



Towards a free and fair
economy for all

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Setting the Limits

The Effect of Minimum Resale Price Maintenance on Franchise Agreements

What are franchise agreements?

Franchise agreements could be described as a contractual agreement or arrangement between the franchisor and the franchisee, whereby the franchisor gives the franchisee a right to use the know-how, trade marks, designs and other intellectual property rights for a fee. There are, however, various forms of franchise agreements or arrangements

depending on the nature of the enterprise. Most franchise agreements would have clauses that stipulate what the franchisee must purchase and from whom, and may also contain provisions which impose restrictions on the ability of the franchisee to price independently to customers. It may be argued that such clauses are necessary as they ensure the maintenance of the quality and reputation of the product/service as well as promoting the brand.

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Does the Competition Act apply to franchise agreements?

In order to answer the question as to whether or not the Competition Act 89 of 1998 (the Act) applies to franchising, it is important to discuss in detail some of the provisions of the Act. The relevant sections for this purpose will include section 3(1) that deals with the application of the Act, section 5(1) on agreements in a vertical relationship, section 5(2) on the practice of minimum resale price maintenance, and section 5(3) on the recommended minimum resale price.

Section 3(1) makes it clear that the Act applies to all economic activity within the Republic, subject to certain exclusions of which franchising is not one. There is no reason to doubt that franchise businesses in South Africa are indeed economic activities and that the provisions of the Act do apply to them as well.

Furthermore, in terms section 5(1) of the Act, a vertical relationship exists between the franchisor and the franchisee. The franchisee is positioned below the franchisor in the chain of distribution, in which case the latter possesses relational power over the former. The application of the Act to franchising is crucial, because most franchise agreements would not only contain restrictions on behaviour, but would typically involve vertical restraints that may substantially lessen or prevent competition or have negative effects on consumers.

Again, section 5(2) prohibits firms in a vertical relationship from practicing minimum resale price maintenance. However, section 5(3) does allow for recommended prices to be determined, but stipulates that it must be clear that such prices are recommended and not binding.

What is meant by the practice of minimum resale price maintenance?

Minimum resale price maintenance (RPM) is a form of price fixing and occurs when a franchisor imposes a minimum resale price on a franchisee, thereby limiting or even excluding

a franchisee's ability to offer discounts. The Antitrust Law¹ indicates that resale price maintenance or vertical price fixing is an agreement between persons at different levels of the market structure, which establishes the resale price of products or services. RPM is administered through the setting of a binding price at which to resell the product.

Section 5(2) of the Act clearly stipulates that RPM is prohibited. In the E.U the court found in the *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis*² case that price fixing was per se illegal in respect of franchising. The findings against Federal Mogul Aftermarket and Toyota SA in SA serve as examples of the seriousness of the Commission in eradicating anti-competitive practices such as RPM. The Competition Tribunal imposed a fine of R3 million on Federal Mogul Aftermarket (appeal court decision awaited) for setting a minimum resale price in respect of spare parts. Toyota SA also paid an administrative penalty of R12 million for dictating maximum discounts that dealers are allowed to give to customers in respect of a certain type of car that Toyota manufactures.

It is clear that RPM can be detrimental to consumers as it prevents them from negotiating discounts on the price of products/services. On the other hand, if a franchisee were to decide on his/her own to give a discount, penalties might be imposed by the franchisor. The problem with the RPM practice is that it effectively ties the hands of the franchisee in respect of offering discounts to customers. Every franchisee is expected to charge the same price, despite the fact that the situations under which businesses are conducted may be different. The other competition concern of RPM is that the differences in the retail costs of various franchisors are not necessarily passed on to the consumer in the form of different retail prices. Consequently, consumers do not enjoy lower prices and in fact intra-brand competition (i.e. competition among dealers of the same label or brand) is removed in the relevant market. In addition, from a competition point of view, RPM could facilitate collusion at the level of the franchisors, a conduct that is also anti-competitive.

How can franchisors comply with the Act?

It must be remembered that RPM is a per se prohibition. This means that all that is required for an offence is proof of the specified practice itself. No efficiency of supply of products or pro-competitive based defence is accepted. Manufacturers or franchisors should therefore realise that the Act does not allow them to dictate to a franchisee, dealer, wholesaler or retailer a minimum price at which to resell goods or to determine the maximum discount that can be given to customers. The franchisor can only recommend a price that he/she feels gives weight to the value and quality of their product or service, but should never bind the retailer or dealer to that price, as this will be a violation of section 5(2) of the Act. Recommended prices are acceptable to most competition authorities in that they communicate information (e.g. quality, brand image, etc.) to consumers and franchisees.

In order to comply with section 5(3), franchisors must therefore revise their pricing clauses in the agreements by stating clearly that their prices are only recommended ones for the franchisees to use. They must also ensure that there is no sanction or penalties meted out to franchisees that resell the products at a price that differs from the one recommended. Franchisees should also be allowed to freely give discounts to their customers when and if they so wish, without fear of being victimised.

Conclusion

In conclusion, it should be noted that the Act also applies to franchising, unless an exemption were to be applied for and granted by the Commission. The Commission does not prescribe to businesses how they should go about conducting their affairs. In fact, the Commission takes cognisance of the fact that franchisors need to protect and promote their brand, ensure customer loyalty and uniformity as well as set standards. However, traders are required to ensure that they do not, through their conduct or agreements, restrain competition or impose conditions such as RPM that have an effect of harming competition to the detriment of small

¹ ABA section of Antitrust law, antitrust law developments (4th ed.1997)

² *Pronuptia v Schillgali* (1996) ER 353)

Settling the Dispute with BHF



The Commission has successfully settled the long-standing dispute between itself and the Board of Healthcare Funders (BHF) through a settlement agreement concluded between the Commission and BHF on 19 August 2004. As part of the conditions of this agreement, BHF has agreed to pay a settlement fee of R500 000, payable within 30 days of the signature of this settlement agreement.

