What is an exclusive lease?

The Oxford Dictionary defines “exclusive” as not admitting other things; incompatible; not shared with others; or catering only for a few. A lease is defined as “a contract granting use or occupation of property during a specified period in exchange for a specified rent or other form of payment.” An exclusive lease therefore restricts the use of a property or makes exceptions on what can be done on the property. There are two or more parties to a lease agreement and in the context of shopping centres in South Africa we have property developers, property owners, property managers and leasing agents (collectively referred to as landlords) and tenants. Tenants can be classified broadly as anchor tenants (these are the main tenants, usually national chains, in a shopping centre whose prestige and brand recognition attracts not only retail customers but also other tenants) and ancillary tenants (these are the smaller tenants of a shopping mall who occupy less space, and are usually Speciality and independent stores). Ancillary tenants will generally follow the anchor tenants into a new development and don’t necessarily generate a lot of traffic by themselves.
Generally, it is expected that the landlord will dictate the terms and conditions of a lease agreement and potentially adopt a “take it or leave it” approach if not happy with the terms and conditions being proposed by the would-be tenant. In the context of shopping centres/malls this does not necessarily happen for reasons to be discussed later. It is considered essential to have a lease commitment from an anchor tenant who is normally a food retailer before a shopping centre can be financed by the banks. The banks generally require that a groceries anchor has committed to a lease for at least the term of the loan, which is usually 10 years. This requirement therefore gives the anchor tenants some “power” to negotiate for long term exclusivity because without an anchor tenant, development of the new mall might not be possible especially for landlords that require bank finance. Retail developments as opposed to residential developments are viewed as income generating ventures and as such the lender has to be satisfied that the development itself produces sufficient revenue to enable the developer to service the loan. To ensure that the developer is able to service the entirety of the loan, the financier will usually require that the landlord ties down anchor tenants on long term leases for at least the length of the loan term.

Another peculiar feature is that these agreements are finalised possibly three to five years before the mall is constructed and the grocery tenant commits to long term leases on the assumption that the mall will attract enough customers. This is not to say that the retail anchor will go into the lease agreement blindly – a lot of research on the location is done by both the anchor and the financial institution (funder) and this includes forecasting the potential disposable income for the area (LSM levels), population growth, competitive dynamics in surrounding shopping centres, etc.

Is there any harm posed by long term exclusive leases?

As defined earlier, exclusive leases do not allow or bar something – and the most common restrictions in the South African context are on landlords allowing competing supermarkets to enter into a particular shopping centre; a store whose primary business is the sale of foodstuffs; a café or delicatessen which sells fresh fish or meat; a grocery; fresh fish shop; butchery; bakery or fruit and vegetable shop to enter a mall. The landlord has to seek approval from the anchor tenant if it is considering bringing an ancillary tenant or even another grocery anchor involved in the activities described above. In general, these restrictions do affect customers' choice in terms of product range, quality and ultimately affect competition. The quality of service (including pricing and promotions) is expected to be much better where there are competing stores at the same shopping centre. These restrictions tend to mostly affect small businesses that are not in a position to attract a lot of customers if located outside the mall. The idea of operating in shopping centres remains a dream for most small businesses that are in direct competition with the large food retailers.
Continued from page 2

To put most of the issues discussed into context, a summary of the cases the Commission dealt with is outlined below.

**Competition Commission’s Cases**

In June 2009, the Commission initiated an investigation into the major supermarket chains and wholesaler-retailers Pick n Pay, Shoprite Checkers, Woolworths, Spar, Massmart and Masscash for alleged contraventions of sections 4(1)(a), 5(1), 8(c) and 8(d)(i) of the Act. The investigation examined various competition concerns in grocery retail, including buyer power, category management, information exchange and long term exclusive lease agreements. After a preliminary investigation, the Commission decided to pursue the practice of long term exclusive lease agreements between food retailers and landlords. The Commission’s preliminary view at that time was that these exclusive leases give rise to considerable competition concerns and could amount to contraventions of sections 5(1), 8(c) and 8(d)(i) of the Act.

The Commission’s allegations were further supported by third party complaints. The complaints were received from Fruit and Veg City, A & M Hirsch Family Trust and Mr Ismail Ganchi of Aquarella Investments 437 (Pty) Limited t/a Mama’s. The Commission consolidated all complaints during the investigation. The Commission further identified property developers, owners and/or managers (hereinafter referred to as “landlords”) as Respondents in this investigation. The Commission alleged that the supermarket chains and landlords entered into and enforced long term exclusive lease agreements through anchor tenancy, to the exclusion of potential competitors at the retail level. The theory of harm pursued was that of foreclosure arising from exclusive dealing and this heightened barriers to entry at the retail level especially for smaller and independent firms and specialist stores such as bakeries and butcheries.

After investigating the case, the Commission made a decision to non-referral the case. The reasons for the non-referral related to the evidence gathered which made it unlikely that the Commission would be able to show substantial lessening of competition directly caused by the exclusive leases. The Commission was of the view at that time that the evidence would not be sufficient to successfully prosecute the firms involved. Despite this non-referral, the Commission highlighted its concerns about the use of long term exclusive leases and was not wholly persuaded by some of the justifications advanced by the Respondents. Some of the justifications include, the anchor tenant brings a positive externality to the shopping centre; investing in a new store is costly and risky and therefore exclusivity is required to recoup the investment; without exclusivity, some investments would not be made especially in marginal areas; and investments made by the supermarket are continual.

In its non-referral press release in January 2014, the Commission decided to pursue advocacy engagements with the industry. The engagements are continuing but it is becoming clear that this process might not lead to speedy resolution of the issues. This has been clearly demonstrated by the increasing number of new complaints that the Commission has received in late 2013 and in the second half of 2014.

The following complaints were received:

- **Mass Stores Proprietary Limited vs. Shoprite Checkers Proprietary Limited and Hyprop Investments Limited (October 2013)** - Mass Stores alleges that Shoprite and Hyprop Investments signed an exclusive lease agreement for the Cape Gate Regional Centre Proprietary Limited in Cape Town. It is alleged that the lease prevents Mass Stores from competing with Shoprite for its retail business, general merchandise and non-perishable food.

- **South African Property Owners Association NPC vs. Pick ‘n Pay Group, Shoprite and Spar Group (September 2014)** - SAPOA alleges that Pick ‘n Pay, Shoprite and Spar have signed exclusive lease agreements in several shopping centres where they operate as anchor tenants. Such agreements give exclusive rights to retailers to trade as grocery supermarkets in the shopping centres, thus precluding landlords from letting their premises to tenants that compete with anchor tenants.

- **Mr. SA Mahwiliri vs. Mr. Isaac Kriel (September 2014)** – the Commission received a complaint from Mr. SA Mahwiliri, a franchisee of Pick n Pay, against Mr. Isaac Kriel, a manager of Kwa-Mhlanga Shopping Complex. Mr. Mahwiliri alleges that he approached Mr. Kriel proposing that he be given lettable space in the shopping centre to operate a Pick n Pay franchise. After consulting with Shoprite, a tenant at the shopping centre, Mr. Kriel allegedly advised Mr. Mwahiliri that there was no space in the shopping centre.
I discuss briefly how the UK and Australians approached these issues. A closer look at how other jurisdictions have allowed. Given the issues highlighted above, the Commission is, would customers continue to be restricted on choice and have been developed in the first place, but the critical question by the anchor tenants is that without them, the mall might not operate a liquor store at various malls in Gauteng.

The fact that the Commission continues to receive complaints is an indication that there are still concerns in the industry despite the Commission’s previous investigation and its advocacy efforts. The situation is worsened by the fact that some of the retailers have embarked on aggressive campaigns to enforce clauses in instances where they had agreed to relax the exclusivity provisions. Another argument that is normally raised by the anchor tenants is that without them, the mall might not have been developed in the first place, but the critical question is, would customers continue to be restricted on choice and for how long? The potential solution might lie in deciding the duration in which these exclusivities where justified might be allowed. Given the issues highlighted above, the Commission should utilise all the powers at its disposal to try and resolve these issues. A closer look at how other jurisdictions have resolved these concerns might be helpful for the Commission. I discuss briefly how the UK and Australians approached their investigations.

The Australian Consumer and Competition Commission (ACCC)

The ACCC held a public inquiry into the competitiveness of retail prices for standard groceries in 2008. This investigation was broad in scope and considered a number of features relating to grocery retail. The ACCC ran this under the auspices of a market inquiry. The ACCC’s inquiry flowed from a concern with high levels of concentration in the industry in conjunction with rapidly rising grocery food prices.

The analysis undertaken by the ACCC included competition between supermarkets, supply chain issues, buyer power and restrictive constraints. Significantly, the market inquiry allowed the ACCC broader powers which allowed them to conduct a detailed effects analysis – this entailed constructing several prices indices and testing the effect of several causal factors on those prices and accounting for how the factors caused the effect. The ACCC were able to demonstrate some kind of preventing or lessening of competition relating to several factors including exclusive leasing arrangements. With regard to exclusive leasing arrangements, the ACCC concluded that restrictive leases acted as an impediment to entry into local areas which entrenched dominance in localised areas and more broadly. However, the ACCC were careful in explaining that this finding was only applicable in certain circumstances, and in particular the level of concentration in the area surrounding the store.

The findings suggested that exclusivity is not necessary to induce investment in metropolitan areas – the only plausible reason supplied by the incumbents was to prevent competitive entry. It is not impossible to forego exclusivity arrangements and still enter and invest in a metropolitan market. In these markets, exclusivity can only guarantee a return on a supermarket’s investment (by creating certainty as to the competitive environment), at least within the centre. However, the ACCC was against an outright prohibition of such arrangements as they have both pro-competitive and anti-competitive effects. Provisions were considered justifiable in the case of development in areas of projected future growth. However, exclusive leases in larger metropolitan areas were not justified.

In light of its findings, the ACCC recommended an advocacy approach entailing the engagement with various relevant stakeholders. Agreement was reached with the incumbent supermarkets to phase out exclusivity clauses in lease agreements such that all new lease agreements concluded will no longer have exclusivity clauses.

