain applications have failed due to a lack of sufficient evidence.

In *Natal Wholesale Chemists vs Astra Pharmaceuticals*, the wholesalers were unsuccessful in their application, alleging that the exclusive distribution agreements in place between various manufacturers and its distribution company constituted prohibited practices. Unlike the first pharmaceutical case, there were no horizontal agreements concluded between the two manufacturers in this case.

In the *Nationwide vs SAA*_case, the applicants failed in their application for interim relief claimed in pursuance of alleged abusive practices by the dominant carrier. Their claim included allegations of predatory pricing by SAA. The Tribunal was not satisfied with the evidence produced by Nationwide to sustain their allegations.

## 8. The staff of the Tribunal secretariat

The staff of the Competition Tribunal provides administrative, research and organisational support to the chairperson and Tribunal members.

**Chief executive officer/registrar**
Shan Ramburuth

**Case managers**
Kim Kampel
Rietsie Badenhorst
Thulani Kunene

**Registry**
Eugene Tsitsi, head of registry
David Tefu, registry clerk
Jerry Ramatlo, court orderly/driver
Tebogo Mputle, receptionist

**Finance**
Janeen de Klerk, head of finance
Donald Phiri, accounts assistant

**Executive secretaries**
Lerato Motaung, executive secretary to the chairperson
Ntombi Mothei, executive secretary to the CEO

## 9. Corporate governance

### *9.1 Compliance with legislation*

**The Competition Act**

The Competition Act and the rules of the Competition Tribunal prescribe the functions, activities and procedures of the institution. The act and the rules were amended with effect from 1 February 2001 and procedures in the Tribunal were adjusted accordingly. The Tribunal secretariat periodically reviews its procedures to ensure that its work processes effectively and efficiently comply with the requirements of its prescribed rules. Workshops were held with staff in October 2000, February 2001 and March 2001 to streamline and strengthen procedures in the secretariat.

**Audit Committee**

An audit committee, established in March 2000, met twice this year**.** The committee is responsible for assisting the executive committee in fulfilling its supervisory responsibilities on internal controls, risk management, compliance with laws, regulations and ethics and financial management. Its functions are outlined in an audit committee charter, which was adopted on 6 December 2001**.**

**Executive members:**
- David Lewis
- Shan Ramburuth
- Janeen de Klerk

**Non-executive members:**
- Thabo Mosololi - chairperson
- Sakile Masuku
- Peter Modiselle
- Tobie Verwey

**Internal audits**
The auditing firm, Sithole AB&T, performs the internal auditing function for the Tribunal. In the current financial year, audits were done quarterly:

April 2000 – June 2000 (signed off on 3 October 2000)
July 2000 – September 2000 (signed off on 15 December 2000)
October 2000 – December 2000 (received and awaiting management comments)
January 2001 – February 2001 (awaiting report)

The audit committee adopted an internal audit charter in December 2000**.**

Internal audits have covered a range of areas identified by management and the internal auditors, including:

- Corporate governance and compliance with relevant legislation

- The efficiency and effectiveness of administrative policies and procedures

- The reliability and integrity of financial and operating information
- The consistency of programmes with established objectives and goals

The internal audits have verified the credibility of effective management controls in the Tribunal.

**External audit**
The office of the auditor general has completed an external audit for the period ending 31 March 2001.

**Reporting to the Department of Trade and Industry**
The Tribunal submits business plans and budgets to the DTI six months in advance of the following financial year and provides monthly reports on its activities, expenditure and budget variance.

**Statutory requirements**
The Tribunal has registered and met its obligations on the following levies and taxes:

The Receiver of Revenue exempted the Tribunal from Section 10(1)(a) of the Income Tax Act (1962) in November 2000.

### 9.2. Executive Committee

The executive committee of the Tribunal held 14 meetings in the review period. The executive committee provides policy direction on operational decision making and expenditure; and receives reports from the chief executive and the head of finance on operational plans and their implementation.

**Members**

- David Lewis, chairperson
- Marumo Moerane, deputy-chairperson
- Shan Ramburuth, CEO
- Janeen de Klerk, head of finance
- Norman Manoim, full-time Tribunal member.

### 9.3. Case Management Committee

The case management committee assists the chairperson in setting down matters on the Tribunal roll, convening panels and overseeing the administration and logistics for hearings. Meetings are recorded using a case management matrix system, which is designed to track the development and progress of each case. This committee meets weekly.

**Members**

- David Lewis - chairperson of the Competition Tribunal
- Norman Manoim – full-time member
- Shan Ramburuth - CEO

- Eugene Tsitsi - head of registry
- Lerato Motaung – executive secretary to the chairperson
- Rietsie Badenhorst - case manager
- Thulani Kunene – case manager
- Kim Kampel - case manager

### 9.4. Staff meetings

Staff meetings were held quarterly and have been effectively used to inform and consult staff on matters relating to the structure and functioning of the Tribunal and on human resource issues.

## 10. Case management

Cases are managed through the case management committee, which tracks the filing of documents and sets down cases for hearing. Case managers liaise with parties and panel members over the substantive aspects of a case, ensuring that relevant information is available. This includes arranging pre-hearings when required. The registry is responsible for document management and the logistics for hearings. The registry also attends to members of the public requesting access to case documents and ensures that confidentiality of documents is respected and maintained.

Case managers provide research support to panels in writing decisions. These include preparing summaries of cases, the acquisition and compilation of academic literature and case law from other jurisdictions and preparing briefing papers on specific topics relevant to cases. In addition, three research papers were prepared in the period under review.

## 11. Communicating the work of the Tribunal

The Competition Tribunal has an integrated communication programme to educate targeted audiences on the role and function of the Tribunal, to highlight decisions and to stimulate debate on competition policy. This includes making presentations at seminars, participation in conferences and providing information to journalists and others. Tribunal decisions are promptly posted on our website (www.comptrib.co.za). The Tribunal has achieved wide coverage in both the electronic and print media.

## 12. Keeping abreast with competition law and economics: conferences and international forums

The Competition Act requires that the Tribunal considers international jurisprudence in its adjudication. Competition law is a rapidly evolving field and the Tribunal has initiated and maintained considerable interaction with international experts and institutions to keep abreast of developments.

There is an active debate internationally on the impact of globalisation and the enforcement of competition law. The Tribunal has engaged with the Department of Trade and Industry and the World Trade Organisation in formulating a South African response to these issues. The chairperson of the Tribunal participates in the steering committee of the *Global Competition Initiative*, which is attempting to formalise and strengthen international cooperation in competition law enforcement. The plenary group includes representation from Mexico, Zambia, the European Union and the United States.

Tribunal members and staff have attended eight international conferences and presented papers at four of these.

The Tribunal has also actively contributed to international debates and has raised the profile of the South African competition regime by co-hosting an annual competition conference with the Competition Commission. The South African competition conference focuses on the role of competition authorities in developing countries and has become a respected event in the international agenda of anti-trust conferences. Two conferences were held in the period: *Regulation and competition* in April 2000 and *The impact of globalisation and new technology on competition* in March 2001. Both were addressed by leading international and local experts, with wide attendance and participation from practitioners, sector regulators, parliamentarians, policy makers, SADC competition officials, trade unions and others.

## 13. Training and human resource development

### *13.1 Employment equity*

The Tribunal took into account employment equity in recruiting staff and this is reflected in the racial and gender distribution. We have complied with the requirements of the Employment Equity Act and timeously submitted our employment equity plan to the Department of Labour on 1 December 2000.

### *13.2 Staff Composition*

The Tribunal secretariat consists of 12 staff - six are female, eight are black, one is Asian and three are white. Fifty percent have a bachelors degree or higher.

### *13.3 Training and Human Resource Development*

The Tribunal is committed to cultivating a culture of learning throughout the organisation by providing employees with opportunities for development and further education in line with our objectives.

Some 88.90 working days have been spent in training during the current financial year. In terms of salary cost, this amounts to R195 863 (ie an average of 6.35 training days per person at an average cost of R2 203 per day). Training and development comprises both in-house training and external courses, workshops and conferences locally and internationally.

In addition, a bursary scheme assists employees to obtain further tertiary qualifications. Study loans cover tuition and examination fees up to R4 000 per annum per employee. Study loans are converted to bursaries on the employee successfully completing a course. During the current financial year, eight staff members received study loans totalling R27 650. Some 80% of these loans were allocated towards university degrees.

## 14. FINANCIAL MANAGEMENT

The budget for the 12-month period ending 31 March 2001 reflected expenditure (inclusive of capital expenditure) of R9.08m and estimated income (generated from fees and interest) of R7.05m.

**Income for the year amounted to R10.28m and was distributed as follows:**

| Category | Amount (Rm) | Percentage (2001) | Percentage (2000) |
|---|---|---|---|
| Government grants | 0 | 0 | 47.88 |
| Donor funds | 0.25 | 2.46 | 0 |
| Filing fees | 9.20 | 89.50 | 49.79 |
| Other income | 0.83 | 8.04 | 2.33 |
| Total income | 10.28 | 100 | 100 |

**Total expenditure (including capital expenditure) for the period was R6.3 million.**

| Category | Percentage (2001) | Percentage (2000) |
|---|---|---|
| Capital | 0.52 | 25.83 |
| Personnel and admin | 79.68 | 59.39 |
| Recruitment and training | 9.69 | 6.26 |
| Professional services | 10.11 | 8.52 |
| Total expenditure | 100 | 100 |

Capital expenditure decreased dramatically as most of these were incurred in set-up costs in the previous year.

Professional service expenditure includes payments to the commission (in terms of the MOU), hearing transcription services, legal fees and media and finance-related consulting services.

Recruitment and training expenditure includes costs associated with co-hosting the second annual competition conference

The variance in expenditure may in the main be attributed to a lower volume of cases (and therefore associated costs) than predicted.

## Annexure – List of cases

### Large mergers

| Parties | Date of decision/order | Decision |
|---|---|---|
| Santam Ltd & Guardian National Insurance | 04 Apr 00 | Approved without conditions |
| Ford Motor Company and SAMCOR | 05 Apr 00 | Approved without conditions |
| P Q Data Trading (Pty) Ltd and Alexander Forbes Group (Pty) Ltd | 05 Apr 00 | Approved without conditions |
| Anglo American Plc and Silicon Smelters (Pty) Ltd | 05 Apr 00 | Approved without conditions |
| Distillers Corporation (SA) Limited and Hygrace Holdings (Pty) Ltd | 10 Apr 00 | Approved without conditions |
| Bromor Foods Ltd and The Game Sports Drink | 14 Apr 00 | Approved with conditions |
| Harmony Gold Mining Company Ltd and Randfontein Estates Limited | 14 Apr 00 | Approved without conditions |
| Pioneer Foods (Pty) Ltd and National Brands Ltd | 19 Apr 00 | Approved without conditions |
| Anglovaal Mining Ltd and De Beers Consolidated Mines Ltd | 19 Apr 00 | Approved without conditions |
| Ceramic Industries Ltd and Vitro Punched Tile | 03 May 00 | Approved without conditions |
| Aerospatiale Matra Societe Anonyme and Daimlerchrysler Aerospace AG | 17 May 00 | Approved without conditions |
| The Dow Chemical Company and Union Carbide Corporation | 17 May 00 | Approved without conditions |
| Imperial Holdings Limited and The Cold Chain (Pty) Ltd | 24 May 00 | Approved with conditions |
| Secotrade 72 (Pty) Ltd and Hyundai Motor Distributors (Pty) Ltd | 01 June 00 | Approved without conditions |
| Naspers Limited and The Education Investment Corporation Limited | 13 Jun 00 | Approved with conditions |
| Imperial Holdings Limited and J H Bachman (Pty) Ltd | 28 Jun 00 | Approved without conditions |
| Grayston Property No. 005 (Pty) Ltd and The Gateway Partnership | 28 Jun 00 | Approved without conditions |
| De Beers Consolidated Mines Limited and Industrial and Commercial Holdings Group Limited | 14 Jul 00 | Approved without conditions |
| Nasmedia Limited and Paarl Post Web Printers (Pty) Ltd | 26 Jul 00 | Approved without conditions |
| BP Amoco plc and Burmah Castrol plc | 07 Aug 00 | Approved without conditions |
| The Bidvest Group Limited and I-Fusion Limited | 07 Aug 00 | Approved without conditions |
| Franco-Nevada Mining Corp. Ltd and Gold Fields Limited | 21 Aug 00 | Approved without conditions |
| JD Group Limited and Ellerine Holdings Limited | 31 Aug 00 | Prohibited |
| Ford Motor Company and Land Rover Group Limited | 06 Sep 00 | Approved without conditions |
| Investec Group Limited and Frame Group Limited | 06 Sep 00 | Approved without conditions |
| Aveng Limited and LTA Limited | 27 Sep 00 | Approved without conditions |
| TPI Investment (Pty) Ltd, Praysa Trade 1062 (Pty) Ltd and Telkom SA Ltd | 02 Oct 00 | Approved with conditions |

| | | |
|---|---|---|
| Tongaat – Hulett Group Ltd and Transvaal Suiker Beperk | 27 Nov 00 | Prohibited |
| Trident Steel (Pty) Ltd and Baldwins Steel | 06 Dec 00 | Approved without conditions |
| Roadway Logistics (Pty) Ltd and Roadway Transport Limited | 13 Dec 00 | Approved without conditions |
| Sasol Chemical Industries Ltd and Polyfos (Pty) Ltd | 13 Dec 00 | Approved without conditions |
| Sasol Chemical Industries Ltd and Fedmis Joint Venture | 13 Dec 00 | Approved without conditions |
| The Chase Manhattan Corporation and JP Morgan and Company Incorporated | 13 Dec 00 | Approved without conditions |
| Framatome Societe Anonyme and Siemens Aktiengesellschaft AG | 14 Mar 01 | Approved without conditions |
| Fabvest Investment Holding Ltd and National Cereal Holdings | 14 Mar 01 | Approved without conditions |

## Intermediate mergers

| **Parties** | **Date of decision/order** | **Decision** |
|---|---|---|
| Food & Allied Workers Union v/s Heinz Frozen Foods and Mc Cain Foods | Pending | Pending |
| Nasmedia Limited and CT Media Limited v/s The Competition Commission | 26 May 00 | Approved |
| Bubble Pac (Pty) Ltd v/s The Competition Commission | 28 Jun 00 | Approved |
| Sealed Air Africa (Pty) Ltd v/s The Competition Commission | 28 Jun 00 | Approved |
| Glaxo Wellcome Plc and Smithkline Beecham v/s The Competition Commission | 28 Jul 00 | Approved with conditions |

## Complaint referrals

| Parties | Date of decision/order | Decision |
|---|---|---|
| The Competition Commission v/s Seven Eleven Corporation SA (Pty) Ltd | | Pending |
| The Competition Commission v/s Seven Eleven Africa (Pty) Ltd | | Pending |
| Cine Biz (Pty) Ltd v/s Nu Metro Entertainment (Pty) Ltd & Nu Metro Theatres (Pty) Ltd | | Taken off the roll |
| South African Recording Rights Association v/s Electronic Media Limited | | Pending |
| Botswana Ash (Pty) Ltd, Chemserve Technical Products (Pty) Ltd v/s American Natural Soda Ash Corporation & Another | | Pending |
| Berry Donaldson (Pty) Ltd v/s South African Airways (Pty) Ltd | | Pending |
| The Competition Commission v/s South African Forestry Company Limited | | Pending |
| Avalon Group (Pty) Ltd v/s Old Mutual Properties | | Pending |
| The Competition Commission v/s Federal Mogul Aftermarket SA | | Pending |
| The Perfume Shoppe (Pty) Ltd v/s The Prestige Group (Pty) Ltd | | Pending |
| The Perfume Shoppe (Pty) Ltd v/s Horton Products (Pty) Ltd | | Pending |
| Aero Africa management (Pty) Ltd v/s South African National Parks | | Pending |
| The Competition Commission v/s South African Airways (Pty) Ltd | | Pending |
| The Competition Commission in re Sphinx Acrylic v/s Acrylic Products and Plexicor | 19 Apr 00 | Consent order |
| The Competition Commission of S A v/s Palabora Mining Company Ltd | 17 May 00 | Consent order |
| The Competition Commission v/s Skye Products | 25 Jan 01 | Consent order |
| The Competition Commission v/s Myal Clothing Industries | 25 Jan 01 | Consent order |
| The Competition Commission v/s Nutri-Health Africa (Pty) Ltd | 25 Jan 01 | Consent order |
| The Competition Commission v/s American Natural Soda Ash & CHG Global (Pty) Ltd | 27 Mar 01 | Consent order |

## Interim relief

| ***Parties*** | **Date of decision/order** | **Decision** |
|---|---|---|
| National Association of Pharmaceutical Wholesalers & Others v/s Glaxo Wellcome SA (Pty) Ltd & Others | | Withdrawn |
| Modisi Moila Family Trust Agency v/s Sappi and Mondi | | Withdrawn |
| Paarl Post Web Printers (Pty) Ltd v/s CTP Holdings & Another | | Withdrawn |
| Sky Envelope & Stationery Manufacturers v/s Sappi Fine Papers | | Taken off the roll |
| York Timber Limited v/s South African Forestry Company Limited | | Withdrawn |
| Atasca Paper Merchants CC v/s Finwood Papers (Pty) Ltd & Others | | Pending |
| Nutrifirst Pharmaceuticals (Pty) Ltd v/s Fresenius Kabi SA (Pty) Ltd & Others | | Withdrawn |
| Netnews Bloemfontein (Pty) Ltd v/s Nasionale Pers Bpk | | Withdrawn |
| New United Pharmaceutical Distributors & Others v/s Novartis SA (Pty) Ltd & Others | | Pending |
| York Timbers Limited v/s South African Forestry Company Limited | | Pending |
| Cine Biz (Pty) Ltd v/s United International Pictures (SA) | N/A | Taken off the roll |
| Cine Biz (Pty) Ltd v/s Nu Metro Entertainment (Pty) Ltd | N/A | Taken off the roll |
| Jakobus P Bezuidenhout v/s Patensie Sitrus Beherend Limited | 10 July 00 | Interim relief granted |
| National Association of Pharmaceutical Wholesalers & Others v/s Glaxo Wellcome SA (Pty) Ltd & Others. | 29 Aug 00 | Interim relief granted |
| Papercor CC v/s Finwood Papers (Pty) Ltd & Others | 20 Oct 00 | Application dismissed |
| Nationwide Airlines (Pty) Ltd v/s SouthAfrican Airways (Pty) Ltd & Others | 21 Dec 00 | Interim relief dismissed with costs |
| Natal Wholesale Chemists (Pty) Ltd v/s Astra Pharmaceuticals (Pty) Ltd | 12 Mar 01 | Interim relief denied |

## Competition Tribunal – 2001 score card

| **Objective as per business plan** | ***Target and result*** | ***Progress*** 0% 100% |
|---|---|---|
| | | |
| **REGISTRY** | | |
| Document management system | Filing system implemented; confidentiality maintained; documents timeously distributed to relevant parties | |
| Case management system | Time-frames in act adhered to; CMC meets weekly, effective communication with all parties; meetings and hearings set down | |
| Logistics | Hearings efficiently scheduled | |
| **RESEARCH** | | |
| Case research | Research conducted for panels as required | |
| Newsletter | Four out of six planned newsletters produced | |
| Briefing papers | Three out of eight planned briefing papers produced | |
| Resource centre and source book | Material acquired; resource centre set up | |
| Annual conference | Conference held in April 2000 and March 2001 | |

| | | |
|---|---|---|
| **OPERATIONS** | | |
| Policies and systems | Risk evaluation undertaken; policies and procedures reviewed at staff meetings | |
| Asset management | Policy approved, register updated monthly, physical assets inspected quarterly | |
| Human resource manual | Human resource policies agreed and manual compiled | |
| Performance management system | System agreed and implemented | |
| Training | Training identified and implemented; conferences attended | |
| Tribunal member meetings and training | Three out of four planned meetings/workshops held | |
| Code of ethics | Completed for staff but not Tribunal members | |
| Communication, media liaison and web site | Fair media coverage on decisions; Decisions publically available on web-site. Average of 400 hits per month | |
| **FINANCE** | | |
| Financial management | Budgets compiled and reviewed; monthly reporting; internal and external audits completed | |
| Asset management | Asset register maintained and labelling process initiated | |
| Compliance with legislation and regulation | Statutory payments made; employment equity plan finalised; adherence to PFMA monitored regularly | |
| Payroll and HR records | Records maintained and updated; compliance with legislation. | |

**Result –** Competition Tribunal was rated **joint fourth out of 24** in a survey of major international competition regulators by Global Competition Review, **ahead** of long-established heavyweights such as the **UK** Competition Commission and **US** Federal Trade Commission.

## III. – QUESTIONNAIRE ON ANTI-CARTELS ACTIONS

The following report is based on a case that is currently at the Competition Tribunal stage. All the information supplied herewith is taken from the final Report thereof. Some of the questions could not be answered because they were either not applicable to the present case or that information had not come to light as a result of the Commission's investigations.

### Background

The Complainants are both farmers of Citrus fruits in the Gamtoos River Valley in the Eastern Cape.

The respondent is a company that was originally a co-operative but was later corporatised and is now duly registered as such under the laws of South Africa. Their main business is the purchase, packaging and sale of citrus fruits.

The complainants became shareholders of the respondent in April1999. On or about that time, the Articles of Association, which form the basis of the complaint to the Commission, were enacted.

These Articles require that all produce be turned over to the respondent if a shareholder resigned and any debt owing to the respondent would become immediately due.

The respondent revealed the following:

a) That the respondent became aware that the existing facilities for packaging and storing of citrus produce were inadequate. It was proposed that additional storage be constructed.

b) The members (or shareholders) agreed, and the new facilities were built at a cost of R20 million.

c) In order to ensure repayment of this debt, the respondent instituted the Articles described hereinabove.

The questions posed are answered herein below:

**Ad question 1:**

a. (i) The respondent is a company registered as such in terms of the laws of South Africa.

(ii) The relevant product market is the packaging and resale of citrus fruits.

(iii) The geographic area is the Gamtoos River Valley in the Eastern Cape.

b. The evidence of collusion is direct, i.e. written in the Articles of Association.

c. The respondent's annual turnover for the past two years was as follows:

(i) 1998/1999 - R72 666 594
(ii) 1999/2000 - R76 294 854

d. Case still pending in the Competition Tribunal

**Ad question 2:**

a. The fixing of trading conditions by the respondent, vis-à-vis its shareholders, that is,

(i) all produce must be turned over to the respondent,

(ii) If a shareholder wants to sell shares, permission needs to be obtained from other shareholders. If the shareholder denies permission, then shares cannot be sold, otherwise penalties are imposed.

b. The fixing of trading conditions is per se illegal. In other words, substantial economic harm is presumed.

c. Counsel for respondent insisted that its client had done nothing wrong, notwithstanding the clear existence of the Articles.

d. None

**B. General Information on Sanctions.**

**Ad question 4:**

The standard of proof for all matters is that which is applicable to civil cases, namely, on a balance of the probabilities. If a firm is proven to have contravened the Act, the Competition Tribunal may impose an administrative penalty of not more than 10% of the firm's annual turnover within South Africa and its exports from South Africa during the firm's preceding financial year (section 59(2) of the Competition Act 89 of 1998, as amended).

There are criminal sanctions if one fails to comply with an order of the Tribunal or Competition Appeal Court, specifically, a fine not in excess of R500, 000.00 or imprisonment not exceeding 10 years.

**Ad question 5:**

With regard to Competition law violations, section 59(3) of the Act provides that when determining an appropriate penalty, the Competition Tribunal must consider the following factors:

a. the nature, duration, gravity and extent of the contravention;
b. any loss or damage suffered as a result of the contravention;

c. the behaviour of the *respondent*;
d. the market circumstances in which the contravention took place;
e. the level of profit derived from the contravention;
f. the degree to which the *respondent* has co-operated with the Competition Commission and the Competition Tribunal; and
g. whether the *respondent* has previously been found in contravention of *this Act.*

Subsection (4) provides that a fine payable in terms of this section must be paid into the National Revenue Fund referred to in section 213 of the *Constitution.*

## IV. – DESCRIPTION OF CASES AT THE COMPETITION TRIBUNAL

**Case Number: 49/CR/Apr00**

**In the matter between:**

| | |
|---|---|
| American Natural Soda Ash Corp | First Applicant |
| CHC Global (Pty) Ltd | Second Applicant |
| and | |
| The Competition Commission | First respondent |
| Botswana Ash (Pty) Ltd | Second respondent (Intervening) |
| Chemserve Technical Products (Pty) Ltd | Third Respondent (Intervening) |

**In the Referral:**

| | |
|---|---|
| The Competition Commission | First Applicant |
| Botswana Ash (Pty) Ltd | Second Applicant (Intervening) |
| Chemserve Technical Products (Pty) Ltd | Third Applicant (Intervening) |
| and | |
| American Natural Soda Ash Corp | First respondent |
| CHC global (Pty) Ltd | Second respondent |

---

**Reasons and Order**

---

**BACKGROUND**

This is an application brought by Ansac and CHC Global Pty Ltd ("Ansac") to dismiss a complaint referred to us by the Competition Commission (the "Commission") in April 2000 and an intervening claim brought by Botash and Chemserve ("Botash") in the same matter.

