Competition News

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Towards a fair and efficient economy for all.

IN THIS EDITION

Not out of the woods yet: the privatisation of Safcol

Getting out of commercial forestry is one aspect of Government's privatisation programme. The disposal of Safcol's forestry assets has now begun, but there are problems with the process, which have implications for the future of forestry and the associated downstream industries.

The State and commercial forestry

Forests have value because they provide us with a variety of goods and services, for example saw logs for industry; wood for fuel; opportunities for ecotourism; all sorts of non-timber forest products, such as resin, ferns, bark, and wildlife, as well as non-market services such as the conservation of water resources and biological diversity.

Government has been involved in the forestry industry since the 1880s, in response to market failure. Private firms were unable to raise the vast amounts of money needed for establishing commercial forestry plantations. The State plantations provided timber for the construction, railway and mining industries, and later on, for the pulp and paper industry. By the turn of the century however, the commercial

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forestry and the pulp and paper industries had grown tremendously. For example, the volume of pulp imports fell by 90 per cent in the 1980s, whereas export volumes increased by 88 per cent.

According to the Department of Water Affairs and Forestry's National Forestry Action Plan, released in 1997, South Africa is endowed with approximately 1,5 million hectares (ha) of commercial forest plantations. South Africa is also endowed with about 20 million ha of woodlands, which are open savannas covered with grass and trees. Woodlands are being used by communities, primarily for wood fuel. Government is concerned about the rate of depletion of woodland resources and has developed a community forest policy to promote sustainable local development.

In respect of commercial forestry, however, it was felt that Government had played its part, so a decision was taken to commercialise the State's forestry interests. Accordingly, Safcol (the South African Forestry Company Limited) was established in 1992 and took control of the State's commercial forests in April 1993. Safcol owns about 400 000ha of South Africa's commercial timber plantations.

Privatising Safcol

Preparation for the next step - the privatisation of Safcol - began in 1996. In 1999, seven packages of forestry assets were offered for sale. These totaled about 330 000 ha of timber plantations and included five sawmills and two pole-processing plants. Rather than selling the land, Government offered the forests on long-term lease and intended to retain ownership of the land. Bidders would have to make up-front payments and pay annual rent. Also on offer was a portion of the former homeland forests.

Initial estimates that the assets of Safcol would fetch a sum of between R1bn and R1,5bn proved too optimistic. Prospective bidders may have been put off by the requirements for the involvement of black empowerment groups in the bids, and the fact that some of Safcol's existing clients had extremely favourable, evergreen contracts. A potential buyer of a package of Safcol land might balk at the prospect of having to supply timber at predetermined low prices, to predetermined parties.

There has also been resistance from communities living in or adjacent to the forests. It has been suggested that rentals be paid to inhabitants and community access to forest products be assured in terms of the deals, but members of the affected communities, quite naturally, want to be involved in the management of these forests. This might be seen as problematic by potential bidders.

Preferred bidders were announced in November 1999 for only four of the packages. In September 2000, some progress was made when final contracts were announced in respect of two of the packages:

- KwaZulu-Natal: a 20 000 ha portion of the assets was sold to the Siyaqhubeka consortium;

- Eastern Cape (North): this package was sold to Singisi Forest Products.

As to Mpumalanga and Northern Province, which previously comprised two packages, these plantations have now been combined into a single package. Amounting to about 135 000 ha of forest plantations, the package is certainly the 'jewel' of the Safcol assets on offer, and three consortia have now been shortlisted for its disposal.

The impact of the privatisation

The Safcol sale will impact on the businesses of, among others, Sappi and Mondi. Together, Sappi and Mondi purchase 30-40% of Safcol's sawn timber, which itself amounts to about 30-40% of SA output. If certain parcels of land are secured by other consortia, this could affect a large part of the inputs of Sappi and Mondi. On the other hand, if Sappi and/or Mondi are able to secure large chunks of Safcol forests for themselves, the resultant vertical integration might lead to increased monopoly power by these groups in their relevant markets.

Against this, bids by Sappi and Mondi might be seen in a favourable light, as both companies seem to comply with the value-adding and export stimulation objectives of the restructuring of Safcol, as set out in the Inter-Ministerial Cabinet Committee's Forestry Privatisation Blueprint.

Safcol holds a very powerful position in the forestry industry in South Africa. A number of complaints about Safcol's conduct were received in the 1990s, which prompted the Competition Board to conduct an investigation (report no. 61 of 1998). A new commercial forestry industry structure will emerge after privatisation and that may well give rise to similar complaints. Some of the grievances that were raised against Safcol are worth noting here, as they could conceivably be repeated against the new owners of the forest assets:

- Safcol was regarded as being in a dominant position;
- in some products and areas, Safcol was a monopoly supplier;
- in several cases, Safcol was abusing its position of dominance/monopoly by, for example, refusing to supply;
- some customers complained of having no security of supply;
- Safcol was discriminating between purchasers;
- Safcol's vertical integration was seen as unfair, in saw milling and value-added products, and its competition for poles supplied by the State was seen as unfair, for it might be able to sway the State in its favour.

Conclusion

The structure of commercial forestry in South Africa is changing as the privatisation of Safcol goes ahead. The State has yet to dispose of all its forestry assets, but the process should be completed in the next year or so. The Competition Commission will have to monitor developments in commercial forestry, as well as in the downstream industries, such as paper and pulp, for the occurrence of anti-competitive practices. Complaints were made about the conduct of Safcol in the 1990s, and the current restructuring of state forestry assets may well give rise to similar problems in the next few years.