This follows an investigation initiated by the Commission in the medical sector against the SA Medical Association (SAMA), Hospital Association of SA (HASA) and BHF in 2002 on alleged collusive agreements. The investigations against HASA and SAMA were settled through consent orders, in terms of which administrative penalties of R4.5 million and R900 000 were levied against both parties respectively.

BHF, which represents about 85% of the medical schemes, had engaged in a practice of determining, recommending and publishing benchmark tariffs for healthcare services on an annual basis. As an association of firms (medical schemes) that are competitors, the Commission concluded that BHF had contravened the Act, in particular section 4(1)(b)(i), as the conduct constitutes price fixing. Price fixing negatively affects consumers, especially because it often limits price competition and reduces incentive for companies to be innovative.

BHF, however, argued that it had not, in its view, contravened the Competition Act and was thus not willing to settle with the Commission. It was at this point that the Commission decided that it would refer the matter to the Competition Tribunal for prosecution.

This matter took a different, not to mention surprising angle, when BHF decided to enter into negotiations with the Commission to settle the matter without having the Competition Tribunal adjudicate on it.

In terms of the settlement agreement, BHF agreed, *without any admission of guilt*, to:

- Cease publishing a tariff, recommended scale of benefit or other form of price guideline for services rendered in the private healthcare sector;
- Inform all its members with a letter indicating that it will no longer recommend, determine or publish tariffs for the provision of medical services - which letter will be published in the next issue of BHF's communiqué; and
- Advise its members on the concerns that arise from deciding to jointly utilise the National Reference Price List (NRPL) and to impress upon its members not to engage in collusive activity.

In addition to the above, BHF will commission a study by an independent person (whether public, private or academically based), which shall provide guidance on the band of charges and range of factors to be considered in determining the cost of providing various healthcare services in South Africa. This can be used by various medical schemes individually in determining the costs of providing various healthcare services.

The Commission is of the view that this settlement addresses the concerns it had and would benefit consumers immensely as it would increase the level of competition in this sector. It is generally accepted that competitive

forces bring about optimum quality, quantity and prices for consumers.

It must be emphasised that price fixing by professional associations and firms in the healthcare sector has been dealt with and prosecuted vigorously in other jurisdictions, such as the United Kingdom, Canada and the United States, over 10 years ago. Until 1998, South Africa did not have a competition regime to address issues of this nature and as a result, they continued to exist as a norm.

It is for this reason that the Commission's intervention in various sectors has been a shock to industry players. It is still difficult for industry players to understand why a conduct, which has existed for such a long time, is suddenly unlawful. The Competition Act has been in existence for five years now, and it is about time that industry players internalise its requirements to their operations and comply fully. This demands an urgent adjustment of mindset in all sectors of the economy to accept that things have changed and that 'it is not business as usual'.

Through proactive interaction, the Commission continues to entrench its role as the 'agent for economic change', and its focus on eradicating all anti-competitive conduct to create a fair and efficient economy for all. This will benefit not only consumers but also small and black businesses that are struggling to enter or survive in markets dominated by anti-competitive practices.

Where associations of industry players wish to engage in practices that are contrary to competition principles entailed in the Competition Act, they must use the relevant provisions of the Competition Act and apply for an exemption.

Controlling Merger Transactions

The concept of control is central to the triggering of a merger as provided for in the Competition Act 89 of 1998 (the Act), as amended.

Section 12 of the Act provides that a merger occurs when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm, which may be achieved in any manner.

Notwithstanding the way that the merger regulation has dominated the activities of the competition authorities, the issue of control continues to be problematic.

The competition authorities have shed more light on what is envisaged by section 12 of the Act on a case-by-case basis. Elementary issues widely accepted about the definition of a merger as set out in section 12 are that:

- The section implies a change in control or an acquisition by a firm of control or a type of control that it never had before the proposed transaction.
- Use of the phrase "one or more firms" in the section implies that more than one firm may, at any given moment, have control over another firm at the same time.¹
- Acquisition of control need not be direct, thus a parent firm could acquire control through a direct acquisition made by its subsidiaries. Firms that belong to a single economic entity or that have one ultimate controller would not have their intra-enterprise transactions resulting in a merger, unless there happens to be a firm that is controlled by an external entity outside of the single economic entity.²
- Control may be acquired in respect of the whole or part of the business of a firm, which includes the acquisition of an asset or assets. It also contemplates that a business is divisible, and hence a merger can be accomplished by the acquisition of part of the business of a target firm.³

Control may be established or acquired in any manner, including through purchase or lease of the shares, an interest or assets of the other firm in question or amalgamation or other combination with the other firm in question. This section sets out the most commonly



occurring situations to be found within the meaning of control but it does not provide an exhaustive list of all the ways in which control might exist.⁴

The provisions of both sections 12(1) and (2) have to a certain degree crystallised the nature of control. It is now acceptable that control may be sole, that is vesting solely on one firm, or it could be a joint type of control,⁵ that is more than one firm having or enjoying control over the same company. Joint control does not necessarily have to be specifically agreed upon by the firms to exist.

Furthermore, control could be de jure or de facto.⁶ The former relates to a firm that has a shareholding of 50% plus in a company. The latter, at its simplest, would relate to a firm that has less than 50% in a company, yet exerts influence and/or control as if it were a majority in the company. The latter is practically difficult to pin point. At times well-intended arrangements, meant to enhance the operations of a company, could confer this kind of control.

A move by firms from one nature of control to

another may trigger a merger. The reason for this is based on the understanding that the quality of control that corresponds with each nature of control, differs from one another. Further, it has been stated that such a situation presents clarity both for the regulator and the regulated when it comes to notification requirement.⁷

The complexity of determining de facto control is largely the aspect that continues to pose most problems. In this regard the provisions of section 12(2)(g) of the Act have caught a number of arrangements entered into by firms, which they believed would not trigger mergers.

This has been observed mostly in transactions that are aimed at Black Economic Empowerment targets or meeting certain industry charter requirements. With these transactions, parties tend to confer more powers on the minorities under the guise of ordinary minority protection rights provided for by the company laws of the Republic.