The Commission and Botash allege that Ansac has contravened the provisions of section 4(1)(b) of the Competition Act, (Act no 89 of 1998)[3]. The hearing into the application has not yet commenced and

3 The Commission alleges a breach of section 4(1)(b)(i), Botash a breach of section 4(1)(b)(i) and (ii).

we have decided that it would be appropriate to hear this application prior to the commencement of the hearing.

The application is composed of two parts /

1. An objection to us hearing the referral on jurisdictional grounds; and

2. Various exceptions to the referral.

In addition we asked the parties to present argument on the interpretation of section 4(1)(b)(i) which we thought could be conveniently heard at the same time as this application.

A short history of the litigation in this matter is appropriate in order for us to place the application in its proper context.

**HISTORY OF THE LITIGATION**

In October 1999 Botash launched an application for interim relief in terms of section 59 of the Competition Act[4] against Ansac. Botash alleged that Ansac was operating in South Africa in contravention of section 4(1)(b)(i) and (4)(1)(b) (ii) of the Act and engaged in predatory behavior in contravention of section 8. Ansac opposed this application and also launched its own application for interim relief against Botash in December 1999, alleging that Botash was engaged in predatory pricing against it

On 10 February 2000 after deliberations between the Commission, Ansac and Botash, the parties agreed to withdraw their respective interim relief applications provided the Commission finalised its investigation into Botash's complaint by 22 March 2000 by which date it had to either refer the complaint or issue a notice of non-referral. If the Commission referred the complaint Botash would have the right to intervene and fully participate in the Tribunal's proceedings, including the right to file a separate statement of particulars of complaint. The conditions were set out in an agreement between the parties that was made an order of the Tribunal.

On 23 March 2000 the Commission filed its complaint referral with the Tribunal. Ansac, responded by filing an application to request further particulars to the referral. The Commission, subsequent to this, decided to withdraw its referral and filed a fresh referral on 14 April 2000. The Tribunal published a notice of this referral in terms of section 51(3) of the Act in Government Gazette No. 21145 on 12 May 2000.

On 25 May Botash served intervening particulars of complaint on both Ansac and the Commission. However, the Competition Commission objected to this on grounds that neither the Act nor the Rules of the Tribunal permitted Botash to file such particulars. Ansac approached the Tribunal for an order seeking declaratory relief and the Tribunal granted Botash leave to intervene on 7 September 2000 after hearing the matter on 10 August 2000.

Ansac subsequently filed answering affidavits to both the Commission's complaint referral and to Botash's particulars of complaint. We then convened a pre-hearing conference on the 12 October 2000. At

4 Although the Competition Second Amendment Act, No. 39 of 2000 and new Tribunal Rules came into affect on 1 February 2001 we will be referring to the Competition Act and Tribunal Rules, as they were immediately before that date unless otherwise indicated.

this hearing the Tribunal member presiding suggested that a number of preliminary legal issues referred to in the papers should be determined initially. It was further suggested that as these legal issues might not be susceptible to adjudication in vacuo the parties should try and reach agreement on a statement of facts.

During subsequent pre-hearing conferences on 31 October and 24 November 2000 it became apparent that the parties were not able to reach agreement on a statement of facts. At the same time the Commission and Botash were insisting on discovery of certain documents from Ansac, which Ansac resisted.

Matters came to a head at a pre-hearing conference held on 14 December 2000 when Ansac claimed that it did not know what case it had to meet and said that the scope and ambit of discovery needed to be more precisely defined before it was prepared to make discovery. It was then agreed that the Commission would have the opportunity to amend its complaint referral and Botash its particulars of complaint. The Tribunal incorporated this, as well as an agreed timetable, into an order issued on 14 December 2000.

The Commission and Botash filed their respective amended pleadings on 8 January 2001. Ansac however did not file its amended answer in accordance with our order , but instead brought the application which is presently before us, on 16 January 2001, asking for the complaint to be dismissed. As the application raised a number of preliminary issues that were not being resolved through the process to get an agreed statement of facts we decided to hear this application before commencing the hearing..

At the commencement of our hearing into this application the Commission disputed whether it is competent for us to hear an exception. We advised the parties that our rules allow us to identify any legal issue that may be disposed of conveniently as a preliminary issue to be heard before the commencement of a hearing[5]. Since this was an appropriate case to follow that procedure we decided to do so. It was therefore entirely academic for us to decide whether we have the power to entertain exceptions or for us to give such proceedings the label of either a special plea, in limine point or exception. The parties accepted this and we proceeded to hear argument on the remaining issues.

**JURISDICTIONAL POINT**

Ansac contends that the complaint referral fails to satisfy the jurisdictional preconditions set out in section 50 of the Act.

That section states:

> *"(50). After completing its investigation, the Competition Commission must-*
>
> (a) refer the matter to the Competition Tribunal, if it determines, that a prohibited practice has been established; or
>
> *(b in any other case issue a notice of non-referral to the complainant in the prescribed form."*

Ansac identifies two jurisdictional preconditions in this section. The first is the Commission must have completed its investigation. The second is that the Commission must have determined that a prohibited practice has been established. Ansac argues that neither of these preconditions has been fulfilled.

5 See Rule 23(2)(a). (Now Rule 21(2)(a))

Ansac firstly relies for these propositions on a statement made by the Commission's counsel, Mr. Pretorius, at a pre-hearing conference on 14 December 2000 during which it alleges he had stated that the Commission had been unable to complete its investigation due to the time constraint imposed by this Tribunal on the referral of the complaint[6]. Ansac says that it thought nothing of this statement at the time considering that it had been made in the heat of the moment. Its attitude changed when on receipt of the Commission's answering affidavit in these objection proceedings Ms Singh[7], according to Ansac's reading of her affidavit, effectively reiterated that the matter had been referred before the investigation was complete and before the Commission had established a prohibited practice.

The chronology is important here. At the time of the last pre-hearing on the 14th of December 2000 Ansac had not yet filed its founding papers in this objection application and when it subsequently did this point was not taken. Nor was any contemporaneous comment made at the time of the pre-hearing on 14 December on the supposedly surprising admission of Mr. Pretorius. Presumably Ansac would say this was because at the time it was not alert to the fact. The first time this issue was raised by Ansac as a ground for objection was in its replying affidavit in this application. Thus when Ms Singh is deposing to her answering affidavit in these objection proceedings, the one on which Ansac places such reliance, she is not alive to this point indeed she is responding apparently to a complaint about discovery. Not surprisingly having seen the replying affidavit from the respondents in which this point is first raised the Commission filed a second affidavit from Ms Singh dealing with this aspect. In paragraph 3 of this affidavit Ms Singh states:

*"The Commission at the time of the Referral, was in possession of sufficient evidence to determine that a prohibited practice had occurred. The Commission, however, would have preferred further time for investigation in order to put before the Tribunal the full extent of the effects of the alleged ANSAC cartel in the Republic of South Africa."*

Ansac uses Mr. Pretorius's *alleged concession to establish its contention that the Commission had not completed its investigation. Whilst conceding that Ms Singh has never herself said so, they say the necessary implication of her failure to rebut Mr. Pretorius amounts to an admission of the correctness of his remarks at the pre-hearing. In the elegant phrase of Ansac's counsel "Ms Singh's silence on this point was clamant"*[8]*. Thus Ansac says the first jurisdictional prerequisite viz. a completed investigation has been shown to be absent. This prerequisite they submit is objectively reviewable.*

They then argue that they have established the second leg as well, notwithstanding Ms Singh's supplementary affidavit. Their reading of the affidavit is that Ms Singh concedes that the prohibited practice determination was based on an invalid assumption. By this we understand Ansac to be referring to her statement that she did not expect Ansac to put in issue that it had:

---

6 As appears from the history set out above in terms of its order in February 2000 the Tribunal required the Commission to make its decision whether to refer the complaint by 22 March 2000. Ordinarily the Commission would have had a longer period to investigate the complaint.

7 Ms Singh is the Commission's investigator in the present complaint and the official who has deposed to the Commission's affidavit in both the Referral and the current application.

8 Mr. Pretorius who appeared for the Commission in these proceedings did not concede that these remarks were correctly attributed to him and declined to be drawn into the debate.(See Transcript pg 156)

*"entered into no agreements with any customer in South Africa during the relevant period". (See Singh answering affidavit 4.2 Record C 71).*

This failure they say makes the decision irrational and hence notwithstanding the subjective nature of this discretion renders it a nullity. (See Transcript pg 118 lines 5 – 20)

To arrive at this conclusion Ansac needed to do some extraordinary reading of the record and to place the most subjective gloss on the history of this litigation.

Let us consider what Ms Singh says and see if it offers a basis for attack on either of the two grounds mentioned above. What Ms Singh is explaining in paragraphs 4 and 5 of her answering affidavit is why the Commission had not anticipated the defence being mounted by Ansac and secondly the background to the dispute between the parties over discovery of Ansac's customer contracts. Ansac's reluctance to make discovery was frustrating the Commission who perceived that they could no longer rely on their investigative powers to compel the production of documents, but had to rely on an application to the Tribunal to effect discovery.

The fact that the Commission did not anticipate the present defence at the time it referred the dispute does not justify a conclusion of irrationality. A glance at Ansac's answer in the erstwhile interim relief application[9] indicates that Ansac did not rely on the current objections, which relate to the post – enactment nature of the transactions alleged, for its defence. Its principal defence and the one that Ms Singh anticipates relates to the issue of the extra- territorial application of this Act. Interestingly this point has not been pursued in this application. This shift in defensive posture, which Ansac is perfectly within its rights to assert, illustrates the fundamental problem of this review. Is the Commission supposed to anticipate every line of defence before referring a case? The answer is no. This proposition is followed in criminal law as the English case of Herniman v Smith illustrates:

> *"It is not the duty of the prosecutor to ascertain whether there is a defence, but whether there is a reasonable and probable cause for prosecution".*[10]

The Commission, having at the time and on an examination of the pleadings in the interim relief application assessed the likely issues in dispute, concluded its investigation and considered it had established a prohibitive practice existed. This Ms Singh states in paragraph 4.7 of her affidavit (Record page C 72) where she states:

*"The Applicant (i.e. the Commission) was and remain convinced that a proper discovery of these documents will show that the respondents did enter into agreements during the relevant period, in addition to giving effect to the agreements referred to above…."*

9 Case no 07/IR/0ct99

10 1938 AC 305 at 319 referred to in Beckenstrater v Rottcher and Theunissen 1955(1) SA 319 at 317.

She goes on at paragraph 5 of the same affidavit to say:

*"The Applicant verily believes that proper discovery will show that other agreements were entered into between the commencement of the Act and the filing of referral"*

These paragraphs clearly indicate that the Commission believes it has established the existence of a prohibited practice and that discovery of the documents will provide evidence to supplement the correctness of its belief as opposed to evidence required to establish the existence of its belief.

Do the suggestions made then in paragraph 6 of her affidavit coupled with Mr. Pretorius's remarks suggest that the Commission's investigation was incomplete? In this paragraph Ms Singh goes on to state:

*"In the circumstances the Applicant would have preferred withdrawing the matter in toto in order to restore its investigative powers in terms of the Act. The Applicant is, however concerned that the provision of Section 67(2) may render the Respondents immune from further action should they do so. The Respondents were requested by the Commission to waive any rights in terms of Section 67(2), but they refused to do so. In the Commission's view the issue relating to the exception is an opportunistic attempt to render themselves immune from the provisions of the Act."*

What the Commission is saying is this. We concluded our investigation. We did not anticipate a new defence made out by Ansac until we received their plea. At that stage we considered our investigative powers were terminated. Ansac refuses to provide us with the relevant documentation because they say no case to impugn them has been pleaded. Had we known all this before we filed the complaint referral we might have used our investigative powers to require their production. At most this is an expression of regret with the benefit of hindsight. It is not an admission that their investigation was not completed.

The structure of Ms Singh's affidavit attached to the April complaint referral suggests that the Commission after receipt of a complaint (paragraph 5) undertook an investigation in terms of which they made "findings". Ms Singh in paragraph 6.1 for instance uses the language:

*"The Applicant investigated the complaint and found that…" (Our emphasis)*

She goes on in paragraph 9 to identify their legal conclusions in a paragraph headed contraventions of the Act. [11]

On a proper reading of this affidavit one comes to the conclusion that the Commission has prima facie -

1. Conducted an investigation;

11 See Record pages A 31 –33.

2. Come to a finding, which suggests that the investigation has been concluded for the purposes of section 50; and

3. Established the existence of a prohibited practice.

Section 50 must be read as a whole. The purpose of the Commission's investigation is to determine whether a prohibited practice has been established in which case they must refer the matter to the Tribunal or if not to issue a notice of non-referral in terms of section 50(b). Thus the completion of the investigation must be read conjunctively with these two subsequent steps - it informs a decision to refer or not to refer. Completion of the investigation does not mean that the Commission must be ready to go to trial with every document in its docket at the moment of referral. Nor does it mean that it must exhaustively investigate each anticipated line of defence. Indeed at the time of referral the respondent will not have been required to indicate its defence and the Commission may be in the dark. While the Commission has powers to elicit information[12] it cannot compel a party to reveal its defence. The first time it is confronted with that defence as a matter of procedure, unless a respondent voluntarily indicates it earlier, is when the respondent files its answering affidavit to the complaint referral – a post section 50 event. Placed in its proper context completion of the investigation means completion for the purposes of a decision to refer or not to refer.

Ansac concedes that the prohibited practice determination entails a subjective discretion. Although they contend that the completion of the investigation is an objective fact they do concede its subjective aspect.

Despite the language of the section a proper analysis of section 50 suggests that the determination of whether an investigation is complete is more subjective than objective in character. The completion of an investigation is inextricably bound up with the consideration of the existence of a prohibited practice. As many investigators would have as many different views as to completeness. Part of this assessment depends on the individual predilections of investigators, part on consideration of what one needs to establish as a matter of law in a given case. Indeed this case is illustrative of the latter. On Botash and the Commission's argument far less extensive evidence of post enactment activity would be necessary to establish a violation. Following such an approach this investigator would come to the conclusion that an investigation had been completed while an investigator who would share Ansac's view of the law would not.

This illustrates the dangers of this type of review of the Commission's powers under section 50. One would be second-guessing the Commission's exercise of its discretion before a matter even came to a hearing before the Tribunal. Setting the standard for what constitutes a completed investigation too high would mean that investigations would take an enormous amount of time to conclude which cannot be in the interests of either complainants or respondents who have a defence. Perversely it is only the respondent likely to be found to have contravened the Act who would benefit by a protracted investigation as they would enjoy the fruits of their market power that much longer. It would also serve as an inducement to opportunistic respondents to force the Commission into a preliminary enquiry into their case prior to the commencement of a hearing.[13]

12 See Part E of Chapter 5.

13 We do not want to overstate the policy concerns as the Act from 1 February 2001 has been amended so that section 50 (1) of the Competition Second Amendment Act, No. 39 of 2000 now reads: " At any time after

Our courts have recognised these dangers in reviewing the power of the Attorney General to prosecute in criminal cases.

As the authors of the Commentary on the Criminal Procedure Act observe:

> *"Courts accept the prerogative of the Attorney General to institute criminal proceedings on charges he deems proper, and are reluctant to interfere. This is no doubt desirable, since the Attorney General is vested with the power and discretion in this regard. He has in front of him facts and material which are not available to the court, or the defence."*[14]

The authors go on to cite authority for the proposition that without proof of mala fides or gross unreasonableness a court of law will not interfere with the discretion of the Attorney General.[15] Even if this approach is subject to criticism of being overly deferent to officialdom when viewed in the context of our more heightened sensitivity to administrative review since the adoption of the Constitution, the facts of this case do not suggest that even a court more animated by an expansive view of administrative rights than its forebears would come to the conclusion that this decision is reviewable.

This does not lead to unfairness for Ansac. The Commission's decisions to complete an investigation and to refer a complaint are merely acts preparatory to a hearing before the Tribunal. The respondent retains its rights to defend itself including through the filing of pleadings, the right to raise preliminary objections on points of law and a full right of audience before the Tribunal during its proceedings. In a fair contest if the Commission is unprepared or has a flawed case it will lose, but we cannot stop it from entering the contest because we are asked a priori to form an opinion that it is not ready to win.

Botash argued that we do not have powers to review the Commission in these circumstances because our powers are confined to our statute. In terms of section 27(1) (c)[16] the Tribunal may "….review any decision of the Competition Commission that may in terms of this Act be referred to it." The Act they point out makes no provision for us to review a decision of the Commission in terms of section 50. Ansac has relied on cases, which suggest that an administrative tribunal has a general power to consider issues of jurisdiction. We do not need to decide this point as we have approached the issue by first making the assumption that we have the review powers Ansac contends we have and then asking whether the Commission's decision is reviewable. Since our answer to that question is in the negative we do not need to go on to decide whether we have such powers.

---

initiating a complaint, the Competition Commission may refer the complaint to the Competition Tribunal." The amended section has removed both the prerequisites at issue in the present matter.

14 See Du Toit, De Jager, Paizes, Skeen and Van der Merwe, "*Commentary on the Criminal Procedure Act"*(Juta 1996) 1-4.

15 The case relied upon is Gillingham v Attorney General 1909 TS 572.

16 Section 27(1)(c) of the Competition Act as amended by the Competition Second Amendment Act, No 39 of 2000.

The objection to our jurisdiction to hear this complaint on the basis that the prerequisites of section 50 have not been established is accordingly dismissed.

**EXCEPTIONS**

We must now consider the various exceptions raised by Ansac.

Ansac argues that the case made out against it cannot extend beyond the ambit of the Commission's complaint referral. With this as its premise it goes on to argue that in the referral the Commission has based its case on the Ansac membership agreement and its agency agreement with CHC and since both these agreements predate the Act, which cannot be interpreted retrospectively to unsettle vested rights, the Commission's case must fail and cannot be resurrected by amendment.[17] Ansac describes the interveners' claim as being "parasitic" upon the complaint referral and if the latter is bad in law, the same fate must befall the interveners, even if a different construction is placed on the interveners' pleadings.

Ansac concede that if we find that the Commission, and of course by extension the interveners, are not bound by the parameters of the complaint referral and that some post enactment discretionary transactions other than the membership agreement and agency agreement could be inferred these would not be immunised by the presumption against retrospectivity. But here they add another bow to their quiver, for they argue as their fall back position that if such agreements are impugnable, they are not impugnable under section 4(1)(b). This is because section 4(1)(b) only impugns price fixing agreements not agreements between buyers and sellers. Ansac declines to identify the section of the Act under which they could be impugned, but since only section 4(1)(b) is relied on it does not need to traverse this.

Finally as the third leg to its objections it states that if post enactment transactions may be relied on then these transactions must be juristic acts and they must be pleaded with proper particularity. This it asserts the Commission and Botash have failed to do and the amendments have not cured this problem.

The Commission and Botash vehemently opposed all these criticisms. Whilst both concede the Act cannot be interpreted retroactively (in the sense that term has been understood in the case of National Director of Public Prosecutions v Carolus & Others 2000 (1) SA 1127 SCA) the ambit of retrospectivity is contested as well as the nature of the post enactment conduct required to establish a contravention of section 4(1)(b) and the Ansac reading of what section 4(1)(b) impugns. They further assert that Ansac has been provided with sufficient particularity to enable it to plead.

At the risk of over simplifying the respective approaches of the parties we would say that the Ansac analysis is premised on formal notions of contract and vested rights – that of the Commission and Botash on performance and effects.

We have decided that these issues would be more usefully decided after we have heard the evidence. The rationale for this conclusion is illustrated by the nature of the debate between the parties over the exception. For example on the retrospectivity point the parties have widely divergent views of what post enactment evidence suffices to establish a contravention. On this point as between Ansac and the Commission we have a continuum that ranges from the conclusion of a juristic act of price fixing, to the solicitation of an order. Absent proof of the nature of the act that took place post enactment and indeed

17 This argument is premised on paragraphs 6.1.1 , 7, 8 and 9 of Pearline Singh's affidavit attached to the Complaint Referral.

whether any are proved at all we see no useful purpose in making a determination now that can lead to imprecision and misinterpretation.

Similarly some of the other issues raised in the exception are also in our view more appropriately resolved once we have heard the evidence. Fundamental to all is the nature of the post enactment activity. We feel we need clarity on what these transactions are i.e. to consider the evidence before we can determine their legal significance. Important issues of law are involved here and we are reluctant to make a decision on the law prematurely based on speculation of what facts may finally be established at the hearing.[18]

Courts of law retain the discretion to order an exception to stand over to trial on the basis of convenience. In Herbstein and Van Winsen, two instances of when a court may exercise such a discretion are described.[19] One is where the exception raises a point of law that may not arise at trial and thus proves academic and the second when a proper decision on the exception is bound up in the merits of the dispute. Both these features characterise aspects of the present exception and we therefore leave the following objections of Ansac to stand over for a decision at the hearing of this matter viz:

1. Whether the transactions sought to be impugned pre-date the enactment of the statute – the retrospectivity argument

2. If post enactment transactions are impugnable they are nevertheless not covered by section 4(1)(b), because they are not acts of price fixing

3. If post enactment transaction are impugnable they must be juristic acts

**Exception Issues to be determined**

The remaining issues in the exception may conveniently be decided at this stage and we proceed to deal with them below.

1. The Commission and Botash are bound by the terms of the referral

Ansac argues that the terms of the referral determine the content and ambit of the complaint upon which the Tribunal may pronounce. These terms are those to be found in the affidavit of Ms Singh annexed to the complaint referral dated 14 April 2000. Ansac argues that Section 52(4) of the Act empowers the Tribunal to make, at the conclusion of the hearing, any order permitted in terms of Chapter 6. In Chapter 6 we find section 60 that sets out the orders the Tribunal may make in relation to a prohibited practice. Ansac then argues that the prohibited practice referred to in section 60 can only be the prohibited practice that is the subject of a referral in terms of section 50. It concludes:

18 This has been our approach to this litigation from the outset and the reason for us at the first pre-hearing trying to get the parties to reach an agreement on the facts, so that points of law were not argued in abstraction.

19 See Herbstein and Van Winsen , "The Civil Practice of the Supreme Court of South Africa", 4th Edition (Juta 1997) by L.Van Winsen , A.Cilliers and C.Loots and edited by M.Dendy , pg 489.

*"It follows, it is submitted, that the Tribunal can only make a decision upon the complaint referred to it and within the compass of the terms of that referral."*

There is nothing in the language of any of the sections cited that supports this proposition. The linkage between section 60 and section 50 which Ansac suggests is not stated expressly nor is there anything to suggest it should be inferred. The fact that both refer to the concept of prohibited practice is hardly remarkable.

Ansac next seek to place reliance on the fact that the Tribunal is obliged to publish the fact of the referral in the Government Gazette in terms of section 51(4). It is common cause that the purpose of this provision is to alert third parties to the impending proceedings. Ansac states that it is crucial that the Tribunal pronounce only on the complaint of which notice is given to the world.

Once again neither the logic nor language of the Act justifies such a conclusion. The purpose of the notice is to alert third parties to the broad parameters of a dispute so they can make further enquires if they so wish. The choice of language in the section is itself instructive. The notice must give details as to the "nature" not the "specifics" of the complaint. The notion that this notice defines the parameters of the dispute is absurd and it does not warrant much further elucidation to see how the approach that Ansac commends can lead to artificial objections being taken by opportunistic respondents on behalf of unnamed and supposedly disenfranchised third parties leading to the unhealthy elevation of form over substance.

We do not understand Ansac to be saying a complaint referral can never be amended (indeed this would mean that the Tribunal Rule that permits amendments is ultra vires the Act) but rather that the extent of the amendment may make it impermissible. Yet the amendments in this case seek to provide specificity and despite the passionate protests of Ansac, neither the Commission nor Botash have re-invented their original case. The foundations remain the same viz. the Ansac members' agreement and the agency agreement - it is further specificity about the post enactment transactions, which have now been supplied. The case has always been premised on the post enactment period. In the CC1 attached to the Commission's complaint referral the period during which the respondent is alleged to have contravened the Competition Act is stated as being from 1/ 09/99 to 14 April 1999.[20]

The amendments occasion no prejudice to Ansac as the hearing has not commenced and it is entitled to file an amended answer if it chooses to. The suggestion that the process should commence de novo is absurd.

