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MERGER CONTROL IN DYNAMIC MARKETS – Contribution from South Africa

- Session III -

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This contribution is submitted by South Africa under Session III of the Global Forum on Competition to be held on 5-6 December 2019.

More documentation related to this discussion can be found at: oe.mcdym.

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Merger Control in Dynamic Markets

- Contribution from South Africa -

Background

1. The following note sets out the Competition Commission of South Africa's ("CCSA") response to the call by the Organisation of Economic Cooperation and Development ("OECD") for written submissions to inform the Roundtable discussion on investigations into Merger Control in Dynamic Markets to be held on the 5-6th December 2019.

2. The Roundtable will look at issues arising in merger investigations in dynamic markets, particularly given the increasingly recognised importance of dynamic competition in a growing number of economic sectors. The purpose of this exercise is to help answer the question: **what is the relevant timeframe of merger review**? that is, whether the authorities should assess the likely effects in one year, five years or in a ten-year period. Further, would this relevant timeframe of analysis apply equally in all markets, and if not, what factors determine how much authorities should look into the future.

3. The request has highlighted that the submission should pay particular focus to the following aspects in addressing the above questions (i) authority's experiences in the assessment of mergers in dynamic environment, (ii) the efficiency claims raised in dynamic markets, and (iii) the design of remedies that address competitive concerns without compromising dynamic efficiency gains. Further, the submission should include examples of merger cases, ex-post assessment and other studies such as market enquiries that are illustrative of the challenges of reviewing mergers in dynamic markets, that provide success stories and lessons learned.

1. Competitive assessment of Mergers in Dynamic markets

4. The South Africa Competition Authorities take into account dynamic effects when assessing the level of competition in a market. Section 12A(2)(e) of the Competition Act specifically mandates the CCSA to consider the dynamic characteristics of the market, including growth, innovation and product differentiation when determining whether a merger will likely result in a substantial prevention or lessening of competition.

5. Typically, such an exercise takes into account the peculiarities of the market in question, looking into the history of entry and exit, levels of barriers and prospects of entry (zoning in on the likelihood, timeliness and sufficiency of entry), the applicable product and process involved in bringing the product to market, creation of new markets and whether the merger is generating any creeping effects given any prior transaction in the applicable markets. In effect, the assessment of dynamics characteristic varies from market to market and from one merger to another. We discuss later below some cases where market dynamism came to the fore.

6. In virtually all mergers assessed, especially those that may raise competition concerns, the CCSA typically applies universally recommended ICN Merger Investigative Tools and Techniques, including for those mergers in dynamic markets. Such tools

typically include defining the applicable relevant markets, generating candidate theories of harm, applying screening tools such as market shares (using various metrics such as revenues, volumes, capacities, site traffic, for example in online platforms, number of wins in bidding markets etc.), evaluating the effects of merger, any efficiencies or pro-competitive arguments and specifically public interest considerations.

7. In applying these investigative tools, there are some challenges that may arise especially if the markets concerned are in fast-evolving sectors, such that some of the metrics above may change within short periods of time. This can occur in sectors such as some services markets, high-technology sectors and most modern digital markets. Such sectors experience high barriers to entry and exit, continuous process of product innovation typified by huge capital budgets on research and development ("R&D"), which processes of innovation continuously disrupt existing business models and create entirely new markets. This feature of disruption came to the fore in a recent merger which was recommended for prohibition by the CCSA.

8. The CCSA has recently assessed a merger, *MIH/WeBuyCars*[1] in which MIH, which is part of the largest e-commerce business in South Africa, Naspers, was buying an effectively new form of business that of the guaranteed wholesale buying of used cars for cash in South Africa. Naspers controls several online platforms in South Africa including Autotrader, which is the largest online automotive classifieds advertising portal for new and used cars, and OLX, which is a generalist online classified portal for a broad range of goods including used cars. In addition, Naspers had also recently acquired a Berlin-based company called Frontier Car Group ("FCG"), which specialises in the guaranteed wholesale buying and selling of used cars in several emerging countries such as Mexico, Pakistan, Nigeria, Indonesia and the UAE, among others. Importantly, FCG does not operate in South Africa. On the other hand, WeBuyCars is the leading wholesale buyer of used cars in South Africa. It virtually pioneered he model of guaranteed wholesale purchase of used cars into South Africa, and it also advertises its stock on Naspers' online Autotrader platform, together with numerous other traditional used car dealers who operate in South Africa. WeBuyCars sells the used cars it purchases mainly to other traditional used car dealers.