Section 12(2)(g) of the Act provides that a person controls a firm if that person has the ability to materially influence the policy of a

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firm in a manner comparable to a person, who in ordinary commercial practice, can exercise an element of control referred to in paragraphs (a) to (f). Minorities could at times legitimately influence the company policies where they have shares. The reason for this is that minorities have financial interests or investments that they have to protect. However, the trite law still remains that legitimate majority shareholders' decision in a company binds the minority.

What should be noted about section 12(2)(g) is that it relates to the mere ability on the part of the person and not necessarily the actual influence. Therefore, if a person possesses that ability to materially influence the policy of a company, such person would be taken to have control, even if he never actually exercised such ability. The mere fact that he has that ability appears to suffice for purposes of this section.

The aspect of "material influence" also poses interpretation challenges. International approaches have provided guidance by limiting material influence to relate to strategic decisions, commercial strategies or decisive influence. However, this is still done on a case-by-case basis.

The invocation of 12(2)(g) mostly arise from a shareholders agreement that governs the relations of the parties inter se or a similar agreement, for example an agreement on Reserved Matters, Stepping In Agreement, Resolutions etc. Through these types of agreements one often finds that the minorities are made part of decision making on the members' meetings or the board on matters that determine the strategic commercial behaviour of a company. Matters like business plans of a company, annual budgets, appointment of senior management, substantial investments, business and/or commercial policy, competitive strategy of the company and corporate planning, would form part of those agreements on which minorities would have a co-determining role.

A common clause in agreements is the one

that requires 75% of the votes of members on reserved matters or strategic decisions. The majority members of the company would at that time be having only 60% of votes and a minority or minorities would have the remainder. Clearly in such a situation a minority or minorities would always be needed to co-determine those Resolutions or Reserved matters. The majority without minority participation will never attain the required 75%. Therefore any decision-making on those matters would have minority influence. The minority would then have the ability referred to in 12(2)(g) in that case.

Another common clause to these would normally require unanimous approval of all shareholders or members of the Board, of which minorities would be part, for a decision on those matters (Reserved Matters or Resolutions, etc). If there is a dispute, a determination would be made by a mutually agreed upon neutral third party, be it a mediator, an arbitrator or auditor. Again in this kind of an arrangement, minorities are put on the same footing with the majority, such that virtually any decision in a company would have their influence, in which case Section 12(2)(g) becomes applicable.

In relation to the above, where in a dispute the majority would have a casting vote, that may be a persuasive indication that control vests with the majority. However, this is not always clear-cut. In some agreements one would find that before the majority eventually gets to exercise its casting power, some other means supposedly aimed at appeasing the minorities may be put in place. It might be said, for example, that before a dispute is declared an expert view should first be sought on a potential dispute. If the obtained expert view does not point to a dispute, parties would have to reconsider the matter instead of the majority exercising its casting powers. In those types of circumstances where casting powers are limited, the ability referred to in section 12(2)(g) may be found to exist on the part of minority.

At times companies would structure the

execution of some of their functions through the mechanism of committees. Such committees would be tasked to determine certain policies of the company. Minorities would participate on those committees and vote. Through that, one could find again that section 12(2)(g) may be applicable as some of those policies determine by those committees could be strategic.

In addition to the above, the Commission has previously pointed out that voting pool arrangements, share swaps and the right to appoint Board members, are some of the arrangements that could trigger mergers.

With the voting pool arrangements, a company with a dispersed shareholding would have a number of shareholders agreeing to vote together at all material times or nominating one of them to vote their votes on their behalf, usually in a manner previously discussed by all or in his own discretion taking into account their interests. The minorities get to influence the strategic decisions of the company through their participation in the voting pool, thus invoking section 12(2)(g).

These arrangements are often conveniently referred to as instances of negative control, safeguarding investments and financial interests merely aimed at that of minorities. It is important to note that the intention of the parties is not a relevant consideration when determining whether a merger is triggered or not. The consideration is often whether control has changed or has it been established and/or acquired or not. If the response is in the affirmative, then a merger gets triggered.

Seeing that the concept of control is not straight forward, it is recommended that the parties that intend to merge and are not sure of the consequences of their proposed transactions in relation to section 12 of the Act, should seek an advisory opinion from the Commission. Although advisory opinions are not binding, they do provide guidance on a given set of facts, which makes it possible for parties to know where they stand with the proposed transaction.

¹ See: Distillers Corporation (SA) Ltd / SFW Group Ltd & Bulmer (SA) Pty Ltd / Seagram Africa (Pty) Ltd 08/CAC/May 01 at page 25, Bulmer SA (Pty) Ltd & another / Distillers Corporation (SA) Ltd 94/FN/ Nov00 101/FN/Dec00 at page 20 and also Ethos Private Equity Fund / The Tsebo Outsourcing Group (Pty) Ltd 30/LM/Jun 03 at paragraphs 26, 28 & 42
² Bulmer SA (Pty) Ltd & another / Distillers Corporation (SA) Ltd 94/FN/ Nov00 101/FN/Dec00 at page 17
³ The Competition Commission / Edgars Consolidated Stores Ltd & another 95/FN/Dec02 at paragraph 23, Edgars case above at paragraphs 28,35,36&37
⁴ Bulmer case above at page 14 and Caxton & CTP Publishers and Printers / Naspers Ltd and Others 16/FN/Mar04 at paragraphs 23 & 25
⁵ Ethos case at paragraph 28, Bulmer case above at page 19
⁶ Bulmer case at page 19
⁷ Ethos case at paragraph 26, 28 & 42

The Relation of the Strong Rand to Import Parity Pricing

Can Both IPP and a Strong Rand be 'Bad' for the Economy?



competition out. However they also want cheap inputs, which is only possible if the rand is strong. This is a dilemma for manufacturers, but it simply indicates that the exchange rate has complex effects that don't all work in the same direction. Furthermore, the exchange rate is but one of many variables that impact on the fortunes of business, so it is simplistic to argue that the strong rand is the cause of all ills.

