# COMPETITION
# ALERT

## MERGER ALERT

A number of recent merger decisions from the competition authorities have made the headlines. While some of the decisions certainly seem to be indicative of trends in the competition authorities' approach to merger proceedings, it may still be too early to draw definitive conclusions as to any new agenda. At the very least, the recent developments in merger proceedings bring an interesting start to 2012.

### RECENT SPATE OF PROHIBITED MERGERS GIVES PAUSE FOR THOUGHT

Between December 2011 and February 2012, the Competition Commission (Commission) prohibited no less than five mergers – not an insignificant number given that out of 229 merger decisions during the previous financial year only two were prohibitions.

In December, the Commission reversed the unconditional approval it gave earlier in 2011 regarding the acquisition of Primedia@Home by Paarl Media. The prohibition follows the Competition Tribunal's (Tribunal) decision to set aside the Commission's unconditional approval of the merger, sending the matter back to the Commission for reconsideration. The Commission reported that the new investigation uncovered information that was not previously submitted by the merging parties. This information indicated vigorous competition between the merging parties as the two main national players in the market for knock-and-drop leaflet distribution. The Commission's new investigation found that the merger would substantially lessen competition. This decision also raises the vexed question of the merging parties' obligation to bring unfavourable economic evidence to the Commission's attention.

In January 2012, the Commission prohibited the proposed sale of SamQuarz, one of South Africa's largest silica producers, to Thaba Chueu Mining (TCM). The Commission found that the merger would lead to foreclosure effects as it enabled TCM to control a critical input to its downstream competitors in certain silica markets. The Commission was also concerned that the proposed merger would alter the structure of the market and increase the likelihood for co-ordination in the market for ferrosilicon. The merging parties have filed a formal notice with the Tribunal requesting that the Tribunal reconsider the Commission's decision to prohibit the merger.

Later in January, the Commission recommended to the Tribunal that the large merger between Joint Medical Holdings and Life Healthcare Group be prohibited. The Commission found that the merger creates regional dominance in the Durban area which would ultimately lead to increases in the cost of healthcare. The Competition Commissioner commented that the Commission is "concerned with what seems like creeping concentration and regional dominance of hospital groups, and will assess hospital mergers very carefully."

Shortly thereafter, the Commission prohibited a merger in the chemicals industry. The prohibition of the proposed acquisition of Cellulose Derivatives by Senmin International (Senmin) was premised on the Commission's finding that the merger will create a market structure in which Senmin, a dominant distributor of carboxymethylcellulose (CMC), will be vertically integrated with the only producer of CMC in South Africa, with the result that the merging parties are likely to deny Senmin's competitors

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in distribution access to CMC, an essential input for mineral extraction in platinum mines. The merging parties have reportedly indicated that they will apply to the Tribunal for a reconsideration of the decision.

On 15 February 2012, the Commission issued a media release detailing its prohibition of the proposed merger involving Maskal Tubes and Copalcor. Copalcor is a customer of Maskal Tubes' copper products. In turn, both Maskal Tubes and Copalcor supply to original equipment manufacturers. Accordingly, the merger has both a horizontal component (the parties compete in the downstream market to supply copper products) and a vertical dimension (Maskal Tubes supplies Copalcor with inputs to make the supply). The Commission's finding was that the concentration in the downstream distribution market was made worse by the fact that the vertical integration would raise barriers to entry so that Maskal Tubes might refuse to supply existing and new competitors in the downstream market.

It is perhaps telling that of the recent spate of prohibitions, all but one have been vertical mergers. This may seem curious since most large jurisdictions consider vertical mergers to be procompetitive. However, the structure of the South African economy often lends itself to oligopolies, particularly in capital intensive industrial product markets. Such market structures often exacerbate foreclosure concerns as entry at both levels of the market may be difficult.

While it is too early to say whether the recent incidences of prohibited mergers indicate an agenda at the Commission to be more conservative on mergers, it certainly does give one pause for thought. No doubt, the outcome of those matters that are taken on appeal for reconsideration by the Tribunal will be closely monitored by dealmakers and their advisors.

## UNSCRAMBLING THE OMELETTE

The recent reversal of two merger decisions previously approved may leave merging parties questioning the validity of merger decisions made by the Commission in the past, as well as the permanence of decisions made by the Commission in the future.

### Primedia@Home and Paarl Media merger

The acquisition of Primedia@Home by Paarl Media was prohibited by the Commission in December 2011 after a review effectively overturned the unconditional approval of the merger which the Commission gave early in 2011. The parties are now faced with having to reverse a merger process which has been implemented for almost a year.

On its website, Paarl Media sees the reversal of the merger as "commercial anarchy", which bodes ill for economic growth and jobs in future. The Group Commercial and Legal Executive of Primedia is also quoted as saying that Primedia will close Primedia@Home if it is handed back, resulting in potential job losses of between 1,200 and 1,400 jobs. The practical impossibility of reversing the merger is also noted by Paarl Media: "the Commission's decision is incapable of being implemented – you cannot unscramble an omelette."

### MTO Forestry, Boskor Sawmill and Boskor Ripplant merger

In March 2007, the merger between MTO Forestry (MTO), Boskor Sawmill and Boskor Ripplant was unconditionally approved by the Commission. In August 2009, following an appeal by a customer of MTO, the Competition Appeal Court (CAC) remitted the case to the Commission for renewed consideration of the merger. In January 2011, almost four years after the initial decision, the Commission approved the merger but subject to a number of conditions.