9. Much of the debate in the merger related to the breadth of the used car market, specifically whether traditional used car dealers sufficiently constrain this new guaranteed wholesale way of buying used cars. The merging parties argued that the market is broad, encompassing all used car dealers in the country such that WeBuyCars is not in a position to exercise market power. However, the CCSA observed that WeBuyCars business model was relatively new and typified by characteristics and features which would render the traditional dealers (more than 2 000 in the country) as non-effective competitors especially on the buying side of the market. Virtually every dealer competes directly on the selling side of used cars.

10. However, the CCSA found there were several factors which rendered it unlikely that the applicable market is as wide. There were numerous factors pointing out to a narrower market comprising only the guaranteed wholesale way of buying used cars which is not sufficiently constrained by the traditional used car dealers. Some of the features of this model which are not typified of traditional dealers are noted below as follows:

[1] CTSA Case No. LM183Sep18.

- There is a core focus on purchasing cars from individuals (rather than from auctions or other dealers)
- a focus on wholesaling cars to other dealers in order to turn stock quickly
- a strong focus on marketing to attract sellers of used cars (high marketing spend directed towards buying)
- using pricing models to accurately price a wide variety of cars
- providing inspection services to prospective sellers (which requires personnel and infrastructure)
- the need for working capital to finance the wholesale purchasing of stock
- network effects (the value increases to customers on one side from the growth of the other side)
- scale benefits, certain costs do not increase in proportion to the number of cars purchased, and the ability to price cars accurately increases with the number of cars purchased
- the importance of building brand awareness, augmenting the importance of first mover advantages
- spreading into adjacent markets, such as offering finance and insurance to customers.
- The model does not serve to trade-in customers, who are principally served by traditional dealers
- The car is bought 'as is' and the transfer and cash is immediate.

11. The merger was prohibited by the CCSA mainly on the basis that the merger would remove potential competition in this 'new' and disruptive market of guaranteed wholesale buying of used cars. WeBuyCars effectively pioneered this model of guaranteed cash buying of used cars in South Africa and is effectively a monopoly at this layer of the market, whereas Naspers had intended to introduce its own version of this similar guaranteed wholesale buying of used cars through FCG, to compete head-on against the incumbent WeBuyCars. There was recognition that the combination of FCG (with its experience and combination with OLX in other markets) and Naspers' Autotrader, would generate significant synergies that would likely create formidable competition against the incumbent WeBuyCars, which virtually has a monopoly position. Therefore, the merger removed potential competition, thus unilateral concerns were likely to result in the market for guaranteed wholesale purchase of used cars.

12. There were also other vertical concerns arising from the merger, particularly as a result of Naspers owning the Autotrader platform. Autotrader is the largest automotive online classified portal in South Africa, wherein virtually all dealers (including WeBuyCars) advertise their stock for prospective buyers. With the combination of WeBuyCars and Autotrader, the CCSA found there would be ample opportunities for Naspers to foreclosure WeBuyCars rivals' by either offering lower advertising rates to WeBuyCars versus its rivals and/or offering preferential terms to WeBuyCars against its rivals, especially given that Autotrader is the 'go-to' platform for all used car dealers.