2. Have the transactions been pleaded with sufficient particularity

Ansac complains that the issues in this case have been framed:

*"so loosely that the respondents have been unable to determine what case they have to meet. …The applicants for their part have exploited the porous state of the pleadings to shift their*

20 See Record page A 27.

*ground and fish for information and the result has been uncertainty on the issues and an attempt at stating a case that has proved wholly abortive."* [21]

They go on to complain that the amendments have done nothing to cure the situation.
Ansac argued that the kind of particularity required of the Complaint referral and, by analogy, the interveners' particulars is one that meets the requirements for a founding affidavit in application proceedings in the High Court. In several High Court cases to which we were referred the point is made that, in application proceedings, since the affidavit replaces essential evidence which would otherwise be led at trial, it must make out this evidence. [22] At the other end of the spectrum are particulars of claim in High Court trial proceedings where pleadings are not accompanied by affidavits and are characteristically sparse and terse. Thus High Court Rule 18(4), which provides for these particulars of claim states:

*"Every pleading shall contain a clear and concise statement of the material facts on which the pleader relies for his claim, defence or answer to any pleading, as the case may be, with sufficient particularity to enable the opposite party to reply thereto." ( Our emphasis)*

In contrast Rule 6 of the High Court rules which regulates the requirements for applications omits the word material and states in Rule 6(1):

*"…every application shall be brought on notice of motion supported by an "affidavit as to the facts upon which the Ansac relies for relief." ( Our emphasis)*

Our Tribunal rule 28(1) which regulates interim relief proceedings echoes this language and states:

*"28(1) A claimant may initiate an interim relief proceeding in terms of section 59 by filing a Notice of Motion in Form CT6, and supporting affidavit setting out the facts on which the application is based."*

In this context we can view Tribunal Rule 17 which provides for the form of a complaint referral. It states:

*"17(2) Subject to Rule 26(1), a Complaint Referral must be supported by an affidavit setting out –*

*(a) a detailed statement of the particulars of the complaint; and*

*(b) the material facts relevant to the complaint and relied on by the person making the referral."*

In one respect Rule 17 is similar to High Court Rule 18 (the particulars of claim rule) in that it requires that only "material" facts be set out, but it differs in another in that more analogous to application proceedings it requires an affidavit. The fact that this is more than an accidental choice of language is

21 Heads of Argument paragraph 25.2.3

22 See for instance Radebe v Eastern Transvaal Development Board, 1988 (2) SA 785, Swissborough Diamond Mines v Government of the RSA 1999 (2) SA 279

borne out by reference to the Tribunal's interim relief rule where as we saw the word 'material' does not appear and the language follows that of Rule 6 of the High Court Rules( the application rule). Thus while interim relief applications mirror the requirements for a High Court application, Rule 17 does not. It might be argued that Ansac is still correct because in contrast to the "material facts" of 17(2)(b), Rule 17(2)(a) requires a "detailed statement" of the particulars of the complaint.

However, reading Rule 17(2) as a whole suggests that what is required is that the prohibited practice be described with precision, but that its factual matrix can be averred with less specificity. Thus I need to know in detail what I am being "charged" with but I am not entitled to know in the referral all the facts which may be led at the hearing. Granted at times these distinctions may blur, but this problem is not pertinent to this case, because as we set out below, the amendments have provided sufficient precision to the complaint referral and particulars of claim to enable Ansac to appreciate the case against it.

Apart from the language of rule 17 the complaint referral's function must be understood in the context of the Rules and the Act. A complaint referral eventually becomes the subject of a hearing before the Tribunal. It is here where the Tribunal has unique procedural powers, which differ vastly from those of a civil court in adversarial civil proceedings. The problem for Ansac is that it has relied on civil court decisions in application proceedings as authority for its criticism of the present pleadings ignoring not only the institutional differences between High Courts and the Tribunal but also the different status that pleadings enjoy in each. We consider these differences below.

Some of the institutional differences between a civil court in adversarial proceedings and the Tribunal are-

The Tribunal is entitled to:

1. Conduct its proceedings inquisitorially (Section 52(2)(b))[23]

2. Call witnesses itself and require documents to be produced (Section 54)

3. At a pre-hearing to require the Commission to investigate specific issues or obtain certain evidence. (Rule 24(1)(b))

This leads us on immediately to the second consideration, for if the Tribunal is entitled to enter the fray in this way, unlike its civil court counterpart, it suggests that the function of pleadings to determine the parameters of a dispute, as we understand them in civil actions is diminished. The policy rationale behind this is that prohibited practices do not just have private effects but also affect the broader public. The Tribunal as the guardian of the purposes of the Act cannot be constrained by the ambit of pleadings to the extent would a civil court in adversarial proceedings. The legislature did not intend to make the Tribunal a prisoner confined by the walls of opposing lawyers' pleadings. We must bear in mind that the primary purpose of pleadings is to define the issues between the parties so that each knows what case it must be prepared to meet and secondly so that the court is in a position to identify the issues on which it must make its decision.[24] In the Tribunal's proceedings pleadings serve this function as well, but their status is less elevated given the inquisitorial nature of the Tribunal and the public character of complaint procedures we alluded to above. Consequently our approach to pleadings will be more flexible than a civil court's. Furthermore in our proceedings the defining of issues is not the sole preserve of the pleadings and

23 section 52(2)(b) of the Competition Act as amended by the Competition Second Amendment Act, No 39 of 2000, previously section 52(2)(a).

24 See L.T.C.Harms, "Civil Procedure in the Supreme Court", (Butterworths, September 2000) pg 263

this function can be supplemented by a pre-hearing conference. In terms of Rule 22(1)(c)[25] one of the functions of the assigned member who presides at a pre-hearing conference is to:

25 Tribunal Rules published on 1 February 2001 in terms of the Competition Act as amended by the Competition Second Amendment Act.

*"Give directions in respect of :*

*(iii) clarifying and simplifying issues;*
*(iv) obtaining admissions of particular facts or documents."*

On the other hand the Tribunal must ensure fairness and compliance with the requirements of natural justice. This is an obligation that does not extend merely to the stage of pleadings but infects the entire process before the Tribunal. This means that the Tribunal must control its proceedings in such a manner to ensure that a respondent can rebut prejudicial allegations to it. To the extent that a respondent wants issues further clarified before a hearing it too can rely on this procedure and it need not have to resort to the procedural formalities that one would utilize in a High Court.

We must now apply this analysis to the facts of this case. We were sympathetic to Ansac's complaint that the Commission's complaint referral and the interveners' particulars of claim lacked particularity about the effects or performance that was being alleged post enactment. However in our view the parties' respective amendments have now cured this.

In the Commission's case these amendments:

- elaborate on the respective relationships of Ansac and CHC; and

- in an alternative formulation, to be found in the new paragraph 9.2, list the customers with whom it is alleged that Ansac has framework agreements and detail the manner in which these agreements were given effect to (See paragraphs 9.2.1.2 and 9.2.2 – 9.2.5)

Botash in its amended particulars also:

- Clarifies the respective roles of Ansac and CHC (See paragraph 13); and

- Has inserted a new section in its particulars under the heading "Ansac's economic activities in South Africa" listing Ansac's customers in South Africa and specifying the acts that it alleges took place or alternatively had an economic effect within South Africa during the relevant period viz. 1 September 1999- April 2000.

In conclusion on this issue we find that:

- Rule 17 must be understood in the context of the procedural framework of the Act, which requires less formality in relation to pleadings than in adversarial civil proceedings because of the unique powers of the Tribunal and the fact that there are other procedural mechanisms that co-exist with pleadings in our Rules to achieve the objectives of defining the issues. On a textual analysis Rule 17 does not require the same elaboration in pleadings as one would expect of an application in the High Court.

- In the light of this analysis the Commission's amended referral and the interveners' amended particulars of claim contain sufficient particularity for the purpose of Rule 17.

**per N. Manoim**

**concurring: D. Terblanche and D Lewis**

**DOES SECTION 4(1)(B) ALLOW FOR AN EFFICIENCY DEFENCE?**

At the pre-hearing on the 24 January 2001 we asked the parties to prepare legal argument on this point, as the conclusion would determine whether this evidence could be led at the hearing. Although the issue did not form part of the application we deemed it convenient to consider the matter now since we were considering the other preliminary legal points.

Section 4 provides

(4)(1) An agreement between, or concerted practice by, firms or a decision by an association of firms, is prohibited if

(a) it is between parties in a horizontal relationship and it has the effect of substantially preventing or lessening competition in a market, unless a party to the agreement, concerted practice, or decision can prove that any technological, efficiency or other pro-competitive, gain resulting from it outweighs that effect; or

*(b) it involves any of the following restrictive horizontal practices:*

(i) directly or indirectly fixing a purchase or selling price or any other trading condition;

*(ii) dividing markets by allocating customers, suppliers, territories, or specific types of goods or services; or*

*(iii) collusive tendering.*[26]

ANSAC contends that even if a transgression of Section 4(1)(b) were to be established, it is entitled to raise an efficiency defence, it is entitled, in other words, to show, in the phrase ubiquitously present in the statute, that the offending agreement produces 'technological, efficiency, or other pro-competitive gain resulting from it that outweighs that effect'. The Commission and BOTASH argue that Section 4(1)(b) permits of no such defense – in the language of US anti-trust, offences specified in Section 4(1)(b) are prohibited *per se.*

We have decided to hear this matter now, because although distinct in character from the *in limine* points otherwise under consideration in the present hearings, the Tribunal's finding on the nature of Section 4(1)(b) will, like the other points at issue here, have an important bearing on the nature of the future hearings in this matter. A finding in favour of the Commission and the interveners presupposes that if, indeed, we conclude that their opponents have engaged in the conduct specified in 4(1)(b) – that is, if they have fixed prices or any other trading condition, divided markets or tendered collusively – then the contravention is established and evidence concerned to demonstrate any pro-competitive gains said to accrue as a result of the transgression will not be relevant. If, on the other hand, we accept the view contended for by ANSAC, then, even in the event that we find a price fixing and/or market sharing arrangement as alleged by the Commission and BOTASH, ANSAC will still be entitled to put up evidence purporting to show that the consequences of the anti-competitive practice are countervailed by efficiency gains for which it is responsible.

---

26 Note that the recent Competition Amendment Act clears up an obvious area of ambiguity in this section by amending 4(1) to read 'An agreement between or concerted practice by, firms, or a decision by an association of firms, is prohibited if it is between parties in a horizontal relationship and if-' thus clarifying that both sub-clauses (a) and (b) refer to agreements between parties in a horizontal relationship.

ANSAC has set itself a considerable task. Section 4 of the Act identifies two classes of agreement between firms both of which it prohibits. The first class of 'horizontal restrictive practice' is identified in Section 4(1)(a). This section does not detail the content of the agreements that it proscribes – any agreement between parties in a horizontal relationship, without regard to its specific content, is put at risk by this section. However, it places an onus on those who would seek to impugn such an agreement to demonstrate that it 'has the effect of substantially preventing or lessening competition in a market' and, then, even if this onus is successfully discharged, the parties to the agreement are entitled to invoke, in their defence, 'any technological, efficiency or other pro-competitive gain ' that outweighs the agreement's negative impact on competition.

Section 4(1)(b), on the other hand, specifically details the very content of the agreements that it seeks to proscribe these being agreements to fix price or any other trading condition, agreements to divide markets, and collusive tendering. But this is all that is specified. In plain contrast with the requirements of Section 4(1)(a), those who set themselves the task of impugning agreements thus described in Section 4(1)(b) do not have to establish any deleterious impact on competition. All that has to be established is the existence of an agreement embodying the features detailed in Section 4(1)(b) (i)-(iii). Quite plainly the Act requires no showing other than that the agreement in question conforms to the content specified in Section 4(1)(b)(i)-(iii).

In other words, Sections 4(1)(a) and 4(1)(b) are distinguished from one another by the requirement contained in the former to undertake an assessment of the balance between the anti- and pro-competitive consequences of the agreement. By arguing that 4(1)(b) allows an efficiency defense – which of course implies a requirement to show the anti-competitive consequences without which there would be nothing against which to balance the pro-competitive gains – ANSAC effectively argues for obliterating the distinction between the two sections of the Act.

ANSAC contends for a 'purposive' interpretation of the Act. Firstly, even if we were, in this instance, to concede the necessity for a 'purposive' interpretation, it is by no means clear that an outright prohibition of price fixing and market allocation by competitors conflicts with the purpose of the Act. These practices are condemned in unusually uncompromising terms precisely because legions of legal scholars and economists as well as ordinary consumers have found them to be egregious attacks on competition which, as a glance at the head note to Section 2 will reveal, the Act purports to 'promote and maintain'.

Secondly, Mr. Unterhalter for Botash, following Schutz JA in Standard Bank and Melunsky AJA in SA Raisins, both judgments with direct reference to the Competition Act, argues that, while our courts have indeed endorsed a purposive approach to statutory interpretation, it is an approach manifestly reserved for circumstances in which the statute under question is ambiguous – where a reading of the legislation imparts a clear and unambiguous meaning it is not for the Tribunal or, for that other matter, any other court, to construct an alternative meaning, one putatively designed to better accommodate the statute's purpose. Section 4(1)(b) of the Competition Act unambiguously purports to prohibit, without recourse to further investigation, three categories of horizontal agreement. All other species of horizontal agreement only fall to be prohibited on a showing by the claimant that the agreement in question lessens or prevents competition and, then, only provided that the parties to the agreement cannot adduce evidence of pro-competitive gains that outweigh the demonstrated diminution of competition. There is no ambiguity and, whether or not we deem this wise policy, it is not within our power to re-make the law.[27]

27 With due respect to the learned authorities upon which Mr. Unterhalter relies, the statute is, in this instance, so devoid of ambiguity that he may have rested his case on Alice's celebrated rejoinder to Humpty Dumpty:

We are content to let the matter rest there. However, Mr. Brassey, for ANSAC, insists, in effect, that this would sanction an absurdity, that '(Section 4(1)(b)) plainly cannot hit every transaction that might conceivably fall within its ambit. If it did every sale would be prohibited, since sales always fix a price; so would every distributorship agreement, since they always create sales turfs and thus allocate markets; likewise every company created by several shareholders, every partnership and every joint venture; and so, indeed, would every other contract, since every contract regulates trading conditions'. (Heads of Argument Para 31.1). But these are, of course, proverbial straw men: a price fixed in a 'sale' is done as part of a vertical agreement and is not within the ambit of 4(1)(b); a distributorship, too, is a vertical arrangement between the producer of a good and service and the (downstream)'on-seller' or the (upstream) provider of distribution services.[28] We repeat: only horizontal agreements conforming to specified characteristics are hit by Section 4(1)(b). Indeed Mr. Brassey's straw men serve to emphasise the narrowness of Section 4(1)(b)'s focus, rather than, as he clearly intended, the broad sweep of its ambit.

ANSAC argues that US and EU courts have found it necessary to place a flexible interpretation on what, from a literal reading of their respective statutes, may 'hit' an inappropriately broad range of horizontal agreements. But, even were we to accept this interpretation of US and European experience, it is not clear how this avails ANSAC. This authority does not enable us, in the face of legislative clarity, to indulge gratuitously in an effective redrafting of the statute. Nor do we accept the implicit analogy drawn between the South African statute and those of the US and EU. Certainly, Section 1 of the Sherman Act is both terse and immensely broad ranging, accounting for Judge Brandeis' oft-cited concern that, on a literal interpretation, legitimate commerce may find itself impugned by the anti-trust statute. However, similar concerns do not extend to the Competition Act that is elaborately detailed and that, at least on this matter of horizontal agreements, admits of no ambiguity.

Nor, even if we were empowered to do so, would we lightly tread the path chosen by the US courts in this area. Our reading of the rather complex standard applied by the US courts is that where the 'quick look' contended for by ANSAC reveals the existence of a price fixing or market allocating restraint then this would be condemned as *per se* illegal, that is, the complainant would not have to establish a diminution of competition and the perpetrators of the restraint would not be entitled to invoke an efficiency defense. It appears, we agree, that the US courts have permitted occasional departures from this standard. This degree of judicial intervention in law making may be the legitimate and inevitable consequence of a statute that is at once extremely broad in its language and that admits of no formal exemptions. It does not, however, with all its attendant uncertainties, commend itself to a setting where the law is both focused in its concerns and where it is permits, again on clearly elaborated criteria, application for exemption. It is indeed conceivable that, in those few cases where the US courts appear to have relaxed their hostility to price fixing and market allocation agreements, the parties to the agreement in question would have found ground for exemption in the South African legislation.

Mr. Unterhalter has described Ansac's various constructions around the interpretation of Section 4(1)(b) as 'torturous'. We concur but conclude that the victim has not revealed any deeply hidden secrets. There are none to be revealed – in the language of US anti-trust jurisprudence, a 'quick look' at the 'facial' expression of Section 4(1)(b) reveals all.

---

"When I use a word", Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean – neither more nor less.'
"The question is", said Alice, "whether you can make words mean so many different things." (Lewis Carroll 'Through the Looking Glass' Macmillan, 1980, p113)

28 A vertical agreement may of course be used to consolidate a horizontal arrangement. However, in that case it is the horizontal dimension, if it includes price fixing or market allocation, that falls foul of Section 4(1)(b) and not the vertical dimension.

**per D. Lewis**
**concurring: N. Manoim and D. Terblanche**

**CONCLUSION**

We find that the objection to the referral based on section 50 of the Act fails. The exception to the Complaint referral and the particulars of the intervener on the basis that they provide insufficient particularity also fails. We further find that the Commission is entitled to amend its complaint referral and Botash its particulars of complaint. We find that the objection that the Commission and Botash are confined to the terms of the original complaint referral are unfounded on the facts of the present case.

The remaining issues raised in the exception have not been decided and are left to the hearing for determination. For the sake of clarity we set out these issues again below:

1. Whether the transactions sought to be impugned pre-date the enactment of the statute – the retrospectivity argument

2. If post enactment transactions are impugnable they are nevertheless not covered by section 4(1)(b)

3. If post enactment transaction are impugnable they must be juristic acts

Ansac is required to file its answer, if any to the Complaint referral as amended, and the interveners' amended particulars of claim, within 10 business days of this decision. Ansac's failure to file its answer within the time period originally determined in our order dated 14 December 2000 is condoned.

On the argument we requested on section 4(1)(b) we find that evidence concerning any technological, efficiency, or other pro-competitive gain that might be admissible in terms of section 4(1)(a) is inadmissible in terms of section 4(1)(b).

Although the objection has been unsuccessful on the issues we have decided thus far, the prospect remains that the Ansac may be successful on the outstanding issues of the exception and accordingly the costs of this application as between Ansac and Botash are reserved for the hearing.

_____ 27 March 2001

**N. Manoim** **Date**

**Concurring**: D. Lewis and D. Terblanche.

**Case No: 78/LM/Jul00**

**In the large merger between:**

**JD Group Limited**

and

**Ellerine Holdings Limited**

**Reasons for Competition Tribunal's Decision**

---

## 1. Prohibition

We prohibit the transaction between the JD Group Limited and Ellerines Holdings. The reasons for our decision are set out below.

## 2. The Transaction

This transaction involves the acquisition of control of Ellerines Holdings (EH) by the JD Group Limited (JD). This will entail JD acquiring the entire issued share capital in, and loan accounts of, all the underlying subsidiary companies of Ellerine Holdings including trademarks. The parties have agreed on an exchange ratio of 1 JD share for every 1,5 EH shares. This exchange will immediately make EH the largest shareholder – approximately 30,6% - in the newly constituted JD. However EH has undertaken to immediately unbundle its shareholding in JD, that is to distribute its interest in JD to its large range of underlying shareholders. Subsequent to this unbundling JD's shares will be held by a diversified range of shareholders – there will be no single controlling bloc of shareholders.

This is no ordinary transaction. It is the merging of two of South Africa's best known firms whose various trading brands are, it is no exaggeration to claim, household names. Literally millions of South Africans will, at one time or another, have entered an Ellerines or a Bradlows or a Russels or a Joshua Doore store. Few can have failed to notice the ubiquitous advertising campaigns of the two groups whether on film, television, radio or in the printed media. And, certainly a more important and lasting

experience than any of the aforementioned, a vast number of South Africans first received credit when purchasing furniture or household appliances from one of the stores in these two groups.

Nor, despite their vast size, are Ellerines and the JD Group faceless corporations led by professional managers on behalf of passive shareholders. Both are, to this day, led by their respective founders, who number as two of the country's more innovative entrepreneurs.

Mr. Eric Ellerine entered the furniture business in 1950 when, at 16 years of age, he opened his first store in Cyrildene, Johannesburg. Legend has it that his first sale was a credit sale. From these small beginnings, Ellerines has developed into a major force in South African retailing. Remarkable to record in these days of growth by acquisition, Ellerines' growth is almost entirely organic. The group comprises some 489 stores grouped into five store brands, of which the Ellerines brand itself, comprising some 218 stores, is the largest. Although several stores are based in neighbouring countries, Ellerines remains, overwhelmingly, a South African company. It is also a major source of credit with a debtors' book of little under R2 billion comprising the accounts of some of South Africa's poorest consumers, many of whom do not even have access to a bank account.

Mr. David Sussman began his working life as an assistant accountant in Eric Ellerine's head office. He left Ellerines in 1983. The rise of Sussman's JD Group is even more meteoric than that of his mentor. A mere 15 years ago Sussman controlled two Price 'n Pride outlets in Johannesburg. At present the JD Group comprises 678 stores organized into 5 different brands. The JD Group, in contrast with Ellerines, has relied for its growth on mergers and acquisitions. However, the JD Group's success is deeply rooted in its innovative trading practices, many adapted from the role model provided by the Ellerines' experience, but also characterized by the introduction of sophisticated technology and state of the art business practices. The JD Group has recently spread its wings into Europe with the acquisition of a chain of Polish furniture and appliance stores.

The significance of this transaction from a competition perspective should not be underestimated. In contrast with many transactions that come before this Tribunal this is not simply a case of the market leader taking over its fading opposition. What we rather have here are two dynamic firms more than capable of withstanding the competitive challenges that face them. Mr. Sussman himself is at pains to distinguish this transaction from previous deals in which he bought up and rescued ailing companies – Ellerines is anything but an ailing company.

However the real competition significance of this transaction is to be found in the direct links between the parties and South African consumers. An anti-trust merger evaluation is always primarily concerned with an assessment of the impact of the transaction in question on consumers. However, many mergers involve firms producing arcane intermediate products with the final consumer located several links lower in the production chain. In these instances the consumers directly affected is often themselves well resourced downstream producers capable of mounting a sophisticated response to a merger that it deems threatening to their commercial interests.

In this case however the parties to the transaction are the final link with the consumers, and, at that, the poorest, least powerful of South African consumers. In other words, the interests directly affected by this merger are represented by millions of atomized, disorganized individuals incapable of defending

their economic interests except to the extent that they are able to exercise a preference for one retail outlet over another. This evaluation will seek to assess whether the transaction has the potential to increase the power of the parties over the consumers that they serve and who are the source of their prosperity.

## 3. The Retail Furniture Trade: pertinent trends and features

### *3.1 Mergers and Acquisitions*

There is a recent history of mergers and consolidation in the retail furniture industry and the consequent emergence of several large groups. In particular the growth of the JD Group, Profurn and Relyant has been driven by acquisition of existing chains. Ellerines' growth, on the other hand, is almost entirely organic. The composition and strategic direction of each of the large groups is briefly profiled.

**The JD Group**

Today's JD group has modest origins. Founder David Sussman commenced in 1983 with two Price 'n Pride stores. In 1986 he purchased the larger, then troubled, Joshua Doore chain from the Russell's grouping. In 1988 the firm acquired World and Bradlows from W&A, and the Score Furnishers chain. Then in 1993 JD acquired the Rusfurn Group.

**The current composition of the JD Group is as follows:**

| Name of Store | Number of Stores | Age of Brand | Target Market |
|---|---|---|---|
| Bradlows | 87(89)* | est 1900 | LSM 5-8 |
| Russels | 173(183) | est 1943 | LSM 4-7 |
| Joshua Doore | 125(133) | est 1973 | LSM 4-7 |
| Giddy's Electrical Express | 90(95) | est 1958 | LSM 4-7 |
| Price'n Pride | 203(159)** | est 1983 | LSM 3-5 |
| Score | | est 1977 | LSM 3-5 |

**Total number of Stores: 678(659)**

Notes

- * These figures are based on the totals in the 1999 Annual Report. The figures in brackets are those given to the Commission in May 2000 and reflect the changes since 1999.
- ** The store figures for Score and Price 'n Pride brands are combined.