Is import parity pricing anti-competitive?

Import parity pricing (IPP) is a price-setting practice used where the domestic market is characterised by limited competition. This pricing technique has been used for a variety of products, such as aluminum, copper, paper and board, sugar, steel, stainless steel and petrochemicals.

What is import parity pricing?

IPP is defined as: "A practice adopted by firms of linking the selling price of their products with, or fixing them at, the same level as the import price of that product or similar products"[1]. The local selling price of the product is therefore set at the international price plus certain imputed or assumed costs, such as freight, insurance, harbour charges, import duty, surcharges and others. Pricing at par with imported products, as the definition suggests, implies that the price is not strictly cost-related. This pricing system does not follow the conventional economic principle of setting prices at the cost of producing the last unit, where marginal cost is equal to marginal revenue. Note that IPP is only possible if the firm is a price-setter in its domestic market, which means that the firm must have a degree of monopoly power.

Why are imports unable to thwart the practice of IPP? It is the existence of import tariffs and transport costs that increase the landed costs of imported products. Certain products are particularly susceptible to the application of IPP in this regard:

- Despite the fact that trade has been liberalised worldwide, including South Africa, there are still products that are subject to hefty import tariffs. Domestic producers of these products may be able to apply IPP if their costs are below the import price plus the tariff.
- Where a product has a *high volume to value ratio*, transport costs become significant, especially if the product is to be brought from another country. An example of a bulky but cheap product is cement. Economists sometimes refer to transport costs as natural trade barriers, for the effect is identical to that of a tariff.
- The *inelastic demand* for certain products. If there is no substitute for the product in question, or if the product is a necessity rather than a luxury, then domestic producers will be better able to apply IPP by adding a margin to their costs. In the face of a price rise, consumers will be unable to switch to a different product if there is nothing else which satisfies the same need. Nor will they be willing to consume much less of the product if it is a necessity.

Of course, it should be remembered that although the above factors make certain markets prone to the practice of IPP, a firm must have a degree of domestic monopoly power in order for it to be able to raise prices profitably.

Producers of goods subject to IPP will naturally be at pains to explain why their adding of a margin to the world price is quite legitimate. Firstly, they may justify higher prices by claiming that the world price is low because exports are subsidised, or that the price reflects dumping, as a means of predatory pricing or market discrimination. As such, it would be unreasonable to expect local prices to be that low. Secondly, and particularly where the product or its components are imported for further processing, local producers may cite their liability for various duties, tariffs, surcharges, harbour charges, freight charges, insurance costs and the like in the "calculation" of their prices.

Now local producers may be subject to such charges, and the world prices of certain commodities are indeed distorted. In the absence of domestic competition, however, these firms are able to apply import parity pricing, whether due to cost considerations or simply in order to increase profits. The

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point is that the ability to practice IPP is the ability to increase prices at will.

International experience of import parity pricing

The use of IPP has been prevalent in several countries, including India and Australia. IPP was introduced as a pricing mechanism for the Indian oil industry in 1948. The prices of India's petroleum products were based on the free on board (FOB) prices of the West Asian products. Thereafter, excise duties, local taxes, dealer margins and agreed marketing margins of each of the refineries were added. However, this pricing mechanism came under criticism and a committee was put in place to investigate its use. The committee did not favour import parity pricing as a benchmark for domestic pricing. The argument was that IPP did not take into account inter-refinery differences in product patterns, types of crude used, or location and scale differences. Furthermore, the structure of West Asian petroleum product prices, which was the basis of determining Indian prices, did not necessarily reflect the cost pattern and operations of Indian refineries. The committee further argued that IPP distorted India's domestic prices.

Import parity pricing in South Africa

In South Africa, import parity pricing has been in use in a variety of industries, such as aluminium, copper, sugar, steel, stainless steel, paper and board products, and petrochemicals. According to Industrial Strategy Project reports[2], the high cost of domestically produced intermediate goods is identified as a major impediment facing downstream producers attempting to enter international markets. South African downstream industries are paying a premium for key commodities produced in South Africa. It is argued that, to a significant extent, IPP is to blame. Where tariffs are imposed on competitively produced domestic inputs, local producers are simply factoring the tariff into their domestic price structure. IPP also arises when local producers include transport and insurance charges that local fabricators would have had to pay if they had chosen to import the required input.

Although South Africa has an adequate resource base in feedstocks/raw materials such as metals, polymers, paper, wood, and sugar and glass, these core inputs are sold at import parity prices. These are prices that local suppliers calculate customers would have to pay, assuming that the feedstock were to be imported, and thus include: the world price, plus transport costs to SA, plus tariffs and other government levies, plus the internal delivery and marketing costs.

The use of IPP negatively affects the viability of downstream industries, for their inputs are too expensive. The direct implication of IPP is that SA manufacturers of products or inputs charged at IPP will be paying higher prices than their competitors in other countries. As a result, IPP plays an important part in the failure of local fabricating industries to move from the small, protected domestic market to the international market.

The lack of international competitiveness is exacerbated when a sector has a monopolistic structure in the local market, for example the aluminium sector in South Africa. Prior to 1994, aluminum price rises were largely linked to local inflation. But from 1994, the industry based its prices on the dollar-denominated LME (London Metal Exchange) price. This change in pricing mechanism led to higher domestic prices and was perpetuated by the monopolistic structure of the industry. If there were, say, four or five world-scale aluminum refineries in SA, instead of only one at the time (Alusaf), the domestic price of aluminium would have fallen to the world price. The main problem lies in the lack of competition between producers in the South African economy. It is all too easy for monopolistic firms to engage in IPP.