13. In addition, there were also other conglomerate effects arising from the merger. There were opportunities for the merged entity to leverage its market power from one market into another. For instance, Naspers has a leading position on private automotive listings on its OLX generalist platform (against other generalist online classifieds rivals such as Gumtree), which OLX portal provides another source of new leads for WeBuyCars. In fact, this is one of the major benefits which had been cited by FCG for its transaction with Naspers, that the combination had been successful in other markets where OLX operates in combination with FCG. Therefore, there were opportunities to now replicate these synergies in South Africa towards WeBuyCars, thus entrenching WeBuyCars' position and at the same time leveraging some market power from WeBuyCars towards OLX since such a strategy would be mutually reinforcing. More so, Autotrader collects significant data and intelligence from other car dealers who place adverts on its platform, which places WeBuyCars in a further advantageous position in terms of pricing cars and other market intelligence not accessible to other dealers pre-merger. Therefore, the merger places WeBuyCars in a much stronger position to outcompete rivals and further entrench its already dominant position merely by virtue of the additional exclusive data it would likely access from Autotrader. There were also several other ancillary conglomerate concerns associated with the merger.

14. Taken together, the merger was prohibited as there were no viable remedies that could alleviate the above concerns. This decision is currently under contest at the Competition Tribunal South Africa ("CTSA") as the merging parties have challenged the prohibition recommendation by the CCSA.

15. It is relatively subjective to recognise a market as dynamic in nature. However, such markets are typically observable in the industries that have high-intensive technology investments, or technologies which change rapidly such as in telecommunications sector, including the mobile markets or recently, internet-based businesses such as e-commerce firms. Other technology intensive industries include those involving global bio-technology firms who develop various agricultural bio-technology seeds used for most agricultural crops. Such firms have large annual R&D budgets (at times approaching US$10 billion annually), as they constantly develop new products which can adapt to different climatic conditions, new forms of crop diseases and the need to adapt and withstand new agro-chemicals. The impacted biotech seeds and associated agro-chemicals rapidly evolve, with new products and processes introduced virtually every season.

16. There have been several mergers assessed in South Africa in such industries including the *Bayer/Monsanto*[2] merger, which raised several competition concerns as well as challenges relating to designing and coordinating the development of global remedies that address the multi-jurisdictional concerns that were arising.

17. Bayer is active in the crop protection business in South Africa, wherein it sells fungicides, insecticides, herbicides and seed treatment products among other related products. In the seeds business, Bayer sells vegetable seeds, cotton seeds and oil seed rape (canola). Monsanto is also active in the development and supply of seeds, bio-technology traits and crop protection products in South Africa. In relation to crop protection, Monsanto only produces and supplies herbicides. Monsanto also sells vegetable seeds, maize seeds, soybean seeds and cotton seeds.

[2] CTSA Case No. LM057May17.

18. The merger presented horizontal overlaps in relation to agrochemicals wherein both Bayer and Monsanto develop and commercialise herbicides. There were also overlaps on the seeds side, Monsanto is active in the development, production and commercialisation of genetically modified (GM) cotton seeds in South Africa. Bayer is only active as a distributor of GM cotton seeds in South Africa through an exclusive licencing agreement with an Australian company, Cotton Seed Distributors (CSD).

19. In relation to cotton seed, the merger was virtually a merger to monopoly in South Africa, with the merged entity having 100% of the GM cotton seeds market post-merger. The parties were ultimately ordered to divest the Bayer cotton business to a third party to remedy the concern.

20. In respect of seeds, the CCSA recognised that Both Monsanto and Bayer have technological systems, that is, the development and production of traited seed and the accompanying herbicides. Monsanto has the Roundup Ready system which is comprised of its glyphosate herbicides (RoundUp) and RoundUp traited seeds. On the other hand, Bayer has the Liberty Link system which is comprised of the glufosinate ammonium herbicides (Liberty) and Liberty Link traits. In terms of systems, when farmers make decisions on which seeds to plant, they make this decision based on the various 'systems' available for the specific crop being planted. The decision on which GM seed to plant locks farmers into what is referred to as a "technological pathway" where only a specific system can be used by the farmer.

21. Given the dominant position that Monsanto and Bayer have in the South African non-selective herbicide market, together with the industry that is characterised by the presence of technological platforms or 'systems', there was a strong likelihood that the merging parties will exercise market power in the non-selective herbicide market post-merger. Although Bayer did not have biotechnology traits registered in South Africa, Bayer did have a system which included their Liberty Link trait for maize, soybean and cotton and its glufosinate ammonium-based herbicide (branded as Liberty) registered for use on glufosinate tolerant maize, soybean and cotton crops. The CCSA found that Bayer had previously considered the introduction of the Liberty Link trait for cotton and canola (which is a glufosinate tolerant trait) into South Africa.