**Relyant Retail**

The Relyant Group was formed in 1998 as a result of a merger between the former Beares and Amrel groups. In March this year it acquired Appliance City. It is currently composed as follows:

| Name of Store | Number Stores | Age of Brand | Target Market |
|---|---|---|---|
| Geen and Richards | 60(58) ** | 63 | LSM(Upper 6 –lower8 |
| Beares | 169(203) | 70 | LSM 6 |
| Furniture City | 17(13) | 20* | LSM(Middle 5-Upper 7) |
| Lubners | 98(93) | 36 | LSM(5) |
| Fairdeal | 93(75) | 40 | LSM(Lower 3 - middle5) |
| Savells | 87(156) | 40 | LSM( Upper 3 – middle 4) |

**The total number of stores 524 (598)**

* Furniture City was Amsterdam Furniture Store, which was started in 1963 and was then changed to its current name in 1980

**The first figure is from the Groups 1999 Annual Report. The figures in brackets are the 1998 figures provided for comparison.

The Relyant group's 1999 Annual Report specifically indicates that it has introduced strict credit granting criteria because at the time of the Amrel/ Beares merger the debtors' book was "significantly in arrear". The emphasis placed on credit management and new systems and the fact that staff performance will be measured against collection management indicates that Relyant's stores are likely to be less likely to grant credit to low income consumers than they were in the past. A 1999 report on the furniture retail trade by a stockbroking firm, Fleming Martin, says Beares and Savells (the latter being in the LSM3-4 category) have been deliberately contracting sales growth in order to improve the quality of their debtors' book. The closure of stores in these brands since 1998 is evidence of this. In addition the group has a higher debt equity ratio, 0.7 than analysts consider the desirable norm for this industry between 0.3 - 0.5. (This ratio is significantly higher than that of JD and Ellerines.)

Relyant has also been positioning its brands within their chosen markets reducing the number of their brands from 12 to 6.Each brand is being partnered by a top advertising agency. Relyant segments the markets at the lower end to a greater extent than the merging parties do. For instance the Annual Financial statements reflect that Savells is upper 3 middle 4, whilst Fairdeal is lower 4 and middle 5.

**Profurn**

The Profurn Group originates in a turnaround of the then Supreme Holdings which in 1992 had been in provisional liquidation. In 1997 the firm acquired Cape based Freedom Furniture which at the time had 12 stores. In 1998 it acquired the Morkels chain and, in 1999, the cash retailer, Hi Fi Corp.

| **Name of Store** | **Number of Stores** | **Age of Brand** | **Target Market** |
|---|---|---|---|
| Morkels | 150 | 50 years | LSM 5-8 |
| Barnett's | 71 | 103 years | LSM 3-5 |
| Protea Furnishers | 105 | 40 years | LSM 3-5 |
| Freedom | 33 | 5 years | LSM 3-5 |

**The total of number of stores in South Africa at the end of 1999 was 359.**

Profurn is engaged in aggressive expansion outside of South Africa. It has expanded into North Africa and Australia and intends opening up 43 stores outside of South Africa this year (Business Report 28/7/2000). The Financial Mail points out that although 2/3rds of its turnover is from SA it accounts for only 53% of its operating profits (Financial Mail Fox Column 12 May 2000). For this reason, overseas investment is said to be a major element of this group's expansion strategy.

The Fleming Martin report observes that " Profurn is growing from a much smaller SA store base (309) than its competitors….." The competitors mentioned are JD and Ellerines.

Profurn, like Relyant, also makes a point of how its debtors' book is improving due to strict credit granting and bad debt write off policies. According to the 1999 Annual report, "deposit rates now average 20% on credit deals" and they go onto state that they are "improving the quality of debtors whilst also enhancing cash flow."

**Ellerine Holdings**

Ellerine's, currently celebrating its 50$^{th}$ anniversary, owes its current size to organic growth rather than acquisition which distinguishes it from the three other listed chains referred to above.

| Name of Store | Number of Stores | Age of Brand | Target Market |
|---|---|---|---|
| FurnCity | 53(52)* | 20 years | LSM 4-7 |
| Ellerines | 218(254) | 50 years | LSM 3-5 |
| Oxford | 52(62) | 30 year | LSM 3-5 |
| Town Talk | 114(116) | 28 years | LSM 3-5 |
| Royal | 52(56) | 25 years | LSM 3-5 |

Total number of stores 489

Notes
* The figures supplied by the parties to the Commission in May 2000. The figures in brackets are taken from the 1999 Annual Report.

**Great Universal Stores**

This U.K based group owns Lewis stores in South Africa and appliance group, Best Electric, which it formed in 1998. It also acquired furniture retailer Dan Hands but has since re-branded this small chain.

| Name of Store | Number of Stores | Age of Brand * | Target Market |
|---|---|---|---|
| Lewis | 430 | approx.50-60 years | LSM4-6 |
| Best Electric | 30 | 2 years | LSM4-6 |

**Total number of stores 460**

An analysis of the groups profiled above reveals the following trends-

- Most have already diversified across LSM categories ranging from LSM 3 – 8.
- In diversifying across these LSM categories they have developed different brands for each category rather than aiming a brand across all categories
- There is a trend towards specialized appliance discounters in each group. Typically these brands cut across LSM segments. They are further distinguished from the traditional furniture and appliance stores serving the lower LSM categories in their larger cash to credit sales ratio. Profurn says its acquisition of HI FI Corp would increase its cash sales to credit from 25% to 40 %. ( Financial Mail Top Companies 2000) These specialized appliance brands appear to operate primarily as discounters and tend to be based in the larger metropolitan areas. The establishment of specialized bedding stores is also a discernible recent trend.
- The brands in the furniture stores are all well established, some over 100 years old. Possibly because of the importance of brand recognition, the national chains tend to prefer (admittedly with some exceptions like Ellerine's FurnCity ) acquiring established brands rather than starting new ones. Interestingly those businesses which tend to have the highest proportion of credit to cash as part of their sales mix tend to be long established brands. FurnCity's lack of success is thought to be due to lack of brand awareness.[29] The due diligence reflects that the Ellerine's brand, the older brand, is better known in the market place than JD's Score and Price'n Pride brands.
- The groups have portfolios of several hundred stores and are nationally dispersed. The annual statements reveal that the opening and closing of stores is a continual process and seems pivotal to the proper management and competitive strategies of the groups.

29 Ellerine Holdings Board Minutes, 2 May 2000

- Innovations by one competitor are matched particularly quickly by the others. Observe how all have moved into cell phone distribution, financial services and insurance packages.

- There is an observed tendency for the groups to contract with manufacturers for the production of exclusive products. See, by way of example, the Relyant Annual Report which refers to time spent with top suppliers to focus on "better value … *exclusivity*…". Both JD and Ellerines have similar arrangements with certain suppliers. This makes intra-brand pricing comparison more difficult for the consumer as we discuss elsewhere.

- The major groups are all expanding offshore either elsewhere in Africa or further afield (in Poland as with JD, or Australia as with Profurn)

- There is evidence of an increasing centralization of strategy and operations in the group or divisional head offices. Branch mangers are given less discretion and are more rule-bound particularly in decisions to grant credit and set prices. Advertising (and hence pricing) is centrally conducted.

- Increasingly sophisticated IT systems to control costs, inventory and to manage debtors are being installed. This naturally leads to centralized management referred to above.

- The ability to squeeze suppliers for discounts, volume rebates and extension of payment terms. Correspondence with suppliers given to us by the parties indicates that JD with its size and volumes is considerably more successful at this than has been Ellerines. Since manufacturers are presumably less tied to LSM segments for their products than are their retailer clients a group with brands across a manufacture ranges has more negotiating leverage than a retailer confined to a smaller extent of the LSM spectrum.[30]

- The groups tend to warehouse stock regionally so that individual stores do not have to be too large but nevertheless ensuring that the stores do not run short of stock. To quote Profurn MD Gavin Walker: " It is a mistake to have too much stock - funding is expensive – but no less problematic to be under stocked."(Financial Mail Top Companies 2000)

- The groups are listed on the stock exchange (Lewis' parent is listed in the UK) and for this reason can fund acquisitions more easily (the proposed merger in this case involves a share swop with no cash component) and can raise capital more cheaply through rights issues.

- The groups appear generally concerned at too great an exposure at the lowest end of the market. Some like Relyant and Profurn are, as already observed, tightening up their credit granting policies. All the groups, as is borne out by comments in their annual financial statements, are concerned about the spending potential of consumers in this market as the retail spend on furniture and appliances is being eroded by competing claims from gambling and lottery, and cell phones. Furthermore the aids pandemic is likely to have a disproportionately large impact on these consumers and both JD and Ellerines have undertaken studies into its impact on their business.

30 From an unpublished draft report prepared by Fleming Martin it appears that JD's 'accounts payable days' (that is on stock purchased) is approximately 150 days, whereas Ellerines is slightly under 80 days. Profurn and Relyant are at approximately the Ellerines level. This is supported by data from the due diligence which also reflects that JD has negotiated longer 'accounts payable' periods than Ellerines.

### *3.2 Brand Diversity*

The large chains are, as already noted, characterized by the diverse market segments occupied by their various brands. The precise significance of this segmentation for the purposes of this anti-trust evaluation is the source of significant difference between the parties and the Commission, the implications of which are examined below. Suffice for now to note that the various brands are commonly identified by their positioning within the market. A feature of JD, Profurn and Relyant is that they have brands positioned across the range of the mass market.[31] Hence JD's Score and Price 'n Price brands are positioned at the lower end of the market, whereas Russell's is directed at the lower to middle and Bradlows' serves a higher income clientele. In Profurn and Relyant we see the same positoning of brand across the LSM range. The Lewis brand is positioned across a broader number of segments than that commonly occupied by a single brand.

The Ellerine's Group is, once again, something of an exception to this rule. It is comprised of five brands – however four of these, Ellerine's, its largest brand, Town Talk, Oxford and Royal are all directed at the lowest segment of the market while only Furn City, a small and reputedly unsuccessful chain, is directed at a higher segment. The Ellerines group is, then, to a far greater extent than its counterparts, focused on a single segment. It is suggested that the pedestrian performance of Ellerines Holdings in the recent past is attributable to this lack of brand diversity.

From a competitiveness perspective the key impetus underlying brand diversity seems to be the ability to exploit brand loyalty by moving customers upward through the groups stores. This is discussed in greater detail below.

In the past the racial identity of the customer base was the simple feature that distinguished one store brand from another. This was largely synonymous with income bands – hence low income stores were 'black stores' while those further up the income ladder were 'white stores'. While income and race are still, by and large, accurate markers of the positioning of the various store brands, in fact the methodology used nowadays to measure this diversity is considerably more complex and nuanced than simply race and income. The measure commonly employed is the Living Standards Measurement or LSM.

Living Standard Measures or LSM's refer to a method of segmenting consumers into profiles so that marketers can accurately identify their target markets. This is done by dividing the population into eight groups of approximately equal size. The LSM categories are divided according to living standards criteria such as education, residence, degree of urbanization, access to household electricity, motor vehicle ownership, preferences for appliances etc. The information is calculated from 20 variables and weighted for each respondent. Retailers use this information to form a picture of their target customers and so to provide for them accordingly. A retailer in the furniture industry who wants to target customers in the LSM 3-5 would study this data to get a picture of how much potential customers in this category spend, on what they spend their disposable income, which appliances they prefer, where they prefer to shop, etc. By way of example we are told in documentation submitted to us that LSM 5's are more likely to decorate their homes internally than LSM 1-4. All the chains we have referred to classify their stores along these lines and determine prices, product mix, advertising and store location accordingly.

---

31 The term 'mass market' and its precise significance is also a source of some contention. Here we use it simply to distinguish any of these stores from the high end design furniture boutiques serving the very wealthy.

The distinction informs advertising strategy in very subtle ways as an amusing example alluded to during our proceedings shows. Ellerines in the LSM 3-5 market offer a free sheep worth R300 if goods above a specified amount are purchased. A graphic of a sheep is depicted in the advert. Bradlow's, the high end JD brand, also offers a free gift for customers purchasing above a specific amount. The gift, however, underlines the difference in social status of the LSM categories- Bradlow's offers not a free sheep, but a coffee table book on 101 ways to cook lamb!

## 4. The Evaluation

### *4.1 The Panel's Approach*

The Competition Commission initially recommended outright rejection of the transaction. It has since recommended that the transaction be approved subject to certain conditions. While the parties naturally disagree and do not admit that the proposed transaction will impact negatively on competition, they have indicated that they are nevertheless willing to accept the conditions proposed by the Commission.

The panel of the Tribunal has approached the evaluation of the transaction in the following way:

We evaluate the transaction as notified to the Commission. Had we concluded that the transaction was unlikely to substantially prevent or lessen competition it would have been approved unconditionally. Under these circumstances the parties may nevertheless have elected to implement voluntarily the conditions agreed with the Commission.

However, given that we have found that the transaction as notified is likely to substantially prevent or lessen competition, and that there are no countervailing efficiency or public interest implications, we then proceeded to examine the proposed conditions.

### *4.2 The Relevant Market*

As is frequently the case in merger evaluation, conflicting views on the impact of the transaction on competition begin with a disagreement on the precise definition of the relevant market.

The Commission holds that the relevant product market comprises furniture and appliances retailers serving the LSM 3-5 category and which provide credit to consumers. Furthermore the Commission holds that there are a large number of local relevant geographic markets corresponding to the geographic area to which consumers can practically turn for alternative sources of product.

The parties, on the other hand, argue that there are six distinguishable product markets at issue. These are furniture, bedding, white goods, brown goods, cellular telephones and financial services. Our reading of the Commission's understanding of 'furniture and appliances' is that it incorporates the first four markets identified by the parties, namely, furniture, bedding, white goods and brown goods. What is at contention is whether these be grouped as a composite product within a single product market (the Commission's view) or whether they be evaluated in relation to distinct product categories thereby

including all stores which compete with the parties for the sale of one, more or all of the products (the parties' view).[32]

Furthermore the parties insist that there is one mass market for each of the products identified. In other words they reject the Commission's argument that the market, or, in their view, the markets are segmented into LSM categories.

It is common cause between the parties and the Commission that the vast majority of furniture and appliance sales to consumers in the LSM 3-5 category are on credit – approximately 99% of Ellerines sales are credit sales, and the equivalent figure for JD's LSM 3-5 purchasers is only marginally lower. For purposes of defining the relevant market we accept the segmentation into credit and cash markets and agree that our concern is with sales of product on credit.

There is deep disagreement between the parties and the Commission with respect to the identification of the relevant geographic market. In contrast with the Commission's identification of a large number of local markets, the parties insist that the market is a national market.

Turning first to the product market(s), we examine the Commission's contention that these are stores operating in the market for 'furniture and appliances', as opposed to the parties' argument that holds that they are firms operating in four distinct product markets, furniture, bedding, white goods and brown goods. From the arguments presented, it is clear that the parties effectively identify two separate markets, namely furniture and appliances – certainly the competitors identified by the parties in their various submission are easily recognized as sellers of furniture or appliances or both. Are we dealing with two distinct product markets for furniture and appliances or a composite furniture and appliances market?

The significance of the argument is clear: accepting the parties' argument implies, in their view, that account be taken of '..the innumerable other stores which compete with the parties in one, more or all of the aforesaid categories….there are 4961 retail stores which compete in the same market for the sale of one, more or all of the products'.[33] In the evidence submitted by the parties they attach particular significance to competition from the large appliance discounters, Game and Dion's, and then from the variety of stores selling a mix of furniture and appliances similar to that sold by the parties themselves. The Commission effectively argues that only the latter, stores selling household furniture and household appliances – stores colloquially referred to as 'furniture shops' – be included in the relevant market. This would not only exclude appliance specialists like Game but it may also exclude high end furniture retailers that do not include the traditional 'furniture shop' mix of audio equipment, television sets, washing machines, refrigerators and other household appliances in their product mix.

An intuitive answer to what a judgment in a US District Court termed the 'general question' to be answered in relevant market enquiries – "whether two products can be used for the same purpose, and if

32 The parties also market cellular telephones and financial services. It is not suggested that the proposed merger portends anti-competitive consequences in these latter two markets. Moreover they do, at this stage, comprise a relatively minor part of the groups' activities. Accordingly they will not form part of this evaluation.

33 *Memorandum* submitted by parties

so, whether and to what extent purchasers are willing to substitute one for the other?"[34] – would almost certainly favour the parties' interpretation. After all a television set purchased from one of the parties' stores is functionally interchangeable with one purchased through any other store; a dining-room table is a dining-room table by another name – its functional characteristics are not altered by the fact that it is sold in a store that also deals in micro-wave ovens. And yet a number of important recent US and EU judgments have found that this apparently common-sense conclusion must be tempered by evidence suggesting that, despite the functional interchangability between the product offerings of the stores in question, different 'store types' frequently compete in distinct product markets.

The oft-cited case of Federal Trade Commission v Staples Inc.[35] relied upon econometric evidence that found that large format super stationery stores set their prices in relation to each other, effectively ignoring other retailers of identical stationery products. In explaining this counter-intuitive, but statistically robust, outcome the court in *Staples* relied upon the earlier Supreme Court decision in Brown Shoe Co. v United States which held that within a broad market "well-defined sub-markets may exist which, in themselves, constitute product markets for antitrust purposes".[36] The court in *Brown Shoe* identified a number of 'practical indicia' for determining whether a sub-market exists including "industry or public recognition of the sub-market as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors."

While sympathizing with the *Staples* judge's inability 'to fully articulate and explain all the ways in which superstores are unique' we too will follow the approach in *Brown Shoe* and examine whether or not there are 'practical indicia' that place 'furniture shops' – the term that we will use to describe the retail format employed by the parties – in a relevant market distinct from that of other sellers of similar or even identical products. This approach has been followed by a number of US Courts. In Bon-Ton Stores, Inc. v. May Department Stores[37], despite acknowledging that '..in a broad sense, traditional department stores do compete in a vast marketplace encompassing retailers in general', an enquiry into the 'practical indicia' of *Brown Shoe* nevertheless led to a rejection of the defendant's view that held that 'traditional department stores' referred to an excessively narrow market in that it excluded from consideration a range of other retail outlets selling products identical to those available from the 'traditional department stores': "Applying the *Brown Shoe* 'practical indicia', the court found that there were qualitative differences between traditional department stores and other retailers, including the physical appearance and layout of the stores, distinctive customers, the wide range of brand-name merchandise, and service." [38]

---

34 Hayden Publishing Co. v. Cox Broadcasting cited *Staples* 1074

35 970 F.Supp. 1066 (D.D.C. 1997)

36 S.Ct. 1502, 370 U.S., 8 L.Ed. 510

37 W.D.N.Y 1994

38 Cited *Staples* 1080. In *Bon Ton* the Judge noted: '..the fact that two vendors both sell a particular type of merchandise does not necessarily mean that they are in the same product market. If the market were defined that broadly, it is hard to conceive of any merger or acquisition involving retailers that would have an anti-competitive effect'. See also State of California ve American Stores; Alpha Beta Acqisition Corp.; Lucky Stores, Inc. (872 F. 2d 837, 57 USLW 2581 where the District Court accepted California's view that '..the relevant produce market was limited to supermarkets – full-line grocery stores with more than 10 000 square feet. The District Court reasoned that only such supermarkets compete for consumers' periodic grocery shopping needs.'

This approach was effectively followed by the European Commission in a recent matter involving the acquisition of the Dutch assets of the US super store toy retailer, Toys R Us, by a Dutch toy retailer, Blokker. Here the EC defined the relevant product market as 'the retail of toys through *specialized* toy retail outlets' thus rejecting the parties' plea to include all toy outlets – department stores, general stores, etc - in the relevant market.[39]

We have not been supplied with econometric evidence that a'la *Staples* establishes that the furniture shops price their appliances only in relation to each other or, conversely, that they do not set their prices in relation to those set by the large appliance discounters. However, the Commission insists that these stores are not part of the relevant market while the parties, essentially relying upon the functional interchangability of the products offered, take the contrary view. We need to ask ourselves whether there are strong 'practical indicia' that serve to place furniture shops in a relevant market distinct from the large appliance discounter chains of which Game is the prime example?

In our view there is, indeed, evidence that these are segmented markets. The furniture shops and the appliance discounters do not appear to target the same market segments. There is first the question of location. The appliance discounters appear to target the large urban markets only, whereas the furniture shop chains have a presence throughout the country, in the large urban centers and in the large as well as smaller rural towns. Moreover, within the urban areas the discounters tend to locate on the peripheries of the cities – in marked contrast with the furniture shops they make no effort to locate themselves in areas convenient to customers who rely on public transport.

Secondly, although the discounters do offer credit their key competitive advantage lies in discounted cash prices, an advantage that the consumer loses in a credit purchase. Hence the ratio of cash to credit sales is considerably higher than that of the parties to this transaction and the discounters make no effort to locate in areas of town convenient to those who would not be able to afford a cash purchase. It appears that although credit is available, the scoring criteria used by the discounters for would be credit customers are considerably more stringent than those applied by the parties to this transaction – in short, the discounters are low price (low margin) and consequently risk averse; the furniture shops operate on relatively high margins and this gives them the ability to take on significantly greater levels of risk.

Thirdly, although there are definite areas of overlap in the products on offer from the discounters and the furniture shops, both are engaged in areas in which there is no overlap at all. Hence the range of appliances on offer from the discounters extends well beyond that offered by the furniture shops – where the discounters sell sports equipment, computer hardware and even CD's, the appliance range of the furniture shops is confined to the more traditional household white good range (large kitchen appliances like fridges and stoves, washing machines, etc) and to those appliances or 'brown goods' that are effectively part of the lounge furniture (music centers and television sets and VCRs). Hence even if functional interchangability is used as the basis for determining the relevant market, it is clear that it would remain confined to a select part of the respective activities of the retailers and furniture shops.

In short then we conclude that there are indeed powerful 'practical indicia' that indicate that the appliance discounters and the furniture shops do not occupy the same relevant market despite a degree of functional overlap in the products each offer. The appliance discounters and the furniture shops are not

39 European Commission – Case No IV/M.890 – Blokker/Toys 'R' Us (98/663/EC)

directed at the same market and this is reflected in their pricing strategies, their approach to credit, and their choice of location.[40] It has been suggested that this choice of market is also reflected in their respective levels of service, with the furniture shops more customer oriented in their service – they are, after all, generally establishing long term relationships with their predominantly credit customers. The discounters, on the other hand, are focused on high cash turnover and provide a notoriously rudimentary service.[41]

The distinction between the furniture shops and the discounters is sharpened if the relevant market is narrowed down, as the Commission proposes, to the LSM 3-5 range of customers. The discounters are not poor people's stores – they are stores aimed at price conscious middle-income consumers. By contrast, argues the Commission, the parties to this transaction are located in a market segment that serves low-income consumers. This view is rejected by the parties who argue that there is a single mass market for furniture and appliances, that is, that differently resourced participants in the market for appliances and furniture do not shop at particular stores to the exclusion of others, and, hence, do not serve to introduce an income or living standard based segment into the relevant market.

The assertion by the parties of a single mass market flies in the face of much of the evidence presented to us. For example the parties themselves use terms like 'traditional' and 'aspirational' to distinguish the market orientation of their brands; they have submitted considerable documentation in which they segment the market using the LSM criteria; the evidence submitted that elaborates how the JD Group decides whether to open a new store, where to position it, and which of its various brands to establish in any given location is clearly indicative of the importance that the parties themselves attach to the various living standards and income measurements.[42]

We have no doubt that these categories and the boundaries between them are dynamic, are constantly shifting. Their range of brands and the sheer number of their stores combined with the diverse formats of their stores (that is, in ascending order of scale, 'satellite stores', 'conventional stores' and 'super stores') gives the parties the ability to open and close stores relatively rapidly in response to changing market conditions and economic circumstances. We also readily accept that at the margins of

---

40 As noted above it appears that the large furniture chains are establishing specialized appliance discounters who may well be in the same relevant market as the discounters like Game.

41 These arguments are borne out in a recent interview with Mr. Allan Herman, the Managing Director of Massdiscounters, the discounters division of Massmart, incorporating Game and Dion's. *Business Report* (24 August 2000) reports that 'Herman said Game's winning formula was price leadership as well as price aggression and range. "Game offers the widest selection of merchandise under one roof" he said.'