UK Competition Commission (UKCC)

The UKCC Grocery Inquiry considered a number of issues in the grocery retail industry including coordination between supermarkets and competition issues in the groceries supply chain. Similar to the ACCC investigation, this was conducted as a market inquiry. The inquiry was undertaken in light of three previous investigations in the grocery retailing sector starting in 2000, including a broad market investigation and two specific merger notifications. The initial broad investigation concluded on a number of prohibited practices at various levels of the supply chain and led to the establishment of a Supermarkets Code of Practice.

The focus of the 2005 inquiry was similar to that of the ACCC - it related to general concerns in the grocery retail market regarding prices at various levels of the supply chain. Hence, exclusivity arrangements were considered only as a barrier to entry or expansion. An “Adverse Effect on Competition” (AEC) was found to occur only in a number of local markets that were highly concentrated. The remedy proposed by the UKCC for exclusivity consisted of a five year exclusivity limit for new shopping centres and the abolishment of existing exclusivity clauses after five years of their report being published. They identified 30 existing exclusivity arrangements as barriers to entry out of 384 stores that were considered to operate in highly concentrated local markets.

Similar to the ACCC outcome, the remedy proposed by the UKCC does not prohibit exclusivity arrangements outright, even where an AEC has been established, but rather allowed such arrangements to continue for a period of up to five years. In addition to limiting the duration to five years, the UKCC recommended an array of regulatory reforms to be introduced.

1 Now Competition and Markets Authority - CMA

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These include:

- Government and the devolved administrators should apply a competition test during the planning process for the development of new stores – the competition test will favour new entrants as opposed to those with significant local market share.
- Grocery retailers to relinquish control over land sites in highly concentrated markets.
- Tightening the provisions of the Supermarkets Code of Practice and broadening its application.
- Legally binding commitments from retailers were sought to establish an Ombudsman to oversee the revised code – if the commitment was not found, Government was recommended to take the necessary steps to facilitate the establishment of the Ombudsman. In August 2009 the UKCC recommended that the Government should put this body on a statutory basis, as it had proved impossible to reach a voluntary agreement on setting up an ombudsman with the supermarkets. In February 2010 the Labour Government launched a consultation exercise on doing this. In its Coalition Agreement published in May 2010, the new Conservative-Liberal Democrat Government announced that it would establish an ombudsman to “proactively enforce the Grocery Supply Code of Practice and curb abuses of power.” Following consultation, the Government published a draft Bill in May 2011. In July 2011 the Business, Innovation and Skills Committee completed scrutiny of the draft Bill, recommending that it should proceed with immediate effect. In May 2012 the Groceries Code Adjudicator Bill was introduced in the House of Lords and received Royal Assent on 25 April 2013.

**Conclusion and Lessons for South Africa**

It is worth noting that both the ACCC and UKCC utilised market inquiry provisions to deal holistically with concerns in the grocery retail market. The piece-meal approach (complaint focus) pursued by the Commission in its previous investigations has to be viewed in the context of the legal framework at that time that did not explicitly make provision for market inquiry. Whilst the Commission at that time utilised its investigative powers before market inquiry provisions, one just wonders if a market inquiry would not be the most appropriate and effective way of dealing with the widespread use of long term exclusive leases. A market inquiry would provide research based evidence and public driven recommendations for policy makers to consider and therefore complementing competition principles. Another dimension would be to consider the inclusive growth and transformation agenda as captured in the preamble of the Competition Act - smaller and independent retailers are the ones bearing the brunt of the exclusive leases and this goes against not only competition principles but also the inclusive growth imperatives. Without making any judgements on the cases being considered by the Commission – if the substantial lessening of competition test is not satisfied for whatever reason, then policy recommendations arising from a market inquiry to guide the conduct of the retailers can be considered. This is partly the reason why the UKCC recommended the establishment of an Ombudsman over and above the Supermarkets Code of Practice. This is despite the fact that an adverse effect on competition was not established in most of the cases except in highly concentrated markets.

The best case scenario would be for the retailers and landlords to agree not to have exclusivity for more than five years as in the case of the UK and Australia – this is a better outcome than having regulations passed by Parliament to bring this into effect which might take time. Because of the serious impact to the inclusive agenda and limiting the benefits of competition, the Commission should be aggressive in making recommendations for regulatory reforms (whilst investigating current cases) and curtail unjustified long term exclusive leases that sometimes run for more than 40 years with options of renewal. This is all against a recoupment period of at most five years.
The proposed merger raises a horizontal overlap because they are both active in online retailing or online shopping. It was therefore incumbent on the Commission to investigate the matter in more detail.

**Outcome of the Commission’s investigation**

Brick and Mortar (B&M) retailers contacted by the Commission indicated that they regard online retailers as direct competitors since the latter, among others, check their prices. Similarly, online retailers, including the merging parties consider the pricing set by B&M retailers when setting their prices. The investigation also showed that there is an increasing trend of local B&M retailers, such as Makro and Pick n Pay extending their product offering online. Moreover up to 50% of the merging parties respective customers have only placed one order in the past two years. This suggests that the majority of customers still shop from B&M retailers. The Commission’s investigation therefore found that there is sufficient competition between B&M retailers and online retailers, but did not conclude the exact parameters of ‘relevant market’, but assessed the potential competitive effects of the proposed transaction on both the broad and narrow product markets for the retail of consumer goods.

The customer survey conducted on behalf of the Commission confirms that the merging parties are the two most popular online retailers in the country with 44% of the customers identifying Kalahari as their most frequently used online retailer and 24% identified Takealot, respectively. The Commission found that despite the high post-merger market share of over 70% of the merged entity in the narrowest market i.e online retailing, they will continue to face competition from B&M retailers, not only as physical retailers but also online. About 80% of the customers surveyed compare prices between online retailers and B&M retailers before making a purchase. This indicates a high degree of substitutability between online stores and B&M retailers. Viewed holistically, the Commission therefore found that the proposed merger is unlikely to lead to substantial lessening or prevention of competition.

The proposed merger does raise public interest concerns due to the fact that about 290 employees might be retrenched as a result of the merger. The Commission estimates that this is about 33% of the merged entity’s staff complement and 57% of Kalahari’s staff complement. Although the merging parties have revised the number of employees likely to be affected by the proposed merger from 290 to 200, the Commission remains of the view that the proposed merger will have a significant impact on public interest in relation to employment.

**Merger conditions agreed on**

The Commission concluded that conditions are necessary to ameliorate the employment concerns raised by the proposed merger. The Commission and the merging parties have agreed on the following conditions:

1. no more than 200 employees will be retrenched as a result of the merger
2. the merging parties shall offer various forms of support to the affected employees and
3. the merging parties shall establish a training/re-skilling fund.

On 7 October 2014 the Commission received a notice of an intermediate merger which stated that Takealot Online (Pty) Ltd (Takealot) intended to acquire Kalahari.com (Kalahari), a division of MIH Internet Africa (Pty) Ltd (MIH). Takealot is a South African company owned and controlled by Tiger Global, an international investment company. Kalahari is a business division of MIH, which in turn is wholly owned by Naspers Limited, a South Africa-based multinational media company with principal operations in electronic media (including pay-television, internet and instant-messaging subscriber platforms and the provision of related technologies) and print media (including the publishing, distribution and printing of magazines, newspapers and books, and the provision of private education services).
On 30 September 2014, the Commission received an intermediate merger notification, which indicated that Life Healthcare Group Proprietary Limited (LHG) intended to acquire Lowveld Hospital Proprietary Limited (Lowveld) and Interstate Clearing (126) Proprietary Limited (Interstate). Lowveld and Interstate are private companies mostly owned by individual doctors practising at Nelspruit’s Lowveld Hospital. The Sale of Shares Agreements indicated that upon completion of the proposed merger, Lowveld and Interstate would be controlled by LHG.

Lowveld is an independent private surgical hospital that offers a wide range of surgical services that include ear, nose and throat surgery, maxillofacial surgery, ophthalmologists (eye specialists), orthopaedic surgery, plastic surgery, general surgery, dentists, gynaecology, dermatology, neurophysiology and urology.

LHG is a private hospital group whose primary business is the provision of acute private hospital services to the medically insured market at hospitals and same day surgical centres located across Southern Africa. The business includes general hospital facilities of various sizes with intensive care units (ICUs), high care units (HCUs), operating theatres, emergency units, maternity units and cardiac units.

There is therefore a horizontal overlap arising from the activities of the merging parties. Moreover the proposed merger could also have a local (Nelspruit and the surrounding areas) and a regional (Mpumalanga province) impact. The competition concerns are however not dependent on whether the geographic market is local or regional. If a narrow geographic market such as the Nelspruit and surrounding areas is considered, there may be no potential geographic overlap because of the proposed merger.

Within the wider geographic market, the merged entity will have a combined market share of approximately 33% based on the number of licenced hospital beds. Mediclinic is however the largest hospital group in both the wider Mpumalanga province and the Nelspruit area. There is also a newly licenced independent hospital, Klaat, that commenced operations in 2014 in the Nelspruit area. The Commission’s assessment shows significant price effects due to the proposed merger which are not dependent on the geographic market adopted.

Potential impact of the merger on the level of competition

The Commission concluded that as a result of the proposed merger, the average hospital bill for patients at Lowveld will increase significantly and immediately since the fee structure will be changed from the current National Hospital Network (NHN) based structure, which is used at Lowveld, to the fee models used by LHG. The Commission is therefore of the view that the proposed merger will potentially lessen competition in the Nelspruit and surrounding areas because Lowveld currently offers lower prices than Mediclinic. Moreover, for the majority of procedures that were compared, the prices charged by LHG are significantly higher than Lowveld’s.

There is a great possibility that after the acquisition, both Mediclinic and LHG will maintain higher prices that will be mutually beneficial for them. The proposed merger is therefore likely to result in substantial competition concerns in the market for the provision of hospital services in the Nelspruit and surrounding areas due to patients having to pay higher prices on average after the merger. The Commission views Lowveld as an important factor to constrain prices and therefore promote competition in the Nelspruit and surrounding areas.