22. In the absence of the merger, there was evidence that Bayer would have entered the market with the Liberty Link system and exerted a competitive constraint on Monsanto's Roundup Ready system. Post-merger, the competitive constraint that Bayer would have been able to exert on the merged entity in the market would be lost, hence, the proposed merger also resulted in the removal of potential competition in South Africa. The CCSA was also concerned about the anti-competitive effects that the combination of Bayer and Monsanto's product portfolios and the development of new bundled product offerings may have on customers and competitors in the seeds industry, as a result of the increase in barriers to entry for potential entrants and the likely negative effect on farmers as a result of potential price increases for the use of technological platforms (systems) post-merger. Further, the CCSA noted that although the merging parties had stated that the rationale for the proposed transaction lay in the combination of two firms that specialise in producing complementary products which will improve product solutions to customers, no quantification of such anticipated pro-competitive benefits and efficiency gains to South African customers had been provided. The merger was ultimately approved subject to conditions.

23. In order to remedy these concerns associated with the technological systems of the merging parties, the merged entity was required to divest the entire Liberty and Liberty Link trait businesses at the global level including the R&D levels of business The disposal of Bayer's glufosinate ammonium business to a third party was deemed to eliminate the market power concerns arising on the non-selective herbicides given Bayer and Monsanto positions in that area. The divestiture remedies were developed in conjunction with other jurisdictions wherein similar competition concerns were arising. The issues arising on remedies will be discussed later below.

24. From the above merger cases and several others, the CCSA has routinely looked at dynamic characteristics of an industry, and has considered various theories of harm such as removal of potential competition (such as *Bayer/Monsanto*), prevention of competition (*MIH/WeBuyCars*) where the loss of potential competition theories were central to the decisions. The reasoning in such cases would be that potential entrants would likely take too long to enter and even if they did, it would unlikely be in a timeous and sufficient scale to be meaningful constraint to the incumbent/s. Barriers to entry in most such dynamic markets are high.

25. In terms of timeframe, there is no set and established time horizon that would be applied in assessing the competitive effects of a merger in a dynamic market. In other words, there is not an established time period that applies uniformly across any and all mergers, regardless of the dynamic nature of the sector. Different periods have been applied on different mergers. The market dynamics influence the time period that applies to the assessment of effects and this typically varies from one merger to another.

2. Efficiency Claims in Dynamic Markets

26. In South Africa, the Competition Act requires consideration of efficiency arguments as a defence against an anti-competitive findings. Section 12A(1)(a)3 of the Act states that "*… 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".* It is therefore a balancing exercise which determines whether efficiency claims can outweigh the competition harm arising.

27. The test for efficiency is well established, having been first determined by the courts in the 2000 merger between *Trident Steel/Dorbyl Limited*[4] which raised significant anticompetitive concerns but was nevertheless approved by the CTSA due to the compelling nature of the efficiencies resulting from the merger. The claimed efficiencies in a merger should be (i) real; (ii) compelling and/or substantial (iii) verifiable; (iv) merger specific, and (iv) passed onto consumers.

[3] Ibid, para. 8.4.6.

[4] Tribunal Case no. 89/LM/Oct00.

28. A question that routinely arises is what type of efficiencies are accepted for this defence. In the *Tongaat-Hulett/Transvaal Suiker Bpk & Others* merger[5], the CTSA suggested that the type of efficiencies considered in the balancing exercise should be those that for example, evidences new products or processes or that identifies new markets that will be penetrated as result of the merger that neither firm on their own would have been capable of entering or that significantly enhances the intensity with which productive capacity is utilised. Such efficiencies are deemed dynamic or production efficiencies. The other category are pecuniary efficiencies, such as tax savings or lower input costs resulting from improved bargaining power with suppliers. Such pecuniary efficiencies do not constitute real economies nor would those efficiencies that result in a mere redistribution of income from customers, suppliers or employees to the merged entity.