It is also necessary to note that Government policy, in particular trade policy, plays an important role in determining IPP. If Government raises its charges (tariffs, duties, etc), then prices will rise.

Is import parity pricing anti-competitive?

It would be difficult to decide on whether the practice of IPP should be regarded as a restrictive practice in general. According to the Competition Board's investigation[3] into restrictive practices in the manufacture and marketing of paper and paper products, firms that base the selling price of their products on import prices might be struggling to retain their market share and protect it against foreign competitors. Some firms or industries were established for a protected domestic market under the previous policy of import substitution and could be internationally uncompetitive. These firms would presumably use IPP merely to break even, rather than as a means of increasing profit margins. Whether such inefficient firms will survive or not will depend on how they can improve their efficiency.

The disadvantage of using IPP is that it is not manufacturing cost-related. Fixing domestic prices at the same level as international prices usually distorts prices of our local goods. Hence, prices set according to IPP will behave as imported prices do, and these tend to rise faster than domestic prices.

The fact that IPP is practised in respect of products where there is little competition in the local market and/or where product substitution is difficult, gives cause for concern. Competition authorities should perhaps intervene in order to facilitate competition in these sectors, by ensuring easier entry. The difficulty lies in identifying industries that abuse IPP. As mentioned above, it may be that some industries charge IPP prices in order to survive, in which case there is no competition concern.

It is evident that government policy, especially trade policy, affects the prices of local goods. Government should review its tariff structure, ensure the existence of effective and efficient infrastructure, and encourage domestic competition, and thereby reduce the scope for firms to engage in import parity pricing.

[1] Competition Board, Report No 29.
[2] See Joffe, Kaplan, Kaplinsky and Lewis, 1995: Improving Manufacturing Performance in South Africa.
[3] Competition Board, Report no. 29.

The effects of changes

to the Competition Act

The second Amendment Act, new rules and forms, including revised thresholds and fee structures, came into effect on 1 February 2001. Amongst the major changes was the removal of section 3(1)d from the Competition Act. This results in the Competition Commission having concurrent jurisdiction on competition issues in all sectors of the economy, including those sectors that were previously regulated only by sector regulators such as the telecommunications industry.

The Consolidated Act incorporates the following amendments:

Competition Amendment Act, No. 35 of 1999 (Date of commencement: 1 September 1999)
Competition Amendment Act, No. 15 of 2000 (Date of commencement: 1 September 2000)
Competition Second Amendment Act, No. 39 of 2000 (Date of commencement: 1 February 2001)

The amendments apply retrospectively to all pending cases. These cases have been reviewed and refunds on cases that fall outside the thresholds, as revised, have been processed.

Key changes

In terms of the Rules of Conduct and Proceedings (Notice No. 22025), practitioners need to pay the filing fee on or before the date of the filing. Therefore, the Commission will require the proof of payment to form part of the filing, including where payment was done electronically.

The Act and the Rules require all parties to do the filing in the prescribed manner and form, as well as submit the additional information required in terms of the form.

Previously, the Act allowed parties to submit filings even if they were inadequate in terms of the Rules. Practitioners must note that the Commission will not accept any filings that do not contain all the documents required by the Act and the Rules.

The Commission also wishes to bring to your attention that it has noted that the definition of the target firm in the Act as amended appears to have reverted to the old definition prior to the amendments of 24 December 1999.

In terms of the aforesaid amendments, the target firm was, for the purposes of calculating the applicable turnover or asset value, defined as the actual target or assets that are being acquired.

This clearly appears to be an oversight that needs to be corrected urgently. Meanwhile, the Commission has taken a policy decision to the effect that the definition of the target firm as stipulated in the 24 December 1999 amendments will be followed until the matter has been corrected.

A further important change is that parties can apply for interim relief to the Competition Tribunal directly and would not need to file first with the Commission.

Set out below are the new fees and thresholds:

MERGERS

Combined Turnover/Assets	Fee (excl. VAT)
Under R200 million, with target firm greater than R30 million	R75 000

EXEMPTIONS

Type of Exemption	Filing Fee	Annual Fee (excl. VAT)
Single exemption	R 5 000	R 500
Category exemption	R 100 000	R1 000
Advisory opinion	R2 500	

The Commission may not charge a fee to any person filing a complaint. For the complete consolidated Act, amended rules, thresholds and forms, please visit the Commission's website at www.compcom.co.za.

Defining the market

in commercial rental property in South Africa

Market definition is a tool of economic analysis to identify the extent or boundaries of competition between firms. In most instances, the definition of the relevant market has a decisive influence on the assessment of competition. Market definition as a tool of economic analysis is mainly used for the analysis of structural changes in a market.

One approach to defining the relevant market is the *hypothetical monopolist* approach. In this approach, the market would consist of the combined sellers of the smallest group of products in the smallest geographic area that can, should they act as the only seller, profit by a significant and non-transitory price increase to levels above the likely competitive level. In most instances a five to ten percent increase is usually considered significant and a period of one year or longer is usually considered to be non-transitory.

Commercial rental property is a derived market, both from the supply and the demand side. In terms of the supply of rental space, it is derived from the supply of rental property, and in terms of the demand, it is derived from the demand for the product of the lessor, for example the demand for office space by an auditing firm (size and location) will depend on the demand for the services of the auditing firm.