LHG presented potential efficiency benefits to address the Commission’s competition concerns. The Commission is however, of the view these “efficiencies” do not arise because of the merger and neither are they measurable, verifiable or compelling. The proposed merger undermines a source of independent competition to the incumbent large hospital group(s) and will result in higher prices for patients after the merger. The Commission therefore prohibited the merger.
A. OVERVIEW OF QUARTER THREE

The growth in merger activity has not abated in the third quarter. South Africa is experiencing a surge in merger activity in line with international trends. “Global deal making in the first nine months of 2014 has eclipsed the level achieved in each of the past five years, after another quarter of resurgent activity fuelled hopes of a sustained boom.” 1 The economic recovery of developed economies especially in North America and Europe largely drives the surge in mergers and acquisitions (M&A) activity.

The Commission has been notified of 325 mergers by the end of the third quarter and it finalized 275 mergers over the same period – see Figure 1.

Table 1 provides an overview of the type of the cases notified and finalized by the Commission by size. The number of intermediate mergers notified to the Commission has increased from 68 to 81 between quarter two and three. Given the statutory time periods in which intermediate mergers need to be finalised, together with the need to meet service standards, these place additional pressure on human and financial resources.

In the third quarter, the Commission received 121 merger notifications, an increase of 9% since the commencement of the financial year and a 21% increase since the second quarter.

1Financial Times article 30 September 2014, titled M&A deals in 2014 eclipse levels in past 5 years, accessed on 15 January 2015

Table 1: Mergers Notified and Finalised for the year to date

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The Commission finalised 110 merger assessments in the third quarter of which it blocked two, approved 14 with conditions and approved 92 without conditions.

The number of mergers that raise competition and/or public interest concerns has increased since the last financial year. At least 23 cases raised competition and or public interest issues in the past financial year. This has increased by about 65% to 38 cases by the end of the third quarter of the current financial year. However, over 80% of all the mergers finalised by the Commission were benign to competition in their respective year. However, over 80% of all the mergers finalised by the Commission were benign to competition in their respective year. This has increased by about 65% to 38 cases by the end of the third quarter of the current financial year. However, over 80% of all the mergers finalised by the Commission were benign to competition in their respective years.

In the Clover-Nkunzi merger, the Commission prohibited the merger because it is of the view, that the transaction has a negative impact on small, medium and micro enterprises (SMMEs) in that small farmers may not be in a position to negotiate better terms with Clover as they would with Nkunzi. This merger was found not to have any benefits that outweigh the potential negative effects likely to accrue to the farmers or likely retrenchments that may occur. Nkunzi should continue to exist as an independent dairy processor or sell to a buyer that will ensure that competition remains in the market, particularly to Clover.

The Commission has also received notification of two additional cases in the telecommunications sector in the third quarter. To date the Commission has finalised three of the six key cases in the telecommunications sector. These cases are:
- Dimension Data and three business divisions of MWEB Connect (Pty) Ltd: MWEB business, Optinet Networks and Optinet Services
- Main Street 1270 (Pty) Ltd and Dimension Data (Pty) Ltd in respect of its wholesale GSM (mobile) business, a wholesale public WiFi hotspot business & WiFi infrastructure, Always on Broadband Wireless
- MTN and Afrihost

In relation to the MTN-Afrihost transaction, after a lengthy and in-depth investigation the Commission recommended that the Tribunal approve the merger without conditions.

In terms of this merger, MTN acquired Afrihost, an independent service provider (ISP) predominantly selling fixed and mobile data Internet connectivity. From a horizontal perspective, there is no competition concerns arising as the merged entity is unlikely to exercise market power in any of the affected markets i.e provision of hosting services, ADSL and mobile data services at a retail level. There were however several concerns arising from third parties in relation to the potential exclusionary conduct that may arise from the vertical relationship between MTN as a wholesaler and Afrihost as its reseller in relation to ADSL and mobile data. The analysis however found that there are no foreclosure concerns arising as a result of the merger because MTN does not have market power and therefore the merger is unlikely to result in a substantial prevention and lessening of competition in any of the markets affected.

The assessment of the potential impact on competition and public interest consideration in the MTN-Telkom RAN asset, Vodacom-Neotel and Telkom-Business Connection transactions are ongoing.

C. SECTOR INSIGHTS IN QUARTER THREE

In the third quarter of the 2014/15 financial year, 110 mergers were finalised by the Commission compared to 105 in the second quarter of the 2014/15 financial year, a quarter-on-quarter growth rate of 5.7% and an annualised quarter-on-quarter growth rate of 37%.

Figure 3 shows that finalised mergers in the third quarter of the 2014/15 financial year were dominated by Manufacturing (25.2%), Property (20.7%), Retail (13.5%), Mining (8.1%) and Wholesale (5.4%) among others. The data does not show a consistent trend on the ultimate acquiring firm. The data suggests that different ultimate acquiring firms are making acquisitions across all sectors of the economy. The only exception was in the property sector where the Pivotal Fund Limited acquired five properties.

[Figure 3: Mergers finalised by sector, third quarter 2014/15 financial year]
Figure 4 shows that in the third quarter of 2014/15 financial year, the sectors which grew (quarter-on-quarter annualised) include Finance, Telecommunications, Wholesale, Retail, Mining, Manufacturing and Property. Sectors, which decelerated, include Healthcare, IT, Construction, Services, Publishing and Storage. Sectors such as Agriculture, Electricity and Insurance remained stagnant. Some sectors grew from a low base in the second quarter of the 2013/14 financial year and recorded some cases finalised. These include Accommodation (1) Advertising (1), Education (1), Engineering (1), Media (1), Recreation (2), Transportation (2) and Waste Management (1).

D. COMPLIANCE AND IMPACT OF REMEDIES IMPOSED IN QUARTER THREE

D1. Status Report on Pending Conditions

At the commencement of Quarter Three, there were 103 active conditions being monitored. At the end of the quarter, seven cases lapsed and 12 new cases were added to the monitoring list. There are therefore 108 mergers approved with conditions that are still active. The Commission only issued A Notice of Apparent Breach in one transaction during the third quarter (Sibanye Gold merger).

The division closed 12 conditions that have lapsed in Quarter Three. These are conditions in which the parties have adhered to the conditions imposed and were informed of the termination of the conditions. These include mergers involving:

- Reutech Limited and the Tactical Communications Business of Saab Grinтек Defence (Pty) Ltd: 2012May0258
- Resilient Properties (Pty) Ltd and Irene Mall (Pty) Ltd: 2014Jun0252
- Richtrau no 229 (Pty) Ltd and Avusa Ltd: 2012Jun0339
- Scaw SA (Pty) Ltd and Ozz Industries (Pty) Ltd: 2007Dec3440
- Eversead (Pty) Ltd and House of York (Pty) Ltd: 2008May3759
- Steinhoff International Holdings Ltd and P J Van Reenen (Pty) Ltd: 2011Jan5604
- Clover Juice S.A. and Real Juice Company Holdings: 2012Jun0352
- Robor (Pty) Ltd and Kmg Steel Services Centres (Pty) Ltd: 2011mar5711
- Shoprite Checkers s.a. (Pty) Ltd and Metcash Seven Eleven (Pty) Ltd & A Portion of the Friendly Distribution Division of Metcash Trading Africa (Pty) Ltd: 2011Apr0011
- Seaton SA (Pty) Ltd and Feltex Automotive Division: 2009Jun4500
- Weir Group (Overseas Holdings) Ltd and Warman Africa (Pty) Ltd: 2007Dec3410

D 1.1 Property transactions

One of the cases closed dealt with the issue of exclusivity clauses in lease agreements as opposed to the five which were closed in the first quarter. The Commission has imposed conditions in various property mergers where it discovered exclusivity clauses in lease agreements. These clauses have the effect of preventing entry and the expansion of small businesses in shopping centres. In this quarter however, the Commission has closed one of such conditions. This was the Resilient Properties (Pty) Ltd and Irene Mall transaction. The purpose of the conditions was to ensure that Resilient used its commercial endeavours to negotiate with Pick n Pay in the removal of the exclusivity clause in the lease agreement. Resilient in good faith did engage in negotiations with Pick n Pay for the removal of the exclusivity clause in the lease agreement. However, Pick n Pay refused to remove the exclusivity clause in the lease agreement.

D1.2 Employment conditions that ceased in Quarter Three

Of the 12 cases that ceased in Quarter Three, 11 cases had employment conditions aimed at addressing public interest concerns.

In the Reutech merger, the conditions required the merged entity to limit the number of retrenchments resulting from the merger to 50 employees. In addition, the merged entity was to set up a training fund for the affected employees. Only one employee was ultimately retrenched. The affected employee was also allocated the R20000 training fund benefit as required by the conditions and the affected employee did enrol for a training course with Unisa.

In the Richtrau and Avusa merger, the conditions essentially required the merged entity to cap merger related retrenchments of employees at Avusa’s head office to 14 for a period of two years. The Commission examined the information received, and was satisfied that the merged entity complied with the conditions in that the retrenchments did not exceed the number prescribed by the Commission as only 12 employees were eventually retrenched.

In the Eversead and House of York merger, the purpose of the conditions was to ensure that the merged entity provide a training fund for the affected employees who were retrenched as a result of the merger. The reports submitted by the merged entity and the Commission’s engagement with Chemical Energy Paper Printing Wood and Allied Workers Union, South African Workers Union (CEPPWAWU) and the merging parties indicated that the affected employees who were interested in being trained were afforded the necessary funding by the merging parties and in fact proceeded to procure the training.

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In the **Le Group Lactalis and Parmalat merger**, the Commission required the merged entity not to retrench any employee as a result of the merger for a period of 12 months after approval. The merged entity however retrenched 14 employees since the merger was approved. However, the Commission found that these were not merger-specific. In addition, the merged entity had hired an additional 15 employees over a 12 month period following the merger approval.

In the **Steinhoff International Holdings Ltd and P J Van Reenen (Pty) Ltd merger**, the Commission required that the merged entity not retrench any employee for a period of three years due to redundancies as a result of duplication of positions arising from the merger. The Commission found that there were no retrenchments of employees as a result of the merger for a period of three years.

