Competition News
The official newsletter of the competitioncommission
Edition 27 • June 2007
Towards a free and fair economy for all

Competition risk looms for private equity investors

A local competition law practitioner caught the essence when stating that "private equity has without doubt become the Beckham of the mergers and acquisitions playing field."[1] In the last few years, ever bigger companies have been gobbled up by private equity investors.

However, the United States Department of Justice has recently commenced an investigation into large private equity firms' auction practices when bidding for the control of target companies. The probe is of significance, as local private equity deals are increasingly structured according to international norms.

One overseas trend occurring in South Africa is that many private equity deals are being initiated through an auction process.[2] The purpose of an auction is to promote competition, and ensure that the full economic value of the target is realised. Another trend is the occurrence of "club" deals, where more than one private equity investors club together. Club deals may be required due to the size of the target company, the possibility of sharing resources or limits having being set on the amounts to be invested by private equity investors into single investments.[3]

However, offers structured in this way could pose competition concerns, as an auction

1 Walker, D (2007). "Private equity muscles into the M&A industry". Without Prejudice, 1 March 2007.
2 Unspecified author (2007). "It makes sense to participate in club deals", The Star, Business Report. 26 February 2007.
3 Ibid.

Editorial Note

After a couple of years of the Competition News, we now intend to revamp it. We have introduced an editorial note to enable us to communicate more directly with our readers, and where necessary, putting into context articles and stories featured. The changes will however go far deeper that just the introduction of the editorial note. We will introduce new and exciting content about the happenings and goings on at the Commission, accompanied by pictures – so that we can truly be a news publication as our name suggests. We will continue to have articles where Commission staff, and on a limited basis external parties (by invitation), debate issues of competition economics and law. We will also continue with updates of cases that were highlights during the period covered by a publication, and we in particular want to discuss more enforcement cases, and cover some of the interesting opinions requested and research studies conducted by the Commission.

We welcome on board the new head of the Commission's communication department, Ms. Keitumetse Letebele, on whose shoulders will rest the responsibility to revamp the Competition News. Judging by her enthusiasm, we can expect a shake-up in our Communications rooms. To improve the quality of Competition News, an editorial Committee constituted by the Chief Economist, Prof Simon Roberts as well as the Chief Legal Counsel, Mark Worsley, the Manager of Compliance, Tembinkosi Bonakele as well as the HOD of Communications, Keitumetse, has been established.

In addition to the usual case updates and articles by Commission staff, in this issue we have a guest contributor for the first time. The guest contribution by Odie Strydom discusses competition implications of private equity deals. In the future we intend to invite contributions on a topic agreed between the editorial committee and the contributor, and views expressed will only be attributable to the contributor, whose contribution shall be subject to the normal editorial oversight of the publisher, the Competition Commission. The aim of guest contributions is to make the newsletter more exciting to external stakeholders, as they too will have an opportunity to contribute to debates. Expressions of interest to make a guest contribution can be sent to Keitumetse.

We will also welcome suggestions on how the Competition News can be improved during the revamping exercise to make it more relevant and exciting. Comments sent will not be published, although a summary of suggestions may be made in the next editorial note.

All comments and expressions of interest to contribute articles should be sent by email to Keitumetse at:
keitumetsel@compcom.co.za

process could be manipulated. Not only could bidders agree to fix the purchasing price; they could also agree to only one bidder tendering for the business of the target. Any bidder would prefer avoiding a price war, as private equity transactions involve a high degree of planning and expenditure.

Depending on the circumstances, club deals could further reduce the actual number of bidders, leading to relatively uncompetitive offers.

The competition authorities would investigate such behaviour in terms of section 4(1)(b) of the Competition Act, 1998. In terms of this section, an agreement between, or concerted practice by, firms, or a decision by an association of firms, is prohibited, if it is between parties in a horizontal relationship and if it involves price fixing, market division or collusive tendering.

These contraventions are serious. The Act does not grant respondents any defence. Penalties of up to 10% of annual turnover could be payable if private equity investors were found to act collusively.

By: Odie Strydom
Senior Consultant
KPMG Competition Advisory Practice

Competition Commission interacts with regulators in the insurance sector

The Competition Commission's cooperation with two regulators, the Pension Funds Adjudicator, Mr Vuyani Ngalwana ("the adjudicator") and the Financial and Intermediary Services Ombud ("the FAIS ombud"), Mr Charles Pillai has led to two significant determinations impacting on consumer welfare in the insurance sector.

The Pension Funds Adjudicator's ruling

The complainant, Hilton Browne, is a member of the South African Retirement Annuity Fund ("SARAF"), a retirement annuity fund underwritten by Old Mutual. Mr Browne wanted to transfer his assets in SARAF to another retirement annuity fund of his choice because he was not satisfied with what he alleged to be poor investment returns that were achieved by SARAF.

SARAF refused his request on the basis that its rules do not provide for a cessation of membership, except in specific instances, such as the death of a member, the winding up of the fund, cessation of contributions by member and so forth. Old Mutual advised the complainant that legislation does not permit payment of retirement annuity benefits until 55 or such other age as the member may have chosen.

The adjudicator requested that the Competition Commission answer the following competition law related question that arose from his consideration of a complaint brought by Hilton Browne:

> ***"Can an approved retirement annuity fund and/or its underwriter lawfully refuse to allow a member of such fund to transfer his or her total interest from such fund to another approved retirement annuity fund before reaching age 55 – or before reaching the chosen retirement date as set out in the underlying policy…."***

In the Competition Commission's submission, it explained that the act of not allowing a member to transfer his total interests to other approved retirement annuity fund of his choice effectively imposed an exclusivity requirement on that member. The Competition Commission explained to the adjudicator how an exclusivity requirement is defined and could have the effect of maintaining, creating or extending market power. In the Commission's opinion when conduct locks in consumers into long-term contracts, potential entrants might effectively be foreclosed from competing for that locked in portion of the market.

Restrictions that lock in customers also significantly raise the cost to consumers of switching to more competitive alternatives. This is clearly contrary to the competition policy objective of providing consumers with competitive prices and product choices. Therefore, in its submission the Competition Commission stated that it strongly advocates against any artificial restrictions that unnecessarily or unreasonably lock in consumers to long-term contracts.

The adjudicator thereafter determined in his ruling on the case before him that retirement annuity rules must explicitly allow members to transfer between retirement annuity funds. In finding the practice of disallowing members the right to transfer contrary to the letter and spirit of the Competition Act, the adjudicator stated:

> ***"First, members have no freedom to move their retirement investments to other approved funds with lower costs, better product choices and investment returns. Second, competitors are locked out of the market in respect of members who in any event want to take their business away from poorly performing funds to competitors. This practice strikes at the very heart of the competition law policy objective and it is a wonder how it can still remain uncorrected some eight years after the Competition Act came into effect."***

The adjudicator has not only applied the principles of competition law in his ruling but the fact that he sought advice from the Competition Commission is evidence of the recognition that regulators are increasingly giving to competition policy.