The relevant market, for competition analysis purposes, would include the actual and potential sources of competition for a specific product or service and is divided into the relevant product and geographic market.

Commercial rental property market

In terms of product, the following distinct markets can be identified:

Office space

- Office parks Grade A
- Office parks Grade B
- Office parks Grade C
- High-rise offices Grade A
- High-rise offices Grade B
- High-rise offices Grade C

Shopping centres

- Malls
- Regional shopping centres
- Community shopping centres
- Neighbourhood shopping centres
- Local convenience shopping centres
- Retail warehouse centres
- Value centres

Industrial properties

- Mini-factory complexes
- Distribution warehouses
- Other specialised premises

Residential properties (sub-divided into distinct markets according to types of residences and income groups).

These markets are distinct in that the products are not easily substitutable for each other. These distinctions are based on product characteristics (office space, shopping centres, industrial properties and residential properties differ to such an obvious extent that it does not warrant discussion); intended end use (as above); functional interchangeability (also as above); and price categories. A prime example of non-substitutability on price levels (and also age of the buildings) would be the further distinction made between office space in the grades A to C. Some market analysts in the property sector make a further distinction between A+ and A-, etc., but the borders for substitutability cannot be drawn as clearly as with the A to C categorisation.

Distinctions between high-rise office buildings and office parks are to a large extent based on consumer (lessor) preferences for a specific type of office space, as the intended end use of the space is similar and they are functionally interchangeable.

In the market for shopping centres, customers have indicated that there is very little substitutability between different types of shopping centres as the actions from which the demand for these centres are derived are very distinct. Different centres offer different types of shopping experiences and are used for very different shopping trips. For example, regional shopping centres are mainly frequented monthly or bi-weekly, whereas neighbourhood and local convenience shopping centres might be frequented weekly, twice weekly and in some instances daily for essentials.

A mall, for example, is another distinct market that does not compete for the same customers as other shopping centres. Other shopping centres do not offer the same shopping range and cinemas, or the same type of anchor tenants as found in a mall. National retail stores will open a store in a community shopping centre within three kilometres of a regional shopping centre and assume that the two stores will not be in competition with each other, as they serve different customers at different times.

Industrial properties can also be sub-divided into further distinct markets with distinct applications. Warehouses are not substitutable with factories. In many cases, industrial properties are developed for a specific customer with specialised needs.

A pure application of the *hypothetical monopolist* test is very difficult in the property market, mainly because lease contracts are longer-term and, in some instances, even the terms of the options to extend are pre-determined 15 years in advance. Therefore to test for a switch due to short-term price rises is difficult. Lessors have, however, indicated that the costs of switching are in most instances very high.

Analyses of the geographic market

The analysis and determination of the geographic market definition for rental property needs to be adjusted for the purposes of rental property. Unlike most other products, rental space is not transportable and cannot therefore be "imported" from another geographical area. It is however important to define the geographical boundaries where the lessor or customer is likely to shop for his or her space. To this end, the substitutability for the same product in a particular area can be used to identify the appropriate geographical boundaries.

In terms of the geographic market the property industry is, in most cases, distinctly local (city based). In some cases, however, city based is too broad. Shopping malls, for example, may have significant monopoly elements. As stated above, they do not compete with other shopping centres, and each shopping mall has its own catchment area and is thus in a sense a local monopoly that does not compete with another mall 10km away. The saying that there are three things that matter in the real estate industry, namely "location, location and location", supports a narrow approach to the geographic market definition.

The geographic market for industrial properties can be broader than city based, i.e. regional or, in some cases, national. It is important to understand that the market for industrial rental space (as for other rental space) is of course a derived market, depending on the type of product/business, economies of scale in its manufacture, etc. Transport costs of the primary production will influence the geographical extent of the derived market for industrial rental property.

Another consideration with industrial properties will be the access to a pool of labour afforded to the geographic area, i.e. the distance to residential areas with the correct demographic profile of inhabitants and the transport infrastructure available. To this end, price divergence in industrial property rental between properties close to and far from labour supply and transport infrastructure support this statement.

Firms involved in the commercial rental property market should take the above into consideration when transactions are filed with the Commission.

Commission Cases

A close-knit family: Seardel and Frame merger approved

The Competition Commission approved the move by clothing group Seardel Investment Corporation to wholly acquire textile manufacturer Frame Group, effectively creating a national company with a turnover estimated at R3,2bn.

Background

Before the merger, the Seardel Group already owned 23 percent of the Frame Group. Seardel is the largest clothing manufacturer in Southern Africa. Its main activities are the manufacture and distribution of men's, women's and children's apparel. It is also involved in travel and the manufacture and distribution of textiles, toys and consumer electronics.

Frame and its subsidiaries are involved in the textile industry. Frame is involved in spinning, weaving, knitting, dyeing, printing and finishing of non-wovens, woven fabric and knitted fabric of various kinds, as well as yarns. Frame is one of the largest players in most of the textile markets it operates in.

The merger was, in essence, a vertical integration between the largest textile manufacturer and the largest clothing manufacturer in South Africa. The Commission thoroughly considered all concerns that may be raised in relation to vertical mergers.

Competition concerns in relation to vertical integrations

Vertical mergers raise competition concerns when the merger results in, inter alia, the elimination of a specific potential competitor, increases barriers to entry in either market and facilitates collusion or raises rivals' costs by the cutting of access to supplies.

A merger between firms where the target firm intended to enter the market of the acquiring firm would result in the elimination of a potential competitor. The merger thus results in a lost opportunity for improvement in market performance from the entrance of a significant competitor.