In the **Clover Juice S.A. and Real Juice Company Holdings merger**, the parties were required not to retrench any employees as a result of the merger for a period of 24 months after the approval of the merger; and to extend the distribution agreements with independent distributors of RJC from three to six months. The merged entity complied with the conditions as no employees were retrenched and the distribution agreements were extended. The Commission further had no record of any complaints of breach of the conditions from either the employees or the Independent Distributors of the merged entity.

In the **Robor (Pty) Ltd and KMG Steel Services Centres merger**, the merged entity was required to not retrench more than 134 employees for a period of 24 months following the approval date of the merger. The merging parties’ submissions indicate that the conditions have been complied with as the number of retrenchments that occurred within 24 months following the approval of the merger was 111, a figure less than the 134 moratorium.

In the **Shoprite Checkers S.A. (Pty) Ltd and Metcash Seven Eleven (Pty) Ltd & A Portion of the Friendly Distribution Division of Metcash Trading Africa (Pty) Ltd transaction**, the Tribunal imposed conditions to ensure that the Merging Parties not retrench any employee without finding them alternative employment or alternatively engage in a voluntary retrenchment process with employees. The merging parties’ submissions indicate that the conditions have been complied with as Metcash accepted the voluntary retrenchments which the employees opted for.

In the **Seaton SA (Pty) Ltd and Feltex Automotive Division**, the conditions were imposed to ensure that the merged entity provided the affected employees an opportunity to acquire skills that will empower them to be re-employed or start their own business after being retrenched. Upon examining the information received by the Commission, the Commission is satisfied that the merged entity has complied with the Conditions.

In the **Weir and Warman merger**, several conditions were imposed to ensure that the merged entity made certain public interest investments in new capital expenditure in South Africa, maintained relationships with third party suppliers and maintained the Warman's outsourcing facility for at least two years. Initially, the economic downturn prevented the merged entity from fully complying with the conditions. This led to the conditions being amended. The merged entity however, complied with the amended conditions. During the Commission’s site visit, the various investments and improvements in the production and operational facilities were visible. Some of the investments undertaken went beyond the scope of the conditions. The parties also maintained the employment levels as required by the conditions and increased exports from South Africa to other countries around the world.

There was only one case that was closed in the quarter that dealt with conditions aimed at addressing competition concerns. In the **Scaw and Ozz transaction**, the purpose of the conditions was to ensure that the merging parties did not increase their prices in a disproportionate manner and required Scaw to use the actual ferrochrome, ferromanganese and ferrosilicon price adjustments received from their suppliers in its calculation of its pricing.

The reports submitted by the independent auditors indicate that Scaw complied with the conditions.

**E. SYNOPOSIS OF CONDITIONS IMPOSED IN QUARTER THREE**

During the quarter, 14 cases were approved with conditions of which 13 were behavioural conditions that are aimed at dictating how the merged entity should behave in order to alleviate both competition and public interest concerns. Only one case was approved to address structural market dynamics in the affected market – see Table 3

**Table 3: Number and Type of conditions imposed in Quarter Three.**

<table>
<thead>
<tr>
<th>Type of Conditions</th>
<th>Number of cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Structural</td>
<td>1</td>
</tr>
<tr>
<td>Behavioural (competition and public interest)</td>
<td>13</td>
</tr>
<tr>
<td>Total number of cases</td>
<td>14</td>
</tr>
</tbody>
</table>

**E.1 Structural Condition**

In the **Holcim Limited and Lafarge S.A merger**, the Commission was concerned that Holcim’s minority shareholding in Afrisam, though non-controlling and non-influential in nature, was sufficient to raise concerns around information sharing and possible collusion post-merger. This concern was exacerbated by the fact that Holcim has an intimate knowledge of the Afrisam business because up until the beginning of 2014, Holcim used to provide Afrisam with technical assistance, the assistance gave Holcim access to Afrisam’s commercially sensitive information. Further, both Holcim and Lafarge have been implicated in cartel investigations in various international jurisdictions including South Africa. In relation to South Africa, all the major cement manufacturers were implicated in the cartel. The Commission therefore imposed a condition that Holcim divest of its shareholding in Afrisam within six months from date of approval and that such shareholding should not be offered to any of the major cement manufacturers in South Africa. This condition was imposed to ensure that the merger does not create a structure that would be conducive to collusion.

To page 12
E 2. Behavioural Conditions addressing public interest concerns

Of the 13 behavioural conditions imposed, 11 were aimed at addressing public interest concerns, particularly issues on employment identified during the merger investigation. The other two behavioural conditions imposed related to the need to continue distribution agreements in the merger between New Laser Corporation - The KO Energy Assets of the KO Energy Business of the Coca-Cola Company and The Real Beverage Company - Dairybelle’s Yoghurt/UHT Milk Businesses. The Commission was of the view that the discontinuation of these distribution agreements was likely to lead to approximately 575 job losses. The conditions which by required the merging parties to continue using the services of third parties saved approximately 575 jobs.

(i) Employment conditions imposed

Eleven of the cases were approved subject to conditions to address a negative impact on employment. Table 4 below reflects the employment related conditions imposed in Quarter Three. Most of the employment conditions imposed took the form of a moratorium on retrenchments that prevents merging parties from undertaking any retrenchments as a result of the merger.

(ii) Impact of merger on jobs in Quarter Three

Table 4 details the number of jobs lost, the number of jobs saved and the number of jobs created through mergers and acquisitions in Quarter Three. In the third quarter, 16 cases had an impact on employment. These were largely in the manufacturing and retail sectors.

Table 4: Summary of the impact of mergers on jobs in Quarter Three

<table>
<thead>
<tr>
<th>Case Number</th>
<th>Primary Acquiring Firm</th>
<th>Primary Target Firm</th>
<th>Market</th>
<th>Condition</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014May0195</td>
<td>The Real Beverage Company (Pty) Ltd</td>
<td>Dairybelle's Yoghurt/UHT Milk Businesses</td>
<td>Manufacturing of dairy products</td>
<td>Moratorium on retrenchments for 3 years; continuation of distribution arrangements</td>
</tr>
<tr>
<td>2014Jun0271</td>
<td>Sun International (SA) Limited</td>
<td>GPI Slots (Pty) Ltd</td>
<td>Gaming</td>
<td>Moratorium on job losses for a period of 2 years.</td>
</tr>
<tr>
<td>2014Oct0590</td>
<td>Coricraft Group Proprietary Limited</td>
<td>The Dial-a-Bed business of Ellerine Furnishers (Pty) Ltd</td>
<td>Retail of furniture</td>
<td>Obligation to offer employment to affected employees</td>
</tr>
<tr>
<td>2014Sep0515</td>
<td>Shogun Holding Und Finanz AG</td>
<td>The Alpha Pharm Group</td>
<td>Pharmaceuticals</td>
<td>Moratorium on job losses indefinitely</td>
</tr>
<tr>
<td>2014Sep0517</td>
<td>Dimension Data (Pty) Ltd</td>
<td>Three business divisions of MWEB Connect (Pty) Ltd: MWEB business, Optinet Networks and Optinet Services</td>
<td>Information Technology</td>
<td>Restriction on job losses to 35</td>
</tr>
<tr>
<td>2014Nov0667</td>
<td>Shoprite Checkers Proprietary Limited</td>
<td>The assignment of certain leases and the employment of employees of final selected stores or Ellerine Furnishers Proprietary Limited</td>
<td>Retail of Furniture</td>
<td>Obligation to re-employ affected employees</td>
</tr>
<tr>
<td>2014Oct0553</td>
<td>Compugroup Medical South Africa (Pty) Ltd</td>
<td>Medical EDI Services (Pty) Ltd</td>
<td>Information Technology</td>
<td>Moratorium on job losses indefinitely</td>
</tr>
<tr>
<td>2014Oct0601</td>
<td>Lewis Stores (Pty) Ltd</td>
<td>Ellerine Furnishers (Pty) Ltd t/a Beares</td>
<td>Retail of furniture</td>
<td>Moratorium on job losses indefinitely and obligation to employ affected employees.</td>
</tr>
<tr>
<td>2014Oct0543</td>
<td>Takealot Online (Pty) Ltd</td>
<td>Kalahari.com, being a division of MIH Internet Africa (Pty) Ltd</td>
<td>Online retailing</td>
<td>Restriction on job losses to 200</td>
</tr>
<tr>
<td>2014Oct0538</td>
<td>Fidelity Security Services (Pty) Ltd</td>
<td>Protea Coin Group (assets in transit and Armed Reaction (Pty) Ltd)</td>
<td>Security</td>
<td>Moratorium on job losses for a period of 3 years</td>
</tr>
</tbody>
</table>

Overall, 301 jobs were lost, 1 894 jobs were saved and 126 jobs created. There was overall a positive effect on employment in Q3 as compared to Q2.

(iii) Property Cases

Fortress Income 2 (Pty) Ltd and Weskus Mall

The transaction was a large merger wherein Fortress intended to acquire a minor regional centre (Weskus Mall). In its investigation, the Commission identified public interest concerns under section 12A (3) (a) and (c) of the Competition Act. The concerns were with exclusivity clauses in two lease agreements in favour of Shoprite Checkers (Pty) Ltd (Shoprite) and Salestalk 560 (Pty) Ltd (Salestalk), trading as Wimpy West Coast Mall (collectively referred to as the Anchor Tenants).
The exclusivity clauses precluded the landlord from leasing portions of the Weskus Mall (and any extensions) without Shoprite’s permission for supermarket, butchery, bakery, among others and Salestalk’s consent for firms that operate businesses which are substantially similar to that conducted by Wimpy. The Commission viewed the clauses as barriers which exclude small businesses and therefore recommended a condition requiring Fortress to endeavour, in good faith, to negotiate with the Anchor Tenants to have the exclusivity clauses removed within 60 days of the Tribunal’s decision. The Tribunal did not accept the Commission’s recommendation and approved the transaction without conditions in December 2014.

