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COMPETITION ALERT

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IN THIS ISSUE

TRIBUNAL KEEPS COMMISSION'S SECRETS SAFE

In an interlocutory matter concerning the Competition Commission's on-going attempt to prosecute Telkom for alleged abuse of dominance in wholesale internet access, the Competition Tribunal has dealt with the extent to which a respondent should have access to the Commission's internal reports and other information leading to a referral.

When conducting an investigation, the Commission will procure evidence from a variety of sources. It will then (hopefully) apply its mind to the evidence through a rigorous internal process. The Commission and its legal and economic advisors will opine, consider, discuss and report internally on the merits of the case. The question arises as to whether these internal documents should be made available to the respondent as part of the discovery process.

In this case, the Commission resisted Telkom's request to be provided with reports by external consultants to the Commission, opinions of third parties, internal emails, opinions by its investigation team and reports to its executive committee on the basis that such documents amounted to restricted information under Rule 14 and were privileged.

Rule 14(1)(d)(i) classifies certain types of documents such as internal communications of the Commission, opinions prepared by or for the Commission and accounts of consultations of the Commission as restricted information. Restricted information is protected from disclosure save in limited circumstances.

Telkom argued that Rule 14 only applies during the Commission's investigation and not once a matter has been referred to the Tribunal. The Tribunal rejected this argument on the basis that the Rules are not merely a practice or custom of the Commission but in fact have the status of subordinate legislation and are of general application. Accordingly, the information described in Rule 14(1)(d)(i) is restricted by nature and such restriction does not fall away merely because the Commission has ceased investigating and is now prosecuting the matter. In addition, the Tribunal suggested (but did not rule on the point) that certain information would also be protected by privilege.

The Tribunal appears to have deliberately dovetailed its ruling with the Competition Appeal Court's (CAC) ruling last year in the Computicket case. Here the CAC ruled that similar documents should be discovered, although need not be produced if they are properly claimed as privileged or restricted. This of course leaves out the question of the evidence underlying any restricted reports and recommendations – that may need to be produced in some form.

Already during the hearing, Telkom indicated its intention to appeal any adverse ruling. Assuming this occurs, it will allow the CAC and possibly even the Constitutional Court in due course to consider whether the documentation sought is by its nature restricted. Even if Telkom is successful, it leaves the question of privilege open for another debate. What is clear is that the merits of this case may not get heard for some time.

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SAA AND QANTAS EXEMPTION EXTENDED

Code sharing and airline alliances have become commonplace in the airline industry, such that a passenger booking a ticket with one airline typically will not be in the least surprised if another airline flies all or part of the trip.

Code sharing allows passengers to benefit from seamless access to another carrier's network in a country of destination while allowing airlines to benefit from access to passengers from beyond the point of departure. Increasingly, code sharing also allows airlines to effectively share an international route and thus more effectively manage their load factors and scheduling.

While code sharing has benefits for consumers and allows airlines to remain visible in markets where they would otherwise not have capacity to operate, in certain respects code sharing inherently restricts competition. In particular, it allows airlines to effectively divide a market so that they cooperate rather than compete on some routes – conduct which is *per se* prohibited despite any efficiency gains and which therefore requires an exemption under the Act.

Accordingly, the Commission has conditionally exempted the Code Share Agreement (CSA) between South African Airways (SAA) and Qantas from prosecution under the Competition Act. This is the sixth time since the Commission first exempted the CSA between the two airlines in 2000.

The CSA legislates coordination between the two airlines in respect of the two direct airline routes between South Africa and Australia. The Johannesburg – Perth route is to be operated by SAA and the Johannesburg – Sydney route is to be operated by Qantas. Furthermore, the airlines will acquire blocks of seats on each other's aircraft.

While the division of the South African – Australian airline sector indeed allocated territories in contravention of s4(1)(b)(ii) of the Act, the arrangement allows SAA to maintain its presence between the two continents, thus promoting and maintaining South Africa's exports, and qualifying for exemption under s10(3)(b)(i) of the Act.

The CSA is clearly of net benefit as SAA would not be able to maintain its daily service to Perth in its absence. The withdrawal of the CSA would force SAA to reduce its flying frequencies to the detriment of travellers.

The exemption only applies to airline services and not cargo or freight services. The two airlines are also required to price and sell their tickets independently of one another and must inform passengers of the carrier actually operating the flight at the time of ticket purchase. Furthermore, for the exemption to operate, the airlines must operate combined services of not less than 10 flights per week.

SANITY PREVAILS – FOR NOW

The Tribunal has unconditionally approved the merger of two distributors of earth moving equipment despite the Commission's recommendation that it be made subject to conditions.

The merging parties, Humulani Marketing (Pty) Ltd (Humulani) and High Power Equipment (Pty) Ltd (HPE) are both involved in the distribution of competing brands of earthmoving equipment.

The Commission found that the extent of the horizontal overlap would not be detrimental to competition as the merged entity would face sufficient competition from other quarters, and customers indicated that they could switch between alternatives if the merged entity raised prices. The Commission also partly based its conclusion on the notion that HPE, despite becoming part of the same group as Humulani, would continue to operate independently of Humulani post the merger. This last consideration introduced some drama into what would otherwise have been a simple merger process.

To preserve pre-merger levels of competition between HPE and Humulani, the Commission sought to impose a condition to prevent the merging parties from appointing common board members to each of the separate distributors within the group; to prevent the sharing of information between the firms; and to require them to develop internal competition compliance policies. In other words, the Commission sought to treat the separate firms in the group as competitors, notwithstanding that they were all ultimately controlled by the same holding company (Invicta Holdings).