42 In its presentation to the Tribunal on the 10th August the Commission supported its arguments by citing numerous statements made by representatives of the parties. For example Mr. Eric Ellerine, in responding positively to the transaction, is quoted as saying: "JD are the market leaders in the middle income group (LSM Market 4 to 8) through their Russels, Bradlows, Joshua Doore and Giddy's Electric Express. We are the market leaders in the lower income group (LSM 3 to 5)". And in an interview with the Commission Mr. David Sussman stated: "Score/Price&Pride on the bottom end of the pyramid – clearly LSM 3-5". And again: "JD Group envisaged creating a new chain of stores – maybe targeted between Bradlows and lower segment or above Score/Price&Pride segment". In documentation submitted to this enquiry the parties noted: 'It intended that, over time, the new JD Group will reposition certain by converting in the region of 100 of the total 436 Ellerines stores currently serving the LSM 3-5 market upwards to target the LSM 4-7 markets'. And further: 'It should also be observed that the consumer market is a dynamic one in which the consumers are constantly changing their store preferences as their income levels rise.'

each of the store brands there is a certain degree of intentional overlapping of product directed at several LSM levels – hence a consumer in the LSM 3-5 category will not always be confined to a store predominantly located in that market segment but will find that the lower priced products in the next category suit her pocket[43]; naturally consumers in higher brackets will frequently source product in lower categories. But none of this serves to deny the legitimacy of segmenting markets by income category or that store brands are specifically positioned to serve designated segments. In short the parties themselves effectively acknowledge the centrality of the LSM categories in the competitive positioning of their stores.

However, possibly the strongest evidence of clear market segmentation is found in the pricing strategies employed by both groups in the lower segment relative to those employed in higher segments. Evidence submitted by the parties clearly establishes that the gross margins in the LSM 3-5 segment are significantly higher than those charged in the segments immediately above. This is clearly associated with the greater risk attached to providing credit and speaks clearly to a marked differentiation or segmentation of the market.

In summary then we conclude that the relevant market is composed of furniture shops (with a product mix of furniture and appliances) directed at credit sales to consumers in the LSM3-5 category.

The final element in defining the relevant market relates to the geographic component of the definition. The parties insist that the market is national, while the Commission argues that there are a large number of local markets.

The geographic market is conventionally understood to refer to that geographic area to which consumers can practically turn for alternative sources of product and in which the antitrust defendant faces competition.

In concluding that the geographic market is local, or, more correctly, that there are a large number of local markets, the Commission has placed emphasis on the first part of the definition, that is, the geographic area in which consumers can practically turn for alternative sources of product. A bulky product like furniture will generally be purchased as close as possible to the location at which it is utilized, the more so when it is bought on credit and the consumers, many 'unbanked' and therefore without access to convenient stop order facilities, have to present themselves at the store each month to pay their credit installment. The parties point out that, in a country where it is still not uncommon for breadwinners to work some distance from their family homes, the preferred site of purchase is one proximate to the place of work precisely to enable the breadwinner to affect the monthly payment. The extensive network of stores then allows the delivery of the product to be affected by a store in the residential neighbourhood.

---

43 This appears to be part of a deliberate and eminently sensible strategy aimed at enabling consumers to 'migrate upwards' – it ensures that the migration upwards takes place along a continuous upward slope rather than a discontinuous leap (see notes of David Sussman's interview with Commission: 'Entry market – credit risk high and therefore risk market is limited. As customers establish a credit record, they are able to migrate upwards'). Note further, Mr. Sussman's statement: 'What I think will happen is that where we have got an abundance of stores competing against each other in a town or an area we will have to look at what is best for the overall group whether it be a JD, a Bradlows, an Ellerines, a Royal or an Oxford. *We have got so many brands to play with and the bridge of merger is if you go up the brand ladder the volumes increase.'* (our emphasis)

It is the second element of the definition – that the merging parties should face competition in the local market – that gives greater pause for thought. The parties insist that prices and credit conditions are set nationally – prices, they aver, are set by the head office managers of the respective chains, while credit conditions are set at group level within the strict parameters laid down by national legislation. This implies that the parties – both national groups comprising national chains of stores – do not respond to competition at the local level, or, conversely, that their key competitive strategies, including pricing and credit policies, are determined in relation to those of other national chains. Note, that the parties make this assertion when defining the relevant market and yet, in their assessment of the competitive impact of their transaction, claim that the regional independents loom large in setting limits to the potential exercise of market power on the part of the national chains. The implications of this inconsistency are explored more fully below.

The Commission argues that while national pricing *parameters* are clearly established, regional and branch managers are given considerable latitude to respond to competitive conditions at the local level. As the Commission points out, the parties conceded that, in the JD Group at least, every store manager may discount products down to cost plus VAT in order to take a sale away from a competitor.

Detailed econometric analysis may provide a definitive answer to this question. It is common cause that regional and branch managers have a degree of latitude in responding to local competitive condition. However in order to decide whether *competition* takes place within the geographic boundaries for which these branch and regional managers have responsibility we must rely on evidence demonstrating the precise extent of this local discretion and identifying when it is used. The JD Group has, in fact, provided detailed evidence suggesting that revenues earned from promotions and other discounted sales account for a relatively insignificant proportion of total revenues.

On the face of it, maintaining rigid national control of prices does not make commercial sense. It means effectively that the national chains are prepared to forego sales to the regional independents in order to maintain centralized national control over pricing and other key competitive variables. Surely it would be preferable to impose turnover or profit targets on local managers and allow them to compete on terms dictated by their local competition? After all, as already discussed, the ability of the consumers to physically purchase product outside of limited geographic boundaries is circumscribed by the nature of the product.

On the other hand, we have presented with persuasive commercial reasons for maintaining national control over or, at least, strict national co-ordination of these key competitive variables. Maintaining the integrity of the brand is one reason advanced by the parties; massive economies of scale in national advertising is another. Mr. David Sussman acknowledged that the national group gave up sales to local independents as a result of its insistence on maintaining a national competitive strategy. However, in Sussman's estimation, it would be 'absolutely impossible to manage a chain if managers were given greater discretion' – in his view 'absolute chaos' was the likely outcome of a decentralized approach to pricing. He noted that, in the absence of national controls, store managers and sales staff, who, he noted, were not entrepreneurs, would be tempted to secure each and every sale to the detriment of the interests of the overall business.[44]

---

44 see transcript of Tribunal hearing of the 21 August 2000, pp. 21-3. Mr. Sussman's statement indicates clearly that he does not permit his managers to respond to competitive initiatives from local furniture stores: ''Sales people and branch managers would normally take the line of least resistance and just say 'oh

It is also possible – and this will be elaborated below – that this centralized strategy may simply reflect the market power of the national chains. In other words, despite the nature of the product, the market may be truly national and dominance by national brands over local markets ensures that the advantages of eliminating all local competition are outweighed by the costs of compromising the other advantages of a national approach to competition. Certainly the European Commission is comfortable with finding a national market in circumstances broadly similar to the case in point. In *Blokker/Toys 'R' Us*, the European Commission pointed out that "In earlier decisions concerning retail operations, the Commission has generally taken the view that retail markets can be defined as national under certain circumstances". It continued:

> "Although the catchment area of a retail outlet, which can be based on the distance a consumer is willing to travel to reach it, is of a local or regional scale, the catchment area does not necessarily determine the geographic market. In a situation where several retail chains operate networks of stores on a national scale, the important parameters of competition are determined on a national scale. Therefore, from the viewpoint of the catchment area, what may be a local or regional market has to be aggregated to a national market in these circumstances."

On the evidence before us, we conclude that the parties to this transaction do, indeed, set prices and key trading conditions nationally. The Executive Chairman of JD has specifically conceded that the group loses sales to local independents in order to maintain national control over its competitive strategies. While the parties have acknowledged that regional and branch managers have a certain discretion with respect to pricing, deviations from national prices have to be sanctioned at the national level and we have been presented with evidence that establishes that this only occurs in exceptional instances. In short, the parties acknowledge that they do not set prices and trading conditions in response to competition from local independents but only in response to other national players. The local independents do not then comprise part of the relevant national market.

Accordingly we find that the relevant market is the sale of furniture and appliances on credit to consumers in the LSM3-5 category through national chains of 'furniture shops'.

### *4.3 The likely impact on competition in the relevant market*

We are enjoined by Section 16(1) of the Act to determine whether or not the transaction 'is likely to substantially prevent or lessen competition' in the relevant market.

A firm's market share reflects the amount of economic activity for which it is responsible in the relevant market. The US Supreme Court has declared that the "amount of annual sales is relevant as a prediction of future competitive strength" and is "the primary index of market power".[45] However, where the structure of the industry or special practices suggest that market share calculations based on sales

---

well, to do business we had to drop our prices or we had to cut prices or we had to sell at cost plus VAT' and so on and so forth. So we discourage this to a very large extent."

45 See United states v General Dynamics Corp., 415 U.S. 486, 501 (1974) and Brown Shoe Co. v United States, 370 U.S. 294, 322 n.38 (1969)

figures would be misleading in assessing the impact of the merger, the US Courts, have also used other data, for example production and capacity figures, in order to calculate concentration.[46]

There are a number of widely accepted empirical indicators of market power. The most common among these is the Herfindahl-Hirschman index and the four-firm concentration ratios. Both are naturally heavily conditioned by the quality of the data used to calculate them and, above all, by the parameters of the relevant market.

The parties have presented us with two sets of HHI measures, the one based on the total furniture and household appliance credit market, the second based on the LSM 3-5 income group market (see tables 1 and 2 below) that, on their data, indicate relatively low levels of concentration and little change in concentration as a result of the merger.

**Table 1: HHI based on total Turnover of Furniture and Household Goods:**

| **Company** | **Turnover R/million** | **Market Share** | **HHI Pre-merger** | **HHI Post-merger** | **Change in HHI** |
|---|---|---|---|---|---|
| JD Group | 1,832 | 9.5 | 90.9 | 184.8 | |
| Game/Dion | 1,966 | 10.2 | 104.7 | 104.7 | |
| Profurn | 1,704 | 8.9 | 78.7 | 78.7 | |
| Relyant | 1,573 | 8.2 | 67.0 | 67.0 | |
| Makro | 1,450 | 7.5 | 57.0 | 57.0 | |
| Ellerines | 780 | 4.1 | 16.5 | | |
| Lewis | 1,815 | 9.4 | 89.2 | 89.2 | |
| OK/Hyperama | 798 | 4.2 | 17.3 | 17.3 | |
| Pick 'n Pay Hypermarket | 650 | 3.4 | 11.4 | 11.4 | |
| Independents | 6 645 | 34,6 | | | |
| **TOTAL** | **19,213** | **100** | **532.7** | **610.1** | **77.4** |

*Source:* Commissioned by the parties from AC Nielsen

A major difficulty in agreeing upon sales figures is that the bases for calculating these figures differ as between the various groups with some reflecting turnover values based on cash price sales while others include finance and insurance charges in their turnover. According to AC Nielsen they scrutinised the annual financial statements of each of the listed groups for the financial year 1999 and extracted from that what they regarded as the common denominator in the definition of "turnover", that is sales at cash price.

There are a number of telling errors in the basic data used. For example, the Lewis figures are from their 2000 Annual Report while the others are all drawn from the 1999 Annual Reports. Moreover, the Lewis figures do not account for the fact that 90% of Lewis's sales are on credit, as stated in the GUS annual report. Assuming a finance charge income at 22% the correct figure should amount to R 1 303 million and not R1 815 million. Given that the figure for the independents is a residual calculated as the

46 United States v. Amax, Inc., 402 F. Supp. 956 (D. Conn. 1975)

difference between the official figure for total sales and those attributed to the groups cited in the table, the effect of this correction is to increase sales attributable to independents by a further R512 million.

Moreover there are certain stores that clearly do not belong in the relevant market – the 'right' to purchase from Makro is restricted to card holders and the Pick 'n Pay Hypermarket is a cash only store.

However, the HHI calculation in Table 1 is most severely distorted by a serious methodological error: The parties cannot, on the one hand, insist that prices and key purchase conditions are set nationally with minimal discretion given to the local managers, and, yet, on the other hand, insist that for HHI purposes the turnover attributable to the independents be included in the size of the market. Setting price nationally implies, per definition, and this is borne out by statements cited above, that the parties do *not* respond to local competition, that, in other words, it is *not relevant* in their market. It implies that those who set their prices nationally have accepted that a share of the market will always belong to the independents, because an all-out pursuit of the independents' sales would involve sacrificing the commercial advantages of centralization. It also has the potential of spilling over into a price war between the national chains. This scenario is not mere conjecture; it is established by the parties' own insistence that their competitive strategies are nationally driven. Stripping the independents out of the data used for calculating the HHI data raises it significantly.

Moreover, these HHI's measure concentration in a product market that we consider broader than the relevant market. In particular, as elaborated above, we have concluded that the appliance discounters are not part of the relevant market.

The second HHI calculation submitted by the parties is of the LSM 3-5 market. As already discussed the parties argue strongly for a single mass market. They have however submitted an HHI calculation of the LSM 3-5 in order to demonstrate that, even on this assumption, the HHI still reveals low levels of concentration.

**Table 2: HHI based on total turnover of Furniture and Household Goods in LSM 3-5 market:**

| | **Turnover R/million** | **Market Share** | **HHI Pre-merger** | **HHI Post-merger** | **Change in HHI** |
|---|---|---|---|---|---|
| Lewis | 1 815 | 22.9 | 525.0 | 525.0 | |
| Profurn | 530 | 6.7 | 44.8 | 44.8 | |
| Relyant | 712 | 9.0 | 80.8 | 80.8 | |
| Ellerines | 680 | 8.6 | 73.7 | 173.1 | |
| JD | 362 | 4.6 | 20.9 | | |
| OK | 500 | 6.3 | 39.8 | 39.8 | |
| Independents | 3 322 | 41.9 | | | |
| **TOTAL** | **7 921** | **100** | **785.7** | **863.5** | **78.5** |

*Source:* Commissioned by the parties from AC Nielsen

However, this calculation suffers from the same methodological flaw as the single mass market HHI reflected in Table 1. That is, the independents are again included despite the parties' insistence that the market is national.

Second, is the surprising inclusion of the Lewis turnover in this data set. In evidence submitted by the parties themselves they have not seen fit to include Lewis in the LSM 3-5 rather placing them in the next market segment. In a later submission the parties indicated that, in their estimation, Lewis spanned the range of LSM 3 through to LSM 8. However for the purposes of this calculation all of Lewis' considerable turnover is placed in the LSM 3-5 range. Note Mr. Eric Ellerine's confident assertion cited earlier: 'We are the market leaders in the lower income group (LSM 3-5') – and yet for the purposes of calculating the HHI for this segment Lewis' turnover in this market is represented as three times higher than Ellerines![47]

Based upon this critique of the HHI calculations submitted by the parties, we have reworked the HHI for the relevant market, as defined in section 4.2 above, as follows:

**Table 3: HHI based on turnover of furniture and appliance shops directed at credit sales in LSM 3-5 excluding independents:**

| Company | Turnover R/million | Market Share | HHI Pre-merger | HHI Post-merger | Change in HHI |
|---|---|---|---|---|---|
| Profurn | 530 | 17.2 | 295.8 | 295.8 | |
| Relyant | 712 | 23.1 | 533.6 | 533.6 | |
| Ellerines | 680 | 22.0 | **484.0** | **1135.7** | |
| JD | 362 | 11.7 | **136.9** | | |
| OK/Hyperama | 500 | 16.2 | 262.4 | 262.4 | |
| Lewis* | 300 | 9.8 | 96.0 | 96.0 | |
| **TOTAL** | **3084** | **100** | **1809** | **2324** | **515** |

*Source:* own calculation

* Note that, cognizant of Lewis' spread across the LSM segments, based on a cash sales turnover figure of approximately R1,3 billion, we have included a figure of R400 million for Lewis in our re-calculated HHI. This is an estimated LSM3-5 turnover figure for Lewis based upon a similar LSM3-5 sales to total sales ratio for Profurn.

A post-merger HHI above 1800 is generally considered to be highly concentrated. Mergers that produce an increase of more than 50 points as in the above calculation clearly raise significant competitive concerns.

The Competition Commission also calculated the HHI in its recommendation. However, it followed a different approach by calculating concentration based on the number of stores of each of the participants in the various local geographic markets excluding the independents. They identified 500 local markets but only calculated HHI's for a sample of 12 markets, 2 major cities in each province[48]. They conclude that in the 12 markets analysed the merged entity will have a market share of 60% in one market,

47 Note diagram in Appendix A. This was submitted by the parties and places Lewis outside of the LSM3-5 segment.

48 Johannesburg, Pretoria, Port Elizabeth, Cape Town, Bloemfontein, Pieter Maritzburg, Rustenburg, Nelspruit, Durban, Kimberley

between 50-60% in four markets and between 40-50% in four markets. In the remaining three markets, the market shares of the merged entity will exceed 30%.[49]

Another method used to calculate concentration is the four firm concentration ratio, CR4 test. It measures the portion of the market accounted for by a given number of leading firms, in this case the four leading firms. If we take the market shares of the top four companies in the LSM 3-5 as calculated in table 3 above the four top firms concentration figure would be as follows:

**Table 4: 4-firm concentration ratio**

| | |
|---|---|
| Profurn | 19,5% |
| Relyant | 26,2% |
| Ellerines | 25,0% |
| JD | 13.3% |
| **Total** | **84%** |

*Source:* Own calculation

The merged firm will therefore supply 38,3% of the relevant market. Competition authorities are, as a general rule, very sceptical of a merger where the combined share of the four largest firms will exceed 75% and the merged firm will supply at least 15% of the relevant market.

In summary, we have used various methods and information to calculate concentration in the relevant market and have found shortcomings and flaws in each of the methods used.

In the premises, given the widely disparate HHI calculations, we are not willing to place complete reliance on any of these measures. Nor do we believe that the HHI, even when a relatively straightforward calculation, should, on its own, constitute the basis for deciding on the outcome of a merger investigation. The HHIs are *indicative* statistical measures; they are not determinant. They must always be bolstered a deeper, qualitative enquiry in order to arrive at a realistic assessment of the impact of the transaction on competition in the relevant market.

Several factors serve to reinforce these statistical indications that the transaction has the potential to impact adversely upon competition:

49 The parties criticized the Commission's attempt to base its concentration measure on the number of stores, pointing out that this lumped together a large variety of distinct stores, conventional stores together with the considerably smaller satellite stores and the significantly larger super stores. While we agree that store numbers is not an ideal measure of concentration, if the market is national and, if one accepts that each of the national chains is similarly composed of store format varieties, then the measure should be seen as providing an indicative measure of concentration.

The first concerns our difficulty in identifying the very basis of competition between the national chains in the relevant market. We have perused the reams of advertising material submitted by the parties. It is unusually difficult to compare cash prices and this because the various participants in the relevant market appear to make a determined effort to bedevil any attempt to compare cash prices at one store with those offered by it various competitors. For example while the specifications of many of the brands on offer are identical the various stores appear to be at pains to ensure that they do not offer the same branded products as those offered by their competitors - television sets are a good example here. Or alternately the precise specifications of the advertised products are shrouded in names that disguise more than they reveal – lounge suites are a good example of this practice. As noted above, the manufacturers produce in-house brands for the large chains and this also bedevils inter-store price comparison. If price comparison has eluded the resources of a competition authority, we can only conclude that the average LSM 3-5 customer is in an even more disadvantageous position in choosing from among the apparently vast array of options on offer.[50]

On the other hand credit terms and conditions appear identical across the various LSM 3-5 chains. This is to be expected given the level of statutory regulation of credit terms and conditions to which we have already alluded. However, it appears that an area of considerable competition centers upon the relative ease of access to credit available through the various competing groups of stores. This factor, above all, appears to act as the principle instrument for attracting custom in the LSM 3-5 category.[51]

---

50 Note that, in any event, consumer behavior in the LSM 3-5 market is not as responsive to price as the parties suggest. This is because in the typical sale the sale price is considerably less than the total cost to the customer. A typical purchase comprises the payment of a 10% deposit and then installments for the balance payable monthly over 24 months. Added to the sale price are-

- Delivery charges of R350.
- finance charges of approximately 22% of the principal debt (i.e. the sale price less the deposit)
- insurance (in Ellerines case 10,5% and in JD's 12% per annum of the sale price).
- Then JD but not Ellerines includes -
  - retrenchment insurance 6% of the outstanding balance (the principal debt plus finance charges) per annum; and
  - its magazine R 209.65 plus VAT.

In a working example prepared by Investec on two goods both with a sale price of R4999 the total cost to an Ellerines purchaser is R7968,82 a monthly installment of R332.03. The total cost to the JD customer is even more at R 8060,49, a monthly installment, of R391.75 . Investec arrives at two conclusions. JD with its additional expenses could charge R1000 less on the sale price and the consumer would still pay the same monthly installment as that charged by Ellerines. More importantly they say that Ellerines insurance charges are lower than the rest of the industry and they could profitably raise them from 10,5 % to 17,5%. If Investec is correct, this on its own is an indication of the potential for market power to be exercised post merger more so if JD is already able to charge 18% on insurances pre-merger. The following statement from the JD Group Board meeting of the 24 May is testament to the anti-competitive potential of this opaque method of pricing product: '(Mr. Strauss – the JD MD) noted that *other income levels at Ellerines could be boosted by at least 5% by the introduction of retrenchment insurance, furniture club membership fees and extended guarantees'*.

51 Note Raphael Kaplinsky and Claudia Manning – Concentration, Competition Policy and the Role of Small and Medium-Sized Enterprises in South Africa's Industrial Development (Journal of Development Studies, Vol. 35, No.1, October 1998): 'Several of the (furniture retail) chains' marketing directors – whom we interviewed – ….informed us that black consumers (the main users of consumer credit) are not 'price sensitive', since they are primarily concerned with getting access to credit..'(p153-4)

However, easy access to credit is clearly a drawcard that has to be managed with consummate care – several major chains have already fallen prey to the dangers of a poorly managed debtors book. While all of the key players in the LSM 3-5 market offer credit on relatively easy terms, Ellerine's longstanding reputation for granting entry level credit and the quality of management of its vast debtor's book is unparalleled. Moreover the unusual strength of Ellerine Holding's balance sheet – primarily because, in contrast with the other national chains, it has not been an aggressive acquisitor, it is ungeared - enables it to extend consumer credit with considerably greater ease than its competitors.

Secondly, and this has a strong relationship to the use of credit facilities in this segment of the retail furniture trade, there is the question of brand loyalty. Brand loyalty here refers to the observed tendency of customers to remain with a single chain or, at least, within a single group of chains. The parties have questioned the extent of brand loyalty but this is at odds with other assessments of customer behaviour in this sector, many of which specifically refer to evidence of strong brand loyalty.[52] A common sense reading of the furniture retail trade would favour those who identify strong brand loyalty – credit accounts for much including a strong interdependence between debtor and creditor.

The upshot is that in acquiring Ellerines, the JD Group does not merely acquire one of the country's best retail brands and the various material assets owned by the company – it actually acquires customers in the form of the large debtors book and, moreover, customers who are likely to remain loyal to the acquiring party. Furthermore, because of the observed, and perfectly understandable tendency (arising again out of the nature of the credit) of *group* (as opposed to mere brand) loyalty the acquisition of Ellerines will not only increase JD's customer base at the LSM 3-5 segment but will provide it with customers who are liable, in Mr. Sussman's words, to 'migrate upwards' to other brands in the group. This is why brands in the lower segment are referred to as 'entry level' brands and those in the higher segments as 'aspirational'.

We should underline that the loyalty described above is not to be taken for granted in most merger transactions – on the contrary competition regulators are generally able to assume that a combined entity will *lose* a certain proportion of its combined customer base to existing competitors. In this case, however, the likelihood is that the merged entity will not only retain the combined LSM 3-5 customer base but will also simultaneously increase the customer base for its higher segment brands. This unusual outcome derives from the fact that the Ellerine's customers and those of Price 'n Price and Score, JD's existing LSM 3-5 stores, are poor people with highly limited access to credit, subject, in other words, to a powerful incentive to remain with those from whom they have already received credit.

Thirdly, we do not share the parties' assessment that entry barriers are low. Information submitted by the parties establishes that the introduction of new national store brands is, by and large, the effective prerogative of the existing national chains.[53] This is not surprising. The economies derived from

52 Diverse sources remark upon the extent of brand loyalty in this trade. See, for example, the Commission's submission and also the Fleming Martin report on the sector. See also the divisional review of Protea Furnishers in the Profurn Annual Report: 'The division furthermore boasts a total of 340 000 accounts or customers *of which 40% contribute to repeat business.'*

53 Nor should the difficulty of establishing new brands, even for the established groups, be underestimated. A glance at the length of time for which many of the established furniture brands have been in existence (see profiles of the groups presented above) bears testament to the difficulties that new entrants will face. On

membership of a large, established group are clearly considerable and relate, most obviously, to IT costs, advertising, supplier discounts and warehousing expenses. The ease with which the established groups are able to open new stores within an established brand must act as a significant deterrent to would be new entrants who, on the evidence presented, would have every reason to expect that any lucrative market will soon attract one of the established brands. Store leases, we are told by the parties, are generally of five years duration and so the sunk cost are significant.

