Competition Law and Employment Law

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SOUTH AFRICA

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COMPETITION LAW AND EMPLOYMENT LAW ALERT

Constitutional Court clarifies when retrenchments are merger specific

South Africa faces one of the highest unemployment rates in the world. This is the primary reason that the Competition Commission (Commission) must consider the effect on employment (as part of its public interest assessment) when evaluating a proposed merger. It has become standard practice in South Africa when there is a merger for restrictions to be imposed by the competition authorities – especially in respect of retrenchments.

The question of how to determine when a retrenchment is merger related as opposed to purely operational has come before the competition authorities and courts on a number of occasions. Issues of fact and law came into play in these inquiries, but the probable cause of retrenchments remained a key consideration. Sensibly, retrenchments not caused by a merger were allowed.

In 2022 the Competition Appeal Court significantly muddied the waters by finding that any retrenchment that could be said to have *"some nexus"* to the incentives of the acquiring firm would have to be considered as merger specific and therefore proscribed by the standard conditions imposed in so many transactions. Unfortunately, this broad test led to significant adverse effects for business and uncertainty for many merged businesses which had agreed to merger conditions on the basis that they would not retrench for any merger related reasons, but could for operational requirements.

In a landmark judgment in the case of *Coca-Cola Beverages Africa (Pty) Ltd v Competition Commission and Another* [CCT 192/22] delivered on 17 April 2024, the Constitutional Court has now confirmed that the distinction between merger related and operational retrenchments must be carefully observed and that the test for determining whether an action by a firm is merger related is that the action must be directly, or at least predominantly, linked to the merger for a breach to have occurred.

The factual history

On 16 May 2016, the Competition Tribunal (Tribunal) approved a merger that resulted in the amalgamation of four independent bottlers into one single bottling entity, Coca-Cola Beverages South Africa (Pty) Ltd (Coca-Cola SA). The merger was approved subject to conditions, including three relevant employment conditions:

1. The merged entity must maintain the aggregate employee numbers from the four operations for three years.
2. No retrenchments of bargaining unit employees were to happen *"as a result of the merger"* and retrenchments outside of the bargaining units were limited to 250 employees (in the Hay Grade category 12 and above).
3. Coca-Cola SA was not prevented from pursuing a section 189 process (in terms of the Labour Relations Act 66 of 1995 (LRA)) where this was necessary due to operational requirements in the ordinary course of business.

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During 2017 the economic conditions deteriorated dramatically for Coca-Cola SA. The Health Promotion Levy on Sugary Beverages (better known as the "*sugar tax*") was imposed from 1 April 2018, the macro-economic climate in South Africa became worse, and there was a sharp increase in raw material prices. Sales volumes were affected and the company lost market share to competitors. As a result, Coca-Cola SA had to consider restructuring its operations, particularly its logistics and commercial functions. Coca-Cola SA wrote to the Commission, informing it of the challenges it faced and warning that retrenchments for operational reasons may be necessary.

Coca-Cola SA engaged with the unions in its workplace (the Food and Allied Workers Union (FAWU) and the National Union of Food, Beverage, Wine, Spirit and Allied Workers (NUFBWSAW) and initiated the retrenchment process provided for in section 189(3) of the LRA. This prompted FAWU to complain to the Commission, alleging a breach of the merger conditions. While engaging with the Commission, Coca-Cola SA concluded the consultation process and implemented the retrenchments.

The Commission issued Coca-Cola SA with a Notice of Apparent Breach. Coca-Cola SA then applied to the Tribunal to review the notice and argued that there had been substantial compliance. The Tribunal agreed, holding that the true reasons for Coca-Cola SA's need to retrench was to reduce costs in light of the adverse economic factors which arose after the merger. The Commission appealed to the Competition Appeal Court (CAC), which decided against Coca-Cola SA. The CAC held that the test is not to assess the probabilities in order to determine the true reason for the retrenchments (as applied by the Tribunal), but whether **some** nexus (or link) exists between the retrenchments and the incentives of the new controller (i.e. the acquiring firm). As would be expected when applying such an overbroad test for causality, the CAC found that some nexus existed and held that the retrenchments were merger related.

Up to this point, it had been generally understood that the test for determining whether retrenchments (or any other action) was merger specific was the "*but for*" test: But for the merger, would this action have been taken? The CAC's decision now introduced a much lower threshold: where **some** nexus existed between the action and the merger, it would be considered merger specific. On the CAC's test, even if the primary reason for the action was not merger specific, any incentive that the company had to terminate jobs in light of the merger, even if this was a minor consideration, would amount to a breach of merger conditions. Coca-Cola SA appealed to the Constitutional Court.

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Before the Constitutional Court

The Constitutional Court explained that as soon as there is the appearance of a breach the Commission must place the alleged perpetrating firm on terms (by issuing a Notice of Apparent Breach), and the alleged offending firm must elect either to submit a plan to remedy the breach or to approach the Tribunal to review the notice. If a firm chooses to approach the Tribunal, it is responsible for demonstrating that there has been substantial compliance with the merger conditions.

The court accepted that the causation rules must be applied *"with good sense"* so as to give effect to the intention of the contracting parties (noting that in the merger conditions context, there are both contractual and statutory considerations). The court held that legal causation involves identifying a proximate cause (considering *"reality, predominance and efficiency"*), which can be determined by *"applying good business sense"*.

The court looked at the wording of the merger conditions *"as a result of"* (or merger specific) and found that the wording was incompatible with the *"some nexus"* test that the CAC had applied. It found that the reasons for the retrenchments were independent of the merger and not *"as a result of"* it. The phrase *"as a result of"* was recognised causal terminology.

The court explained that the test to be applied by the Tribunal in determining whether any action is merger specific is a two-fold causation test:

- Firstly, is there factual causation? Does it follow logically that but for the merger, the retrenchments (or other action) would not have occurred?
- Secondly, is there legal causation? Are the retrenchments (or other action) directly linked, or at least predominantly related to, the merger?

If both answers are *"yes"*, the action is merger related and a breach of a merger condition. The court clarified that the test must be applied at the time of the breach, but while considering all that has transpired since the merger, including the lapse of time from the merger approval to the actual retrenchments. The longer the time lapse, the less probable a link with the merger. The court found that the reasons for the retrenchments were directly related to the reduction of labour costs post the merger and were not merger specific. This is a welcome confirmation.

Conclusion

The Constitutional Court has delivered a judgment that provides much-needed guidance – particularly in confirming that the test for determining whether an action by a firm is merger related is that the action must directly, or at least predominantly, linked to the merger for a breach to have occurred. The court has taken a practical approach, alive to the realities facing businesses in tough economic circumstances.

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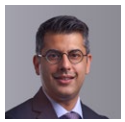

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