Mergence Africa - Redefine with portfolio of six letting enterprises

The transaction was an intermediate merger wherein Mergence intended to acquire six retail centres from Redefine. The Commission identified public interest concerns under section 12A (3) (a) and (c) of the Competition Act due to exclusivity clauses in lease agreements of five of the target properties. The anchor tenants in this respect were Pick n Pay Retailers (Pty) Ltd (PnP) and Shoprite Checkers (Pty) Ltd (Shoprite) (collectively referred to as the Anchor Tenants). The exclusivity clauses in the respective lease agreements gave the Anchor Tenants the sole discretion to grant or refuse permission to the Lessor to lease space to firms that operate among others a supermarket, butchery, and bakery. The Commission viewed the clauses as barriers which exclude small businesses and therefore approved the transaction subject to a condition requiring Mergence to endeavor, in good faith, to negotiate with the Anchor Tenants to have the exclusivity clauses removed within 60 days of the Commission’s decision.

F. OUTLOOK FOR QUARTER FOUR of 2014/15

The increase in merger activity is expected to continue into the last quarter of the financial year. At the end of the past financial year (2013/14), 329 mergers were finalised. With 282 transactions already finalised by the end of Quarter Three of the current financial year (2014/15), the number of finalised cases at the end of Quarter Four will likely exceed the 329 finalised in total for 2013/14 and 331 projected for 2014/15.

“2014 is the best year for deals by value since 2007. This year will go down as the year when mega-deals (> $10 billion) made a comeback and so far 26 such deals have been announced amounting to $672 billion.

We forecast global deal volumes in Q4 2014 to recover and reach around 8,500, which will make a total of around 31,500 for the year. Though less pronounced, it represents an increase of 3% over last year and would make 2014 the best year for volumes since 2011.

Looking ahead to 2015, following the end of the US quantitative easing programme, the pace of the US economic recovery is expected to continue. However other economies, including the Eurozone and many of the emerging markets are facing challenges. These diverging economic trajectories mean that the US companies could take advantage of an appreciating US dollar to pursue cross-border M&A deals.

Globally corporates are in a position of strength, they have record levels of cash reserves, have rebuilt balance sheets, stock market rallies have lifted their share prices and M&A spend as a percentage of market capitalisation remains lower than average. However the conditions for global economic growth remain challenged and with heightened geo-political risk and investor scrutiny following high-profile deal withdrawals, we expect companies to display patience and consideration while pursuing M&A activities in 2015.”

2 Deloitte Merger Activity Report.
“What is competition good for - weighing the wider benefits of competition and the costs of pursuing non-competition objectives.” This subject matter is from an unpublished article by John Oxenham and Patrick Smith which was presented at the Eighth Annual Conference on Competition Law, Economics & Policy. While the underlying message of the Oxenham and Smith piece regarding the effects of competition on the statutory public interest considerations is certainly a point to take home, a purported argument to shun the immediate negative public interest effects of mergers is certainly not an inference which the authors, being experienced competition practitioners, would have wanted a reader to draw from their paper.

In this regard one can assume that the authors agree that public interest considerations as set out in the Competition Act are not simple consequences of a pure competition review, otherwise it would not have been necessary for the legislature to make specific provisions for their assessment. It also appears that the authors echo Minister Ebrahim Patel’s sentiments when he noted as follows in his speech delivered at the same conference in which their paper was delivered:

“Seventh, the Competition Act goes beyond issues of competition to embrace our wider developmental and industrial goals. Indeed, our legislation is both innovative and pioneering in its focus on industrial development, employment and transformation as explicit considerations that the competition authorities must apply to certain proposed transactions.”

One would expect the authors to also share the view of Commissioner Tembinkosi Bonakele, that:

“If our competition laws are an expression of aspirations going beyond the conventional efficiency approach to competition regulation, embracing the notion of an inclusive growth, it is because it was a product of deliberations of various constituencies within NEDLAC.”

A question that can be posed is why the authors sought to elevate efficiency enhancing effects of mergers by attempting to demonstrate the positive effects of such efficiencies on public interests considerations as set out in the Competition Act? There are two possible responses to this. Firstly, that the competition authorities should balance the immediate public interest losses against future public interest gains. Secondly, that guidance should be provided on the approach that the competition authorities adopt in assessment of public interest issues. Each of these is briefly dealt with below.

Balancing of immediate and future public interest gains

The authors may have perceived from experience that competition authorities do not seem to appreciate the effects of efficiency gains, arising from mergers in competitive markets, on certain of the public interest considerations whenever there are also immediate negative merger specific public interest effects. For instance, in a merger in which employment losses are envisaged, there is a mere account for the immediate employment losses without a balancing with potential gains in employment arising from merger specific efficiencies.

While it may be accurate that there is rarely a balancing of immediate negative public interest effects of a merger and the longer run positive efficiency related public interest benefits, the responsibility for this state of affairs cannot be placed at the door of competition authorities. Firstly, the merging parties themselves are often more willing to provide guarantees that there will not be employment losses for a certain period without seeking to show that the envisaged employment losses are not significant or will be neutralised by other forms of benefits arising from the merger. Secondly, it has been the practice for merging parties to demonstrate efficiency gains only once the competition authorities have determined that the merger is likely to result in substantial prevention or lessening of competition
Continued from page 14

(SLC). Therefore, rarely, if at all, are efficiencies demonstrated in a merger not giving rise to SLC even if such merger results in employment losses.

Accordingly, without a demonstration of the magnitude of efficiencies likely to arise from a merger the competition authorities will be placed with an unenviable task of relying solely on the presumption that since a merger does not give rise to SLC it should have been premised on potential efficiency gains. This is sometimes referred to as “the general presumption approach.”

As noted in the Background Note to the OECD Policy Roundtable on The Role of Efficiency Claims in Antitrust Proceedings:

“The first approach [The general-presumption approach] saves scarce resources and reduces the informational burden on the parties. However, because it relies on indirect, structural indicators (such as market shares or concentration indices), it entails the risk of reaching the wrong conclusions.”

How then does one even begin to weigh the efficiency related public interest benefits which are themselves contingent on the achievement of certain underdemonstrated costs savings against the immediate losses of a public interest nature? In this regard, while Oxenham and Smith may truly desire that the competition authorities should engage in a weighing exercise of this sort, the responsibility still remains with the merging parties to at least demonstrate in concrete terms the potential efficiencies as a counter not just to a finding that a merger is likely to give rise to SLC but also to employment losses or other negative effects on public interest.

An implicit petition for guidance on how public interest issues should be assessed

A plausible explanation for the authors' elevation of efficiency considerations may be found from a hope, which is likely to be shared by almost all practitioners in the field, that the competition authorities should issue guidelines on how they approach public interest issues. The authors may have hinted on the approach that the competition authorities should potentially take in assessing the public interest effects. Their focus on competition seems to hint at the fact that in markets where there is no effective competition the efficiency gains are unlikely to be passed on to consumers in the form of lower prices and hence will not be compensated by future gains in employment.

It should be noted that there may still be a requirement for the merging parties to concretely demonstrate efficiency gains which arise out of their transaction in both competitive and inadequately competitive markets. In the former, slight gains in efficiencies could be sufficient to outweigh negative public interest effects. However, in the latter there has to be significantly large efficiency gains to result in demonstrable positive customer benefits despite the merging parties' substantial market power. One should expect some but limited intervention on public interest grounds by the competition authorities in less concentrated markets than in highly concentrated ones. Highly concentrated markets may tend to be those that employ the most people as the Commissioner noted:

“I am immensely proud of the cases and issues the Competition Commission tackled in the past fifteen years, which range from prosecuting cartels and addressing anti-competitive behaviour and structures in basic food products (such as bread, maize meal, flour, milk, eggs) to industrial input products that are important for industrialisation, infrastructure and employment (such as steel, cement, concrete pipes, plastic pipes, polymers (plastic derivative), diesel, glass)...”

Minister Patel has also placed emphasis of a shift in focus and pursuit of remedies in highly concentrated markets:

“Because our efforts must be directed at better outcomes, the competition regime will need to shift from its current focus principally on market conduct to looking at industrial structure. That may require greater resort to divestiture remedies to address market power.”

In this regard one would hope that this will resonate in a number of aspects covered by the Commission's mandate and encompass a more systematic and targeted approach to public interest considerations as well.

Conclusion

An assessment of public interest issues is a separate and independent consideration from a pure competition review. Passing a competition test does not automatically absolve a merger from scrutiny on public interest grounds. However, it will provide a measure of comfort to would-be merging parties if guidance is provided on the competition authorities’ approach to public interest issues, especially if there is acknowledgement that public interest benefits arising from efficiency gains will also be taken into account.


GUIDELINES for the DETERMINATION of Administrative Penalties for Prohibited Practices

Temosh Sekgobela & Nelly Sakata

On 24 December 2014 the Commission published Draft Guidelines for the Determination of Administrative Penalties for Prohibited Practices (Draft Guidelines) in government gazette number 38340, as well as on the Commission’s website. The Draft Guidelines were issued in terms of section 79(1) of the Competition Act No. 89 of 1998 (as amended) (the Competition Act), which allows the Commission to prepare guidelines to indicate its policy approach on any matter falling within its jurisdiction.

The Commission regards administrative penalties as an important tool in enforcing the Competition Act and the Commission considers the primary objective of administrative penalties to be a deterrent. Administrative penalties serve as a specific deterrent against future anti-competitive behaviour by firms that have contravened the Competition Act and as a general deterrent to other firms that may consider engaging in anti-competitive conduct. To this end, the Commission undertook to develop the Draft Guidelines in order to provide objectivity and transparency in the determination of administrative penalties as well as achieving maximum deterrence for contraventions of the Competition Act.

The Commission also took heed of the growing call from the Competition Tribunal (the Tribunal), the Competition Appeal Court (CAC) and stakeholders for some guidance in the determination of administrative penalties. The Draft Guidelines therefore present the general methodology that the Commission will follow in determining administrative penalties for purposes of concluding consent orders, settlement agreements and recommending an administrative penalty in complaint referrals before the Tribunal. This is done mindful of the fact that in terms of section 59 of the Competition Act, the Commission is not the final arbiter of administrative penalties, consent orders or settlement agreements. Rather, the recommendations of administrative penalties by the Commission are subject to the approval of the Tribunal and oversight by the courts through appeals and/or review. However, this does not detract from the need for the Commission to indicate a clear and consistent policy approach to administrative penalties in the form of the Draft Guidelines.