For consumers too, the impact of a strong rand has several effects. In the short term, a strong rand boosts consumer spending by reducing the price of imports and their locally made substitutes. The strong rand has also protected consumers from the recent surge in the oil price, which would have been a major shock to the SA economy if the rand were still at ten to the dollar, rather than six-and-a-half.

In the longer term, consumers as workers might be hurt if firms are unable to retain them as employees in the face of declining export revenues. The SA economy is still heavily dependent upon exports. Equally, many businesses depend on imported components, so it is clear that export success cannot be built upon a weak rand.

The half-point decrease in the repo rate, announced on 12th August 2004, will lead to some weakening of the rand and this may bring some relief to exporters, but the flipside is that the prices of imported consumer goods, oil, capital equipment and other inputs into production processes will start to rise again. In addition, the availability of cheaper money will boost consumer demand, which is already at high levels. The danger is that inflation may rise in response.

It does seem that there is an undue preoccupation with the level of the exchange rate at present. The SA Reserve Bank has perhaps been slightly too restrictive in its monetary policy stance lately, but there is no doubt that consumers have benefited greatly from the resultant decline in inflation.

Many firms have complained that import parity pricing (IPP) is anti-competitive; but a lengthy report by the Commission found that IPP is not necessarily anti-competitive. Nevertheless, Harmony Gold is pursuing its case against Iscor at the Competition Tribunal, arguing that IPP of Iscor steel amounts to excessive pricing.

Nedlac stakeholders, too, see IPP as a problem and have set up a task team to look for solutions. At a Nedlac meeting on 4th August 2004, concerns about IPP were re-stated by Nimrod Zalk of the Department of Trade and Industry (dti). Thereafter, business and labour representatives had their say. Interestingly, speakers condemned both IPP and the strong rand as two key causes of manufacturers' problems.

On the one hand, IPP was condemned as leading to high input costs for manufacturers. On the other hand, the strong rand was blamed for manufacturers' inability to price their goods competitively in export markets and for the rise of import competition.

But can one rationally condemn IPP and in the very next breath complain about the strong

rand, as well as the low level of import tariffs? Not if one's arguments are to be consistent. Ultimately the extent to which input costs are inflated by IPP depends on a weak rand. The weaker the rand is against foreign currencies, the more costly are imported substitute products, and therefore the higher are domestic prices set at import parity. Once the rand strengthens, however, IPP is reduced and the domestic suppliers of inputs must lower their prices accordingly.

All participants in the economy must realise a fundamental law of economics: you can't have your cake and eat it. If manufacturers want a weak rand to keep their exports competitive in world markets, and to keep imported substitutes for their products expensive in the domestic market, then they must put up with high input prices, either of imported inputs or of local inputs priced at or near import parity. Alternatively, if manufacturers consider that IPP is the main problem, then a strong rand is the surest way to reduce prices set at import parity. However a strong rand will also increase the competitiveness of imported manufactures in the domestic marketplace.

Manufacturers often call for a weak rand (and higher import tariffs) to keep the imported

Regulatory Inflation

The Role of the Commission and Regulatory Impact Assessment

Introduction

The OECD defines regulation broadly as a full range of legal instruments by which governing institutions, at all levels, impose obligations or constraints on private sector behaviour.¹ For purposes of this article, regulation shall encompass all laws, regulations, and requirements placed by government on business and society. Regulation can be divided into two main forms - economic and social. Economic regulation is concerned with the regulation of prices, profits, revenue, output, service delivery or market entry by firms. Social regulation focuses on such issues as environmental and safety standards, the treatment of workers and eliminating discriminatory practices against minorities. It may also be aimed at giving opportunities to previously disadvantaged communities. The purpose of all regulation is to prevent undesirable behaviour, actions and activities while at the same time enabling and facilitating desirable ones. While most government regulation serves the public interest and, its objectives and purposes, in most instances, laudable, regulations have what are called 'unintended consequences' or side effects that may manifest in the form of inhibited business competitiveness, reduced investment, decreased competition, derailed economic growth, heightened job losses and an increased cost of doing business.

This article attempts to highlight the crucial necessity of assessing regulations before and after implementation, for purposes of accountability, transparency, consistency, efficiency and effectiveness. It also seeks to draw attention to the vital role that the Commission plays in assessing the competition impact of new laws and regulations and in ensuring a proper regulatory regime during the transition to market liberalisation, all as part of its advocacy function.

Regulatory burden and reform

South Africa is undergoing a major double-pronged regulatory reform phase. On the one hand, some state owned enterprises have been liberalised and opened up to competition² while others are being restructured in different ways.³ On the other hand we have a proliferation of new legislation and regulations with which business, both big and small, have to comply. These range from environmental regulations, procurement laws, labour laws, tax laws, to price regulations. Close to eight



hundred new laws have been passed since 1994,⁴ in addition to countless regulations. These developments require both a rethink of the regulatory regime to take into account new developments in the market and the impact of regulations on the ability of firms to perform optimally.

Whilst the objectives of these laws are highly appreciated and the public interest they serve well understood, it is not always clear at what cost these benefits are attained. The cost of regulation involves the compliance costs borne by businesses and the implementation costs borne by government. The cost of complying with legislation increases the transactions cost of doing business, which impedes productivity, competitiveness, job creation and economic growth. In order to keep abreast of and to comply with a myriad of laws, companies are employing what are called 'compliance officers'. To the extent that all these costs form part of the operational costs of firms, they are passed on to consumers in the form of higher prices.⁵ At the same time, government employs multitudes of bureaucrats whose jobs are to churn out, implement, monitor and enforce compliance with these laws. The result is heightened red tape, increased government expenditure and an intrusive regulatory environment that dampens the spirit of entrepreneurship. Because of their small size and limited resources, regulations seem to weigh more heavily on small and medium sized entities. Some businesses may even choose to remain informal to avoid getting entrapped in the regulatory net. This entails a cost to society in the form of forgone jobs, investment, innovation and growth.