Above all new entrants are constrained by the requirements of running a large debtor's book. The parties assert that this entry barrier only pertains to an entrant that wants to run its own debtors book and it notes the availability of credit from other financial institutions, including some dedicated to providing credit to purchasers of furniture. However, we are persuaded by the evidence gathered by the Commission to the effect that this credit is both limited, a veritable drop in the ocean compared to the parties ability to extend credit, and costly.[54]

The remarkably high margins, particularly in the LSM 3-5 range, are themselves indicative of market power and of high barriers to entry. Ellerine's gross margins are 53,5%. In the LSM 3-5 brands the JD Group's gross margins are 44% and in the LSM 6-8 they go down to between 27% and 33%. We accept that the margins reflect the exceptional degree of risk that the participants are willing to assume in this low income, credit-based market. But they clearly establish that not many others are willing to assume this risk even at margins strikingly higher than those generally available in the retail trade. Pick 'n Pay's response to the Commission to the effect that it would only consider entering this market if prices went up by 10% is indicative of the hurdles that even this experienced and well resourced retailer perceives in the low income furniture market.

Finally, there is no doubt that the transaction results in the removal of an effective competitor. As already noted David Sussman himself has been at pains to acknowledge the strength of Ellerines. The Financial Mail reports: "At JD they regarded Ellerines as serious rivals. 'In the market we're their biggest rival', says Sussman. 'We weren't as concentrated at the entry level (lower end of the market) as Ellerines are. But we were really slogging it out toe to toe'"

We accordingly find that the transaction is likely to substantially lessen competition in the relevant market. This conclusion is based on the share that the merged entity will have of the LSM 3-5 market in combination with the role played by credit allocation in attracting and maintaining a customer base, Ellerine's unusually powerful position in the business of granting credit, high levels of brand loyalty, high barriers to entry, and that fact that the transaction will result in the removal of an extremely effective competitor.

---

the other hand the Commission's sample survey of independents and their inability to even track down a significant proportion of those in a large sample indicates that new entrants are subject to a high failure rate and tend to exit very rapidly.

54 See Commission's presentation to the Tribunal hearing of the 10 August 2000. Credcor, the largest source of credit for customers of the independents, has a debtors book totaling R90 million in respect of furniture and appliance retailers, while the parties alone have a combined book of the R2,8 billion. Moreover, Credcor derives its income not only from interest on the credit it extends but it also levies a fee on the retailer thus raising the cost of credit sourced through Credcor. Furthermore, the Commission avers that the credit checks imposed by Credcor are stricter than those applied by the parties.

We should note that we give no credence to the notion that because the Ellerine's brand will be retained it will continue to provide the same level of competition to the existing JD brands. Although different brands, they will be subject to a single controlling mind and to view them as competitors for anti-trust purposes is without precedent and, we respectfully submit, good sense.[55]

### *4.4 A note on the independent furniture retailers*

We have identified South Africa as the relevant geographic market. The effect of this is to exclude the local independent stores from the relevant market – as already elaborated, the parties themselves aver that they do not respond to competitive initiatives from this quarter. However, despite the glaring inconsistency in their approach, the parties nevertheless attempt to make much of the alleged competitive presence of the independents.

The Commission, for its part, finds local geographic markets but then, also exhibiting a certain inconsistency in its approach, finds that the independents are not a significant source of competition in these markets.

Our finding that the relevant market is national relies principally on evidence submitted by the parties. We accept, as outlined above, that there are rational commercial grounds why large national chains should value centralized, national determination of their key competitive strategies and, conversely, why they should not respond to initiatives from the local independents. However, if this issue is examined from the perspective of the current competitive strength and future prospects of the independents, then it is not difficult to see why they are all but ignored by the participants in the relevant market – the large national chains – in the preparation of their competitive strategies.

There appear to be two types of independent operators. The first, the vast majority, operate a conventional store format . The second operate a very large super store format. Some of the independents group two or three stores but most are single store operations. They are owner-managed enterprises.

The evidence gathered by the Commission regarding the former grouping of independents is striking. The parties informed the Commission investigators that there were 1251 independents in the 99 local markets in which both parties compete. A survey conducted by the Commission of 202 of these independents in the Eastern Cape, Northern Province and the Free State established that 93 were no longer in business, 12 were not in the relevant product market, and four declined to respond to the Commission's queries. Of the remaining 93 only 13 – 6,5% of the sample surveyed - serve the low-income market and provide credit.

The parties also referred to Furnex, a company that buys products and obtains financial services on behalf of its members all of whom are independent retailers. The parties argue that Furnex's collective

55 The parties have stated that the base price of products in the JD Group is the same for each business unit in the Group. (Par 5.2.4.1 of their filing made on 3rd August) This contradicts their assertions elsewhere (Par 5.1.12) that individual units compete with one another.

buying power constitutes its members as a real competitive threat to the large national chains. We disagree. Furnex's members may be able to use their collective purchasing power to reduce the cost of their product, but there is no indication that firms graduate from Furnex membership to become significant chains. Indeed each Furnex member controls, on average, a trifling 1,5 stores.

The parties made much of the competition from the large format independents. They provided four examples. Although found in very few areas, these are undoubtedly very large stores. However these stores are a particular manifestation of South Africa's past and the conditions for expansion of these stores and for new entry by large format independent have disappeared.

The four stores used by the parties are indicative of this. They are owned by Indian entrepreneurs whom the Group Areas Act confined to particular locales of the large rural towns in which they are all based. These were generally located in proximity to the transport routes from the African townships, precisely the sites now favoured by the parties and the other large national chains in the low income segment of the market. These stores, managed by extremely able entrepreneurs, were prevented by the Group Areas Act and by restrictions on raising capital, from expanding out of their prescribed bases. Had they not been restricted by apartheid they may well have been in the position occupied today by the parties to this transaction. However, the unfortunate truth is that they remain confined to their original bases, they remain family-owned and managed with all the limitations that implies for rapid expansion, and they now have to contend with added competition from the multi-store chains. We asked the parties whether any of the stores cited by them as examples of large independent super stores had been in existence for less than 10 years. They have not been. We would indeed be surprised if any had been in existence for less than 20, even 30 years. This confirms that new entry at this scale of operation is not feasible. This, combined with the obstacles in the way of expansion on the part of the existing players, leads us to conclude that they are, at most, significant in a small number of regions and that the extent of competitive pressure from this source is, if anything, likely to decline rapidly.

### *4.5 The Impact of the transaction on the manufacturers of furniture*

A constant refrain running through the investigation and evaluation of this transaction concerns its possible impact on relations between, on the one hand, the manufacturers of furniture and, on the other, the retailers. Various concerns have been expressed: more powerful retailers, operating in a less competitive retail market, are better able to squeeze the profit margins of the manufacturers; the preponderance of large national retail outlets with centralized purchasing departments inevitably means that the volumes ordered will exceed the capacities of the smaller manufacturers; the close relationship alleged to exist between the JD Group and the Steinhoff Group, much the largest manufacturer of furniture in South Africa, would further underpin the progressive exclusion of the smaller manufacturers from large parts of the market; the additional purchasing power of the new group combined with its allegedly close relationship with Steinhoff would give JD a competitive edge over other furniture retailers.[56] [57]

---

56 Cf. footnote 2, above. This provides evidence suggesting that the JD Group already received payment terms from the manufacturers that are preferable to those available to the other chains.

57 Note Kaplinsky and Manning (op cit) whose analysis of the industrial structure of the furniture manufacturing industry bears out many of these fears: 'The retail chains we interviewed all informed us that they could not source from small producers because the latter could not produce sufficient quantities. Consequently the bulk of the retailers' purchases came from large enterprises.' This research them bears

A group of small furniture manufacturers submitted a statement of their concerns to the Commission. However, they requested that they not be identified and the Tribunal has accordingly had no regard to their statements.

The parties, for their part, have furnished the Tribunal with more than 120 letters from manufacturers expressing support of the transaction. A Commission investigator has submitted an affidavit in which she attests that certain manufacturers have reported (and again declined to be named) that they were pressurized by senior representatives of the parties to submit these letters. The parties have denied these allegations. The Tribunal must again decline to accept anonymous submissions, though it records that the alacrity with which the manufacturers responded to the request for support and the near unanimity of the response ((there was a single detractor) suggests that the parties do command a not inconsiderable degree of power vis a vis the manufacturers.

However given that we could not rely on the anonymous grievances submitted, this issue has not influenced the outcome of the Tribunal's evaluation of this transaction. We do note though that the purchasing power – market power, in other words – of the large retailers vis 'a vis the smaller producers is cause for concern and calls for vigilance on the part of the competition authority. We also note the parties' undertaking to maintain existing supplier relations.

### *4.6 Pro-competitive gain*

The parties have not identified pro-competitive gains in the relevant market. On the contrary, as already noted, Mr. Sussman has been at pains to distinguish this transaction from previous acquisitions by the JD Group. In the other transactions JD acquired ailing chains and turned them around. These pecuniary gains have not been claimed in this transaction, where the target company is identified as a well managed, thriving group.

The only efficiency claims made are in respect of the parties' activities in financial services. These are examined under public interest.

### *4.7 Public Interest*

In undertaking a merger evaluation we are enjoined by Section 16(3) of the Act to consider specified public interest issues. Where, as in the case, the merger has been found to diminish competition, we enquire whether a positive impact on public interest outweighs the negative impact on competition, thus permitting approval of the merger. Note that the Act specifies the public interest grounds that the Tribunal may consider these being the impact of the merger on a particular sector or region, on employment, on the ability of small businesses and firms controlled by historically disadvantaged persons to become competitive, and the ability of national industries to compete in international markets. Note too

---

out the central argument in their paper, namely, 'that the process of retail concentration serves to undermine the market access opportunities of smaller producers.' (p152-3)

that the mere existence of a public interest ground is not enough in itself. The Act requires the public interest ground to be substantial.

In this merger the merging parties have, whilst not conceding the merger is anticompetitive, raised under the public interest rubric an aspect of the deal affecting their respective financial service arms, which they say, is in the public interest.

*4.7.1 Financial Services*

The parties have raised the increase in their ability to offer financial services as a public interest ground in that they are helping bank the "unbanked".

They say that with an increased store base of approximately 1250 outlets in SA they will be in a better position to do so. They also stated that certain stores could be converted into franchises particularly in the Electrical Express Chain and that this would be beneficial for small business and create employment opportunities.

All these objectives are very laudable, but what we have to assess is whether the parties require the merger in order to implement them. Nothing the parties have told us suggests they cannot implement these strategies without the merger.

We turn first to the claims regarding financial services and note at the outset that it is not clear under which of the specified public interest grounds this claim is made. However, that having been noted, we will nevertheless proceed to examine the substance of the claim.

The parties claim that the additional store base will lower the costs of rolling out their financial services arm. However, both Ellerines and JD have extensive and often overlapping networks of stores. Neither party needs a merger to reduce the costs of rollout.

Nor do they require the merger to increase their ability to raise capital. Both have already embarked on expanding into financial services prior to contemplation of the deal and are already operating divisions, have marketing strategies in place and, in the case of Ellerines, have developed a separate brand in Rainbow Loans. If anything the market for these loans will become less competitive if two competitors providing these products are merged. We do not base our decision to find the merger lessens competition on this, we merely use this to reject the suggestion that the merger brings with it a substantial public interest.

In short, the parties do not need this merger to enter this market - they have already entered and are better resourced than most to sustain that entry.

The suggestion that these activities bring banking to the unbanked must also be treated with some skepticism. The financial services offered do not replicate the traditional services of the banking sector i.e. local branches for savings accounts etc, that is, they do not 'bank the unbanked'. They extend credit and stimulate consumption – they do not facilitate or encourage savings. Moreover, as the evidence of the parties clearly indicates, micro loan schemes are ubiquitous and there is no suggestion that these services, as opposed to the more traditional banking services, are not getting to the "unbanked".

As to the suggestion that the parties may involve themselves in franchising, although not stated expressly we assume the motivation is based on 16(3) (ii) and (iii) of the Act, which deal respectively with employment and the ability of small business and businesses owned by HDI's to become competitive. The

'offer' to promote franchising is vague. Moreover, we should point out that franchising is a business strategy aimed at spreading risk and we presume that this would be the basis of a decision to franchise certain brands. Franchising will not be embarked upon in order to promote the public interest. Furthermore if the parties wish to pursue franchising there is no apparent reason why this is contingent upon the merger.

*4.7.2 Employment*

Undertakings were made to the employees and we are satisfied that the merger raises no concerns on this ground

*4.7.3 Other Public Interest Grounds*

None of the other public interest issues were raised by either the merging parties or the Commission and so we do not need to consider them.

**4.8 The Proposed Conditional Acceptance**

The Commission initially recommended prohibition of the transaction. However, it subsequently reconsidered its position and has recommended that the transaction be approved subject to a number of conditions. Although the parties do not admit that their transaction will substantially reduce competition and, accordingly, that the imposition of conditions is warranted, it has agreed to accept the conditions in order to secure approval of the transaction.

The panel is empowered to approve the transaction conditionally. We will, accordingly, examine the proposed conditions.

The core condition is that, within 9 months of the date of approval of the transaction (or, with the Commission's agreement, a further 3 months), the merged entity will divest itself of 150 stores in the LSM 3-5 category. The stores selected for divestiture must be acceptable to the Commission. The purchaser shall preferably be a Black Economic Empowerment Group approved by the Commission, or, failing that, another buyer approved by the Commission. Furthermore, once the stores are selected for divestiture, the merged entity undertakes to manage the chosen stores efficiently 'so as to ensure that the new purchaser shall become a viable competitor of the JD Group after the sale by the JD Group'. The statement of conditions submitted by the Commission specifically records that, in determining the identity of the purchaser, 'its ongoing viability must be paramount'. The Standard Bank will be appointed at JD's expense to monitor compliance with the conditions.

Finally, it is noted that, 'Section 14(5) shall be applicable to all the aforesaid conditions'. Section 14(5) allows the Commission to revoke its decision to approve or conditionally approve an intermediate merger, in the event of, inter alia, a breach of any obligation attached to the decision.

A number of other conditions relating to employment and the parties' involvement in financial services are proposed. However, important though they may be, they do not impact on the competition concerns that have led us to prohibit the transaction. Accordingly, the imposition of these conditions would not cause us to reverse our finding. However the conditions relating to the divestiture of certain of

the stores in the portfolio of the merged entity are manifestly intended to address the competition concerns arising from the merger. We will accordingly confine our decision to these conditions.

Turning to the substantive conditions proposed, we note that it is not uncommon for the competition authorities or the courts in other jurisdictions to impose divestiture as a condition for the approval of a merger. Under the previous competition law regime in South Africa divestiture agreements were struck in the context of merger investigations. There are many examples of successful divestiture arrangements, that is, divestiture arrangements that have permitted a revised transaction, one that meets the requirements of both the parties and the competition regulators, to go ahead. Merger regulation must recognize that many mergers are efficiency enhancing and, in general, part of the legitimate conduct of business. Accordingly, if an anti-competitive merger can be 'rescued' by excising those aspects that generate concern, then the Commission and the parties are encouraged to seek out these solutions. Furthermore, a structural solution such as divestiture, is generally to be preferred to a behavioural condition that requires constant monitoring by the competiton authorities or, expressed otherwise, ongoing regulatory intervention in the affairs of the merged entity.

However, not every anti-competitive merger can be cured by a divestiture order. Or, conversely, it is not simply any divestiture order that will cure an anti-competitive merger. The finer details – the precise assets to be divested, the identity of the purchaser, the price, the length of time taken to effect the divestiture, the post-divestiture relationship between the merged and divested entities – are all important. However, the conditions proposed here contain only the barest of detail. On the other hand there is persuasive evidence that suggests that a divestment has only a slim prospect of overcoming the anti-competitive consequences of this transaction.

The litmus test of the effectiveness of divestiture is whether it maintains competition in the post-merger relevant market, or, in the language of the Act, whether or not it permits of a transaction that does not 'substantially prevent or lessen competition'. The Federal Trade Commission holds that

> *"The order, the divestiture contract, the buyer and the buyer's business plan should be evaluated in terms of whether the divestiture will restore competition in the complaint market. This means that the divested entity must have the same potential and incentives to expand and innovate as the firm that disappeared. It should not be a firm that has continuing dependency on the respondent or that is frozen in a static product or locked in a narrow competitive niche."* [58]

In other words, the practical measure of the effectiveness of a pro-competitive divestiture is whether or not the divested assets constitute the basis for introducing a new competitor into the market, or for strengthening the competitiveness of an established participant. This test imposes a conflicting set of incentives on the merging parties – on the one hand, they are eager to proceed with the transaction and are, therefore, encouraged to find a buyer who meets these criteria; on the other hand, they would not wish, in the process, to create a powerful new opposing competitive force, to sow, as it were, the potential seeds of its own future destruction.

The Competition Commission is clearly cognizant of these considerations, of these conflicting incentives. This is presumably why the Commission makes much of the requirement that the purchaser of

58 Federal Trade Commission (1999) – A Study of the Commission's Divestiture Process (p.37)

the divested assets be 'viable', why the merged entity is specifically enjoined to facilitate the viability of the purchasers, and why a merchant bank is employed to ensure that these conditions are respected.

However we are not persuaded that these conditions reverse the dangers to competition that have caused us to prohibit the transaction.

Firstly, precious little detail has been provided. Indeed there is as yet simply no detail to provide. With respect to the assets divested it is clear that the value that attaches to the stores is to be found in the brand or brands, the staff and the management systems, the debtors book, and, to a varying extent, the store leases.

On the face of it, there is nothing to suggest that a chain of this size and this structure will be viable. Certainly there is no successful role model. The other national chains, against whom the new entity will compete, all have LSM 3-5 interests larger than that represented by the 150 stores and, possibly more important, all have major interests in other segments of the market. It is suggested by the parties themselves that even Ellerine's Holdings, with its powerful LSM 3-5 stake, suffered in consequence of its limited presence in the other market segments. It will lack the purchasing power that brings its competitors critical advantages on the supply side and it will lack the diversity that allows the other chains to view its LSM 3-5 brand as its entry level clients ultimately to be 'migrated' into the lower risk, cash-oriented segments of the market. In our view the stake offered is at once too small and too undiversified to compete successfully against the established retail groups.

However, it is simultaneously too large to be managed by interests with no experience of this highly specialized and risky trade. A strong conclusion of the Federal Trade Commission's review of its experience of divestiture conditions is that 'the most successful buyers are the most knowledgeable. Buyers who are making geographic extension mergers of ongoing businesses are the most successful'.[59] In this instance nothing is known of the prospective purchaser except that a Black empowerment group is preferred. The only significant Black ownership in the furniture retail trade is to be found among the few large independents and a sale to these interests may be the only way of ensuring that these assets remain competitive. We have, however, been given no indication that any of these parties may be interested, nor do we envisage that the new JD Group will respond enthusiastically to the prospect of selling to one of these companies.

A certain level of experience will be available to the new owners if the current management of those stores and the brands that are sold is retained. However, there are solid grounds for skepticism here. The key managers of the sold assets clearly enjoyed substantial career prospects when their stores and brands were under the umbrella of one of the large, expanding chains. This prospect is now eliminated and even if the merged JD/Ellerines Group behaved in good faith and resisted the temptation to poach the best of the staff, there is no reason to expect the competitor chains to play by these rules. We note that the parties have assured us that they will put in place an ownership incentive scheme aimed at retaining key personnel but the success of this scheme will depend crucially on the staff's assessment of the potential of the new group.

59 op cit p38

Moreover, and possibly more important, the skill, experience and entrepreneurship of the group leadership clearly makes a powerful contribution to the competitiveness of each of the brands. Mr Sussman, himself, observes that his branch and regional managers are not entrepreneurs and that it is partly for this reason that key decisions over pricing and credit are made in head office, frequently in the group head office. Other key aspect of the infrastructure of management – some, like JD's sophisticated IT system, very costly and skill intensive – are centralized in the group. It is unlikely that these will be available to the new entity post-divestiture and, from a competition perspective, nor is it desirable for two competitors to be sharing these critical competitive resources.

A purchaser that may successfully overcome all of these problems could come from one of the existing national furniture chains, although this is unlikely to meet the test of maintaining competition at pre-merger levels. A retail chain not currently involved in the relevant market would be well placed to manage the chains. However, there is no indication of any interest from this quarter and it is unlikely that the assets on offer are of sufficient size to attract interest from one of the large retail chains. For a Pick 'n Pay or Shoprite or Massmart intent upon entering the furniture retail trade, Ellerines Holdings itself may constitute an attractive purchase. However, there is no reason to expect that the assets on offer will attract interest from this quarter.

Nor will the lengthy time period allowed for the divestiture enhance the prospect of a competitive new entrant. Again the Federal Trade Commission's experience is apposite:

> *"In order to eliminate competitive harm, the Commission has greatly shortened the period by which a required divestiture must be completed in more recent orders. The working rule now is that the divestiture must be accomplished within six months after the consent order is signed. Earlier orders typically gave the respondent 12 months or more from the date the order became final to divest. To further reduce or eliminate interim harm by obtaining quicker divestitures, recent orders have required 'up-front' divestitures. The up-front divestiture not only reduces the opportunity for interim competitive harm by expediting the divestiture process, but it assures at the outset that there will be an acceptable buyer for the to-be divested assets."*[60]

In this instance concern regarding the 9-12 month period permitted for the divestiture to take place also goes to the potential impact on the viability of the divested assets. We note that the Commission proposes that the conditions to be imposed require the merged entity 'to manage these stores efficiently and according to sound business practices'. We also note that the Commission asks that a merchant bank be appointed at the merged entity's expense to monitor compliance with this and other conditions.

While we note the JD Group's acceptance of these conditions and do not question its sincerity in making the undertaking, we do not believe that it is capable of fulfillment. We have little doubt that those basic, visible factors that influence the competitiveness of the assets to be divested will be maintained in place – we are confident that advertising spend will be maintained, that relationships with suppliers will be kept in place, that the stores will remain price competitive, and that the debtor's book will be effectively managed.

---

60 op cit p39. In the case of an order requiring an up-front divestiture the merger may not be consummated until an acceptable buyer is found and the buyer has conducted a due diligence and submitted its business plan to the competition authority

However there is much that cannot be observed and it has to do with the way in which the JD Group manages the stores that it will *not* be divesting. The new JD Group will be intimately familiar with the stores to be divested. It is bound to manage its own assets strategically so as to blunt the competitive impact of the divestiture on its own performance. We cannot accept that JD, renowned for its robust competitive presence, would behave any differently. Nor can this be easily observed. To attempt to monitor JD's conduct in this regard would require a degree of intervention in its affairs that we would not wish to impose upon its management. And, in any event, given the 'information asymmetry', the disparity in the information to which the monitor and monitored would be privy, it would simply not be possible to vouch for JD's compliance in this regard.

*Accordingly we find that the conditions relating to divestiture that are proposed by the Commission and that have been accepted by the parties do not reverse the anti-competitive effects of the transaction.*

We considered the possibility of imposing additional conditions but have not been able to identify any that would reverse the anti-competitive consequences of the transaction. Acceptable conditions hinge critically on the viability of the divested assets. In order to assess this, the conditions would have to incorporate a considerably more developed description of the assets involved and of the purchaser. The divestiture would also have to be accomplished in a considerably shorter time frame than that permitted here. The Tribunal is clearly not able to develop a set of conditions at the required level of detail. This would have to be negotiated between the parties, the Commission and an identified purchaser. We note here that the panel had proposed to the parties and the Commission that we postpone our decision in order to allow the parties to identify a buyer and develop a more detailed set of proposals. However, this was not acceptable to the parties.

We note the specific reference to Section 14(5) (more correctly Section 15(3)) of the Act and the view of Mr. Katz, for the parties, that, any risk arising out of non-compliance (for example, the failure to find a viable purchaser) resides with the parties given that, in the event of a breach of the conditions, the right to withdraw the approval is retained by the competition authority. We are however not persuaded by this argument. It would not be possible to unwind this transaction a possible full year after its consummation. This path portends massive uncertainty, an extremely burdensome supervisory task for the competition authorities, likely litigation and the effective imposition of a shackle on the competitive process.

We emphasise that our conclusion is based on the facts of this case and on the conditions proposed. It does not, in any sense, suggest a general hostility towards conditional approvals or the place of divestiture in these conditions.