There is a clear logical failing in such a condition. Having already found that competition is not substantially lessened through the removal of HPE as a competitor to other distributors in the Invicta Group, a condition to preserve that competition would appear unnecessary. Worse, such an outcome would have introduced great uncertainty as to whether the distributors formed part of a single economic entity – something one would think is a given in the context of a single corporate structure. By not countenancing the condition, the Tribunal thankfully avoided any future debate around whether, despite merger approval, the parties might still be prosecuted for coordinating their activities. This is already a vexed issue and the Commission's contention would only have further muddied the waters. Up until this point, the Commission's approach was to assume that a horizontal merger would eliminate competition between the merging parties, even where the parties alleged that they would continue to be run separately. This approach at least allows for some certainty in the analysis as well as in respect of the ability of the group to efficiently arrange its intra-group affairs post-merger.

Another anomaly the Commission sought to introduce was a condition related to information exchange alleged to take place at the industry association. This appears to be an attempt by the Commission to extend its powers in relation to the merger to address broader concerns in the market. The Tribunal rejected this on the basis that the Commission ought rather to investigate alleged anti-competitive exchanges of information as a separate process.

continued

BUT IN OTHER NEWS…

The Commission's approach in the Humulani merger above suggests that, to its mind at least, firms in the same holding company might not be part of a single economic entity.

However, that same argument appears to have fallen flat in the context of a consent order recently concluded between Pangbourne Properties Ltd, Morulat Properties Investments 2 (Pty) Ltd and Proud Heritage Properties 283 (Pty) Ltd and the Commission.

In 2008, Pangbourne disposed of a number of properties to Morulat and Proud Heritage respectively. Neither sale met the thresholds for merger notification so both were implemented as small mergers. However, overlooked at the time was that Morulat and Proud Heritage were both wholly owned subsidiaries of the MWS Trust. On this basis, the Commission argued that the two transactions are more properly viewed as a single, intermediate merger whereby MWS Trust acquired control of all the properties concerned, albeit through two separate subsidiaries. Rather than push the point, the merging parties notified the intermediate merger and subsequently agreed to a R75,000 penalty for prior implementation of the transaction.

The Commission's approach makes intuitive sense – as failure to view the transaction in that way allows for a considerable loophole in composite sales to the same ultimate holding company if the sale is split among a number of subsidiaries and styled as a myriad of (non-notifiable) small mergers rather than a single larger merger.

However, it presupposes that the acquisition amounts to one by a single economic entity which is in contradistinction to the Commission's approach in the Humulani merger, where it ignored the fact of a common holding company.

MARKET INQUIRIES READY TO LAUNCH

The Competition Amendment Act, No 89 of 1998 has been languishing on the statute books since 2009, but has not been brought into force.

This is surely in part because of a reluctance to incarnate certain controversial provisions (such as criminalisation of cartel conduct and complex monopolies). However, the delay has resulted in certain quite useful provisions also being left in limbo. One of these is the formalisation of the Commission's power to conduct market inquiries.

The Commission's long planned inquiry into the working of the private healthcare sector was recently made contingent on the market inquiry provisions of the Amendment Act coming into force. Apparently this provided the necessary impetus for the President to proclaim that this provision will come into force on 1 April 2013.

The Commission will no doubt be glad of the development as it effectively allows the Commission to exercise considerable investigatory powers into sectors where the Commission may believe that there is a lack of competition, but where it does not have reasonable grounds to believe that particular forms of anticompetitive conduct are taking place – a threshold for investigation that has been set by the superior courts in various cases dealt with over the last three years.

The Commission has a residual advocacy function under s21 of the Competition Act to 'enquire into and report on' any matter concerning the purpose of that Act. However, express provision for market inquiries is useful, as the Commission's jurisdiction to conduct such projects has been unclear. Although the banking inquiry worked relatively well, it was never clear whether industry players were obliged to participate or whether this was voluntary. The amendments now imbue the Commission with clear powers to wield its investigatory powers to summons witnesses and subpoena information.

It also provides for a formal and publicly transparent framework within which such inquiries must take place, which should ensure some certainty in respect of terms of reference. Essentially, the amendment allows the Commission to formally investigate an industry as a whole where the Commission has cause to believe that there are features to the market that may distort competition but cannot initially attribute that to any particular conduct by any specific firm or firms.

This is in keeping with the notion that South Africa's socio-economic history may have resulted in the development of oligopolistic markets that are not efficient and which are structurally uncompetitive, rather than beset by anticompetitive conduct. The Commission is now able to formally consider this problem and if necessary, make recommendations for new policy or laws. That is a positive development as it allows the Commission to play a more effective advocacy role as the country's preeminent economic regulator.

One risk to participants in a market inquiry is that if evidence is uncovered of anti-competitive conduct (such as abuse of dominance or price fixing) then the Commission can easily convert that into a complaint and prosecute the firm concerned. Prior to the amendment coming into force, the Commission would need to have good cause to investigate a particular named firm before it could launch an investigation, and a general complaint against an industry was arguably insufficient to legitimately investigate and prosecute specific firms.

That said, it is not likely that the new provisions can be used for a fishing expedition where the Commission has no good reason to suspect a problem. The process is circumscribed by a number of formalities and requires a great deal of time and resources to put in place – with the result that they will not be embarked upon lightly as an alternative to a targeted investigation.

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