Vertical integrations can increase barriers to entry into markets when it leaves only a small amount of unintegrated capacity at either of the two levels of activity. A new entrant would thus have to enter both markets simultaneously and when this requires greater levels of sunk costs, barriers to entry are raised.

When high levels of vertical integration by upstream firms into the retail market makes price monitoring significantly easier, collusion may be facilitated. Also, when a vertical merger eliminates a disruptive buyer in a downstream market, collusion in the upstream market may be easier.

Finally, vertical integration can lead to competitors being dependent on the vertically integrated firm for their supply. When access to supply is foreclosed or rendered more difficult or more expensive, the rival's costs rise.

The competition analysis of the case was further complicated by the African Growth and Opportunities Act and fears of possible textile shortages as a result of AGOA.

The opportunity of the African Growth and Opportunities Act

The African Growth and Opportunities Act (AGOA), an American legislation, is an exciting development for the industry. According to this Act, SA manufacturers can export duty-free and quota-free to the USA on the condition that at least three levels of conversion in the clothing and textile industry took place in sub-Saharan Africa, i.e. clothing manufactured for export to the USA must make use of textiles from sub-Saharan Africa. The impact of this Act is enormous. Although SA clothing manufacturers have less than 0,1 percent of the USA import market for clothing, orders to SA clothing manufacturers from this source are huge by domestic standards. Sub-Saharan textile manufacturers may not be able to supply adequate quantities of textiles to meet the increased demand for the inputs in the future.

The supply situation and prospects for the future

Seardel sourced only 7,5 percent of its textiles from Frame before the merger. Frame sold 4,45 percent of its output to Seardel. Should more of Frame's output be channeled to Seardel and therefore not be available on the market, it would have a substantial negative impact on the clothing sector in South Africa as manufacturers may find it difficult to secure supply of textiles.

Seardel however indicated that it will maintain its current method of supply and thus encourage competition amongst textile producers. Frame also undertook to continue supply to its current customer base. Frame has seven distribution channels aimed at the SMMEs that do not take large enough orders to be sourced through the normal distribution channels. These outlets will also be maintained.

If shortages were to develop in the textile market because of the increased demand due to AGOA, the Frame/Seardel operation is big enough to expand capacity in the textile industry. It would make economic sense to expand on the textile output level and with regard to exports to the USA. Supplying their competitors with inputs would still be profitable as the USA market is big enough to absorb all output generated by SA manufacturers.

Parties to proposed Trident merger withdraw after Competition Commission decision

On 15 December 2000, the Commission submitted its recommendation to the Tribunal to prohibit the proposed supply and distribution joint venture between Shell SA (Proprietary) Limited ("Shell"), BP Southern Africa (Proprietary) Limited ("BP"), Caltex Oil (SA) (Proprietary) Limited ("Caltex") and Trident Logistics (Proprietary) Limited ("Trident").

On 22 January 2001 the parties withdrew their application from the Tribunal. In light of this withdrawal, the Competition Commission's recommendation to prohibit the proposed joint venture remains before the Tribunal for its approval.

The proposed transaction involved the consolidation of certain services of three major oil companies in South Africa, i.e. Shell, Caltex, and BP. Through a joint venture, the three parties would form Trident, to manage, contract, and provide logistical services on their behalf. Trident would provide the supply and distribution services that include those associated with refining, storage and handling at depots, pipeline, railway, ship and road transportation.

The proposed merger would have had the effect of substantially lessening competition between the parties. More specifically, the Commission believed that it would have had the effect of substantially lessening competition in the markets for product exchange services and hospitality services. The joint venture, in the Commission's view, would also have essentially reduced the incentives for vigorous future competition, once momentum was given to the deregulation of the industry.

Furthermore, no efficiency, technology or other pro-competitive gains result from the joint venture that would outweigh or offset the potentially anti-competitive effects. The Commission found that the parties failed to demonstrate which efficiencies are unique to the merger as opposed to gains that the parties would achieve in the absence of any merger. More importantly, they failed to convincingly show that the efficiencies would benefit consumers in any manner. The Commission, therefore, was of the view that the parties failed to demonstrate that efficiency gains that arise from the proposed venture are likely to outweigh the potential and existing anti-competitive effects of the proposed venture.

The proposed joint venture also raised certain public interest concerns, more specifically, regarding employment and empowerment issues, within the context of the dynamics of the oil industry and the overall restructuring vision of Government. While the merger would benefit the parties in terms of one-time cost savings, it would not contribute to the overall competitiveness of the South African oil industry. In fact, the proposed merger would significantly reduce the potential for competition in the hospitality and product exchange markets and would hold no benefit for consumers.

One of the eleven cornerstones of future Government policy on the liquid fuels industry is that black economic empowerment should be reflected in the composition of the industry at all levels, and significant domestic black ownership or control in all facets of the industry.

Although the aim of competition legislation is not to protect competitors but the competitive process, the effect of the proposed transaction on the empowerment firms in the industry does raise concerns within the context of the broader aims of the legislation, i.e. that of ensuring that small and medium-sized enterprises have an equitable opportunity to participate in the economy and the promotion of a greater spread of ownership, in particular the ownership stakes of historically disadvantaged persons.