_____ 30 August 2000

D.H. Lewis Date

Concurring: P. Maponya and N.M. Manoim

**Case No: 23/LM/May01**

**In the large merger between**

**Schumann Sasol (South Africa) (Pty) Ltd**

**and**

**Price's Daelite (Pty) Ltd**

**REASONS FOR THE TRIBUNAL'S DECISION – NON-CONFIDENTIAL VERSION**

---

**Decision**

1. The Competition Tribunal prohibited the merger between Schumann Sasol (Pty) Ltd (SCHS) and Price's Daelite (Pty) Ltd (PD) on 1 July 2001. The reasons for the decision follow.

**The Proposed Transaction**

2. Schumann Sasol (South Africa)(Pty) Ltd (SCHS), the primary acquiring firm, will acquire the entire issued share capital of Price's Daelite (Pty) Ltd (PD), the primary target firm. The shareholders of PD will transfer the entire issued share capital of PD to SCHS.

3. Schumann Sasol International Aktiengesellschaft holds 100% of the shares in SCHS. The ultimate holding company of the Sasol Group is Sasol Limited. SCHS does not have any subsidiaries.

4. The Leo Goodman Family Trust owns 62,6% of the issued share capital in PD. The Leo Goodman Family Trust also controls Cambridge Candles. PD has no subsidiaries but it does control Price's Candles (South Africa)(Pty) Ltd and Price's Candles (Natal) (Pty) Ltd.

5. SCHS previously disinvested from the candle manufacturing market in 1995 by selling its business known as Price's Candles to the Goodman family because, it avers, it wanted to end the situation of being both a major supplier and competitor in the same market as its customers.

6. The effect of the current transaction would be to return the parties to the situation that they were in before the Goodman family purchased Price's Candles from SCHS in 1995.

7. The transaction, according to the parties, is the unavoidable consequence of the financial situation of PD, which is heavily indebted to SCHS, and the unresolved disputes between the parties. The parties aver that the transaction is to be viewed as part and parcel of a settlement agreement resolving the disputes between SCHS and the Goodman family.

8. SCHS avers that post the transaction PD will continue operations as an independent subsidiary of SCHS with full profit and loss responsibility. Its Board will consist of the Chairman and the Managing Director of SCHS and the Managing Director of PD.[61] According to the parties SCHS will supply PD with wax on an arms length basis.

**The Analysis**

***Vertical Mergers and Competition Law***

9. We are evaluating a transaction between two firms in a vertical relationship: SCHS, the acquiring firm, supplies candle wax to the target firm, PD, a candle manufacturer. We emphasise this at the outset because our analysis will proceed cognizant of, and in general sympathy with, the characteristically permissive approach taken by anti-trust to vertical mergers, indeed to vertical agreements generally.

10. It is relationships between competitors – that is horizontal mergers (and horizontal agreements generally) - that tend to attract the immediate attention of anti-trust enforcement. Vertical arrangements do not, on the face of it, lessen competition in either of the markets in which the contracting parties are active. On the contrary, a strong body of opinion holds that vertical arrangements are frequently competitiveness enhancing, that is, far from diminishing competition, these arrangements actually enable the contracting parties to produce or distribute a better or lower priced product or service. In general then, it is argued, anti-trust proscription of these arrangements confuses the requirement to defend competition, with action essentially designed to defend competitors.

11. However, the Competition Act, in common with competition statutes elsewhere, does cover vertical mergers. It does so because it is widely recognized that, under particular circumstances, vertical mergers may impact negatively on competition. Alarm bells will sound where one or both of the parties to the transaction dominate the markets in which they operate.[62] We shall elaborate the reasons underlying these concerns below. Suffice to note that while a vertical transaction

61 After the conclusion of the hearings into this matter, SCHS tabled an alternate structure for the post-merger decision. In terms of this structure a holding company would be incorporated in South Africa with SCHS and PD reporting to the holding company. Although briefly discussed at the hearing, the details pertaining to the post-merger structure of the companies have not influenced our decision in any material respect.

62 William G. Shepherd, *The Economics of Industrial Organization*, 4th Edition, 1996, page 388 and on page 277 Sheppard states that "high market shares raise a presumption that the social costs of a vertical merger exceed the benefits."

involving a dominant firm portends a variety of potentially anti-competitive outcomes, for the purposes of the present transaction it is the prospect of increased entry barriers[63] as well as the possibility of market foreclosure[64] and the related ability to raise rival's costs[65] that are of most immediate concern.[66]

12. It is frequently pointed out that the decision to integrate vertically is a business decision generally made to enhance the efficiency, the competitiveness, of the product or service brought to market. A manufacturer may, in order to secure a reliable source of input, or an improved input, freely elect to provide the input itself. By the same token, a manufacturer anxious to ensure effective distribution of its product, may freely elect to handle distribution itself rather than entrusting it to a third party. This argument is, for the most part, unimpeachable, but it still does not eliminate the necessity for regulating vertical mergers. By analogy, firms are encouraged to expand horizontally in their chosen markets through the pro-competitive provision of superior products but may nevertheless be restrained from expanding through merging with their competitors. By the same token, although a firm's, even a monopolist's, pursuit of 'internal' vertical integration may excite little anti-trust concern, there may nevertheless be solid anti-trust grounds for proscribing an attempt to integrate vertically through the merger process. Anti-trust scholars, Areeda, Hovenkamp and Solow, identify several reasons for adopting a less sympathetic approach to vertical integration through mergers than through internal expansion.[67]

13. What the literature does clearly reveal is that, as with much of anti-trust adjudication, the impact of a vertical merger on competition is acutely sensitive to the facts of the case. At the level of general principle, it is fair to say that vertical mergers raise fewer competition concerns and generates larger pro-competitive gains than their horizontal counterparts. On the other hand, it may be credibly claimed that vertical transactions in which one or both of the parties dominate their respective markets are liable to raise greater anti-trust concerns than those involving firms with

---

63 The ease with which new firms can enter has been recognized as an important consideration in evaluating the ability of existing firms in a concentrated industry to increase prices above competitive levels. See Antitrust Law Developments Volume I (third edition) page 307.

64 Traditional foreclosure theory posits that a vertical merger may foreclose new entry at one level of production or service by eliminating potential purchasers or suppliers for a potential entrant and thereby making it necessary to enter at two levels in order to succeed – Antitrust Law Developments, fourth edition, Chapter IIIC, page 352.

65 Raising rivals' costs is described as a form of non-price predation carried out by raising rivals' supply cost, rather than the traditional predatory tactic of reducing their output price by flooding the market - *Understanding "raising rivals' costs"* by Timothy J. Brennan, Antitrust Bulletin Spring 1988.

66 For a summary of the economic consequences of vertical mergers and possible substantial impairments of competition arising from these transactions see Areeda, Hovenkamp and Solow – Antitrust Law Vol. IVA pp 142-144. In addition to foreclosure, price discrimination and increased entry barriers, they identify the following possible threats to competition arising from a vertical merger: supply preemption in times of shortage, the facilitation of horizontal collusion, the elimination of a large, aggressive buyer, and raising the cost of rivals

67 These include, firstly, the relative ease of identifying and controlling mergers as opposed to internal expansion; secondly, the fact that even if a vertical merger is prohibited it remains open to the firm to achieve the same benefits through internal expansion; thirdly, internal expansion introduces new capacity and competition. This is likely to generate greater efficiencies because this new capacity will have to win its way in the market. Fourthly, a vertical merger, as opposed to internal vertical integration, is less likely to generate immediate economies in production because the plants are unlikely to be combined. (Areeda, Hovenkamp and Solow – Antitrust Law, Vol. IVA p.141)

relatively small market shares. But this does not take us very far – clearly the evaluation requires a detailed examination of the facts of the case in question and it is to this that we now turn.

***The Relevant Markets***

14. SCHS and PD are in a vertical supplier/customer relationship and the two relevant markets with which we are concerned in this merger are the supply of medium wax to the candle industry in South Africa (the 'upstream market'), and the production and marketing of household candles in South Africa (the 'downstream market'). Both SCHS and PD sell their products throughout the Republic. Note that both the Commission and the merging parties agree that the relevant product markets affected by this transaction are the market for candle wax and the market for household candles. They also agree that the relevant geographical market is South Africa.

*The upstream market*

15. SCHS produces and markets *hard waxes*, that are used in the hot melt adhesive, polymer processing and printing inks industries; *medium waxes*, that are mainly used in the candle manufacturing industry; and *paraffins*, that are used in the oil exploration, synthetic rubber and solvents industries.

16. Waxes may be divided into different groups based upon the oil content of their respective products with the lowest, fully refined paraffin wax, having an oil content of 0,5% and the highest, slack wax, with an oil content of 5-20%. The higher the oil content, the softer the wax and the less suitable for producing candles.

17. Of the different waxes that can be distinguished in the industry, that is, fully refined paraffin wax, semi-refined wax, SCHS medium wax and slack wax, only a wax blended from a combination of slack wax and a better quality semi-refined wax, could be regarded as reasonably substitutable for the medium wax produced by SCHS, in order to produce candles. The medium wax produced by SCHS, which is used for candle manufacturing, is allegedly of a lower quality than the imported semi-refined wax. When the higher quality imported wax is used for candle manufacturing it is first blended with lower quality slack wax.[68]

18. The medium wax manufactured by SCHS is manufactured at Sasolburg, using raw material purchased from Sasol Ltd in Boksburg and slack wax from Shell, BP and overseas suppliers. This is a continuous process and the output, which is immediately suitable for use in the manufacture of household candles, must be removed from the factory because candle wax cannot be stored

68 Although there is a price differential of approximately 11-15% between imported semi refined wax and medium wax, it was confirmed at the hearing that the former is of a higher quality than the latter and that, before use in candle production, the imported wax was 'extended' by blending it with slack wax, which is cheaper – thus the effective price of the imported wax that goes into local production (that is, after it has been blended with the less costly local slack wax) is not significantly above medium wax. Unless the costs of production of local medium wax, on the one hand, and the blended imported wax, on the other hand, are identical this would indicate that SCHS is pricing at import parity, a pricing strategy available only to monopolists (or, what is the same thing, colluding oligopolists).

economically. If the wax cannot be sold to candle manufacturers, it must be "cracked" into fuel and sold at a lower realisable value.[69]

19. The estimated market shares of participants in the medium wax supply industry are SCHS 75%, Masterrank 8%, G Zabel 6%, Reach Industrial 6%, BP 5% and Shell 2%. Although some submissions claimed that SCHS's current share of the domestic market for household candle wax was considerably in excess of 75%, it is common cause that its share is no less than 75%.

20. Note that most of the competitors mentioned above – all, with the exception of BP and Shell – do not produce wax.[70] They import it and distribute it and account for approximately 20% of the local market. Imported, unprocessed medium wax is not subject to import duties. It appears that, for the most part, the share of imported wax used in the domestic candle market is a residual of that available from SCHS, that is, when SCHS does not have supplies of wax available candle manufacturers resort to the higher priced imported wax which they then 'extend' by blending with cheaper (because inferior) South African produced slack wax. Manufacturers of decorative candles – not part of the relevant market - use imported wax, the South African product not being suitable for this segment of the candle market.

*The downstream market*

21. PD produces and markets household candles, which consist of a pack of six white candles each weighing 75g or 450g in total. This candle market must be distinguished from decorative candles. . Candles may not be sold as household candles unless they comply with the specifications laid down in SABS Standard No. CKS60.

22. Although possible substitutes for candle-use include oil lamps (paraffin) and electricity the fact of the matter is that, at present, a large portion of the South African population, especially the very poor, still rely on candles for primary lighting purposes.

23. The estimated market shares of the five largest participants in the market for the manufacture and distribution of household candles are PD with 42%, Willowton and Cake Mills 13%, Morlite Industries (Buffalo) 11%, Boardman Brothers, t/a Newdons[71] 9% and Sealake Industries 7%. SCHS currently is the only supplier of wax to PD, Willowton and Cake Mills and Morlite Industries, which covers 66% of the household candle market.

---

69 It appears that this feature of the product dictates SCHS's preference for long term supply contracts with its principal customers in the downstream market. It has enjoyed such an arrangement with PD since 1995, the year in which SCHS sold PD to the Goodman family trust. It has a supply agreement in place with Willowton, the second largest candle producer – with a 13% market share – in South Africa. Note however, that contrary to the impression sometimes created, there is an alternate use for the wax – it may be 'cracked' into fuel– but it is a less commercially attractive use.

70 BP and Shell actually sell some of their slack waxes to SCHS as well as to the importers of wax for blending purposes.

71 However it alleges that it does not compete with PD because it is operates in a niche market -it uses higher quality imported wax, the candles have a smoother appearance and the packaging differs slightly.

24. South African manufacturers – both decorative and household candles - are protected from imports by a standard duty of 20% on imported candles. According to the parties imported candles, both decorative and household, account for only 8% of the candles distributed in South Africa.

25. The parties estimate that candle manufacturers are operating at 60% of their capacity.

***The Act***

26. The Act requires us to consider mergers in terms of section 12A, which states in subsection 12A(1):

'Whenever required to consider a merger, the Competition Commission or Competition Tribunal must initially determine whether or not the merger is likely to substantially prevent or lessen competition, by assessing the factors set out in subsection (2), and –

a) If it appears that the merger is likely to substantially prevent or lessen competition, then determine -

i. Whether or not the merger is likely to result in any technological, efficiency or other pro-competitive gain which will be greater than, and offset, the effects of any prevention or lessening of competition, that may result or is likely to result from the merger, and would not likely be obtained if the merger is prevented; and

ii. Whether the merger can or cannot be justified on substantial public interest grounds by assessing the factors set out in subsection (3); or

b) Otherwise, determine whether the merger can or cannot be justified on substantial public interest grounds by assessing the factors set out in subsection (3).'

27. Section 12A(2) reads:

'When determining whether or not a merger is likely to substantially prevent or lessen competition, the Competition Commission or Competition Tribunal must assess the strength of competition in the relevant market, and the probability that the firms in the market after the merger will behave competitively or co-operatively, taking into account any factor that is relevant to competition in that market, including –

a) the actual and potential level of import competition in the market;
b) the ease of entry into the market, including tariff and regulatory barriers;
c) the level and trends of concentration, and history of collusion, in the market;
d) the degree of countervailing power in the market;
e) the dynamic characteristics of the market, including growth, innovation, and product differentiation;
f) the nature and extent of vertical integration in the market;
g) whether the business or part of the business of a party to the merger or proposed merger has failed or is likely to fail; and
h) whether the merger will result in the removal of an effective competitor.'

***The Impact of the Transaction on Competition in the Relevant Markets***

28. By any measure of concentration both SCHS and PD enjoy powerful positions in their respective markets. The Herfindahl-Hirschman index (HHI) that measures concentration and which guides anti-trust investigation and adjudication indicates significant market power in each of the markets in question with an HHI in the upstream market of 5786 points and in the downstream market at 2222 points.[72]

29. Furthermore, in the upstream market the single-firm concentration ratio (the C1 ratio) is exceptionally high at 75%. In the downstream market, the C1 ratio is also notably high at 42% and the C3 ratio (the three firm concentration ratio) is 66%.

30. Antitrust scholars Areeda, Hovenkamp and Solow observe that in the USA vertical mergers are unlikely to be challenged unless the HHI in the upstream market exceeds 1800, and a large percentage of the upstream product would be sold through vertically integrated retail outlets after the merger.[73] In this case SCHS, in 2000-2001, sold approximately [*this evidence is claimed confidential*] of its domestic wax supply to PD with whom it has a supply agreement.[74]

31. However, as with all vertical transactions, these measures of concentration and indicators of market power do not increase in consequence of the transaction and, hence, by these measures alone, competition cannot be said to have lessened.[75] The question that must rather be asked is whether the transaction allows the parties or one of the parties to prevent competition in the relevant market(s) thus maintaining or extending the anti-competitive structure of both or one of the markets[76].

32. As we shall elaborate, we find that the transaction prevents or lessens competition in the candle wax market, the upstream market, by raising barriers to entry in respect of that market. Furthermore, the transaction significantly increases the capacity of the merged entity to consolidate and extend PD's already powerful position in the downstream market. We will show that

---

72 According to the U.S. Department of Justice and the Federal Trade Commission Horizontal Merger Guidelines HHI values below 1000 involve no significant monopoly power, whereas those above 1800 clearly do.

73 Areeda, Hovenkamp and Solow: Antitrust Law, Volume IVA p.168

74 It also sold, in the same year, approximately [*confidential information*] of its product to Willowton, its second largest customer, with whom it has a supply agreement.

75 See footnote 13 above.

76 Areeda, Hovenkamp and Solow, Antitrust Law Vol. IVA, p.137: "A vertical merger, standing alone, does not alter concentration … Accordingly, any anticompetitive effects of a vertical merger must arise from other structural or behavioral consequences such as increased entry barriers, the elimination of non-integrated rivals by foreclosure, or the raising of rivals' costs".

dominating the downstream market allows SCHS to protect its monopoly position in the upstream market for candle wax.

***The Impact on Competition in the Candle Wax (upstream) Market***

33. SCHS are major international producers of candle wax. The company clearly dominates the local market in the product. SCHS insists that its overwhelming interest is in the production of wax. It does not, it says, have a primary interest in the production of candles or in the price of candles except insofar as these impact on its ability to sell wax. In fact in 1995 it exited the local candle market when it sold Price's Candles to the Goodman family precisely, it avers, to avoid the conflict with its other candle manufacturer customers that was generated by SCHS's presence in both upstream and downstream markets.

34. SCHS's normal commercial interest in ensuring that its wax enjoys widespread support in the market is intensified by the nature of the product. Firstly, as already noted, wax cannot be economically stored. Secondly, it is a by-product of a larger chemical production process thus constraining, it appears, SCHS's ability to adjust, in the face of changes in demand, the supply of wax that it brings to market.[77] This has, it appears, dictated a particularly close relationship between supplier and customer manifest in, inter alia, exclusive supply relationships with its major customers, notably, in South Africa, with PD.

35. The security and stability of SCHS's relationship with its market has been disturbed by a conflictual relationship with PD, its major customer. A supply agreement between the parties has been in force since the sale of Price's to the Goodman family trust in 1995. The agreement essentially provides that PD shall procure the lion's share of its wax input from SCHS. It is permitted to source a small amount of wax from suppliers other than SCHS.

36. It appears, however, that relations between the parties have been fraught with conflict. The upshot is that PD has run up a significant trading debt with SCHS. SCHS has secured its debt by concluding a pledge agreement with the Leo Goodman Family Trust.[78] Moreover, it appears that there has been significant conflict between the parties regarding the terms of the contract and the performance of the contract. These conflicts had been referred to arbitration. The Tribunal has not been provided with details of this conflict. Suffice to say that immediately prior to arbitration SCHS offered, in exchange for settlement of all disputes between the parties and outstanding debt, to acquire PD from the Goodman Family Trust.

37. This, as outlined above, is the origin of the transaction before us, one that has been presented by the parties as the inevitable outcome of a commercial relationship gone sour and of a company,

---

77 Dr. Barth, the Chairman of SCHS, put it thus to the panel: "…I'm not so much interested as Schumann Sasol what happens to the candle price. I'm interested to my supply in wax and as we have stated earlier it's a continuous process and if we would say we reduce the manufacturing of wax for whichever period by even only 20% or 30% then that would have an immediate effect on the whole production of our Sasolburg plant because it's a continuous process and it's a process with complementary products, you either produce or you do not produce. You cannot produce only one product and not produce the others." (Transcript of hearing, 28 June 2001 pp.48-9)

78 The Leo Goodman Family Trust pledged its shareholding in PD to SCHS as security for amounts owing under the wax supply agreement.

SCHS, attempting to settle a conflict with its contracting partner and to exercise its security rights. From the perspective of a major creditor, this presentation of the transaction is perfectly plausible. However, from a competition perspective, it must be given a somewhat different cast, one supported by other concerns articulated by the parties.[79]

38. From a competition perspective the transaction is to be viewed as the action of a producer intent upon defending or extending its market share. This motivation is unimpeachable at competition law. Indeed it is, or may be, the very stuff of competition *as long as the mechanism for achieving that objective is the provision of a superior or lower-priced product.* Our task is to ensure that this otherwise laudable objective is not realized through an anti-competitive mechanism.

39. Consider, again, the background: the dominant player in a market is faced with, what appears to be endemic conflict with its major customer. At stake is the potential loss of that customer – it may seek an alternate supplier or it may exit the market altogether. The normal commercial concern that would inevitably accompany that threat is exacerbated by the nature of the product, by, in other words, the imperative to maintain the level of output and to ensure that the output is consumed as soon as it is produced.

40. This situation is ripe for competitive entry into the candle wax market. And there are potential competitors on the horizon. There are no tariff barriers and international competition, particularly in the form of Chinese imports, already has a toehold in this market. Moreover, it appears that Shell, a potential alternate supplier of a competing wax product, has recently resolved some significant technical problems at its Malaysian refinery and is eyeing the local market. This is, quite understandably, a situation in which any producer would feel acutely vulnerable, all the more so one with the technical constraints faced by SCHS.

41. In the event that PD survives, there exists the real possibility that it may change its allegiance to another supplier, the more so if the arbitration allows it to escape its obligations under the supply agreement. If, on the other hand, PD fails then a large portion of the candle market is unaccounted for. It may be taken up by imports, by new entrants or by producers currently active in the market, producers who have not entered into supply agreements with SCHS. Both of these scenarios are immensely threatening to SCHS's interests, a threat significantly exacerbated by the nature of the product. As Dr. Barth, the Chairman of SCHS, eloquently expressed it at the Tribunal hearing: "Please imagine just for a moment that the candle industry would decide for 2 months period to buy Chinese wax instead of Schumann Sasol wax."

42. From a competition perspective it is this consideration that has driven SCHS's decision to acquire its largest customer. When PD's custom is secured, it, together with the supply agreement with Willowton, secures for SCHS the lion's share of the South African wax market. There are other mechanisms for achieving SCHS's objective, but they carry a greater risk of failure. The pro-competitive mechanism preferred by competition law is through the provision of a better or less

79 The parties have effectively suggested that the financial ties between the parties – dominated by PD's debt to SCHS – necessitate subjecting this transaction to a lower competition standard than that accorded another transaction. This plea has no merit. We must naturally base our decision on the competition perspective, on the impact of the transaction upon competition. The transaction may make perfect sense from a private commercial perspective but we must still confine ourselves to the competition perspective and to the other factors – efficiency gains and public interest - specified in the Competition Act. Expressed otherwise the Competition Act does not permit us to suspend or dilute our standards of evaluation because one of the parties to a proposed transaction seeks relief, through merger, from the consequences of an imprudent or unfortunate business decision.

expensive product. Supply agreements along the lines of that between SCHS and PD is another option. However, as Mr. Barth expressed it "the experience which we made with the selling the business in '95 to the Goodman family, would not be an argument in favour of trying to do that again."[80]

43. From SCHS's perspective then the immediate virtue of the acquisition – its narrower financial considerations aside – is that it secures a share of the candle wax market that is not subject, as in the PD situation, to the vagaries of a disputed contract and to the possibility of hold-up by its largest customer. However, from a broader competition perspective it ensures that SCHS's competitors are reduced to the role of bit players participating at the fringes of the market. They are excluded from the largest part of the market in an area of production subject to scale economies and in which the respective participants – the supplier and customer – place a high premium on certainty of supply and demand. Their only way of entering the upstream candle wax market would be to enter, simultaneously, the downstream candle market. But this is unlikely to happen. Like SCHS, they are not candle manufacturers and, in a market where there is already one dominant candle producer, one owned, moreover, by the dominant competitor in the candle wax market, this approach is fraught with risk. Under the circumstances the competitors are likely to accept their bit player status.

44. Confined to the fringes of a monopolized market, the presence of competitors does not represent a threat to SCHS. Quite the contrary, they perform a useful function, and this is precisely why the supply agreements permit the candle manufacturers to purchase a small share of their candle wax from alternative suppliers. As already noted at length, SCHS's technical constraints do not permit it to fine tune its production levels, to adjust output to short run spikes and troughs in demand. In this circumstance the presence of fringe suppliers is useful – they can be competed with in demand troughs for the fringe of the market; and they can help order the market when demand spikes thus allowing SCHS to avoid having to introduce additional capacity that may not find available demand in down periods. In response to Shell's re-entry at the fringes of the market Dr. Barth noted that its presence "will then also balance the supply and demand situation so that situations as we had in the past (where) we are not able to meet additional demands for product will then not be repeated." The entry of a competitor, even a potentially formidable competitor, is welcomed in the firm knowledge that SCHS's acquisition of the largest candle manufacturer ensures that its competitor remains confined to the fringes.[81]

45. We must, in concluding our finding on entry barriers in the candle wax market, respond to one other argument advanced by the parties. It is argued that SCHS already has its dominant position secured by the supply agreements with PD and Willowton. Hence, the argument continues, the acquisition does not disturb the *status quo*; it does not raise already high entry barriers. We are not persuaded by this argument. A contractual agreement is not immutable. The very proof of that - if any is needed – is provided by the relationship between PD and SCHS. Moreover, even well

---

80 There are also indications in the SCHS submission to its supervisory board that it feared that the supply agreements would not pass muster with the competition authorities.