The FAIS Ombud's referral

Helene Davis had concluded a home loan agreement with Nedbank. At that time, she had an existing homeowner's cover under Santam, which she offered to cede to Nedbank. Nedbank rejected her offer and compelled her to choose Nedbank's insurer. Banks have for years been using a section in the Short Term Insurance Act 1998 (section 43(5)(a)) to deny home owners the right to choose their own insurer for a property that is bonded to that bank.

The FAIS ombud ruled against Nedbank for engaging in this conduct and was of the opinion that not allowing consumers the choice of their own insurer had the effect of preventing them from obtaining lower premiums and was anti-competitive. He then referred the matter to the Competition Commission for our attention.

The Competition Commission agreed with the FAIS ombud and held the view that section 43(5)(a) was contrary to the spirit of competition and the objectives of the Act. The Commission also held the view that the conduct of the banks in this regard seemed to have the effect of distorting competition in the insurance industry with regards to the insurance product concerned. The insurance companies that are preferred by the banks would have an unfair advantage, which was likely to enhance their dominance and foreclosure of the market.

The Competition Commission referred the matter to the Minister of Trade and Industry in November 2005 requesting his intervention to amend the relevant provision of the Short-Term Insurance Act and that the Department of Trade and Industry engage the Ministry of Finance in this matter.

Arising from the Commission's intervention and that of the FAIS ombud, the National Credit Act 34 of 2005, which governs all credit agreements including home loans, now includes a section 106 that allows the consumer freedom of choice. Section 43 of the Short Term Insurance Act was also amended to include a new subsection 6. The effect the amendment is that consumers will now be able to choose their insurer when taking a home loan with a bank.

By using its advocacy function, the Competition Commission and the sector regulators have ultimately saved consumers millions of rands.[1] It is encouraging that regulators continue to recognise the significance of competition law and policy and are working with the Competition Commission in a complementary manner to protect and benefit consumers.

By: Anisa Kessery
Office of the Commissioner

1 Rhys Dyer, the insurance director at MortgageSA, stated in an article on www.persfin.co.za, "New credit law could save homeowners millions", dated 29 July 2005, by Charlene Clayton, as follows: "if … you could shop around for the most competitive insurance product, homeowners could save more than R650 million annually on premiums, assuming a premium reduction of 30 percent."

Competition News

Compulsory Licensing of Intellectual Property rights in pharmaceutical products:

WHAT GROUND FOR COMPETITION LAW?

1. Introduction: The Interface between Intellectual Property Rights and Competition Law

Access to pharmaceutical products remains a challenge faced by developing countries, including South Africa. According to the World Health Organization ("WHO") 50 percent of the population in developing countries lack access to essential drugs.[1] Predominantly, broad access to pharmaceutical products is inhibited by high prices charged by pharmaceutical firms. This is in part attributable to intellectual property rights ("IPR"), which are held over the production and sale of many pharmaceuticals.

Pharmaceutical inventions are about new information or knowledge, which require research effort. Market for information and knowledge are not likely to function like efficient competitive markets, because information is not a good, which is used up in consumption. Once it exists, it can be acquired almost costlessly by others.[2] This means that, it would be difficult for inventors to appropriate the returns from their research efforts and therefore the incentives for future research would be sub-optimal. Therefore, patents, as the protection of IPR, essentially seek to change these incentives by conferring exclusive or monopoly rights to the inventor or creator of a new product, such as a pharmaceutical product, for a set period of time, normally twenty years.

Nevertheless, the entry of competing generic products has been shown to lead to decreases in prices; however, this depends on license agreements such that the generic producers do not infringe on the intellectual property rights of the original developer of the product. Generic drugs are copy products, requiring no basic research, which are a 'bio-equivalent', containing the same active chemical ingredients as the original brand name drug.[3] Generics can thus typically enter the market rapidly. Without the R&D expenses, generic manufacturers have only to take into account the license costs and the costs of manufacturing, hence their prices are lower than the brand versions.

There is thus a basic tension between the intellectual property rights embodied in patents, which purpose is to allow firms to reap the gains from research and development ("R&D") by preventing copying by potential competitors, and the interests in having cheaper generic products through increased competition in the short term.

While there may appear to be a tension between Competition Law and the protection of IPR, both seek to stimulate innovation and enhance consumer welfare. IPR incentivises greater private research effort and thus greater numbers of new competing products over time. Similarly, intense competition also stimulates the ongoing development of new and improved products. To the extent that a strong and effective intellectual property framework contributes to this innovation, it supports competition; and to the extent that competition stimulates innovation, it clearly contributes to the development of intellectual property.[4]

But, from a competition perspective, patents grant products exclusivity for the duration of the patent term and result in patent holders having control over the production, supply, distribution and the price of the products, which confers market power.[5] Accordingly patent holders are expected to charge higher prices that than they could if they faced immediate competition.

1 WHO Essential Drugs and Medicines Policy. www.who.int/medicines.

2 It thus has 'public good' characteristics (see, for example, Church & Ware, Industrial Organization, p.589)

3 The Concise Oxford English Dictionary defines generic, when applied to goods especially medicinal drugs, as those having no brand name.

4 Sheridan, S. 2006. Competition Law and Intellectual Property Law: Getting the balance "just". University of Victoria faculty of Law International Intellectual Property Law Symposium. Competition Bureau Canada.

5 Market power refers to the power of a firm to control prices, or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers.

In addition, research and experience has shown that the introduction of generic competition in the pharmaceutical market brings about pro-competitive benefits that result in substantial decreases in prices and broadened access to pharmaceutical products.[6] As such, the legal protection of IPR provided by patents can result in unaffordable prices of life saving pharmaceuticals for poor individuals, particularly in developing countries.

2. What is Licensing ?

In as much as patents confer exclusivity to the patent holders, these rights can be licensed under a contractual arrangement in which a licensor provides a licensee with certain rights to use its intellectual property. There are two types of IPR Licensing arrangements, voluntary Licensing and compulsory licensing. Patents allow the holder to benefit from their rights by voluntarily granting permission to some other group or individual to make use of its proprietary material in return for specified compensation or other payment. Compulsory Licensing, on the other hand, refers to a situation wherein the state authorises itself or third parties to use the proprietary subject without the authorisation of the IPR holder, if it can be justified by public interest considerations. In this instance, the IPR holder would thus be forced to tolerate the exploitation of its invention by a third party or the government itself.

Licensing of patents is subject to the legislative authority of the Patents Act[7] specifically sections 53-58, and the Trade Related Aspects of Intellectual Property agreement ("TRIPS") of the World Trade Organisation ("WTO").

From a competition perspective, licensing allows for more players to use the property whilst ensuring that the patent holders obtain compensation for the use of the invention. The effect of these is that more competing products are available in the market, at competitive prices, which consequently results in more affordable access to pharmaceutical products.