INFLUENCE OF INTERNATIONAL COMPETITION AUTHORITIES

The contents of the Draft Guidelines did not only take cognisance of the approach now adopted by the Tribunal and the CAC in the six-step methodology, but also bore in mind guidelines and penal codes developed by other competition law jurisdictions such as the European Commission, the Department of Justice and the Federal Trade Commission in the United States of America and the United Kingdom’s Competition and Markets Authority. In doing so, the Commission was able to engage in a detailed review of the nuances and variations in various jurisdictions whilst recognising the differences in the nature of prohibited practices under Chapter 2 of the Competition Act. Of the latter, the Commission noted, inter alia, that some prohibited practices are per se prohibited and/or are generally seen as most egregious and inherently result in harm and/or loss. These types of prohibited practices warrant maximum deterrence.

SIX-STEP METHODOLOGY

With the Tribunal’s six-step methodology in mind, the Draft Guidelines therefore represent the Commission’s interpretation of the application of the six-step methodology in consent or settlement agreements as well as in recommending the imposition of administrative penalties in complaint referrals before the Tribunal and the CAC. In terms of the Draft Guidelines, the Commission will apply the six steps, which are:

1. determining the affected turnover in the base year
2. calculating the base amount, being that proportion of the affected turnover relied upon
3. multiplying the amount obtained in 2 above by the duration of the contravention
4. rounding off the figure obtained in 3 above if it exceeds the cap provided for by section 59(2) of the Competition Act
5. considering factors that might mitigate and/or aggravate the amount reached in 4 above, by way of a discount or premium expressed as a percentage of that amount that is either subtracted from or added to it and
6. rounding off the amount determined in 5 above if it exceeds the cap provided for in section 59(2) of the Act.

Where appropriate, the Commission will exercise its discretion, for example in settlement and other exceptional circumstances such as the inability to pay. The Commission’s Draft Guidelines have also given a clearer indication of what it will determine as affected turnover especially where the Tribunal and the CAC have not given specific guidance. This includes the determination of affected turnover in contraventions such as those which take place within the auspices of an association of firms, in market allocation cases where the affected turnover is essentially nil and different cases of bid rigging. Moreover, the Commission, may, where appropriate, impute liability for payment of the final administrative penalty on a holding or parent company where its subsidiary has been found to have contravened the Competition Act. The Commission will apply this principle in cases where it can show, inter alia, that the holding or parent company, through its ownership and day-to-day conduct, directs the commercial policy of the subsidiary.

The Commission considers the Draft Guidelines to be quite comprehensive and largely in line with the Tribunal and CAC approach. The Draft Guidelines have been published for public comment prior to finalisation.

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1 See Competition Commission v. Southern Pipelines Contractors & Conrite Walls (Pty) Ltd Case No.: 23/CR/Feb09 at paragraphs 40, 42 and 43
2 See Southern Pipelines Contractors & Conrite Walls (Pty) Ltd v. Competition Commission Case Nos.: 105 &106/CAC/Dec10
3 Competition Commission v. Aveng (Africa) Limited t/a Steeledale, Reinforcing Mesh Solutions (Pty) Ltd, Vulcania Reinforcing (Pty) Ltd and BRC Mesh Reinforcing (Pty) Ltd Case Nos.: 84/CR Dec09 Reinforcing Mesh Solutions (Pty) Ltd and Vulcania Reinforcing (Pty) Ltd v. Competition Commission 119 & 120/CAC/May2013
4 Formerly known as the Office of Fair Trading
Anti-competitive behaviour exposed

In June 2013, the Southern Africa Milk Co-operative Limited (Samilco) filed two exemption applications on behalf of its members to be exempted from certain provisions of Chapter Two of the Competition Act. During the investigation of the exemption applications, the Commission obtained information that gave rise to a reasonable suspicion that Parmalat has and continues to engage in conduct that may be in contravention of sections 8(c) and/or 8(d)(i) of the Competition Act through using a bonus scheme when sourcing milk from farmers.

The likely effect of the bonus scheme is that it discourages milk farmers from switching to other milk buyers/processors, who are competitors to Parmalat, thereby potentially lessening competition in the production and supply of raw milk by milk farmers; and the procurement or demand of raw milk by milk buyers/processors in the Western and Eastern Cape Provinces.

**Bonus scheme stifles competition**

Parmalat uses the bonus scheme to reward milk farmers for the continuous supply of raw milk in the Western and Eastern Cape Provinces. The bonus scheme was introduced in August 2013, effective from January 2013. In terms of the bonus scheme, milk farmers who supply raw milk to Parmalat for an uninterrupted period of 12 months (the period) receive a bonus payment three months after the period, on condition that the farmer has not given notice to terminate its milk supply contract with Parmalat at the time of the bonus payment. If the milk farmer gives notice to terminate the milk supply agreement before the bonus is paid, it foregoes its bonus payment irrespective of the fact that it supplied Parmalat with raw milk for the entire 12 month period. The volume of raw milk supplied through the milk supply agreements between Parmalat and the milk farmers is agreed upon based on the milk farmer’s previous year’s raw milk production and Parmalat’s estimated raw milk requirements for the coming year.
The Commission received a total of 116 complaints during the period under review. About 17 complaints were carried over from the 2013/14 financial year. Thus, the Screening Unit handled a total of 133 complaints during the period under review.

<table>
<thead>
<tr>
<th>Total complaints received for the period April 2014 to date</th>
<th>116</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case inherited from the previous financial year</td>
<td>17</td>
</tr>
<tr>
<td>Preliminary investigations finalized (CM decision)</td>
<td>102</td>
</tr>
<tr>
<td>Non-referred</td>
<td>86</td>
</tr>
<tr>
<td>Further investigated after screening</td>
<td>11</td>
</tr>
<tr>
<td>Withdrawn</td>
<td>2</td>
</tr>
</tbody>
</table>

**INDUSTRIES / SECTORS FROM WHICH COMPLAINTS WERE RECEIVED**

The Screening Unit has broken down the complaints received over the reporting period into the relevant sectors or industries as shown in Figure 2. The top six sectors / industries that generated most of the complaints in the period under review are (a) Food and Agriculture, (b) Healthcare, (c) Banking and Finance, (d) Telecoms and IT, (e) Automotive and (f) Construction and Building.

In the last financial year (2013/14), the majority of complaints came from the following top six sectors or industries (a) Food and Agriculture, (b) Healthcare, (c) Banking and Finance, (d) Telecoms and IT, (e) Energy, Fuel and Gas and (f) Automotive. The majority of the sectors or industries that have generated most of the complaints in the past year have remained consistent except for the period under review the Energy, Fuel and Gas industry has now been replaced by the Building and Construction industry in the top six. It is interesting to note that, except for the last financial year, the Building and Construction industry has consistently been in the top six in previous years. In the same token, the Telecoms and IT sector, which has not been in the top six previously, has for two consecutive years (2013/14 and 2014/15) joined that grouping.

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1 Out of the two (5) complaints withdrawn, one (1) was filed with the Commission in the 2013/2014 financial year and the other was filed in the current financial year.
Figure 2: Sectors from which complaints were received
(April 2014 to Jan 2015)
Source: Competition Commission

**Food and Agriculture**

This sector has consistently remained the sector that generates the most complaints. Complaints received in this sector were based on allegations pertaining to, among other things, disputes emanating from franchise agreements, exclusive distribution agreements and excessive pricing of various products such as poultry and vegetables. For the period under review, the number of cases filed with the Commission in this sector has thus far grown by approximately 16% compared to the previous financial year.

**Healthcare**

A number of complaints were received regarding managed care and the conduct of players in this market segment. Complaints were also received from small independent pharmacies against Discovery Health and other medical health organisations for their system of dispensing tariffs. There were also complaints relating to the referral of patients to professionals such as therapists, and complaints relating to the supply of medical devices. Most of these complaints were referred to the Health Inquiry. There has been a 50% decline in the number of cases filed in this sector compared to the previous financial year.

**Banking and Finance**

Complaints in this category included a wide range of matters reported to the Commission. Allegations raised included concerns such as high interest rates and collusion in the assessment criteria for home loan applications. The complaints also relate to exclusive agreements that insurance companies have concluded with service providers. The actual number of cases filed in this sector has remained constant over the past two years.

**Telecommunications and IT**

In this sector, the Commission received complaints filed against mobile operators (Vodacom and MTN), exclusive distributors of IT products such as tablet computers, and a firm that provides various telecommunications services to an estate on an exclusive basis. The Commission has since taken a decision to conduct a fully-fledged investigation into the complaint against mobile operators\(^2\). There has been a 11% decrease in the number of cases filed in this sector.

**Automotive**

Complaints in the automotive sector were filed mainly against Original Equipment Manufacturers (OEMs) and motor vehicle dealers. Most of the complaints were in relation to concerns such as the excessive pricing of spare parts, the sale of defective motor vehicles, and the misuse of trademarks. There has been a 40% increase in the number of cases filed in this sector compared to the previous financial year.

**Building and Construction**

This sector has replaced the Energy, Fuel and Gas sector in the top six. In this sector, the Commission received complaints pertaining to, among other things, the exclusive supply agreements between stakeholders in the industry, and the terms of the electricity supply agreements between Eskom and BHP Billiton.

**Cases Withdrawn**

A total of two complaints were withdrawn during the reporting period and the Commission (after considering the possible anti-competitive effects) accepted the withdrawals without initiating any further investigations.

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\(^2\) See the minutes of the Commission Meeting dated 15 April 2014.
1. INTRODUCTION

The purpose of the policy brief is to provide analysis and comment from a competition policy perspective on the regulations imposed by the Department of Health (DOH) with regard to restricting advertising and promotional activities of certain designated infant food products. In December 2012 the Minister of Health published Regulation 991 relating to foodstuffs for infants and young children. The aim of the new regulations is to promote breastfeeding as the best method at birth and to ensure that infants and young children up to three years of age receive a suitable diet. The restrictions imposed by the new regulation are discussed in greater detail in the sections below.