81 Note that participants who are compelled to operate in this manner at the fringes of the market are compelled to absorb most of the risk of market fluctuation. As Areeda et. al observe "A risk is a kind of cost, and a firm that faces higher risk must customarily pay more for capital, and must charge higher prices during strong demand periods to make up for increased losses during weak periods of shortage. To that end, the ability to shift the risk to rivals effectively raises their costs" (Areeda et al p. 181). Note too the evidence of considerable 'churning' (that is rapid entry and exit) of firms at the fringes of the market. This of course increases the risk assumed by wax producers reliant upon this end of their market for their custom.

functioning contractual relationships provide for termination and are subject to re-negotiation and this at least allows a potential entrant to contemplate a substantial presence in this market. As important, it forces the incumbent to contemplate a competitor entering the market. This potential is precluded by the acquisition. Accordingly, the acquisition lessens the potential for competition; it indeed prevents competition, by raising entry barriers above those present as a result of the supply agreement.

46. The Commission has proposed that this transaction be approved subject to the imposition of certain conditions. None of the conditions proposed will overcome the heightened entry barriers in the market for candle wax. In fact, the Commission confined its considerations and concerns to the candle market and it does not appear to have considered the transaction's impact on the candle wax market despite having identified this as one of the markets affected by the transaction. We have not been able to devise conditions designed to cure the effect of the transaction on entry barriers in the candle wax market.

***The Impact on Competition in the Household Candle (downstream) Market***

47. The Commission expressed the view that the proposed deal would diminish competition in the household candles market should the transaction be approved unconditionally. An unconditional approval, in the Commission's opinion, would lessen the number of participants in the candle production and distribution market in future in what is already a concentrated industry. Future competition, i.e. new entry, could be adversely affected if not totally eliminated. In addition, the Commission provide evidence establishing that, in the past, many new entrants found it impossible to survive in the market place. In the Commission's view the proposed transaction would not only make new entry highly unlikely, but the potential restriction on competition and anti-competitive practices that could flow from this transaction could also force existing participants, mostly small to medium-sized firms, from the candle production and distribution market.

48. As already indicated, SCHS insists that its overriding interest is in the candle wax market. It denies that it has primary designs on establishing a dominant position in candle manufacturing. Far from that being the case, it insists that it is cognizant that its interests as a manufacturer of candle wax (the upstream market) are in potential conflict with a presence in the downstream candle market and that this will temper any prospect of anti-competitive behaviour on its part in that latter market. In support of this contention it points to its withdrawal from candle manufacturing in 1995 and insists that its re-entry into the business of manufacturing candles was forced upon it by its fraught relationship, concretely including its financial relationship, with PD and the likelihood of that company's imminent demise.

49. We will however demonstrate that, from the perspective of the interests of SCHS, the wax producer, there is, nevertheless, considerable incentive for the merged entity to extend its powerful position in the downstream market, the candle market. And we will then show that this transaction provides the wherewithal for an anti-competitive response to that incentive. In other words, we have demonstrated above that, despite its powerful position in the candle wax market, SCHS has strong grounds for feeling vulnerable to potential entry into this market. The acquisition by SCHS of PD, its largest customer, is, we have found, a mechanism for shoring up its dominance of the upstream market by raising barriers to entry in that market. By the same token, SCHS's imperative to defend its dominance in the upstream market provides the incentive for anti-competitive behaviour in the downstream market and the transaction provides the means for

pursuing that conduct.[82] We emphasize that SCHS is not hereby discouraged from defending its market share in candle wax provided it achieves this through the pro-competitive mechanism of a superior product. We are simply enjoining a mechanism – the merger – that will permit the realization of this objective through anti-competitive practices in either of the affected markets.

50. SCHS has consistently maintained that it has no interest in favouring its prospective subsidiary, PD, over its other customers. It points out that although PD consumes approximately [*confidential information*] of SCHS's medium wax supply, it must still, particularly given SCHS technical constraints, ensure the loyalty of the remainder of its customer base. This imperative, it avers, predisposes it against anti-competitive practices directed at PD's competitors who remain important customers of SCHS.

51. The Commission has sought to bolster this assurance by recommending the imposition of the following conditions on the transaction, designed to prevent SCHS from discriminating in favour of PD relative to that of its competitors in the candle market:

    *(i)* *The primary acquiring firm is reminded that at all times it shall comply with the provisions of Section 8 and Section 9 of the Competition Second Amendment Act;*
    *(ii)* *SCHS must at all times adhere to the principles of transparency and non-preference in supplying candle manufacturers with wax;*
    *(iii)* *SCHS will not refuse to sell wax directly to any potential purchasers. However, if a single transaction is in respect of less than 100kg, SCHS may refer such potential purchaser to a retailer of wax;*
    *(iv)* *In the event of production shortages, the available wax would be proportionally supplied to all customers. SCHS must apply generally accepted trade standards (i.e. an equitable method of supply) that would not give preference to Daelite in these periods of shortages;*
    *(v)* *SCHS shall not give any confidential rebates or other advantages to Daelite;*
    (vi) *SCHS may only apply price differentiation and other differential treatment as provided for in Section 9 of the Competition Second Amendment Act, and then only if such differential treatment is economically justifiable.*

52. We are, however, not persuaded by this recommendation. In our estimation, should SCHS believe that its share of the candle wax market, the upstream market, is threatened by a possible tie-up between an alternative supplier of wax and one of the smaller producers of candles, its dominance of the upstream market combined with its powerful position in the downstream candle market will enable it to consolidate its position in the latter market precisely in order to maintain the already significant barriers in the upstream market that have, as we have demonstrated above, been consolidated and extended by this transaction.

53. Note that this does not necessarily presuppose that the upstream firm engages in unlawful restrictive practices of the sort contemplated by the Commission's proposed conditions. PD in the downstream market is accorded a massive anti-competitive advantage by the mere fact that SCHS, its parent in the upstream market, has intimate, direct and immediate knowledge of the production capacities and output levels of all PD's competitors in the downstream market, including knowledge of fluctuations in their demand for wax (which, in turn, is directly derived from the

82 Although at opposite ends of the technology spectrum, this is remarkably similar to the conclusion of the US Appeals Court in its much quoted recent decision in the Microsoft case: "Microsoft's efforts to gain market share in one market (browsers) served to meet the threat to Microsoft's monopoly in another market (operating systems) by keeping rival browsers from gaining the critical mass of users necessary to attract developer attention away from Windows." - U.S. v. Microsoft Corp. decided on 28 June 2001.

demand for their candles). In other words, SCHS may behave quite lawfully in relation to its customers – it may refrain from discrimination, from withdrawals of supply, or from foreclosure. However, its vantage point as the dominant supplier of the critical input in candle manufacturing accords it privileged insight into the capacities and strategies of its downstream subsidiary's competitors. The conditions proposed by the Commission do not restrain this and nor do we believe that it is possible to achieve this through the creation of artificial 'fire walls'.[83]

54. Moreover, while the conditions may limit the ability of SCHS to engage in discriminatory practices that favour PD they clearly do not limit PD's ability to engage in other anti-competitive practices. One example is predation. A number of submissions suggest that PD has already engaged in this practice. A counter-argument, and one that is borne out by the allegation that predation has already occurred, is that the transaction does not enhance PD's ability to predate – its ability to predate was given by its pre-merger market power and this has not increased in consequence of the merger. However, there is little question that the ability to predate is substantially enhanced by the deep pockets of a powerful shareholder, particularly one that may be willing to take significant losses downstream in order to defend its dominance in an important upstream market.[84]

55. Our concerns in this regard are confirmed by submissions that indicate that enhanced domination of the candle industry is already part of SCHS's game plan. In a submission made by Morelite, PD's largest competitor in Gauteng, it was averred that in a meeting held in September 2000 between representatives of SCHS and Morelite, the former outlined his company's intention to acquire PD and then to transform the other candle manufacturers into distributors of PD manufactured output. This claim was denied by SCHS at the hearing. Moreover, on the morning of the hearing Morelite informed us that it had reached an accommodation with SCHS – the precise nature of which was not placed before us – and that it accordingly withdrew its objection to the transaction. However, the submission to SCHS' Board of Directors confirms the Morelite account.[85] We should add that this interpretation was not denied by SCHS (although the meeting

---

83 The US Federal Trade Commission recently considered a vertical transaction between the Ingram Book Group and Barnes & Noble, respectively the largest wholesaler and retailer of books in the United States. The transaction appears to have been withdrawn at the 11th hour while the FTC was considering behavioural remedies broadly similar to those proposed by the Commission in this matter. Richard Parker and David Balto, two FTC officials, comment as follows: 'The only remedy that might have addressed the situation is a set of behavioral rules—essentially a set of non-discrimination or 'fair dealing' provisions. But those kinds of rules can be problematic. They are susceptible to evasion and difficult to monitor, particularly in a transactional setting where discrimination could be exercised in subtle ways on several different variables. While the (Federal Trade) Commission has on occasion accepted some form of behavioral relief in mergers, those approaches may not have worked in this context. Recall the Supreme Court's admonition in *DuPont* (United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316 (1961) that "the public interest should not in this case be required to depend upon the often cumbersome and time-consuming injunctive remedy" to enforce behavioral rules "- *The Evolving Approach to Merger Remedies by Richard G. Parker & David A. Balto, published in Antitrust Report (May 2000).*.

84 The parties have insisted that they have not been found guilty of restrictive practices in the past and that we cannot make our decision on the basis of an inference of future conduct. We cannot, it is insisted, engage in speculation about the future; we must rather concern ourselves with evidence from the present. We do not understand this argument. Merger regulation is, in significant part, inherently speculative - it is pre-emptive insofar as it designed to ensure that the merger proposed does not give rise to a market structure that lends itself to restrictive practices. It is our view that the market structure that will emerge from this transaction does lend itself to a number of restrictive practices, including predation, not all of which can be forestalled by the imposition of conditions.

85 This evidence is borne out by a confidential statement.

with Morelite was denied). It sought rather to downplay the significance of this (confidential) statement by suggesting that it simply reflected discussions regarding the long-term future of the candle industry.

56. It was also pointed out that entry barriers into candle manufacturing are relatively low. We accept this – it is borne out by evidence of new entry. . We note however the extremely high rate of attrition or exit. It appears then that while entry requires relatively little technological sophistication or capital, it is nevertheless difficult to sustain. This is not surprising. Simply put it is difficult to sustain a presence in a market in which the largest participant has a 42% market share and the three largest share 66% of the market. The fact that the largest player is owned by the dominant supplier of the key input renders this market particularly inhospitable. It suggests that, at best, new entrants into the candle market will, as with new entrants into the candle wax market, have to content themselves with the fringes of their market thus posing no competitive threat to the dominant players.

57. In sum then, we conclude that the transaction before us enables SCHS to maintain and extend its dominant position in the market for candle wax. Furthermore, should SCHS deem it necessary to further secure its position in the upstream market by extending its powerful position in the downstream market then this too is facilitated by the transaction. Accordingly we find that the transaction will substantially lessen or prevent competition in both markets in question.

***A failing firm***

58. Section 12A(2)(g) of the Act enjoins us to consider "whether the business of part of the business of a party to the merger or proposed merger has failed or is likely to fail." The parties have raised the failing firm defense.[86] In effect, they argue, as they are entitled to do, that the prospective failure of PD, the target firm, justifies the application of a lower anti-trust standard to this transaction. The merger, they claim, is necessary to ensure PD's continued presence in the market. Absent the merger, PD will fail. In that event, a significant competitor will have been removed from the market - competition will have been diminished in consequence of the failure of this competitor, more particularly if the productive capacity represented by PD's material assets exits the market altogether. Under these circumstances – that is, if the firm (and, more so, its assets) exits the market - competition will actually have diminished thus exerting upward pressure on candle prices.

59. We should, at the outset, indicate a plausible alternative scenario in the event of PD's demise. There is, it is common cause, considerable excess capacity – 40% is the figure given – in this industry. Moreover it is common cause that that there is relative ease of entry into candle manufacturing, the downstream market. It is, in our view, eminently plausible that, upon PD's

86 Anti-trust jurisdictions differ in the way in which they treat the failing firm defence. The concept originated in the United States where it provides an absolute defense to a finding that a merger will substantially lessen competition. It was first recognized in International Shoe Co. v. FTC, 280 U.S. 291 (1930). Because it provides an absolute defence its requirements are rigorous and difficult to meet. Also see the 1992 US Merger Guidelines. The EU in Kali-Salz/MdK/Treuhand, Case IV/M308 [1994] 0.J. L186 has broadly followed United States v. General Dynamics Corp., 415 U.S. 486 (1974) in dealing with the failing firm defence. With regard to Canadian merger law Paul S. Crampton in his book *Mergers and the Competition Act*, 1990 in footnote 59a on p.408 quotes the Competition Authority in the Wadair/PWA merger indicating that "In assessing the failing firm factor in mergers that are otherwise considered to be substantially anti-competitive, the Director requires information relating to two issues: 1) the extent to which failure is, in fact likely to occur; and 2) whether there are alternatives to the merger that would be less restrictive of competition."

exit, its existing competitors will, through utilizing their spare capacity, increase their output and compete for a share of PD's erstwhile market. Equally, new firms may enter the market, possibly availing themselves of those of PD's material assets that come onto the market. Indeed SCHS itself has insisted that it will enter the market should PD fail.[87] On this scenario competition will actually intensify in the wake of PD's failure. Moreover, the relative resilience of PD's competitors will have been rewarded by the market share that they will gain as a result of the very process of competition.

60. However, the 'failing firm' is a term of art in merger regulation and it is incumbent upon us to examine the criteria commonly used in assessing the salience of the failing firm defence in this case. We do however insist that, as in most anti-trust assessments, the facts of the specific case will take precedence over the application of a derived formula. In our view the existence of considerable excess capacity is a salient fact that militates against the prospect of a shortfall in supply, and therefore upward pressure on price, in the wake of failure.[88] We nevertheless will reflect on the range of tests and criteria conventionally employed to assess the impact of potential firm failure on the competition implications of a merger.

61. First, is PD failing? According to the parties: " PD is demonstrably insolvent". [89]

62. There is little doubt that PD's financial predicament is dire. We should note that we do not understand, nor have the parties or the commission shed any light upon, how a firm with significant market share in a mature industry has landed in this sorry situation. It has not, after all, been derailed by a new innovation to which it has not had access. The Commission claims that the firm's auditors believe that the firm sold by SCHS to the Goodman family in 1995 was already in trouble. Others suggest that PD has been pricing below cost, presumably cushioned by a steady supply of loan capital from SCHS. The Goodman's allege that PD has been prejudiced by SCHS failure to adhere to the terms of the supply agreement. SCHS implies that management failure accounts for the firm's predicament.

63. None of these various allegations and explanations has been satisfactorily supported by evidence. However, an understanding of the causes of PD's failure is pertinent for two reasons: In the first place, it is not clear how SCHS intends post merger to address the cause of PD's possible failure and, as we shall demonstrate below, this has bearing on the merger evaluation, particularly on the question of countervailing efficiency gains resulting from the transaction as well as its impact on public interest. Moreover, failure, if it is to occur, will happen at the behest of SCHS, immeasurably the largest creditor. It appears that PD's failure could have been triggered by SCHS at any time over the last several years.

---

87 SCHS suggests that the fact that it will enter the market should PD fail is further evidence that prohibiting the transaction will make no difference to the competitive structure of the market. Regardless of whether the transaction is approved or prohibited, we will have a vertically integrated firm participating in the market. We do not accept this argument. SCHS is, of course, perfectly entitled to vertically integrate through internal growth because in order to do so it will have to compete for its share of the downstream market in much the same way as a firm is entitled to expand horizontally, even to monopoly, as long as it achieves this by competing. Merger regulation is meant to prevent the attainment of an anti-competitive position through means other than competition.

88 The parties have acknowledged this argument but insist that this will only take place with a considerable time lag – eighteen months was suggested. During the intervening period there will be a shortfall in demand. However with a large proportion of unutilised capacity already in place and relative ease of entry, we cannot understand why there should be such a slow response in a situation of excess demand.

89 This is substantiated by evidence, which is claimed confidential.

64. Unless we understand why the firm has been unable to survive profitably, it is difficult to understand why SCHS should trigger liquidation now rather than 12 months ago or, indeed, rather than 12 months hence. One possible inference is that SCHS has chosen to subsidise a captive, though inefficient, customer in preference to instability (read, competition) in the market for its candle wax. If this is so then SCHS has reaped the consequences that protection so often begets: increasing inefficiency matched by increasing subsidy. It should not expect the competition authorities to rescue it by sanctioning the ultimate protective umbrella, namely full vertical integration, regardless of the impact on competition. In short, while we believe that PD is in dire straits, we are not certain whether its failure is necessarily imminent – that will depend upon SCHS's continued interest in protecting the company.

65. Secondly, has there been any attempt to find an alternative suitor for PD, one that raises fewer competition concerns than SCHS? SCHS makes the plausible argument that few buyers would be willing to assume PD's massive debt. However it appears that there has been a concerted attempt to find a buyer for PD. Note that this search has specifically excluded other South African candle manufacturers. SCHS avers that they have been excluded in part because it was calculated that a horizontal transaction would not have received competition approval. SCHS has also made it emphatically clear that it would not welcome a situation where it was beholden to a single large customer. The absence or presence of willing buyers is, for the most part, a function of price – this is after all not a new untested product; its market and mode of distribution is well known and relatively predictable. The price of PD is largely a derivative of the extent to which SCHS is willing to assume the target company's debt. SCHS is proposing to purchase PD for a nominal sum because it has effectively been willing to write off its massive debt in exchange for vertical integration. Should it be willing to do the same in respect of other purchasers then alternative offers may come to the fore.

66. Thirdly, is there any prospect of re-organising PD? That is, is there any prospect of PD surviving without the merger? As we shall elaborate when we discuss the prospect of countervailing efficiency gains, little has been said about the prospects of raising PD's performance. We are accordingly unable to answer this question. SCHS, though revealing few details, believes that it is capable of turning around PD. It is not clear why it cannot achieve this without first merging. SCHS has argued that it has been in effective control of PD since 1998 – if it is possible to restore PD's fortunes through the adoption of pro-competitive strategies then surely SCHS should be able to achieve this from its present position without resorting to the expedient of an anti-competitive merger.

67. Fourthly, what will happen to PD's market share? The Commission errs by asking where PD's market share will go post-merger. Clearly, it will go to the acquiring firm, SCHS, or, technically, it will remain with PD now controlled by SCHS. However, what is pertinent is what will happen to its market share post-failure? If it can be shown that the acquiring firm (SCHS) will simply mop up the target firms (PD's) market share post-failure then there is, it is argued, little point in prohibiting the merger because the impact on market shares in the downstream market will be identical – either way, the acquiring firm will take the target's market share. However as we have demonstrated above the post-failure outcome is by no means clear because there will be several competitors contending for PD's market share including existing participants in the candle market and possibly new entrants, including SCHS itself.

68. Finally, what will become of PD's assets post failure? We have already suggested that the pertinence of this question is eroded by the existence of significant over-capacity. On the evidence the most likely outcome is that certain of the assets, to the extent that they are divisible, will be

acquired by new entrants, while others may find their way out of the country. However, in the context of considerable excess capacity we do not believe that the market will be characterized by a significant supply shortfall post-failure.

69. In summary, we find that the failing firm defence does not support approval of this transaction. First, it is not clear that the firm will actually fail despite its parlous circumstances. Secondly, the extent of excess capacity in the industry and ease of entry suggests that the competitive situation will not deteriorate in consequence of the exit of PD (or its assets) – quite the contrary, we are likely to see an intensification in competition. Third, if SCHS has a pro-competitive strategy for reviving PD's fortunes it is not clear why this cannot be pursued through means other than the merger. Finally, while we are persuaded that SCHS and PD have sought alternative purchasers, the success of their search will, in a relatively stable industry, depend on price and that, in turn, will depend on the quantum of PD's debt that SCHS is willing to assume – it is the only purchaser because it has only been willing to write off its own debt in exchange for complete vertical integration. [90]

***Pro-competitive Efficiency Gains***

70. Are the anti-competitive consequences of the transaction countervailed by pro-competitive efficiency gains?

71. The Commission points out that SCHS has not specified efficiency gains arising from the transaction aside, that is, from a blanket assertion that these are assured by the injection of SCHS's superior management and financial resources. We have already pointed out that SCHS's financial resources have long been at PD's disposal and these have not apparently improved the latter's competitive position. We have also noted that SCHS's financial resources may plausibly give rise to anti-competitive predation rather than a pro-competitive resolution of PD's predicament.

72. SCHS has, in fact, only proposed one concrete strategy for alleviating PD's plight.[91] Note that there is no certainty that PD's competitors will respond to this strategy by taking market share from PD. Certain of PD's competitors have already intimated that PD has been pricing its output below cost. Under these circumstances a more plausible scenario is that they will accept price leadership from PD – in that event PD's competitors will similarly seek to enhance their profitability by hiking their own prices in a market in which the price elasticity for the product is, given the absence of ready substitutes, likely to be low.[92] Given a C1 ratio of 42% and a C3 ratio of 66% price leadership would be extremely likely.

---

90 Expressed conversely, through writing off its debt (that is, through assuming PD's debt) SCHS has effectively demonstrated its willingness to pay a premium price for PD – the inference is that it is willing to pay this price because, through vertical integration, it secures dominance of the markets in question. Other purchasers would not be willing to pay this price – or, assume this level of debt – because they would not be able to reap the anti-competitive benefits of vertical integration. However, at a more realistic price, one that reflected simply the cost of acquiring a significant candle manufacturer, alternative purchasers may well be available.

91 Evidence to this effect is born out by a statement in the Submission to the Board of Directors of SCHS for settlement with Goodman Family, which is a confidential document.

92 Refer to *The Economics of Industrial Organization*, fourth edition by William Shepherd, p.261 where the author points out that concentration, homogeneity of products, stable industry conditions, and long familiarity among firms favours tacit collusion, of which price leadership is one form. Also see Areeda and Turner, Antirust Law, Vol.V, p.230 where they mention the three grounds on which the largest firm might become a price leader, one being that the largest might be thought the wisest or at least the more knowledgeable about industry prospects and trends.

***Public Interest***

73. There are three public interest factors that must be assessed in this transaction. These are export competitiveness, small business and employment.

74. SCHS has asserted that it will focus on penetrating export markets. However, we have not been told how this will be achieved and no further weight is given to this bland assertion. It is certainly not clear that a successful export strategy requires the merging of SCHS and PD.

75. We concur with the Commission that small business is, if anything, promoted by prohibition of the merger. Low entry barriers lend themselves to an active SME presence. Indeed this is a rare case where SMEs seem to have succeeded in maintaining and, it appears, extending their market share, while the only large firm in the industry has floundered. As we have outlined PD's travails may constitute a golden opportunity for SMEs already active in the industry to consolidate and advance their own interests. On the other hand, protecting PD by allowing it to integrate with SCHS may well be the route for realizing one of SCHS's stated alternative strategies of converting existing small and medium-sized candle manufacturers into distributors of PD product.

76. Finally, we must consider the impact on employment. SCHS avers that, absent the transaction, PD will fail and 315 workers will lose their employment.[93] As we have pointed out, there is no certainty that PD will fail despite its parlous circumstances. Second, if, in the event of failure, PD's assets are acquired by a new entrant, certain of these jobs may be restored. Thirdly, we are not told how SCHS will re-organise production in order to restore PD's competitive position – this process inevitably entails job loss and we have not been provided with estimates of this. Indeed, one of SCHS's expressed alternative re-organisation strategies is to relocate the PD operation to Sasolburg and this will, in all likelihood mean that the present employees, who are, for the most part, employed through a labour broker, will lose their employment.

77. We accordingly conclude that the impact on public interest does not outweigh the anti-competitive consequences of the transaction. It should be borne in mind that it is the poorest consumers who consume candles – accordingly, the public interest loss would have to be considerable and certain in order to justify us approving an anti-competitive merger.

_____ 18 July 2001

D.H. Lewis Date

Concurring: M. Holden and U. Bhoola

---

93 This figure includes 45 full time employees, 1 temporary employee, 3 independent contractors involved in sale and 267 persons employed through labour brokerage.