This is not to say that all regulation is bad. Although it is common to hear the private sector complaining about the potential cost of environmental regulations, occupational health and safety regulations and labour laws, the truth of the matter is that some amount of regulation is necessary. It serves to rein in unbecoming behaviour by firms and to correct imbalances caused by the market system and the past political dispensation, often for the good of all, including the private sector.

The role of a regulatory impact assessment technique

The lack of regulatory impact assessment is a flaw in the formulation and implementation of legislation. Policy makers either overlook or simply do not explore other options of achieving the same results. For instance, it might be that there are ways of ensuring low prices for consumer products other than price regulation. Simply put, policy makers rarely employ a cost-benefit analysis of proposed and existing regulations. This leads to a proliferation of ineffective, inappropriate and unnecessary laws that do not stand up to scrutiny, and lots that are sometimes never implemented. All this is a sheer waste of much needed resources that could be employed productively elsewhere.

A regulatory impact assessment (RIA), also known as a regulatory impact analysis, is a form of a regulatory cost-benefit analysis tool, a means of appraising the costs and benefits of proposed regulation and evaluating the performance of existing ones.⁶ The use of a

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RIA helps policy makers to ask such questions as: Is there a need for this law, and for how long? Will it meet its objectives? Is it the most cost-effective method of protecting the public interest? Will it have unintended side effects? What are the likely benefits of this law? What about the costs to firms/society? etc.

Most countries, at different stages of development, now have RIAs in place that allow lawmakers to justify whatever law they propose by enabling them to compare various options, identify costs and benefits for each option and choose the option with the least cost, whose benefits exceed the costs. It is time that South Africa should use the same approach. Moreover, at a time when governance is a top priority for both the private and public sectors across the globe, RIAs can also be used as processes that contribute to better governance, by improving transparency and the accountability of public decision-making. The advantages of RIA include the protection of independent regulators from political interference, the establishment of regulatory legitimacy and the assurance to government, business, consumers and stakeholders of the logic of regulatory decisions.

There is no single method of conducting a RIA. Some methodologies consider the monetary values only in their estimations whilst others use a combination of quantitative and qualitative data. In terms of structure, a RIA unit can be housed within a commerce department like the departments of trade and industry, finance or public enterprises. Alternatively it can be the function of the parliamentary public accounts committee. Other countries have stand-alone units that evaluate all laws in the country while others leave it up to individual regulators or government departments to do their own RIAs. Whatever the structure or methodology used, the fact of the matter is that RIAs should be an integral part of any modern public governance structure.

The role of the Competition Commission

The Commission has a crucial advocacy role to play in this double-pronged regulatory reform process. With regard to the restructuring and privatisation of state-owned enterprises, the

Commission has to ensure that the process leads to a competitive outcome. The resultant market structures should be such that new entrants can compete fairly with incumbents. In other words, for these industries to be fairly contestable, the playing field between the incumbents and new entrants must be levelled. To do this, previous benefits like tax exemptions, preferential access to scarce inputs and discriminatory subsidies enjoyed by these former state-owned enterprises ought to be phased out. It's not enough to simply substitute private monopolies for public ones.

The need for continued access, economic, safety and technical regulation has necessitated the establishment of more regulatory bodies to undertake these functions. Where new regulators are established, these must be independent, efficient and effective. Also, a consolidation of multiple regulators into one regulator in industries such as energy, transport and communications is advisable in order to, among other things, reduce regulatory costs and avoid overlaps, duplication and jurisdictional conflict. The founding legislations of these bodies must spell out their functions and powers clearly and cede all previous competition investigation powers to the competition authorities. Whilst it is clear from government policy⁷ that competition authorities in South Africa should undertake competition regulation, there is still a lot of new legislation that mandates sector regulators to deal with competition matters. Although concurrent jurisdiction can work under certain circumstances, it has its own demerits, which include forum shopping, double jeopardy and inter-organisational conflict.

With regard to new laws and regulations, the Commission is also mandated to play an active role. In terms of section 21 (1)(k) of the Competition Act, the Commission is responsible to, "over time, review legislation and public regulations, and report to the Minister concerning any provision that permits uncompetitive behaviour." Whilst the Act is clear about the Commission's advocacy function in this regard, the 2003 OECD Peer review Report notes that "most of the efforts of the Commission have been aimed at raising public awareness of the Act, rather than studying and advising about the effect of laws and regulations on competition." However, it is heartening to note that there has been a paradigm shift since the release of this report,

as evidenced by the number of parliamentary and government departmental submissions made by the Commission on various legislative and policy proposals since then. Notwithstanding this, we continue to witness a number of laws being passed with little regard to their impact on competition.

In its assessments, the Commission would look at whether the proposed regulations are likely to affect the structure of the industry concerned, or the behaviour of firms in that industry and their ability to compete effectively. Whereas the Commission's interventions have been limited to the competition impact of these laws, government appraisal would go a step further to consider the effects thereof on employees, consumers, the environment, civil society, etc.

Conclusion

The Minister of Finance, in his budget speech⁸ identified the easing of the regulatory burden on the small business sector as a key microeconomic reform strategy. President Mbeki added his voice to this call, in his state-of-the-nation address,⁹ by stating that as a means of helping small businesses, government "will carry out a comprehensive review of the regulatory framework that impacts on this sector, to facilitate its further growth and development." Such a review should not be limited to the regulatory institutions nor to small businesses only, but should include a review of all the laws that impact on the economy as a whole.

In order to promote an efficient and effective regulatory regime and without perpetrating a regulatory state, government should pass a "Regulatory Impact Assessment Bill" that will make it compulsory for public servants to justify the need for any proposed law and assist them to write regulations that are simple and easy to understand, provide a sunset clause in all regulations to allow review after a certain period, study the economic impact of proposed regulations and encourage market-driven responses in place of regulation.¹⁰ Until then, the Commission should reinforce its advocacy function and play a more aggressive role in assessing not only the competition effects, but also the economy-wide impact of proposed legislation and policies as well.