29. Given that it is the dynamic efficiencies that are typically accepted in an efficiency defence, a common challenge that arises in most mergers (not just those in dynamic markets but even more pronounced in such mergers), and it has previously been observed by the OECD report[6] is that dynamic efficiencies are extremely difficult to measure. This is because dynamic efficiencies and innovation in particular, generates huge uncertainty with regard to cost, timing and success. More so, the returns from innovation may accrue only in the long term and innovation may lead to quality improvements, not price effects, making it harder to calculate the likely welfare improvement.

30. The debate on challenges associated with dynamic efficiencies came to the fore prominently in the *Pioneer Hi-Bred/Pannar* [7] merger. Both Pioneer Hi-Bred and Pannar were 2 of the only 3 major biotechnology maize seed producers in South Africa, such that the merger was effectively a 3-2 merger, with Monsanto the remaining and leading biotechnology maize seed producer in South Africa (and effectively Africa as well). The merger raised competition concerns of a unilateral nature, given the concentrated nature of the industry, and was prohibited by both the CCSA as well as the CTSA when it was challenged. The merging parties raised dynamic efficiency arguments, which was ultimately one of the reasons it was ultimately approved at the Competition Appeal Court ("CAC").

31. The merging parties proffered expansive dynamic efficiency arguments which they deemed would outweigh any harm identified on competition assessment. In particular, it was noted that there are three elements required to produce GM maize seed, an adaptable and appropriate germplasm (seed genetics that are adaptable to the weather conditions of that particular climatic region), advanced breeding technologies ("ABTs") and biotechnology traits. Pioneer had the ABTs and global access to cheaper biotechnology traits which Pannar lacked and on the other hand Pannar had the most adaptable germplasm to South Africa weather conditions which Pioneer lacked. Pioneer was therefore bringing its ABTs to apply to the germplasm which Pannar had, with the aim to bring better and higher yielding GM and hybrid maize seed into the market, at a quicker and faster pace (2-3 years versus 5-7 years for Pannar) than each of Pioneer Hi-Bred and Pannar would have managed to achieve absent the merger.

[5] CCTA Case No. 89/LM/Oct00.

[6] OECD, 2007. Policy Roundtables: Dynamic Efficiencies in Merger Analysis.

32. The merging parties even quantified the maize seed yield gains arising from the combinations of their complementary germplasms and ABTs, at 5% yield gain, which however was subjected to significant contestation by the CCSA (and ultimately the CTSA). Given the debate and contestation on the quantitative methods applied in measuring the efficiencies, the CCSA also applied qualitative assessment of the dynamic efficiencies, looking at factors such as: (i) whether the merging parties had been successful in their R&D efforts in the past (ii) have the R&D efforts led to successful innovations (iii) have they integrated well in past mergers (iv) what kind of product development do customers want and will the merger improve the parties' ability to deliver this, and (v) are the parties' facilities complements or substitutes? Such qualitative assessment is considered when measurement cannot be reasonably performed, and conversely where measurement is in dispute, qualitative assessment can also complement the quantitative measures of claimed efficiencies.

33. Although the CCSA and CTSA had found the efficiencies to be real and dynamic in nature, the claimed efficiencies were ultimately deemed achievable even outside the merger and it was also questionable if they could be verifiable. There was some evidence Pannar could have accessed the ABTs through other means, hence the efficiencies would be arisen through potentially less anti-competitive means. In all, the efficiency arguments were deemed insufficient to outweigh the competition harm as this was effectively a 3-2 merger in a key and priority sector. Accordingly, the risk of price rises from the loss of competitive rivalry was deemed too steep in such a critical sector against the dynamic efficiencies that were doubtable and likely achievable in other means other than the proposed merger. Therefore, both the CCSA and CTSA had reasoned to prohibit the merger.

34. On further appeal, the CAC approved the merger, subjected to some conditions. The CAC largely accepted the efficiency arguments and found them adequate to outweigh any conceivable competition harm (the CAC did not find a compelling case for substantial lessening of competition in the first place). The remedies imposed largely related to setting up a technology hub in South Africa in order to transfer the breeding technologies as well as some behavioural pricing remedies for a period of 3 years.