In recent years the Commission investigated two merger transactions in the South African infant milk formula (IMF) market. In June 2012, Nestlé South Africa notified the Commission of its intention to acquire the local infant nutrition business of Pfizer Inc. (the Nestlé-Pfizer transaction). In December 2012, the Commission recommended the approval of the transaction to the Tribunal, which was subsequently approved with conditions, entailing a “transitional re-branding remedy”. The transitional re-branding remedy imposed by the Tribunal envisaged Nestlé divesting the Pfizer brands to an independent third party through a transitional rebranding arrangement. In summary, the remedy is based on a 10 year transitional rebranding period whereby the successful purchaser of the divested Pfizer brands would rebrand the products, followed by a 10 year blackout period where neither the licensee nor Nestlé can re-introduce the original Pfizer brands into the South African market. After the blackout period, Nestlé would – should it wish to do so – be allowed to re-introduce the divested brands into the South African market.

The second transaction investigated by the Commission arose as a result of the remedy imposed by the Tribunal in the Nestlé-Pfizer transaction. In May 2013, Aspen Nutritionals notified the Commission of its intention to acquire the South African infant nutrition business of Pfizer (the Aspen-Pfizer transaction). Following the Commission’s investigation of the Aspen-Pfizer transaction, the Commission recommended to the Tribunal that the merger be approved without conditions. After a week-long hearing in December 2013, the Tribunal accepted the Commission’s recommendation and approved the merger without conditions.

According to recent media reports, opinion is divided in the South African infant feeding industry over the new regulation that prohibits the advertising, promoting and marketing of infant milk formula, certain baby foods and products, baby bottles and feeding cups for young children. Since some of the concerns that have been raised by industry participants relate to a decrease in competition that might arise in the South African IMF market as a result of the new advertising restrictions imposed by the DOH and given the history of the Commission’s recent merger investigations in the infant milk industry, it is appropriate for the latter to comment on the new regulations.

In the following sections the authors firstly provide a brief overview of the economic literature covering the effect of advertising restrictions on competition. Secondly, the market dynamics of the South African IMF market and the potential implications for competition in the market as a result of the regulation imposed are discussed. Lastly, the authors conclude with a few policy recommendations.

2. LITERATURE REVIEW

It is widely accepted that advertising is an essential part of the competitive process. Without advertising, consumers will have less choice and information on what goods and services are on offer and competition between producers of products will be diminished (Whish & Bailey 2012). In competitive markets, businesses compete with each other to attract customers. Advertising generally plays a major role to assist businesses to successfully do this. According to Whish and Bailey (2012), competition policy should ensure that advertising is not restricted in order to provide the consumer with the information needed to enable him or her to make a an informed choice.

Whish and Bailey however acknowledge that a counter argument to this might be that advertising costs can be a serious barrier to entry for new firms wishing to enter certain markets as well as potentially being a wasteful use of resources (Whish & Bailey 2012). In some markets such as breakfast cereals, a large amount of money is spent over long periods of time in building a brand image. New entrants would be unable to spend the amount of money on advertising needed to match this. It has been argued in the past by economists such as Bain (1956) that advertising deters entry. Regression analysis shows a positive relation between advertising and profits. This argument has however been criticised heavily by authors such as Sutton (1991) on...
the basis of endogeneity associated with investments in research and development (R&D) and advertising.

Restrictions on advertising not only impact on the sales of the affected firms, but can in all likelihood affect competition in the concerned market as well. For instance, the restriction on advertising can hinder price competition between firms in the market, leaving some firms better off than others according to Clarke (2007). Given the restriction on advertising, the degree of the impact on specific firms is determined by the type of role that advertising plays in the market concerned. Clarke (2007) identified that advertising can be either informative whereby the main purpose is to “inform new customers about a product’s existence and characteristics…” or persuasive when the main purpose is to persuade customers rather than just provide information.

A restriction on advertising that plays an informative role in the market concerned is likely to benefit the better established and well-known brands rather than those brands that are not so well established or well-known. New products or brands, in particular will be prevented from using advertising to inform customers or to create awareness of their products and their products characteristics. According to Clarke (2007), an advertising ban is likely to harm the less established or new brands more than the well established brands in the concerned market. As will be discussed in the following section, this is particularly relevant for the South African infant milk formula market which is characterised by high degrees of brand loyalty among consumers.

Clarke (2007) further emphasises that where advertising is meant to be informative, it should lead to price competition and therefore lower prices, given that such advertising would dampen the perception of product differentiation. The study showed that the advertising restrictions on children’s breakfast cereal in the Quebec region of Canada resulted in higher prices compared to other regions in Canada where there were no advertising restrictions on children’s breakfast cereal. Clarke (2007) states that the higher prices show that with an advertising ban, firms were unable to inform consumers about their brands or their brands characteristics.

Furthermore, the advertising ban not only affects prices in the concerned market but it can also have an impact on the market shares of specific brands in the concerned market. For example, well established brands may benefit more than the less established brands which might be disadvantaged by the advertising restrictions. In the context of informative advertising, established brands are those that consumers are aware of and are well known. The inability to communicate and inform both existing and new customers about a product’s existence and characteristics… will hinder their ability to compete in the market concerned. Clarke (2007) found that children cereal breakfast brands were not successful in the Quebec region given that they were unable to inform customers about their existence or their products characteristics.

With regard to the question on whether advertising should be limited through direct policy actions, Comanor and Wilson (1979) concluded that this practical issue is not easily resolved because there are many factors to consider in making policy decisions on advertising restrictions in specific markets. These include balancing the need to promote increased competition through giving consumers access to more information about available choices against advertising costs as a barrier to entry for new firms. Comanor and Wilson concluded that the appraisal of specific policies requires policy makers to compare the value to consumers of the information lost by reducing the volume of advertising with the value of lower prices that would likely accompany a reduction of brand power.

3. IMPLICATIONS OF ADVERTISING RESTRICTIONS FOR COMPETITION IN THE SOUTH AFRICAN INFANT MILK INDUSTRY

The IMF market in South Africa is oligopolistic, characterised by differentiated products, high levels of concentration, significant barriers to entry and brand loyalty. The restrictions on promotional and advertising activities can potentially have a significant impact on key competitive characteristics of the infant formula market such as developing brand loyalty, educating healthcare professionals and advancing research and development successes.

From the Nestlé-Pfizer and the Aspen-Pfizer transactions, the Commission identified that the South African IMF market is segmented into three main stages which are essentially associated with the development or age of infants and young children. Stage one, often known as starter formula, involves infants who are between the ages of nought to six months old, whilst stage two, commonly referred to as follow-on formula involves infants who are between seven months and 12 months old. Stage three, also known as ‘growing-up milk’ involves infants and young children who are older than 12 months but younger than five years old. Another segment of the IMF market is the speciality segment which is infant formula designed for infants or young children who have special dietary or medical requirements.

Through Regulation 991 the DOH, has identified similar IMF market segments, with slight variations in the terms and definitions used for the different stages of IMF. The recently promulgated Regulation 991 designates the following products:

(i) IMF suitable for infants during the first months up until the introduction of complementary food
(ii) follow-up milk formula suitable for infants from six months onwards or suitable for a young child(iii) infant or follow-up ready-to-drink milk formula for infants with special medical conditions
(iv) complementary food given to an infant from six months(v) liquid milks, powered drinks, powdered milks, or modified powdered milks suitable for infants or young children(vi) feeding teats, bottles and feeding cups with straws, spouts of teats and any additional products that are published by notice in the Gazette by the Minister.

In general, according to Regulation 991, the designated products refer to starter formula for infants up to six months old, follow-up formula for infants from six months or for young children, i.e. those who are older than 12 months but younger than 36 months. This is in line with the Commission’s understanding of the infant formula market, and therefore the designated infant formula products under Regulation 991 are based on starter; follow-on; growing-up milk; and speciality infant formula which cut across these three stages; as well as the other designated products listed above.

The South African IMF market is concentrated with only three players active in the starter, follow-on and growing-up milk market and only four players active in the speciality segment of the IMF market. Nestlé is the market leader in each of the segments with an approximate market share of between 65% to 75%, while Aspen’s market share is approximately 15% to 25% save for the specialty segment where its market share is between 1% and 5%. Prior to the merger between Aspen and Pfizer, Pfizer’s market share was less than 10% in the infant, follow-on and growing-up milk segment with a very low (2%) market share in the specialty segment.

IMF manufacturers compete with one another through various avenues, such as through: (i) distribution channel, i.e retail, pharmacy and hospital; (ii) shelf space; and (iii) product differentiation. The retail distribution channel is the biggest platform that IMF manufacturers compete in. Through the Commission’s investigations of the respective mergers, it was found that retailers, taking other factors into consideration, stock infant formula based on the rate of sales, i.e. the higher the market share of a brand the more shelf space that brand would be allocated. Furthermore, product differentiation in the IMF market takes many forms from different pack sizes, the classification of brands, i.e. mainstream and premium, to improvements in formulae, i.e. research and development. Research and development is a core function of the IMF market and infant formula suppliers invest large amounts of money and time in order to improve and shape their brands according to customers’ demands and needs.

In light of the above, the authors provide below an overview of the potential competition concerns in the South African IMF market arising from Regulation 991. Several key features of the infant formula market

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6 See for example Bain (1955); Telser (1964); and Brozen (1974).
7 Clarke (2007) found that new children cereal breakfast brands were not successful in the Quebec region given that they were unable to inform customers about their existence or their products characteristics.
8 Regulation 991 defines “young child” as a child that is older than 12 months but is younger than 36 months of age.
9 See the Tribunal’s non-confidential decision: Case number 657/LM/Jun12.
are considered. The authors also explore how Regulation 991 could potentially influence or affect the South African infant formula market using learnings from the Nestlé-Pfizer and Aspen-Pfizer mergers.

### 3.1 BRAND LOYALTY AND BRAND AWARENESS

Through its investigations of the two mergers, the Commission found that given the importance and sensitivity of an infant’s nutrition and needs, well established and trusted brands enjoy what is known as ‘brand equity’. If the infant is thriving and healthy on a particular brand of formula, parents are likely to continue using that particular brand throughout the infant’s development, and are unlikely to switch to other brands.

Brand loyalty constitutes a barrier to entry as it becomes difficult for new entrants to compete in the market. The Commission is of the view that the brand itself needs to have well established presence or reputation of reliability as purchasers of infant formula are unlikely to consider brands with no reputation or reliable presence in the market. Brand awareness, therefore plays a significant role in the infant formula market particularly for the success of a new entrant or expansion by existing players.