Storage facilities are necessary to facilitate the economic movement of products from refinery to end consumer. Access to these facilities is particularly important to the BEE companies. The smaller, empowerment firms in the liquid fuels market are dependant on the other industry participants for both product exchange services and hospitality services, since they do not own any refineries or depots themselves. Similarly, access to these facilities and services would be crucial to any future new entrant into the industry. Within this context, the Commission found that the proposed joint venture would not facilitate the achievement of the proposed empowerment goals of Government and, furthermore, would not contribute to an overall competitive industry.

Commission Cases continued...

Virgin Active Holdings: the Health & Racquet case

The LeisureNet group was placed into final liquidation on 30 November 2000 together with its primary asset, the Health & Racquet chain of health clubs. The liquidators were mandated to continue the operations of the Health and Racquet Club operation pending its sale as a going concern.

The parties advised that after an intensive six-week bid process, Virgin, a wholly-owned subsidiary of Virgin Active Holdings Limited, was selected as the preferred bidder out of approximately 50 other bidders and the High Court granted the liquidators authority to sell the Health & Racquet Club business.

Although Virgin Active Holdings Limited operates health clubs in the United Kingdom, it does not have any such interests in South Africa.

The target firm employed 5,234 people at the end of August 2000. The liquidation process had led to some job losses (about 45 in October 2000). A further 100 commission sales staff also resigned due to a lack of sales. The parties also envisage some job losses to result from unprofitable clubs being closed. They informed the Commission that the closure of such clubs is likely to lead to the retrenchment of about 217 staff members, representing about 4.5% of the total staff employed. The parties involved did state that all efforts will be made to minimize these retrenchments.

The Distributive, Catering, Hotels and Allied Workers Union was notified of the proposed deal on 22 December 2000. The said union did not file a Notice of Intention to Participate in the merger proceedings. Notices of the transaction were also displayed in all the Health & Racquet clubs.

Overall, the merger is expected to save jobs, since the Health & Racquet operation is being acquired as a going concern and the majority of staff will be retained. According to the parties, the consequences for employment would be much worse without the proposed deal.

The Commission approved the transaction unconditionally as it is not likely to prevent or substantially lessen competition in the South African health and fitness service market.

Promoting exports and anti-competitive actions: balancing the Act

Conditional Exemption granted to SAA and Qantas

The Competition Commission recently granted a conditional exemption to South African Airways (Proprietary) Limited (SAA) for its code-sharing and ancillary commercial agreement with Qantas Airways Limited (Qantas) in respect of the SA/Australian route.

The application was, however, only approved for a 16-month period - until 30 June 2002. The approval of the application is subject to the following conditions that the parties must comply with:

- During the period of the exemption, both parties to the agreement must, independently of one another, submit quarterly reports, detailing the following:
  - The actual fares charged for all seat classes, over the period of the exemption;
  - The number of code-share seats sold by each party on the other's services; and
  - The volumes of cargo, rates charged for cargo, and the revenue derived from cargo as well as any increase and/or decrease in the laid value, sales and revenue.
- The parties shall not share or pool revenues with each other under the code-share or commercial agreements.
- The parties must independently establish and determine their own tariffs and fares on the code-share flights, and market these flights independently of one another.
- SAA must show how exports have been promoted or maintained in terms of both passenger and cargo revenues during the period for which the exemption has been granted.
- Any amendment to the agreement shall not be implemented until approved by the Commission.

One of the reasons for the conditional approval of the exemption is the broader concern that the Commission has about code-share agreements. Some code-share agreements have a negative impact on competition and on consumers on specific routes. In general, competition authorities will only approve code-share agreements should they be satisfied that the likely pro-competitive effects (such as efficiencies that can be passed on to consumers in the form of lower ticket prices) will outweigh the anti-competitive effects.

Indeed, code-share agreements may be used by airlines to extract as much revenue from passengers as possible (particularly time-sensitive travelers, such as those in business class). Used in conjunction with frequent-flyer programmes and dominance over airport slots and gates, airlines are able to make it very costly and inconvenient for passengers to switch airlines in response to a rise in fares.

The Commission is aware of at least five other code-share agreements involving SAA currently in place. SAA has to date only applied for an exemption from one of these code-share agreements. As code-share agreements, by their very nature, are collusive and result in market sharing and market allocation, they are for the most part outright violations of the Competition Act.

Investigating the alcoholic beverages industry

In November 2000, the Competition Commission initiated a complaint in the alcoholic beverages industry. The investigation is based on the information received by the Commission alleging that there are restrictive practices involving the major players in that industry.

The Commission's decision to initiate the complaint is based on evidence pertaining to general restrictive practices, conditions of trade, collusion and the abuse of a dominant position.

The Commission is currently investigating Rembrandt Limited and its subsidiaries Distillers Limited and Stellenbosch Farmers' Winery Limited (SFW), South African Breweries Limited and KWV Limited.

The recent announcement of a merger between Distillers Limited and Stellenbosch Farmers' Winery Limited (SFW), resulted in participants in the industry raising concerns about the dominant position that the parties to the merger have in the industry and emphasized that this merger will, amongst others, substantially increase barriers to entry for new entrants into various markets within the industry.

The Commission has one year to investigate a complaint. During the investigation period, no information about the investigation may be divulged. Once the Commission has concluded the investigation, a report will be submitted to the Competition Tribunal, at which point the Commission would be communicating information on its findings.

Commission Cases continued...

Scotprop complaint against property network

Competition Commission rules in favour of complainant

Scotprop, a newly-established estate agency attempting to trade in the Pietermaritzburg area, filed a complaint against Property Network, an association of estate agents based in Kwazulu-Natal, with the Commission in September 2000.