3. Competition Law Perspective on Licensing

The Competition Act 89 of 1998 as amended ("the Act") does not make specific provision for the handling of matters relating to intellectual property rights. The only specific reference to intellectual property falls within Section 10(4) of the Act that provides for an application for exemption from provisions of the Act. However, the Act derives jurisdiction on IPR matters from Article 40 of the TRIPS agreement, which takes cognisance of the fact that some licensing practices or conditions pertaining to IPR may restrain competition, and thus result in adverse effects on competition. As such, it is allowed for member states to enforce their respective competition legislations with regard to practices or conditions that may constitute an abuse of a patent.

Accordingly, the Act would apply to any anticompetitive conduct by patent holders, unless otherwise exempted in terms the Act. Although TRIPS does not specify the type of practices, these would ***inter alia*** include anti-competitive conduct such as excessive pricing, refusal to give a competitor access to an essential facility or engaging in exclusionary conduct or restrictive acts that substantially prevent or lessen competition in a market. Such conduct would then be scrutinised under Section 8 of the Act that deals with abuse of dominance.

Section 58(1)(a) of the Act further contains provisions that allow competition authorities to impose certain conditions or remedies in relation to anticompetitive conduct in order to restore the conditions of fair competition. In addition, it is well accepted that Licensing of IPR[8] is an effective, available remedy for anticompetitive conduct related to IPR. In this respect, provided that there is

6 Untangling the Web of Price Reductions. 2005. Médecins Sans Frontières.
7 Patents Act No. 57 of 1978.
8 Myrick, R. & Gleklen, J. 2003. Antitrust Liability for the Exercise of Intellectual Property Rights under the US Law.

conclusive evidence of anticompetitive conduct, and if the anti-competitive effects of that conduct outweighs its technological, efficiency or other pro-competitive gain, the competition authorities may enforce an order requiring the IPR holder to grant licenses to other parties, as a remedy to the anticompetitive effects of the such conduct. For example, if a patent holder is found to have engaged in unlawful excessive pricing of pharmaceutical products the competition authorities may enforce an order requiring the patent holder to grant licenses to generic manufacturers, as a remedy to the anticompetitive effects of the conduct.

It is also notable that the TRIPS agreement provides for compulsory Licensing where it can be conclusively shown that the party requesting the license had unsuccessfully exercised its best efforts to obtain a voluntary license on reasonable commercial terms and within a reasonable period of time from the patent holder.

4. Difficulties with the use of Competition Law in Compulsory Licensing

Although it is recognised that Competition Law has a significant role to play in preventing abuse of the intellectual property system, and enforcing compulsory licenses to remedy such conduct, it is nevertheless imperative to highlight that the extent to which this may occur is limited and exceptional.

Firstly, the burden of proof of anticompetitive conduct relating to the practice of IPR is hugely demanding. As mentioned above, patents grant exclusivity for the duration of the patent term, which results in patent holders having control over the production, supply, distribution and the price of the product. But, this market exclusivity is the very essence of patents because of the gains it provides in rewarding research effort. Moreover, the extent of market power conferred by a patent depends on the narrowness of the specific input, process, or work in question, and whether there are reasonable substitutes.

In addition, there is some complexity presented by a complaint of excessive pricing resulting from the use of patents. An excessive price is defined as one that is unrelated to the economic value, frequently regarded as the cost of a good or service, and is higher than that economic value. Thus, determining the cost of bringing a single unit of a pharmaceutical product to the market, given the high R&D cost involved in the pharmaceutical industry, is a difficult task. With respect to section 8(c) or (d) contraventions, that is, exclusionary conduct, it would also be exceptionally demanding to succeed against a patent owner in such a case because both the sections provide for efficiency and pro-competitive justifications of the conduct. The recognised benefits of patents may outweigh the anti-competitive effects of exclusionary conduct a patent holder might engage in.

Secondly, the South African Competition Act, unlike other jurisdictions, does not have separate guidelines on how to handle competition matters relating to the abuse of IPR. The Canadian Competition Act, for instance refers specifically analysis of IPR matters. Similarly the US Antitrust law encompasses Intellectual Property Antitrust Guidelines, which set the standards for antitrust analysis to intellectual property.[9] These guidelines recognise that intellectual property has important characteristics, such as ease of misappropriation, that distinguish it from many other forms of property. These characteristics are being taken into account in competition analysis, though they do not require the application of fundamentally different principles.[10] Thus the main challenge with the South African law is the lack of clear guidelines on how to assess competition violations relating to IPR.

Competition authorities therefore respect IPR and acknowledge the important role these rights play in economic development. Conversely compulsory Licensing can lead to inefficient entry, encourage free riding and generally reduce the incentives to invest and innovate, which in the long run harms competition. Adjudicating on possible anti-competitive behaviour or practices by holders of patent rights in pharmaceutical products thus requires a careful exercise of judgement.

5. Conclusion

Competition Law has a significant role to play in preventing abuse of the IPR system, which may prevent sustainable and affordable access to pharmaceutical products. Competition Law may be enforced where anticompetitive conduct by patent holders has been established, unless otherwise such conduct is exempted by the authorities under the relevant provisions of the Act. The Licensing of the proprietary subject may then be granted as a remedy to the anticompetitive practices.

Notwithstanding, caution would be widely exercised when enforcing such compulsory licenses, wherein the competition authorities would as well carefully consider the potential harm to innovation and consumer welfare. There must be conclusive anticompetitive conduct that warrants a remedy, and where compulsory licensing is the only effective remedy.

Ultimately, it must also be remembered that access to affordable pharmaceuticals forms part of broader public health issues which do not necessarily fall within the ambit of Competition Law.