3. Remedies in Dynamic Markets

35. According to the ICN Merger Working Group: Analytical Framework Subgroup, remedies should only be applied to address the identified competitive detriments expected to arise from a merger transaction. In the absence of remedies, competitive detriments resulting from a merger could only be addressed by prohibiting the transaction in its entirety. The key contribution of remedies is to enable a modified outcome to merger transactions which restores or maintains the competition whilst permitting the realisation of relevant merger benefits, thus achieving a better outcome than straightforward prohibit or permit decision.[8] The CCSA adopts this approach of considering only those remedies which restore or maintain competition.

[8] CTSA Case No. LM057May17.

36. If the competition problem arising from a merger is structural in nature, the CCSA typically only considers structural remedies. This is because behavioural remedies may be misaligned to the structural problem that is arising from the merger. More so, behavioural remedies may present challenges in terms of monitoring, especially if it relates to dynamic markets.

37. For example, in the recent *MIH/WeBuyCars* merger alluded to earlier, one of the potential remedies explored related to imposition of barriers that prevent the harm stemming from the potential leveraging of preferential information flowing from the Naspers' online platforms towards WeBuyCars ahead of other rival used car dealers. A typical challenge in such digital platforms (where the leveraging was arising from) was how the CCSA could monitor algorithms which could be used to transmit leads towards WeBuyCars before other rivals can receive such leads. The CCSA would be unlikely, in the medium term, to have the expertise to monitor behavioural remedies that can be undermined using algorithms. Designing remedies, especially behavioural remedies in such fast moving, unpredictable and uncertain environment is difficult. The alternative is to impose a structural remedies which usually implies selling the business but since this is the reason for the merger in the first place, it effectively becomes a prohibition of the merger.

38. Other challenges that arise relate to coordinating the implementation of structural remedies across multiple jurisdictions. For instance, in the global biotechnology and chemical industries which the CCSA considered, there were numerous markets impacted across the chemical industries and the bio-technology sectors in the *Bayer/Monsanto* global merger. However, in South Africa for example, both Bayer and Monsanto only have commercialisation businesses, the seed development businesses sat elsewhere in the world, in Europe and America where the parent businesses are headquartered.

39. This presented challenges in that the unilateral concern arose in South Africa, but the core problem associated with the unilateral concern stems from the development stage of the seeds and chemicals which occurs outside South Africa. Divesting a local commercialisation business alone is insufficient a remedy since the market power stems from the development stage of the various seeds and chemicals commercialised in South Africa. Furthermore, the notification at different stages presented mismatches on decision making process between different authorities in the world. For instance, in the *Bayer/Monsanto* merger, the CCSA had 60 business days to decide on the merger, whereas the merger was at Phase 2 stages in several other jurisdictions, with significant concerns arising.

40. Ultimately, through cross border coordination among authorities, Bayer was ultimately required to divest and sell the entire global biotechnology Liberty Link technology business and the associated Liberty branded agro-chemicals business, which were remedies designed to address the concentration and source of market power which is at the R&D level where there were very few large global players. The remedies were generally aimed at dismantling the concentration of R&D efforts between the few global biotechnology firms at the upstream level, instead of implementing structural remedies only at the commercialisation stage. The principles of the remedies are that the parties acquiring the divested business must have the capabilities to develop and introduce new products into the future in direct competition with the firms that would have been ordered to divest parts of businesses. Where divested, other third parties should be licensed and granted access to the technologies in order to compete against the technology developers.

41. The periods imposed for behavioural remedies for mergers in dynamics markets also varies from merger to merger. In most instances, the period rages from 2-5 years wherein the CCSA takes the approach that such times would be sufficient for the markets to develop and self-correct.

42. To cater for unforeseen market changes that may render the conditions difficult to perform as imposed, the Competition Authorities also typically includes revision clauses when designing remedies. Virtually almost all remedies include a variation clause, which allows the parties to approach the Competition Authorities at any point in the life of the conditions, whenever market conditions change which render it difficult or impossible to adhere to the imposed conditions. The onus is on the merging parties to demonstrate how market condition change render it impossible or difficult to meet the imposed remedy.