¹ OECD. 1996 Regulatory reform: Overview, Paris: OECD

² Eg. the telecoms sector

³ Eg. The proposed port concessioning and the introduction of independent power producers in the electricity sector

⁴ Including amendments to existing legislation

⁵ Louw, L. Repel tidal wave of redundant regulation. Business Day, 14 January 2004

⁶ Kirkpatrick C; Parker, D & Zhang, Y. 2003. Regulatory impact assessment in developing and transition economies: A survey of current practice and recommendations for further development.

⁷ Paper delivered at the Regulatory Impact Assessment Conference, University of Manchester, 26-27 November 2003

⁸ Department of Public Enterprises. 2000. An accelerated agenda towards the restructuring of state owned enterprises: A policy framework

⁹ Budget speech. Minister of Finance, Trevor Manuel. February 18, 2004

¹⁰ Address of the President of South Africa, Thabo Mbeki, to the first joint sitting of the third democratic parliament, Cape Town, May 21, 2004

¹¹ Mihlar, F. 1998. The Cost of Regulation in Canada. Public Policy Sources, No. 12

Money Talks

Administrative Penalties and Settlement Fees



The key achievement for the Commission this year has been the completion and resolution of major, precedent-setting cases that have clearly reiterated and brought to the fore the Commission's mandate of ensuring a fair and efficient economy for all. Through public and visible settlement of such high profile cases, the legitimacy of the law is established. Punishment in the form of substantial fines becomes a real deterrent to would-be transgressors.

During the financial year 2003/04, the Commission received administrative penalties and settlement fees totalling R38, 823,000.

Boehringer Ingelheim / GlaxoSmithKline

The Commission concluded settlement agreements in December 2003 with Boehringer Ingelheim (BI) and GlaxoSmithKline (GSK) pertaining to anti-retrovirals (ARVs). GSK and BI had, in the Commission's view, contravened the Competition Act of 1998. From the investigation into the complaint filed by Ms Hazel Tau and others, the Commission concluded that GSK and BI had abused their dominant positions in their respective ARV markets. Though GSK and BI denied the alleged contraventions, both GSK and BI agreed between them to issue a total of seven voluntary licences to generic manufacturers. This is expected to significantly reduce the cost of ARV drugs through the introduction of more competition into the market.

International Health Distributors

Another settlement agreement was reached with International Health Distributors (IHD) and certain pharmaceutical drug manufacturers, in terms of which the parties agreed to pay a settlement fee of R20 million, the highest yet in South Africa. The drug manufacturers further agreed to dispose of their interests in IHD, in view of our concerns that this was a forum where the drug manufacturers could fix prices and trading conditions

South African Medical Association/Hospital Association of South Africa

The Commission concluded consent orders with the South African Medical Association (SAMA) and the Hospital Association of South Africa (HASA). The Commission is of the view that its actions will result in the opening up of the healthcare market by empowering hospitals and doctors to negotiate their own individual rates. As a benefit of increased competition between service providers, the consumer should in the long run reap the benefits of lower fees for specific services. In terms of the consent orders, HASA agreed to pay an administrative penalty of R4,5 million, while SAMA agreed to pay R900, 000.

Pretoria Association of Attorneys

A consent order was concluded with the Pretoria Association of Attorneys, in terms of which that association agreed to pay administrative penalties of R223, 000 for collusion between its members on legal fees

to be charged for certain services in the Pretoria area.

Nail/Tiso

The Commission concluded a consent order with the parties regarding the implementation of the merger prior to approval by the Commission. The parties agreed to pay an administrative penalty of R500, 000. This followed the implementation of a merger in terms of which Tiso acquired the assets and shares of Nail. The Commission concluded that this transaction was a merger and should have been notified before implementation.

Toyota

The Commission concluded a consent agreement with Toyota, after its investigation revealed that Toyota engaged in the practice of minimum resale price maintenance. In terms of the consent order, Toyota has agreed to discontinue the practice and to pay an administrative penalty of R12 million.

USAP

The Commission concluded a consent agreement with United South African Pharmacies (USAP), an association of retail pharmacies, in respect of conduct in terms of which USAP decided on a 'group boycott' against Anglo American Corporation Medical Scheme and Engen Medical Fund in contravention of the Competition Act. The consent agreement was confirmed by the Competition Tribunal. The consent agreement includes an administrative penalty of R250 000.

Regulators' Forum Gets a New Life

The South African Regulators' Forum (SARF) took off in a very promising way this year. SARF has already held two of its quarterly meetings for this financial year, in which more than 80% of its members were represented. The Commission and the Security Regulatory Panel (SRP) respectively, hosted these meetings.

Current regulatory changes and developments were discussed, among other things, the recent amendments to the Gambling Act and updates on recent leadership changes in regulatory authorities such as the National Electricity Regulator (NER), the Registrar of Banks, the Estate Agency Affairs Board (EAAB) and the South African Bureau of Standards (SABS). SARF members made a commitment to engage each other through discussion and input on any proposed amendments

to legislation governing each member. In order to increase the effectiveness of SARF, a website has been established to facilitate access to information to all regulatory authorities. Interested persons can visit SARF's website at <http://www.saregulators.co.za>.

SARF's official newsletter 'Regulator', will be launched in November/ December and will provide current information and updates on the regulatory authorities, as well as developments in the regulatory framework and regulated sectors. This will add value to the regulatory environment, in particular among regulatory authorities and the public.

SARF was established in 2002 particularly to provide a platform for regulatory authorities to engage each other on issues of common interest, share information and build regulatory capacity. Various activities such as seminars

will be organised this year for this purpose. Thus, this promises to be a fruitful year for SARF and the public will benefit from increased interaction of regulators. Through cooperation, regulatory authorities can enhance service delivery and consumer welfare.