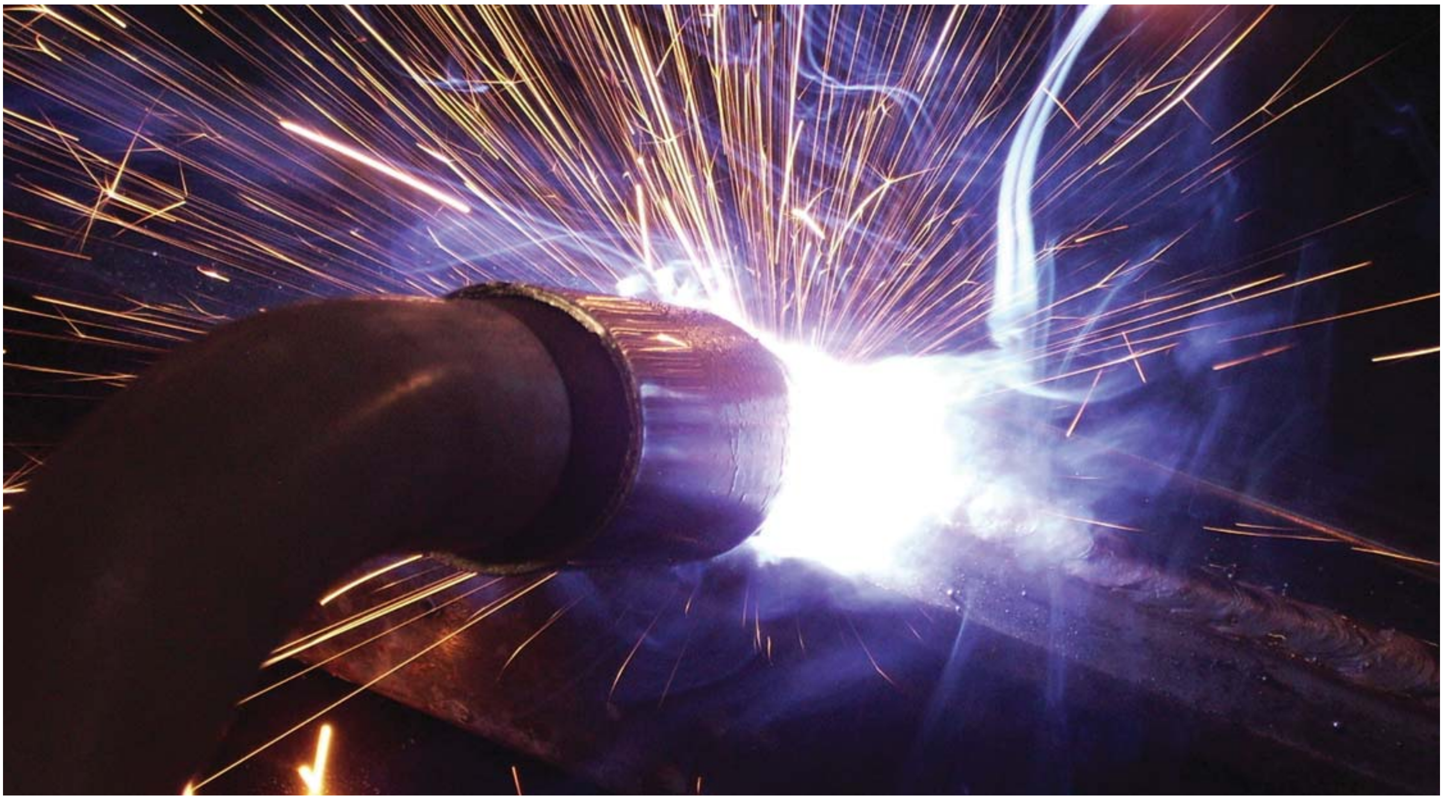
By: Mapato Rakhudu
Policy and Research

9 See the Antitrust Guidelines for the Licensing of Intellectual Property. Issued by the U.S. Department of Justice and the Federal Trade Commission

10 The EU and Australian law also provides for competition issues of intellectual property rights.

Cases

African Oxygen Limited and Refrigeration Investment Company (Pty) Limited



In terms of the proposed deal African Oxygen Limited ("Afrox") would acquire control of Refrigeration Investment Company (Pty) Limited ("Rico") by acquiring its entire issued share capital.

The activities of the said merging parties overlap horizontally in that both parties:

(i) Operate as importers and bulk-breakers of refrigerant gases.
(ii) Operate as importers of refrigerant gases in "disposacans", effectively disposable canisters containing refrigerant gases, which are sold to customers "as is" and which are disposed of by customers once used.

Based on its market investigation the Commission concluded that the broad product market for the distribution/(whole)sale of refrigerant gases can be further delineated into separate relevant product markets according to the method of distribution/supply, i.e.:

(i) Tonnage/drums (normally 700 kg to 1000 kg drums),
(ii) Refillable cylinders (normally 20 kg to 60 kg cylinders), and
(iii) Disposable cylinders or disposacans (normally 10 kg to 15 kg cylinders).

Market for disposacans

The Commission concluded that there is no substantial prevention or lessening of competition as a result of the proposed transaction in the market for the importation and distribution/(whole)sale of disposacans in South Africa. There are currently numerous players in this market who import and distribute disposacans and barriers to entry into this market appear to be low. Furthermore, to the extent that activities comprise solely of the supply of disposacans, importers of same incur little sunk costs.

Markets for refillable cylinders and drums

In the markets related to refrigerant gas distribution/(whole)sale in (i) tonnage/ drums and (ii) refillable cylinders the merged entity would post merger have very high market shares. A-Gas would be the only significant competitor to the merged entity in the abovementioned two markets post merger. Kovco, the fourth largest player, is a small and insignificant competitor compared to the size of the merged entity and A-gas. This means that this transaction would in effect reduce the current large players from three to two in the said relevant product markets.

The Commission found no evidence of any counterfactuals that would mitigate against the competition concerns. Customers confirmed that this deal would eliminate an effective competitor from the abovementioned markets and leave them with less choice. The Commission's investigation also showed that barriers to entry into the decanting of gases at a scale that would effectively compete with the two large players in these markets post merger, i.e. the merged entity and A-gas, are significant. Moreover, the proposed deal would raise these barriers for a potential new entrant. Furthermore, customers confirmed to the Commission that they have no countervailing power in the procurement of refrigerant gases. The Commission's investigation confirmed that a hypothetical incease in refrigerant gas prices of between 5% to 10% post merger would not necessarily move customers to import refrigerant gas directly and/or invest in a decanting facility themselves.

Conclusion

The Commission concluded that the proposed transaction would remove an effective competitor from already concentrated markets and result in a substantial lessening or prevention of competition in the markets for refrigerant gas distribution/(whole)sale in (i) tonnage/drums and (ii) refillable cylinders.

Divestiture

The merging parties proposed a remedy to the abovementioned competition concerns, i.e. the divestiture of the Rico "gas business" to be acquired. This remedy would eliminate the horizontal overlap between the activities of the merging parties. The Commission is the view that the proposed divestiture adequately addresses the identified competition concerns resulting from the proposed deal and recommended this to the Competition Tribunal. The Tribunal has subsequently approved the merger subject to the above condition.

Telkom SA Ltd and Business Connexion Group Ltd

The Commission recommended the prohibition of the merger between Telkom SA Ltd ("Telkom") and Business Connexion Group Ltd ("BCX").

Telkom is the monopoly supplier of network infrastructure for telecommunication services in South Africa. Telkom is also a key player in the market for electronic communication services that relies on network infrastructure as a critical input. Electronic communication services include corporate Internet access and managed data network services (e.g. the provision of virtual private networks that allow companies to transmit data and voice between multiple sites).

BCX's main activities are in the provision of information technology services such as the planning, implementation, operations management and support necessary to run an organisation's information technology requirements. BCX's outsourcing activities include the provision of on-site date centres, application and desktop management, as well as support and management of networks. Importantly, BCX is also active in the market for the provision of electronic communication services.

The Commission found that the merger has horizontal, vertical and portfolio dimensions. Horizontally the activities of Telkom and BCX overlap in the market for the provision of electronic communication services. In this market, and particularly the sub-market for managed network services the merged entity would post-merger enjoy a high market share. Combined with the vertical effects described below, the high market shares would likely give the parties the ability to increase prices to customers.