The complainant alleged that new entrants to the real estate market struggled to establish themselves as a viable alternative to the well-established market participants and members of Property Network.

In order to survive as an estate agency in Pietermaritzburg, an estate agent had two options:

- To be a well-established independent estate agent; or

- To be a member of Property Network, because a seller of property who signs a contract with any of the members of Property Network has the benefit of having its property marketed by all other members of the Network. An estate agent who is not a member of the Network is prohibited from marketing the seller's property.

This was further hampered by the restrictive nature of Property Network's membership criteria.

Findings of investigation

The Commission investigated the allegations and found that the membership criteria of the participants in the Property Network Agreement are restrictive. For instance, Clause 23 is restrictive in that it limits competition amongst the members, that is, "No participants shall be allowed to participate in any property listing system which, in the sole opinion of Property Network, constitutes competition with Property Network".

To avoid a prosecution in the Tribunal, Scotprop agreed to a consent order which the Commission recommended to the Tribunal for approval. This was approved and effected on 4 December 2000.

It was agreed that:

- The existing membership criteria of the Property Network Participation Agreement be expunged and substituted with a new set of membership criteria agreed to by the Competition Commission. These new criteria are not restrictive as they allow for easy membership to the Property Network.
- The Provisions of Clause 23 of the Participation Agreement be expunged and eliminated.
- The Commission reserves the right to review and assess any anti-competitive effects which, in future, may arise within the context of the new Membership Criteria or the amended Participation Agreement in the Property Network Participation Agreement.

Overview of M&A Activity

for the third and fourth quarters of 2000

A sample of 133 investigative reports produced by the M&A division for the period July to December 2000 reveals some aspects of M&A activity. More than half of the cases reviewed involve the merging of firms which operate in similar or identical markets. A quarter of the merger cases reviewed in the third quarter (July to September) and a third of those reviewed from October to December (fourth quarter) were conglomerate mergers.

This indicates that a significant number of acquisitions are motivated by firms

TABLE 1. FEATURES OF M&A ACTIVITY: THIRD AND FOURTH QUARTERS 2000

	Third Quarter		Fourth Quarter	
	Number of mergers	**%**	**Number of mergers**	**%**
Type of merger:				
Purely Horizontal	50	55%	23	55%
Purely Vertical	10	11%	3	7%
Conglomerate	23	25%	14	33%
Management buy-out	2	2%	1	2.5%
Horizontal/ Vertical mix	6	7%	1	2.5%
Total	91	100%	42	100%
Foreign direct investment	14	15%	5	11%
Failing firm argument	2	2%	1	2%
Anticipated job losses	7	8%	3	7%

wishing to diversify their interests. Mergers of a purely vertical nature were fairly rare, but it should be noted that, in a number of cases, firms were already vertically integrated, prior to the proposed merger.

A recent KPMG survey noted that South Africa has recorded US$7.6 billion of cross-border inward and outward mergers & acquisitions since June 2000. Comparing M&A activity in South Africa with the previous year, the report found that inward investment declined, while outward investment increased in value.

Mergers have been concentrated in the manufacturing sector, with wholesale businesses also engaging in a fair degree of merger activity. However, manufacturing (and wholesale) is rather broadly defined. It should be noted that significant merger activity has taken place in the information technology sector, financial services and real estate. The seven leading sectors for the second and third quarters appear in Figure 1.

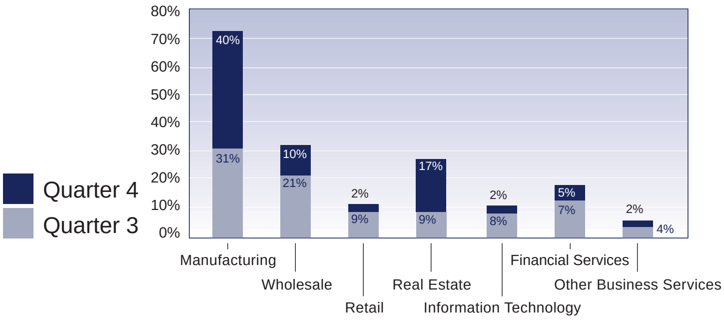


FIGURE 1. TOP SEVEN SECTORS: THIRD AND FOURTH QUARTERS, 2000

A breakdown of the manufacturing sector appears in Figures 2 and 3 for the third and fourth quarters respectively.

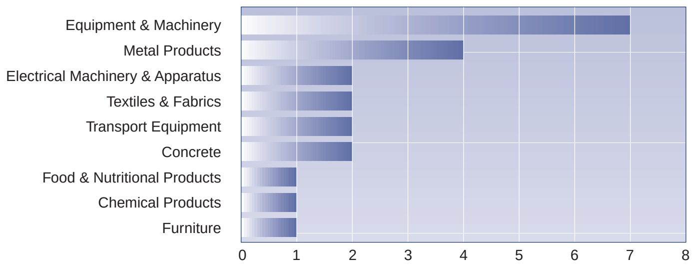


FIGURE 2. OCCURRENCE OF MERGERS IN THE MANUFACTURING SECTOR: THIRD QUARTER, 2000

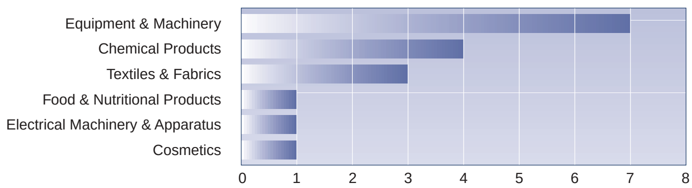


FIGURE 3. OCCURRENCE OF MERGERS IN THE MANUFACTURING SECTOR: FOURTH QUARTER, 2000

Job losses were anticipated in approximately eight percent of the merger cases reviewed from July to December. In the third quarter it was anticipated that 231 jobs would be lost. This figure increased to 261 for the fourth quarter. The anticipated loss of jobs in the fourth quarter has been due mainly to the Leisurenet/Virgin merger with the beleaguered Health & Racquet Club expecting to shed more than 217 staff with the closure of unprofitable clubs. Otherwise, job losses were mainly anticipated in the manufacturing sector, although job losses were also anticipated in the financial services sector.