A United Front

Report on Meeting Held With Trade Unions' General Secretaries



The Commission recently held a successful Trade Unions' Consultative Forum Meeting (the Forum) on the 21st of July 2004 at the Elegant Lodge in Pretoria. The event was attended by a total of 24 delegates representing the Commission and the trade unions' general secretaries or senior union officials, who from time to time interact with the Commission on mergers and acquisitions matters. The theme for the day was "Making

Participation of Trade Unions more Efficient and Effective in Mergers and Acquisitions Processes".

The Congress of South African Trade Unions (Cosatu) gave a detailed presentation on the challenges and concerns facing trade unions. These concerns included the fact that unions perceive the rulings of the Competition Authorities as not reflecting the protection of jobs, which is the main goal for unions. They

further pointed out that the time frames in the Act for union participation is not sufficient. They are also concerned that lawyers and firms that merge often withhold information from them in the guise that it is confidential information. They urged the Commission to seriously scrutinise confidentiality claims made by firms so that they can have access to as sufficient information as possible on mergers.

This forum serve as a platform through which the parties discuss and debate issues of mutual concern. There are encouraging signs that this initiative is contributing positively to finding ways in which participation of trade unions in merger proceedings could be enhanced. Frank discussions and constructive debate that occurred contributed to increasing cooperation and understanding of the challenges facing both parties. It also provided an opportunity to reflect on the parties' experiences in various transactions as well as to review the effectiveness of their interaction.

Cases

Steel and plastics containers merger prohibited

The Commission prohibited the merger between Greif South Africa (Greif) and Rheem South Africa (Pty) Ltd.

The primary acquiring firm is Greif and the primary target firm is Rheem. Greif is controlled by Greif Inc: a company based in the United States of America and has no other operating subsidiaries.

The merging firms are both involved in the production and distribution of a wide variety of industrial containers. Greif produces both steel and plastics containers while Rheem is only involved in the steel containers market.

The parties defined the relevant market broadly, encompassing all industrial containers in South Africa. The Commission investigated the market definition and has concluded that the relevant market can be segmented according to container sizes ranging from small, to intermediate and large drums. In assessing this merger, there is evidence of substitution between steel and plastic in the small and intermediate drum category, but no substitution at the large drum level. The Commission therefore regarded a separate relevant market to be the large 210-litre steel drum market. The Commission's investigation found that the relevant geographic markets within which the parties competed was, in particular, Kwa-Zulu Natal and Gauteng, as the cost of transport of new steel drums prohibited the distribution thereof to areas beyond the geographic boundaries.

The merging parties are the two largest suppliers of the largest steel drums in the relevant geographic areas. Accordingly, their joint market share would be 100% post merger.

The customers of the merging parties argued that the merger would result in a single supplier post merger. In the short term they would not switch to plastics and would therefore be forced to purchase at high prices. Imports were not considered as an alternative due to high costs.

The Commission did not believe that ease in entry would constrain the merged entity's dominance in the relevant markets. Customers demand huge volumes and require reliable and sustainable sources of supply. New entrants are unlikely to meet these



requirements, notwithstanding that a new entrant has entered the Kwa-Zulu Natal market.

The countervailing power arguments presented by the parties were not convincing. Customers may be large multinationals, but they would still have to negotiate with a single source of supply.

The Commission submitted that the efficiencies arguments presented by the parties would not outweigh the likely anti-competitive effects identified.

The Commission therefore prohibited the merger.

Merger in the pathology industry approved

The Commission unconditionally approved the merger between Du Buisson Bruinette Kramer Incorporated and Ampath Trust and the businesses of Dr van Drimmelen and Associates Incorporated and Dr van Drimmelen Laboratories.

Du Buisson Bruinette Kramer Incorporated is an independent incorporated pathology group practice providing pathology practices to the private sector. Ampath provides administrative and management services to Du Buisson Bruinette Kramer Incorporated.

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Van Drimmelen Inc. is an independent incorporated pathology group practice operating in the Southern Gauteng area. Van Drimmelen Laboratories provides administrative and management services to Van Drimmelen and Associates Incorporated.

The Commission considered the relevant market to be the market for the provision of pathology services in the Southern Gauteng region. In its assessment, the Commission found that the merger would result in high market shares and high concentration levels which would effectively result in the creation of a duopoly in the relevant market. Notwithstanding the high market shares and concentration levels that would result from the merger, the Commission found that the transaction was unlikely to substantially prevent or lessen competition.

The Commission reached this conclusion after having considered that barriers to entry were not prohibitively high and that medical aids have countervailing power and would continue to possess bargaining strength after the merger. Furthermore, the Commission found that the Van Drimmelen practice was not an effective competitor pre-merger and therefore did not significantly constrain the activities and behaviour of the two largest participants in the market.

The transaction raised no significant public interest concerns and was therefore approved without conditions.

Commission gives conditional approval for Aspen to acquire FCC

The Competition Commission has approved the acquisition of Fine Chemicals Corporation (Pty) Limited (FCC) by Aspen Pharmacare

Holdings Limited (Aspen), subject to conditions. This acquisition allows Aspen, one of the largest pharmaceutical companies in the country, to vertically integrate by acquiring FCC, a local manufacturer of "active pharmaceutical ingredients" or APIs. Aspen seeks to add domestic manufacturing capability and to become more competitive in the global market through this acquisition.

In analysing the proposed acquisition, the Commission found that a number of competition concerns were evident. FCC is currently the only firm in South Africa with a licence to manufacture certain controlled substances, including codeine phosphate, an ingredient often used in analgesic medicines (painkillers). FCC is also the only South African manufacturer of paracetamol, a widely used non-prescription drug that is also used in analgesic medicines. Thus, a number of pharmaceutical firms, including Aspen, currently source codeine phosphate and paracetamol from FCC.

Several FCC customers were concerned that if the Commission approved the acquisition, Aspen would seek to advantage itself to the disadvantage of its competitors through its ownership of FCC. They submitted that the acquisition would result in them, as competitors of Aspen, being forced to pay higher prices for ingredients they purchase from FCC, or face the possibility of being cut out of the market altogether. Consumers could also be harmed by the possibility of higher prices, particularly for painkillers.