The vertical integration would occur through the consolidation between the activities of Telkom (as the monopoly supplier of network infrastructure in South Africa) and the activities of both parties in the downstream market for the provision of electronic communication services. Providers of electronic communication services need network infrastructure as an essential input in the delivery of services to customers. Although customers of electronic communication services can procure network infrastructure directly from Telkom to be used in combination with the provision of value added electronic communication services, the dependency on access to network infrastructure (whether directly or indirectly) is a key element for effective participation by electronic communication services providers.

Telkom, being the monopolist supplier of network infrastructure and facing insignificant (if any) price competition from the second network operator, Neotel, could raise the input costs of its rivals in the downstream market by increasing the costs of network infrastructure to the other players in the electronic communication services markets. Telkom could do this by directly increasing prices for network infrastructure or by frustrating access to network infrastructure for competitors through providing cheaper, faster and higher quality inputs to itself and/ or charging higher prices, and delivering lower quality with longer lead times to its competitors. Due to its upstream market operations where it is a monopolist, Telkom could also successfully implement a strategy of cross-subsidisation where it takes profit in the upstream market and subsidises its downstream activities, thereby having the ability to price at exclusionary levels that will negatively affect the ability of other service providers to fairly compete for the market.

Portfolio effects arise from the activities of Telkom and BCX in the provision of electronic communication services that may influence the competitive dynamics of the related (but separate) information technology services markets, particularly in light of convergence in the information technology industry. Just like Telkom has the ability to cross-subsidise between network infrastructure and electronic communication services, it could extend this behaviour to its information technology services and other operations.

Post-merger Telkom would be the only player able to offer the full range of network infrastructure, electronic communication services and information technology services. Telkom could extend its market power in network infrastructure and managed network services to the broader electronic communication and information technology services markets by tying or bundling certain products together.

Without fair access to network infrastructure players in the market for electronic communication services would not be able to effectively compete in the downstream markets. In the longer term it is likely that these entities would exit the market, permanently changing the competitive structure of the market and leaving Telkom as a monopolist in the market.

The main concerns with the merger thus arise from Telkom's ability to exclude its downstream competitors from the market segments of electronic communication services and information technology services through the raising of its rivals' costs, bundling of services and cross-subsidisation. Telkom's ability to extend its monopoly power in the upstream market to the downstream markets would be increased through the merger. Each of the above factors (raising rivals' costs, cross-subsidisation and tying and bundling of services) on their own raise significant competition concerns. These factors are interlinked and cumulatively are highly likely to result in a substantial prevention or lessening of competition.

Telkom, through the proposed merger, is increasing its ability to raise prices to customers in the downstream market in the face of possible increased price regulation in the market for electronic communication services.

The Commission thus found that Telkom would have both the ability and incentive to engage in strategies to remove competitors and competition from the markets.

The Commission thus concluded that the transaction was likely to substantially prevent or lessen competition in the markets for electronic communication services and information technology services, specifically, and the broad information technology sector generally.

Telkom submitted that the merger would give rise to efficiency gains arising from eliminating overlapping functions, less investment in infrastructure development and the provision of integrated or converged services to consumers locally and globally. However, not all of the claimed efficiency gains were found to be merger specific, as they can be attained through organic efforts from Telkom. More importantly, given the severity of the negative impact of the merger on competition and the South African economy, the Commission found that the claimed efficiencies (whether merger-specific or not) are unlikely to outweigh the anti-competitive effects of the merger.

The transaction, if allowed, would likely have no negative effect on the public interest dimensions of employment and international competitiveness. The transaction would however, likely negatively impact on the public interest aspect of increasing the ability of small and medium enterprises and firms owned by historically disadvantaged competitors to become competitive, as it would be difficult for network customers and competitors of the merged entity (some of whom are owned and managed by previously disadvantaged persons) to remain active in the relevant markets when faced by the foreclosure, bundling and cross-subsidisation strategies that Telkom is likely to employ. The negative competitive effects would likely spill over to the information technology sector. The Commission thus concluded that the transaction is likely to have a negative impact on the public interest.

As an input into doing business in South Africa, price increases in electronic communication and information technology services may increase the total costs of doing business in South Africa. This merger is thus not only likely to directly harm consumers of electronic communication and information technology services, but may ultimately harm economic growth in South Africa.

Having concluded that the merger is likely to substantially prevent or lessen competition and negatively impact on the public interest, and without any efficiencies to outweigh the negative effects, the Commission considered the imposition of conditions to remedy the negative effects of the transaction. However, both structural and behavioural remedies were found wanting in attaining the desired effects of restoring competition.

The Commission thus recommended the prohibition of the merger.

Lafarge Roofing (Pty) Ltd and Kulu Group of Companies

The Commission conditionally approved the merger between Lafarge Roofing (Pty) Ltd ("Lafarge Roofing") and the Kulu Group of Companies. Lafarge Roofing is wholly owned by Lafarge International Holdings Limited ("Lafarge International"). Lafarge Roofing conducts the business of producing and selling concrete roof tiles in South Africa. The primary target firms are Kulu Concrete Products (Pty) Ltd ("Kulu KZN"), Kulu Roof Tiles Cape (Pty) Ltd ("Kulu Western Cape") and Kulu Roof Tiles ("Kulu Gauteng"), collectively referred to as the Kulu Group of companies ("Kulu Group or Kulu"). Kulu's shareholding is split between three shareholders being Mr. A. Redford, Mr. R. Moschinsky and Mr. M Stirling. Kulu is also involved in the concrete tile market.

Product overlap

The activities of the merging parties overlap in the area of the production and sale of concrete roof tiles.

Market delineation

The parties argued that the relevant market for assessing the merger is the market for pitched roof coverings in South Africa.

The Commission's market investigation revealed that the relevant product market was narrower than the abovementioned pitched roof coverings. The Commission considered that the relevant product market could be segmented into (i) an affordable and (ii) a traditional segment. However, there was minimal overlap between the activities of the merging parties in the affordable segment and the Commission, therefore, did not consider this market segment further in its assessment. Within the traditional segment the Commission further found that there was a niche area wherein consumers are not price sensitive and could switch between more elite tile products and other expensive roofing material. However, within the broader traditional segment, consumers are largely price insensitive and base decisions of roof covering on aesthetics, design / style, product qualities, personal appeal and preferences. Hence, once the consumer has selected a specific type of roof covering it is highly unlikely to switch to another roofing material, even if prices had to increase by 5% to 10%. In addition, when the costs of the various roofing solutions were considered, then significant prices differences were evident. Moreover, the Commission considered that concrete roof tiles possess unique qualities that influences consumer's choice in roofing material. For example, concrete tiles are more durable and require less maintenance and are therefore more cost effective when compared to other types of roof covering, for example steel. Based on its findings the Commission therefore concluded that concrete tiles are a separate relevant product market.

In its geographic market assessment the Commission considered various arguments including demand-side and supply-side factors. The Commission ***inter alia*** considered (i) the supply pattern of industry players, (ii) the buying patterns of consumers and (iii) transport costs, including transport costs in relation to product costs. The evidence suggested that relevant geographic markets were regional in scope.