The merging parties have applied to the Tribunal for a reconsideration of the decision. In the interim, in an attempt to avoid 'unscrambling the omelette', the merging parties made an application to the Tribunal for a temporary suspension of the operation of the conditions imposed by the Commission pending the outcome of the Tribunal's reconsideration proceedings.

The Tribunal dismissed the application for temporary suspension of the conditions, rather than create a mechanism for merging parties to temporarily reap the benefits of a merger without the encumbrances of the merger conditions imposed. In its decision, the Tribunal cautions that "it may very well be impossible to restore the harm done to competition in the affected markets and consumers in the period of suspension, if suspension was a possibility."

The cases call into question the certainty of merger approval based on the risk that the investigation may be picked-apart at some later stage. A solution may be to limit the time within which a review application can be brought (currently, the Promotion of Administrative Justice Act caters for a maximum 180 days to bring a review of an administrative decision) so that at the very least, there is less of a danger that the merger would have been implemented for many months before it is sought to be overturned.

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## PUBLIC INTEREST FOCUS

The past year saw the Commission imposing public interest related conditions to a number of mergers. Noteworthy cases in 2011 include the hostile takeover by Kansai Paint Co of Freeworld Coatings and the merger between Aon South Africa and Glenrand. In the Kansai/Freeworld merger, the Commission imposed a condition that requires that the merged entity refrain from any retrenchments of employees for the next three years. The Aon/Glenrand merger was initially approved by the Commission subject to the condition that no dismissals were to take place at the merged entity apart from skilled employees, defined as those employees earning in excess of R30,000 per month. Not happy with the condition, the merging parties applied to the Tribunal for reconsideration. During the proceedings before the Tribunal, the parties agreed on the conditions that there will be no dismissals of employees earning less than R15,000 a month and there will be no more than 24 dismissals of employees earning between R15,000 and R30,000 a month.

The conditions imposed in these mergers seem to suggest a heightened approach to the public interest considerations set out in the Competition Act (Act). They also illustrate increasing "trade unionification" of the merger process. Economic Development Minister Ebrahim Patel was recently quoted in the press as saying that "competition policy is a critical tool to help achieve the wider goals of the New Growth Path and grow the economy" and President Jacob Zuma told the National Assembly that the government is "looking to competition policy to improve job creation." This has raised the possibility that merger control might be used to require merging parties to take positive steps to improve the public interest rather than merely show that the merger is not harmful to the public interest.

The recent decision of the CAC in the Walmart/Massmart merger is further illustrative of the increasing impact that trade unions have in the merger approval process. In partly upholding the trade unions' appeal, at least two aspects of the CAC's decision on key public interest factors merit comment.

The first aspect is the CAC's ruling that 503 employees need to be reinstated. Here, the CAC found that there was evidence to find that these retrenchments were effected in contemplation of a possible takeover, and thus may be seen as merger specific. Notably, the Act does not outlaw merger-specific retrenchments but merely lists the effect on employment as a public interest factor to be taken into account. In ordering that the employees be reinstated, the CAC makes no finding that the retrenchments were unreasonable or substantially contrary to the public interest. This robust approach is also at odds with the ruling in connection with the broader protection the trade unions sought, where the CAC found that the Act should not be used by trade unions as leverage to further interests that ought to be pursued through the usual power-play between labour and employers.

The second aspect is the CAC's decision dealing with the condition imposed by the Tribunal that a programme be set up, at the merging parties expense, to promote local suppliers. The CAC found that the programme lacked specifics and should have been more carefully interrogated by the Tribunal before endorsing it. Rather than refer this condition back to the Tribunal, the CAC adopted a "dialogic model" in terms of which the CAC itself will gather evidence to determine the best mechanism whereby local suppliers might be empowered to participate in Walmart's global value chain, as well as the costs that may be incurred to do so. This novel approach leaves the merging parties without a clear understanding of what the condition may end up entailing. The study may determine that an amount far in excess of (or less than) the R100 million tendered is required, or impose other conditions on the merging parties including on how Walmart implements its global procurement policy.

While it was hoped that the CAC's ruling in this merger would provide some clarity on the interplay between economic policy and competition law, the decision does not particularly clarify how public interest considerations fit into merger analysis. It seems that adverse public interest issues could trump a finding based on consumer welfare where the public interest issues are sufficiently "substantial" to question a merger that does not harm consumer welfare. This is a question of evidence – which in the Walmart case, the CAC found was lacking in weight to prohibit the merger, but sufficient to warrant a condition. The problem, it seems, lies in being able to produce a set of calculations that will allow the impact of a merger on societal welfare to be quantified with economic certainty.

If there is a conclusion to be drawn from recent decisions, it is that public interest issues will rarely result in a procompetitive merger being prohibited (thanks to the difficulty in conducting an empirical analysis) but may result in quite onerous conditions aimed at "socio-economic" engineering. What is heartening, is that for the time being, the CAC decision puts paid to the notion that a merger should evidence a positive effect on public interest before it can be cleared. Nevertheless, any potentially negative public interest effects of a proposed merger will increasingly attract careful scrutiny.

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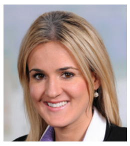

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