Similarly, entering or expanding into a market segment that already has well established, reliable and successful brands would require new entrants to invest in significant amounts of advertising and promotional activities to create awareness for the new brands, and establish distribution networks in order to increase market share. Regulation 991 further prevents infant formula suppliers from providing incentives, invitations or enticements on the label or in the marketing of designated products that may influence consumers to make contact with a manufacturer or distributor that might result in the sale or promotion of that designated product. Furthermore, advertisements on television, radio, written publications, electronic media, exhibitions and other advertisements such as on billboards are also prohibited.

The prohibition of advertising and promotional activities was previously limited to infant formula and follow-on formula. Before the new regulation, IMF manufacturers could indirectly promote their brands through their growing-up milk brands, therefore entry barriers into the growing-up milk market were relatively lower. However, the current regulation prevents advertising and promoting activities across the infant, follow-on, growing-up and specialty milks, as well other designated products.

In terms of sales and promotions, the regulations stipulate that no person will be allowed to engage in any promotional practices or use advertisements in any of the designated products for the new brands, and establish distribution networks in order to increase market share. Regulation 991 prevents advertising and promotional activities across the infant, follow-on, growing-up and specialty milks, as well other designated products.

In essence the inability of new or expanding entrants to promote their brands restricts their ability and incentive to enter or expand within market segments. Healthcare professionals, subsequently play an important role in the recommendation of infant formula brands to mothers. Ultimately the choice of brand recommended could potentially lead to increased brand loyalty. The effect of the regulation on healthcare professionals is discussed in the following section.

### 3.2 THE IMPORTANCE OF HEALTHCARE PROFESSIONALS

A mother or customer’s perception of a particular brand is likely to influence her decision and therefore the success of the brand. How well the brand is established in the market plays a key role in a mother’s purchasing decision of infant formula. In the Commission’s investigation of both the Nestlé-Pfizer and Aspen-Pfizer mergers, it was found that the healthcare professionals (HCPs) play a critical role in the infant formula market given that infant formula manufacturers are prevented from directly advertising and interacting with consumers who purchase infant formula. Note that consumers choices of which infant formula brand to purchase are influenced by the guidance of family and friends, as well as the recommendations made by HCPs. Consequently, IMF manufacturers have invested in medical delegate teams who target HCPs in order to educate and convince the HCPs to recommend their specific brand to the consumer. Therefore, the Commission is of the view that the recommendations made by HCPs (and the presence of brand loyalty) are likely to influence the success of the brand and subsequently the product sales of infant formula manufacturers.

Regulation 991 prohibits infant formula manufacturers from promotional and advertising activities of infant, follow-on and growing-up milk to HCPs. The distribution of any educational materials or information relating to nutrition of the feeding of infants and young children is also prohibited. No person is allowed to promote, sell or advertise any of the designated products under this regulation to healthcare personnel or health establishments. Promotional materials or practices include any provision, direct or indirect; of any gift in cash or in kind, contribution, and other benefits to health care personnel.

In addition, no institutional pharmacy in a private health establishment may advertise or engage in promotional activities of any of the designated products. Similarly, health establishments are prevented from providing or distributing gift packs that either contain or refer to the designated products in combination or individually. Furthermore, no distributor or manufacturers of the designated products or associated samples are permitted to distribute free or at low cost to health care personnel or to a health establishment.

The regulation further prevents these infant formula manufacturers from providing HCPs with promotional and/or distribution gift packs that contain information or refer to specific infant formula brands. Essentially, infant formula suppliers are limited to providing only scientific information and facts to HCPs. A person, manufacturer or distributor may however provide technical scientific material to a health care provider based on the following conditions:

(i) the information or material is strictly related to current scientific and factual matters
(ii) the material bears no health, medical or nutrition claims either in text or in picture format
(iii) relates only to the use of the designated product and
(iv) excludes any promotion of the designated products.

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9 IMF manufacturers keep their branding and labelling of their infant formula products the same throughout the different IMF stages. Purchasers of infant formula are highly likely to remain brand loyal throughout the different stages of development of the infant.
10 Note that the follow-up designated product in Regulation 991 includes both the follow-on and growing-up milks segments identified by the Commission in its investigation of the Nestlé-Pfizer and Aspen-Pfizer mergers.
The Commission is of the view that the regulation will raise barriers to entry in the IMF market. The regulations prevent IMF manufacturers from advertising, promoting and educating healthcare professionals about their products. Given the advertising restrictions, HCPs played an important role in the market. Access to HCPs is therefore of critical importance in order to compete in the IMF market and appear to require significant investments in time and money. Given that access to HCPs is of great importance in order to compete in the infant formula market, the regulation significantly limits the ability of IMF manufacturers and distributors to promote their products to HCPs.

It is therefore the view of the Commission that the restriction of access to HCPs and the ability to educate and promote an infant milk formula product through an HCP, is likely to increase barriers to entry. One of the intrinsic opportunities for medical delegate sales teams, who targeted HCPs, was that they could promote the enhancements or improvements of the brand. This is directly related to the importance of research and development (R&D) in the infant formula market. During the Commission’s investigations into the Nestlé-Pfizer and Aspen-Pfizer transactions market participants confirmed that R&D is a significant capital intensive barrier to entry in the IMF market. The possible competition effect of Regulation 991 on R&D is discussed below.

3.3 RESEARCH AND DEVELOPMENT

R&D is a key characteristic of the infant formula market. Infant formula manufacturers are continuously developing and improving their products in order to satisfy their customers’ different nutritional needs. Therefore the ability of existing infant formula manufacturers, as well as potential entrants, to innovate and improve their products to satisfy consumers’ needs is key as it will enable them to compete effectively in the infant formula market. R&D is not only limited to improving existing brands but is also important for introducing new infant formula brands into the market.

In terms of labelling, composition, packaging and manufacturing matters, the regulation states that no medicinal, nutritional or health claims will be allowed for any of the designated products. Should the designated product have a medicinal claim for example, it must be submitted for registration to the Medicine Control Council, in terms of section 13 of the Medicines Act. However, in order to effectively compete in the market, R&D is vital for infant formula manufacturers as it allows them to differentiate their brands from other competing brands. Infant formula manufacturers therefore may rely on their medicinal, nutritional or health claims as a way to differentiate themselves from others.

Regulation 991, specifically in relation to labelling and other requirements for infant, follow-on and growing-up milk formula, as well as formula for special dietary or medical conditions, states that the container or label on the front panel of the designated product must contain certain phrases in a specific font and a specific size such as “...bold letters at least 3mm in height...”. These compulsory phrases or statements could possibly raise printing costs for the infant formula supplier. Furthermore the nature of the phrases and statements are not supportive of infant formula and therefore the R&D of the infant formula supplier might be harmed. Moreover, infant formula suppliers’ space to advertise their R&D improvements on their products might be limited as well.

Regulation 991 therefore inhibits the incentive for IMF manufacturers to undertake R&D. IMF manufacturers will not be able to market any medicinal, nutritional or health claims on the label of the product without certain registrations and approvals of such claims. Furthermore, the limit on advertising or educating HCPs about the R&D advancements of the designated product disincentivises IMF manufacturers to undertake such R&D. The regulations compelling IMF manufacturers to put certain statements on the label of their brand, are likely to firstly limit the space available for manufacturers to feature any registered and approved medicinal, health or nutritional claims; and secondly increase their printing costs.

4. CONCLUSION

Regulation 991 was recently promulgated by the DOH and it affects the IMF market through the restrictions placed on advertising by manufacturers of the designated products. The goal of this initiative is to promote breastfeeding as the best option for mothers when feeding infants, given the health benefits associated with this method of feeding.

Given the importance of brand awareness and brand loyalty, the restrictions on labelling, promotion, packaging and composition have a significant effect on the barriers to entry in the infant formula market. New entrants need access to advertising and promotional activities to create awareness of their brands and their product characteristics. In essence the inability of new entrants to promote their brands restricts their ability and incentive to enter or expand within market segments. Subsequently, healthcare professionals (or HCPs) play an important role in the recommendation of infant formula brands to mothers. Ultimately the choice of brand recommended could potentially lead to increased brand loyalty.

The restriction of access to HCPs and the opportunity to educate and promote an infant milk formula product through an HCP is likely to increase barriers to entry. One of the intrinsic opportunities for medical delegate sales teams, who targeted HCPs, was that they could promote the enhancements or improvements of the brand. This is directly related to the importance of R&D in the infant formula market.

Regulation 991, however disincentivises IMF manufacturers to undertake R&D. IMF manufacturers will not be able to market any medicinal, nutritional or health claims on the labels of their products without certain registrations and approvals of such claims. Furthermore, the limit on advertising or educating HCPs about the R&D advancements of the designated product further disincentivises IMF manufacturers to conduct such R&D. The regulations compelling IMF manufacturers to put certain statements on the label of their brand, are likely to firstly limit the space available for manufacturers to feature any registered and approved medicinal, health or nutritional claims; and secondly increase their printing costs. Another implication of the restrictions on advertising is that infant milk formula manufacturers will have to compete more strongly for retail shelf space as a means of marketing their products, which will result in higher prices for the limited available shelf space. Smaller players and potential new entrants in the market will not be able to compete with the bigger players for more expensive shelf space, thereby losing out on an avenue for marketing. With the existing high barriers to entry and brand loyalty, restrictions on advertising in the IMF market will potentially further inhibit the smaller players from growing their volumes and creating awareness of their brands amongst consumers, thereby entrenching the existing market power of the big firms.

In conclusion, although the DOH’s policy with regard to imposing advertising restrictions on infant formula and other related baby food and products is motivated by good intentions from a health perspective, it needs to be balanced against the implications for competition in the market. Given that the imposition of advertising restrictions will likely increase barriers to entry and reduce investment into R&D by manufacturers of IMF products, it is the authors’ view that alternative avenues such as HCP’s training new mothers could have been explored by the government to achieve its desired outcome of promoting breastfeeding as the better feeding option for infants.

BIBLIOGRAPHY

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