Competitive assessment

The Commission considered the markets of overlap in (i) Gauteng and inland regions, (ii) KwaZulu Natal and (iii) the Western Cape regions.

It found that in the inland region, the parties would face competition from several other players.

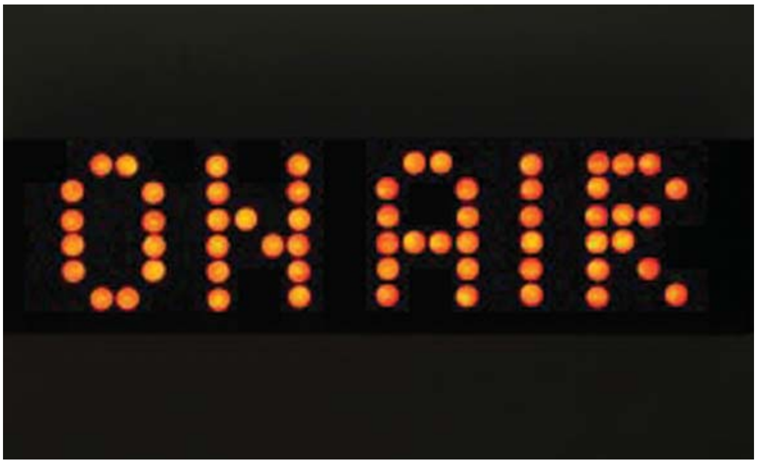
In the KZN market, the Commission found that the merged entity would have a market share of at least 60%. However, there are at least five other players, in this relevant market. In addition, there is evidence of recent entry. Barriers to entry were assessed and it was found to be surmountable. In addition, the Commission assessed the capacity levels of competitors and found that most small players in the market were operating at well below their maximum capacities and could easily expand production should the merged entity restrict output post merger. Hence, even if barriers to entry were high the existing players in the market could expand capacity and increase supplies into the market and drive prices down post merger. The Commission therefore concluded that no significant anti-competitive effects are likely to arise from the merger in this market.

The Commission examined the Western Cape market and found that the merger would create a monopoly in this relevant market. Furthermore, the Commission found that the instant transaction would raise barriers to entry. Furthermore, it was noted that the Western Cape market is unique in that there are only eight roofing contractors who do the major portion of roof installations in this geographic area. These roofing contractors could easily be tied up in volume discounts and rebate structures and could deter any further entry into the market. Hence barriers to entry post merger would increase significantly. The Commission investigated whether there would be mitigating factors that would militate against the likely anti-competitive effects in the abovementioned relevant market. The Commission furthermore found that there was no countervailing power by customers. The merger would in effect remove the only other credible competitor in the Western Cape market. The Commission also found no evidence of any other mitigating factors.

The Commission therefore concluded that the merger would substantially prevent and lessen competition in the concrete tile market in the Western Cape. Furthermore, the Commission found that the parties' could attain some of the alleged efficiencies outside this merger.

Remedy

In light of the above, the Commission recommended that the merger be approved subject to the condition that Lafarge Roofing must divest of the Kulu concrete tile plant in the Western Cape. This remedy would eliminate the horizontal overlap that would give rise to the identified competition concern. The Tribunal subsequently approved the merger subject to the recommended condition and an additional behavioural remedy for the KZN market.



Merger in the radio industry involving Primedia & Kaya FM

During the November 2006 the Commission Tribunal held hearings into the proposed merger between Primedia Limited ("Primedia"), Capricorn Capital Partners (Pty) Ltd ("Capricorn") and New Africa Investments Limited ('NAIL"). NAIL's only asset is an equity interest of 24,9% in Kaya FM.

The hearing before the Tribunal was initiated by the merging parties who requested the Competition Tribunal to reconsider the decision made by the Commission to approve the merger subject to conditions, which had aimed to nullify any control that Primedia or Capricorn could have over Kaya FM. According to the merging parties the conditions imposed by the Commission were too onerous.

African Media Entertainment ("AME") intervened in the proceedings in opposition of the proposed merger. AME had earlier made a counter offer to the NAIL shareholders in order to acquire its shareholding in Kaya FM.

All parties to the hearing were afforded an opportunity to present evidence. The parties called industry participants, executives from the merging parties and an economic expert. The Commission relied on an economic expert and an industry expert for its case. The interveners called only an economic expert to present their case.

The witnesses covered two central issues, the first relates to the rationale and the ability of the acquiring firm to control or materially influence the behaviour of Kaya FM. The second relates to the market in which Kaya FM and radio stations owned by Primedia (i.e. 94.7 Highveld Stereo and 702 Talk Radio) competes. The radio stations compete in two sided markets, on the one side there are listeners, who have a particular profile, and on the other side there are advertisers, who target a particular audience. Topics such as listener profiles of particular radio stations were discussed which includes, age profile, race profile, income profile. Other topics included, radio station formats (i.e. adult contemporary vs talk radio) commercial radio stations, public service stations, language, geographic location etc. All these topics resulted in a lively, active debate on the dynamics of the market and how the market should be defined.

The Tribunal ruled that the acquisition of a 24.9% shares held by Nail in Kaya FM will not lead to Primedia and its partners acquiring control over Kaya FM. In view of this conclusion the Tribunal found that the merger was unlikely to lead to substantial lessening or prevention of competition in any of the markets in which the parties compete. The Tribunal accordingly approved the merger without conditions. This is in contrast to the Commission's view that the 24.9% shareholding provided Primedia and its partners with a director on the Kaya FM board and would enable Primedia to materially influence the business of Kaya FM as well as give them access to commercially sensitive information.

The merger is currently subject to review in the Competition Appeal Court.

Metso Corporation OY and Kvaerner's Pulping and Power

On 3 July 2006, the Competition Commission ("The Commission") received a notification from Metso Corporation Oy ("Metso") of its intention to acquire Kvaerner's Pulping and Power ("AKPP"). Metso is a Finnish public company, with seven satellite companies in South Africa, which is currently engaged in the development and manufacture of machinery and engineering processes, operated through four business groups, namely: Metso Paper, Metso Minerals, Metso Automation and Metso Ventures. The Metso Paper and Automation divisions provide ***inter alia*** chemical pulp equipment and were relevant for the instant transaction. On the other hand, AKPP is active in the supply of machinery and systems, as well as providing designs, engineering, fabrications and project management services for fibreline, recovery boilers and power boilers for use in the chemical pulp industries.

In terms of the merger Metso intended to acquire full ownership of AKPP from Aker Kvaerner's E&C Group AS. The parties submitted that the transaction would enable Metso to expand its product range to include continuous digesters, a whole range of chemical recovery equipment and power boilers. The parties noted that Metso will post-merger be in a position to respond to their customers' increasing demand for the supply of complete pulp mill equipment, as well as increased after sales involvement.

