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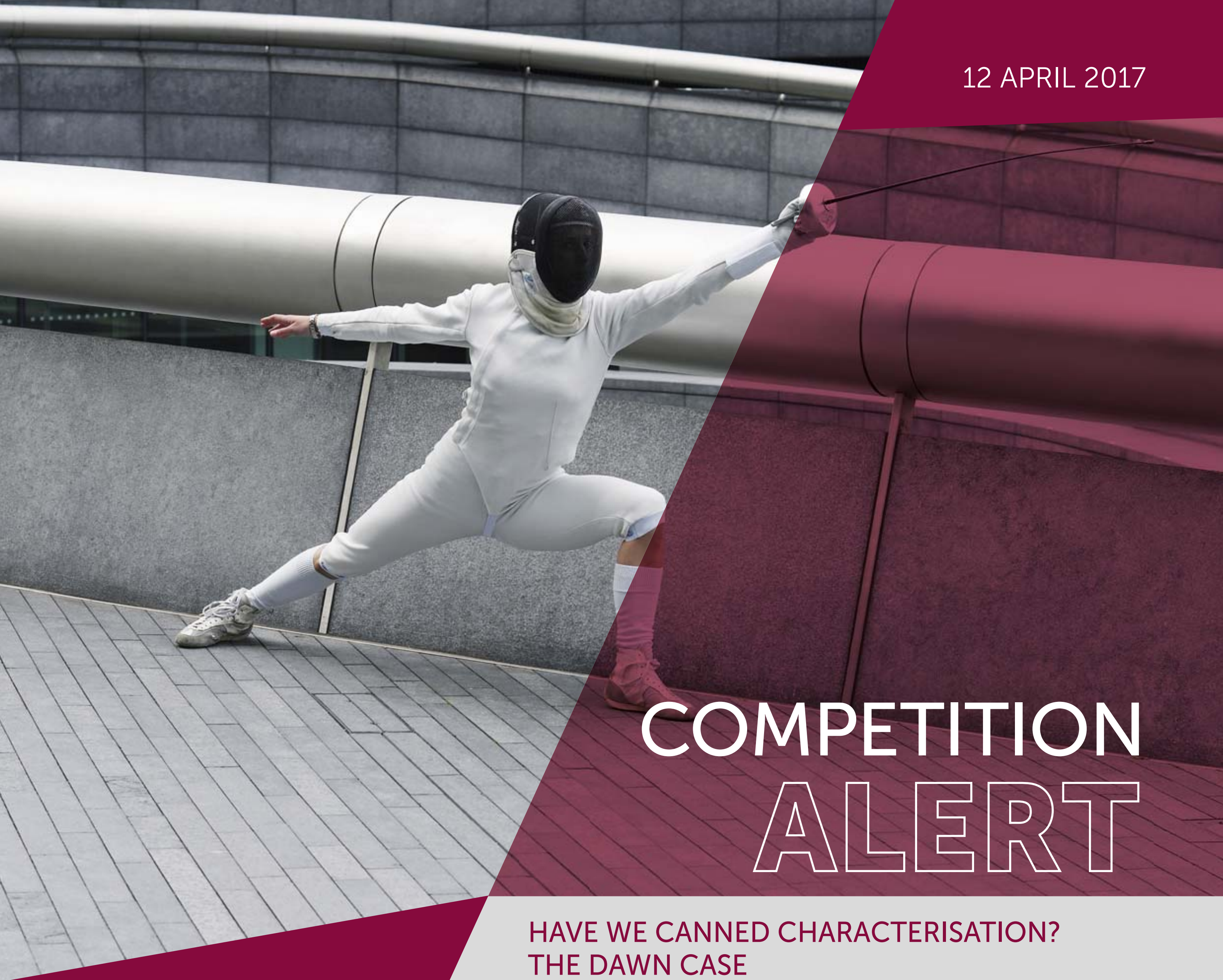

COMPETITION ALERT

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HAVE WE CANNED CHARACTERISATION? THE DAWN CASE

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THE COMPETITION APPEAL COURT UPHOLDS TRIBUNAL DECISION TO PROHIBIT THE IMERYS/ANDALUSITE RESOURCES MERGER

On 2 March 2017, the Competition Appeal Court (CAC) upheld the decision of the Competition Tribunal (Tribunal) to prohibit the intermediate merger between Imerys South Africa (Pty) Ltd and Andalusite Resources (Pty) Ltd (AR).