There is also information in the Commission's possession suggesting that imports of finished products could constrain the ability of Aspen to hurt its competitors in the marketplace. However, the Commission was not convinced that imports are currently an effective constraint on the prices consumers pay at the pharmacy.

While vertical mergers often do not raise competition concerns, in some instances they may have horizontal effects where they put a firm in a position to exclude or disadvantage competitors and further harm consumers. This acquisition in particular raised concerns because of FCC's position as the sole manufacturer of two key ingredients in pain medicines, a position strengthened through regulatory and other barriers prevailing in this industry. The Commission therefore needed assurances that FCC would continue dealing with its customers on a fair and equitable basis. The Commission therefore decided to attach conditions to this acquisition in an attempt to alleviate these concerns.

The conditions attached include the following:

- FCC will continue to supply South African customers that currently purchase narcotic products from it and undertakes to supply new South African customers.
- FCC undertakes to price the narcotics, including codeine phosphate, based on the current pricing scale it uses.
- In the event that FCC increases the price of narcotics, it shall provide the Commission with written notice of such an increase, the formula used to calculate the increase and supporting documentation. The formula will set out the cost component of the relevant products as well as the basis for the increase.
- FCC shall provide the Commission with detailed annual reports proving compliance with the undertakings, together with affidavits by a senior official in the company.

These conditions will be in effect for a period of three years.





Ceramic tile industry merger approved

The merger between Zanwood Trading 7 (Pty) Ltd (Zanwood) and Tile Afrika Group was unconditionally approved by the Commission. In its evaluation, the Commission considered that Zanwood, TAL (Pty) Ltd (TAL) and Johnson Tile (Pty) Ltd were all wholly owned subsidiaries of Norcros SA (Pty) Ltd (Norcros). The Commission found that vertical integration

would result from the merger as the acquiring group was involved in the manufacture and supply of tile adhesives and ceramic tiles and the target firm was active in the retailing of tiles and tile adhesives.

In assessing the merger, the Commission considered the view that the manufacture and distribution of ceramic tiles was an international market, as approximately 35% of all tiles sold in South Africa are imported. Although the tile manufacturing market in South Africa was

found to be highly concentrated with only two significant players, the Commission found that both local manufacturers would be vertically integrated after the merger.

In addition, the merger would not lead to input foreclosure or the raising of rivals' costs, as imports would continue, post merger, to provide a competitive constraint on the merging parties. The Commission also considered that independent retailers would continue looking towards imports as a viable alternative source

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of supply of ceramic tiles. With regard to the market for the supply of tile adhesive, the Commission found that various alternative suppliers existed in the market from which the independent retailers could source supplies.

The Commission therefore found that the merger was unlikely to substantially prevent or lessen competition in any of the relevant product markets within which the merging parties competed. There were no significant public interest issues arising from the merger.

Waterwarehouse and Robor Water merger approved

The primary acquiring firm is Waterwarehouse (Pty) Limited (Waterwarehouse), a wholly owned subsidiary of Waterholdings (Pty) Ltd (Waterholdings). The primary target firm is Robor Water, a division of Barloworld Robor (Pty) Ltd (BWR).

In terms of the structure of the transaction, Waterwarehouse will acquire the business of Robor Water from BWR as a going concern.

The transaction results in an overlap in the activities of the merging firms in respect of the supply of pipe connectors and fittings in the Gauteng, Mpumalanga and Western Cape provinces.

The Commission concluded that the proposed transaction is not likely to substantially prevent or lessen competition in the relevant markets as the accretion in market share is insignificant. Furthermore, there are a number of other strong players in the relevant market, which compete with the merging firms.

In addition, the transaction did not raise significant public interest concerns that would justify a conditional approval or prohibition of the merger.

The Commission therefore approved the transaction without conditions.

Pioneer Foods and Bromor Foods

The Tribunal accepted the Commission's unconditional approval of the merger between Pioneer Foods (Pty) Ltd and John Moir's, a

division of Bromor Foods (Pty) Ltd. Both parties are involved in the manufacture of various food products. The Commission considered the markets for glacé cherries, baking powder and flour.

In its assessment, the Commission found that both horizontal and vertical issues arose in the glacé cherry market. With respect to the concern of collusion post-merger, the Commission found that this would be unlikely as competitors were not price followers and competed intensely with the merging parties. In addition, imports were considered to be a viable and competitive alternative and would constrain the merged entity should it behave anti-competitively. With respect to vertical issues, the Commission considered the possibility of input foreclosure and found that competitors could source from importers.

With regards to the baking powder market, the merging firms do not currently compete. From a vertical perspective, the Commission considered the possibility of input and customer foreclosure and found that customers could source from alternate suppliers and would therefore not be foreclosed from the market. With respect to concerns of Moirs only supplying Pioneer post merger with baking powder, the Commission found that customer foreclosure was unlikely as competitors would still be able to supply other customers in the market.

In the flour market, the Commission examined concerns arising from vertical integration between Pioneer as a supplier of flour and Moirs as its customer. It found that no input foreclosure would arise as Moirs was an insignificant purchaser of flour and that it would not make economic sense for Pioneer to self-deal post merger.

Based on the above assessment, the Commission concluded that the proposed transaction would unlikely substantially prevent or lessen competition in any of the markets. There were no significant public interest issues arising from the merger.

The Commission therefore recommended that the merger be approved unconditionally.



Our New Home

The Competition Commission has Relocated Offices

The Commission has relocated from its Faerie Glen offices and is now operating from the new dti campus.

The move to the dti campus will ensure greater access for stakeholders to Commission services and will foster closer working relationships between the Commission and other regulators within the dti group of institutions. This will also foster a stronger working relationship between the Commission and the dti without undermining the independence of the Commission.

On the dti campus, key regulatory, development finance and specialist services agencies will, for the first time, be "under one roof", providing a "one-stop shop" for the public.

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