The transaction was also notified to the competition authorities in the European Union and Brazil. However, due to statutory deadlines, the Commission had to take a decision before the investigations were finalised in other jurisdictions.

The Commission identified product overlaps between the activities of the merging parties in the manufacture of brown stock washing equipment, oxygen delignification equipment and bleaching equipment in a globally defined geographic market. These markets are characterised by sales through bidding markets. Despite the contention that bidding markets are generally contestable, customers of the merging parties in the manufacture of brown stock washing equipment, oxygen delignification and bleaching equipment do not have the ability to exercise countervailing power to constrain the merging parties from behaving anti-competitively. These customers also indicated that firms that bid to supply of brown stock washing equipment, oxygen delignification equipment and bleaching equipment are generally limited to the merging parties and Andritz AG. The merger would decrease the number of viable bidders from three to two.

In the markets for the manufacture of brown stock washing, oxygen delignification and bleaching equipment, the Commission's investigation established that there are barriers to entry in the form of: the need for a supplier track record, intellectual property rights regarding some equipment, large initial capital requirements, and a long waiting period before reaching take-off. There has practically also been no *de novo* entrants over the last 50 years and entry is only attainable through the acquisition of a license for the manufacture of an existing product.

The Commission found that the combined market share for the merging parties in each of the said overlapping areas would be in excess of 40%, with the rest of the market being constituted by the largest player and another relatively small player.

Given the high barriers to entry, the Commission found that these markets would be less contestable and that the implementation of the proposed merger would likely entrench this. The Commission noted that the proposed transaction removed an effective and dynamic player with the capacity and capability to ensure that the affected markets, which are of an oligopoly nature, would remain competitive. The Commission was concerned that the implementation of the merger would result in anti-competitive outcomes.

The transaction also gave rise to vertical integration as Metso is involved in the manufacture of automation systems, which are in turn supplied to manufacturers of power boilers. The Commission's investigation revealed that the transaction was unlikely to raise vertical integration concerns mainly as a result of the relatively low market share for Metso in the affected upstream market.

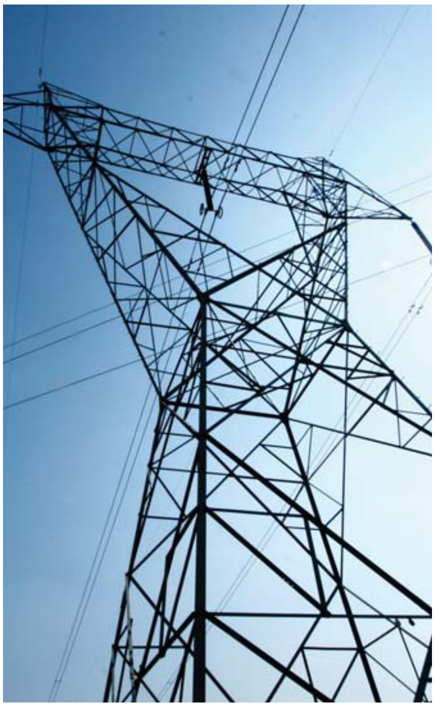
The Commission, therefore, concluded that the proposed transaction is likely to lead to a substantial prevention or lessening of competition in the markets for the manufacture of brown stock washing, oxygen delignification and bleaching equipment. There were no additional perceived efficiencies which the parties advanced that could be attained in these markets that could outweigh the anti-competitive outcome that would likely arise from the consolidation of the merging parties' operations in the relevant affected markets.

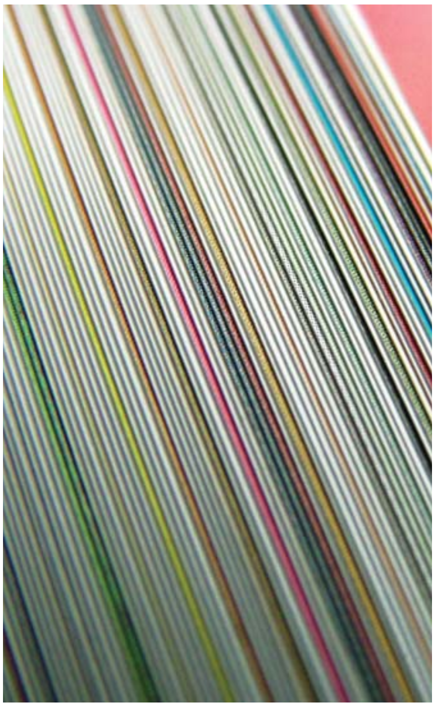
However, there are other efficiencies that may be obtained through the consolidation of the complementary activities of the parties, such as the chemical recovery and power boilers business of AKPP and the fibreline of and wood-handling business of Metso. On balance, however, the Commission remained concerned about the competitive effect of the proposed transaction on the manufacturers of pulp and paper products in South Africa, and ultimately the consumers of their end products.

The merging parties proposed certain remedies to address the anti-competitive outcomes of the merger. The Commission evaluated the proposed remedies, and determined that, with certain adjustments to the proposals, a divestiture of AKPP's existing assets relating to the supply of brown stock washing, oxygen delignification and bleaching equipment and processes would restore the market to pre-merger competitive levels.

On 27 September 2006 the Commission approved the transaction subject to the merging parties divesting of the existing AKPP's assets relating to the supply of brown stock washing, oxygen delignification and bleaching equipment and processes, together with auxiliary products such as pumps and mixers. The business had to include all tools, moulds, key machines, patents, trademarks and know-how related to the divested assets.

The European Commission also approved the transaction subject to conditions similar to those imposed by the Commission.





Are competition authorities failing SMEs and not fulfilling their mandate?

There has been a lot of frustration and anger at the perceived inability or even unwillingness by the Competition Authorities to take a firm and decisive stand with regard to anti-competitive conduct impacting negatively on small businesses.

In a article published in Business Day, Barrie Terblanche[1] stated that "our Competition Act is one of the few in the world that make specific mention of protecting small businesses, but our competition authorities are not exactly carving out a name for themselves as champions of small businesses fighting against collusive and abusive corporations." He also quoted a complainant stating that the authorities are "absolutely useless". This gave an impression that not only are we failing this sector but also that we are unable, as an institution, to fulfill our mandate.

Ms Zodwa Ntuli[2] stated in an FSB article that "the objectives of the Competition Act appear to be ambitious and optimistic, which is of course a positive feature. Yet, the Act does not seem to provide for adequate means and mechanisms to achieve these objectives. It seems to raise in vain the hopes of vulnerable consumers and small businesses, most of which look to the regulators for immediate solutions to their problems."

The Competition Act's ("the Act"), No 89 of 1998 (as amended) main objective is to promote and maintain competition through, amongst other things, ensuring level playing fields, promoting equitable participation in the economy and promoting a greater spread of ownership in particular by previously disadvantaged individuals. The main thrust is for the competition authorities to ensure that the environment businesses operate in is conducive, free and fair.