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The Commission alleged that the clause sought to allocate the market as contemplated in s4(1)(b)(ii) of the Competition Act, No 89 of 1998 by preventing Dawn from entering the relevant market.

The Competition Tribunal (Tribunal) in *Competition Commission v Dawn Consolidated (Pty) Ltd and Others* [Case no CR023May15] has found that Dawn Consolidated Holdings (Pty) Ltd (Dawn) and Sangio Pipe (Pty) Ltd (Sangio) engaged in market division in relation to the plastics pipes market in South Africa, despite the respondents' argument that the conduct should not be characterised as collusive.

In the Dawn matter, the Tribunal decided that the conduct on the face of it could not be characterised as falling outside of the scope of s4(1)(b).

The matter involved a merger transaction where Dawn, which had 49% in Sangio, wished to increase its shareholding to 100%. The Commission initially approved the transaction without conditions, however during the investigation it found that the shareholders' agreement between Dawn and Sangio had a non-compete clause which provided that Dawn and its subsidiaries would not manufacture HDPE piping (a certain type of plastic piping) in South Africa. The Commission alleged that the clause sought to allocate the market as contemplated in s4(1)(b)(ii) of the Competition Act, No 89 of 1998 by preventing Dawn from entering the relevant market.

To counter the allegation of collusion, Dawn and Sangio argued that, if properly characterised, the non-compete clause "was not an agreement designed to avoid competition but was a normal restraint in joint ventures to protect the investments in the joint venture and had no effect on competition in the market".

The concept of "characterising" conduct prohibited by the Act was mooted by the Supreme Court of Appeal in *American Natural Soda Ash Corporation and Another v Competition Commission of South Africa* ([2005] 3 All SA 1 (SCA)). "Characterisation" involves establishing whether the character of the conduct complained of coincides with the character of the prohibited conduct. Certain conduct which, at face value, appears to meet the strict definition of price fixing or market allocation in the Act, may actually be designed to achieve outcomes other than anti-competitive and consumer-welfare-diminishing outcomes. In such circumstances, one should first determine the character of the agreement before embarking on the enquiry of whether or not it falls within the legislative prohibition in s4(1)(b). For example, both cartel agreements and joint venture agreements are collaborative agreements between competitors. However, the difference is that where a cartel is intended to lessen competition, a joint venture is intended to achieve economies of scale. In the latter case, even if the joint venture strictly or literally involves the fixing of a joint price, or the division of responsibilities between the different parties, the conduct should not be characterised as collusive, and therefore should not be evaluated in terms of s4(1)(b) of the Act.

In the *Dawn* matter, the Tribunal decided that the conduct on the face of it could not be characterised as falling outside of the scope of s4(1)(b). It concluded that

HAVE WE CANNED CHARACTERISATION? THE DAWN CASE

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The Tribunal finally found in the Commission's favour after analysing the question of whether the parties were competitors in the relevant market, and concluding that the respondents had failed to put up sufficient evidence to contradict the prima face case.

the shareholders' agreement was not a joint venture because the agreement itself stated that the arrangement was not a joint venture. It then concluded the restraint was not a commercially justifiable restraint associated with a joint venture arrangement because the arrangement was explicitly not a joint venture. In addition, the Tribunal found that the non-compete clause was also not a garden-variety restraint of trade because it sought to restrain the buyer (instead of the seller) for a long period of time and not the usual short period. Therefore, according to the Tribunal, on a *prima facie* basis, the relevant clause limited competition between Dawn and Sangio in the national market for regular HDPE piping, and needed to be assessed under s4(1)(b) of the Act. The Tribunal finally found in the Commission's favour after analysing the question of whether the parties were competitors in the relevant market, and concluding that the respondents had failed to put up sufficient evidence to contradict the *prima facie* case.

The Tribunal appears to have paid lip service to the characterisation assessment, emphasising the "plain reading" and "textual" interpretation of the shareholders' agreement in order to understand the character of the conduct. However, it does not appear to have given much thought to the nature of the relationship, rather focusing on what the relationship was called in the agreement. Accordingly, we still have little guidance from the Tribunal as to whether ancillary restraints required for commercial purposes in the context of collaborative arrangements can be found to be justifiable.

Although characterisation has not been canned entirely, the *Dawn* case suggests that parties entering into collaborative agreements must carefully consider any restraints they may want imposed, and they cannot be assured that such restraints purportedly imposed for commercially justifiable reasons will be sufficient to take the parties out of the realm of s4(1)(b).

Dawn is appealing the Tribunal's decision.

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THE COMPETITION APPEAL COURT UPHOLDS TRIBUNAL DECISION TO PROHIBIT THE IMERYS/ANDALUSITE RESOURCES MERGER

The primary basis for the prohibition by the Tribunal was that the proposed acquisition would result in a merger-to-monopoly in the mining, processing and sale of andalusite in South Africa.

On 2 March 2017, the Competition Appeal Court (CAC) upheld the decision of the Competition Tribunal (Tribunal) to prohibit the intermediate merger between Imerys South Africa (Pty) Ltd and Andalusite Resources (Pty) Ltd (AR).

In January 2015, the parties notified an intermediate transaction to the Competition Commission (Commission) in terms of which Imerys sought to acquire the entire issued share capital of AR.

Imerys and AR are currently the only two miners and suppliers of andalusite in South Africa and are both engaged in the mining and supply of fine and medium grade (0-3mm) andalusite which they on-sell to producers of refractories nationally and internationally. The primary basis for the prohibition by the Tribunal was that the proposed acquisition would result in a merger-to-monopoly in the mining, processing and sale of andalusite in South Africa. The Imerys transaction, had it been approved, would have had far-reaching consequences for producers and end-users of andalusite based refractories which were concerned that the merged entity would be in a position to increase prices and divert andalusite sales from South Africa to export markets.

In January 2015, the parties notified an intermediate transaction to the Competition Commission (Commission) in terms of which Imerys sought to acquire the entire issued share capital of AR. The Commission found that the transaction resulted in substantial competition and public interest concerns and prohibited the transaction in April 2015. The parties subsequently referred the merger to the Tribunal for consideration. The initial case before the Tribunal was one of substitution where the merging parties contended that even though the parties were the only two suppliers of andalusite, there were technical and/or economic substitutes for the product. As the hearing progressed, the merging parties conceded that in reality there were no sufficient alternatives to andalusite. However, the parties contended that post-merger, both Imerys and AR would immediately become capacity constrained, forcing them to raise andalusite prices to export parity levels and preventing the transaction from impacting their ability to exercise market power.

Notwithstanding the evidence lead by the merging parties and their economic experts, the Tribunal noted that the merging parties' internal strategic documents spoke directly to the rationale for the transaction and appeared to corroborate the Commission's concerns regarding the anti-competitive effects. In the Tribunal's view, Imerys' internal strategic documents clearly indicated that AR was an effective competitor, which had taken away significant market share from Imerys in the past year. Moreover, the strategic documents contradicted the parties' assertions that the merged entity would

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immediately become capacity constrained post-merger and in direct contrast indicated that it was actually concerned about overcapacity and had tailored its strategies to mitigate this issue. Significantly, the acquisition of AR formed part of this strategy.

The Tribunal further emphasised the fact that pre-merger there was a substantial discrepancy between the prices charged by Imerys and AR, which meant that AR served as a competitive constraint on Imerys' pricing. The transaction would therefore place the merged entity in a position where it could increase prices of andalusite at its own will and to the detriment of its customers.

The Tribunal ultimately found that the transaction constituted a merger-to-monopoly and that it resulted in anti-competitive effects in relation to price and non-price competition. According to the Tribunal, the monopoly would signify a "permanent structural change in the andalusite market", which would continue indefinitely in circumstances where the market is characterised by high barriers to entry with no realistic possibility of new market entry. The Tribunal accordingly prohibited the transaction and found that there were no conditions capable of remedying the anti-competitive effect.

The merging parties appealed against the Tribunal's decision, contending that the merger should have been permitted subject to conditions, which were offered by the parties. On appeal, the CAC agreed with the Tribunal's approach and found that the Tribunal was requested to approve a transaction that would "irreversibly change the structure of the market (form duopoly to monopoly), on the basis of conditions which would protect the domestic market for five years but deprive it of price competition" in the future. In light of the fact that there were no countervailing pro-competitive gains or public interest considerations to offset the anti-competitive effects, the CAC agreed that prohibition rather than conditional approval was the only legitimate remedy in this instance.

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BBBEE STATUS: LEVEL THREE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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