The Act talks about promoting and maintaining competition and gives the impression that once this mandate is fulfilled all the other sub-objectives would be fulfilled. The assumption is that where there is competition it should be easier for others to enter and compete in those markets as when there is competition there would be less cartel activity, barriers to entry and any other anti-competitive conduct. Unfortunately, we have seen through market behavior and complaints channeled through the Commission that it is not possible to maintain this standard without some of intervention from the authorities. However, our work has been complicated by the fact that we do not have a mandate to protect individuals, while the nature and/or quality of complaints coming through has also posed challenges. Some of these challenges relates to a lack of evidence; proving dominace. Some of them being:

Evidence to back the complaint not found

Some complainants tend to base their allegations on assumptions and hearsay without having verified the accuracy of facts or information before lodging a complaint with the Commission. Without evidence or proof that links the respondent to the alleged conduct, the prospects of the cases succeeding at the Tribunal are highly unlikely. Particularly in cases of refusal to supply when the complainant has not even dealt with the respondent before but assuming that they will refuse to supply because his/her business is too small to compete with others in that market.

It is however important as well for the Commission to ascertain that such evidence does not exist before non-referring a case on that basis, otherwise it may be accused of not applying its mind or the powers that it has to obtain such evidence where the complainants have provided leads.

Dominance could not be proved

In most cases SMEs would expect the Commission to intervene or 'punish' a respondent because of its size and as a result of it having abused its market power in contravention of the Act. This is a difficult area to investigate due to the fact that what appears to be an abuse of dominance case may also be a prohibited restrictive vertical practice under section 5(1). This therefore suggests that the Commission always has to assess if there are alternative charges or allegations that are prosecutable despite the fact that dominance or abuse thereof could not be established. This is because in most cases, the complainant would be in a vertical relationship with the firm alleged to be dominant in which case it would be necessary to assess the complaint against both the abuse of dominance and prohibited restrictive vertical practices.

Another aspect of this area posing difficulty is that more often the complainant is dependent on the firm against which a complaint is made for supply. For this reason, there is a possibility that the element of fear plays a big role in determining the level of cooperation by the complainant in providing relevant information. On the other hand, the SMEs/HDI firms may be abusing the Commission processes to try and get out of failure to pay debts owed to suppliers. Thus, there is always a need for the Commission

1 Barrie Terblanche, freelance journalist: Business Day; 28 November 2006
2 Ms Zodwa Ntuli former Manager, Compliance (Competition Commission): FSB (Financial Services Board) Bulletin Fourth Quarter 2005

to balance these dimensions through verification of facts.

There are cases that invoke unfair business practice by alleged dominant firms that cannot be investigated nor prosecuted because the Act defines a dominant firm clearly. There is a need for the Commission to consider narrowing the relevant market or product definition in order to determine abuse, thereby ensuring that the competitiveness of the SMEs/HDIs are not negatively impacted upon.

Substantial lessening of competition (SLC) not proved

The Act requires a high standard in that even though a conduct may appear anticompetitive, if it is a rule of reason contravention, there is a requirement that the effect on competition must be 'substantial' and this term is unfortunately not defined.

The requirement of a 'substantial' effect on competition is another reason why SMEs or HDI firms' concerns cannot be addressed through the Act as in many cases the conduct affects the competitiveness of a number of small players in the industry, such conduct is not found to be substantial within the broader context. If you remove the requirement, most unfair business practices raised by SMEs and HDI firms could be addressed through the Act. It is possible that the test may be too high for the South African market and conditions, in which case it may require amendments.

Therefore, market definition plays a significant role in this area of complaints and determining the effect on competition is continuing to be a difficult task. It appears that there are indeed pointers to a need of reassessing approaches and previous decisions from time to time as market conditions change regularly.

Availability or existence of substitutes

There are genuine cases raising competition concerns pertaining to refusal to supply, however, preliminary investigations by the Commission have established that the complainants could access other products or services quite easily and possibly at reasonable prices elsewhere.

These kinds of complaints are sometimes linked with section 5(1) or section 8 and may also be non-referred unless they meet the high SLC and dominance tests. What appears to be a tendency is that SMEs and HDI firms would react to what is normal business conduct by lodging a complaint without exploring what possible substitutes exists for them. This normally happens when they have used one supplier for a longer period and have since become comfortable hence the frustration when such supply is suddenly not available.

Effect on Competitor not Competition

These kinds of complaints tend to deal with harm to individual businesses but not necessarily the competition process. The concerns were mostly about unfair business conduct and restraint of trade but did not show harm caused to competition or consumers. This takes us back to the issue of substantial prevention or lessening of competition and that the purpose of the Act is to promote competition and not competitors.

If the Commission finds that no barriers to entry exist or that no harm is caused to consumers, such a case is non-referred even if it affects a particular competitor negatively. This is purely because it is unlikely that a SLC will be found if the effect is on a competitor but does not affect a competitive process in that market.

The only area that appears to address effect on competitor is abuse of dominance, especially the provisions that relate to buying up scarce goods required by a competitor as well as refusal to give access to an essential facility.

The large number of non-referrals can easily create an impression that the Commission is not fulfilling its mandate of promoting the competitiveness of small and black businesses. The complaints received by the Commission can be categorized into two. The first category consists of those that raise genuine competition concerns but fail to meet the high tests required by the Competition Act mostly because they do not result in substantially lessening of competition or cause harm to consumers.

The second category of complaints includes those that raise no competition concerns, and cannot therefore be dealt with by either the Commission or any other agency or structure. Examples include unfair business practices, unreasonable clauses in contracts, franchising problems, etc.

Conclusion

There is an indication that amending some sections of the Act could enable the Commission to deal with some of the problems that are raised by SMEs more effectively and decisively. The amendment could include all unfair business practices and related matters to enable the competition authorities to deal with them. Also the possibly of removing the word "substantial" in sections 4 and 5 need to be removed in order to lower the high test required to prove existence of anticompetitive conduct.

There is also a need for the dti to undertake a comprehensive legislative review of laws governing SMEs with the aim of solving, assisting, mentoring and contributing positively towards the growth and sustainability of SMEs. Further, Seda could be empowered to deal with these issues thereby giving SMEs the protection they require without losing sight that they are business entities and should be treated as such.

This does not, however, absolve the Commission from its mandate of ensuring that we have dynamic markets that are innovate, conducive, fair and free where any one who competes or enters any market can do so without any unnecessary hindrances/barriers. It is our role to curtail cartels, abuse of dominance and substantial lessening of competition that has no justification.

By: Busi Ngwenya
Compliance Division

Towards a free and fair economy for all

Where to get hold of us

Visit the Competition Commission online at www.compcom.co.za for more information about the Commission and the Act, as well as the rules and amendments to the Act. You may also forward enquiries, comments and letters to:

THE EDITOR
Compliance Division
Private Bag X23
Lynnwood Ridge
0040
E-mail: CCSA@compcom.co.za
Tel: (012) 394 3200
Fax: (012) 394 0166

Competition News is issued quarterly and if you would like to receive future copies, please forward your particulars to enable us to add your details to the distribution list.