A review of complaints

lodged with E&E in the second half of 2000

Of the 57 complaints lodged with the Enforcements and Exemptions Division over the period July to December 2000, 31 were concluded and 26 are still under investigation. This period includes the third quarter (July to September) and the fourth quarter (October to November) of 2000 (see Table 1).

Chapter two of the Competition Act makes provision for 'Prohibited Practices'. This is divided into two parts, 'Restrictive Practices' and 'Abuse of Dominant Position'. Restrictive Practices include Horizontal Restrictive Practices (Section 4 of the Act) and Vertical Restrictive Practices (Section 5 of the Act). Abuse of Dominant Position is detailed under Section 8 of the Act. Section 9 deals with Price Discrimination by a dominant firm (see Table 2).

TABLE 1. COMPLAINTS CONCLUDED AND UNDER INVESTIGATION IN THE SECOND AND THIRD QUARTERS 2000

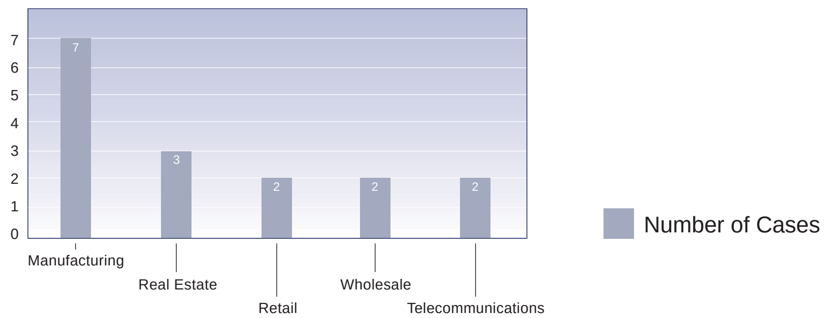
	Concluded	Under Investigation	Total
Third Quarter	18	7	25
Fourth Quarter	13	19	32
Total	**31**	**26**	**57**

TABLE 2. COMPLAINTS DEALT WITH IN TERMS OF SECTIONS 4, 5, 8 AND 9 OF THE ACT – THIRD AND FOURTH QUARTERS 2000

	Third Quarter		Fourth Quarter	
Provisions of the Act	**Number Received**	**Percentage of Total**	**Number Received**	**Percentage of Total**
Horizontal Restrictive Practices (Section 4)	6	20%	6	18%
Vertical Restrictive Practices (Section 5)	2	6%	11	32%
Abuse of Dominance (Section 8)*	15	48%	17	50%
No Jurisdiction	8	26%	0	0%
TOTAL	**31**	**100%**	**34**	**100%**

* Note that price discrimination (Section 9) is a concern if it involves an abuse of dominance and, as such, is considered as part of Section 8 of the Act.

FIGURE 1. LEADING SECTORS: COMPLAINTS – THIRD QUARTER 2000



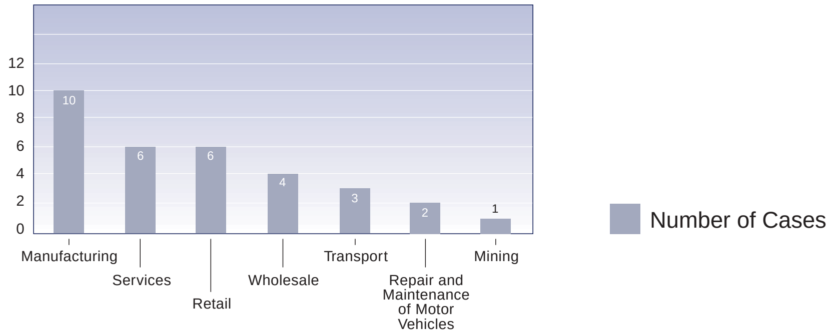
Of the total number of cases filed during the third and fourth quarter, most of the complaints related to activities in the manufacturing sector. Figures 1 and 2 show the top five sectors in which there was a concentration of complaints in the third and fourth quarters respectively (see Figure 1).

There were also complaints (one for each) in repair and maintenance of motor vehicles, financial services, healthcare, restaurants, bars and canteens, education and printing.

A breakdown of the manufacturing sector shows that complaints were lodged with respect to the manufacturing of pharmaceuticals, glass, food, aerospace and aircraft parts, chemicals, and the manufacture of crockery and chinaware (see Figure 2).

In the manufacturing sector, complaints were lodged in sub-sectors such as electrical machinery and equipment (with four cases in this sector having to do with steel bearings and power transmission products), electronics, metal products, and pharmaceuticals. Complaints pertaining to the services sector related to legal services, automotive testing, healthcare services, medical aid and tourism. The wholesale sector included two cases regarding pharmaceutical distribution as well as the distribution of petroleum and alcoholic beverages. Transportation also featured with complaints pertaining to airlines and freight.

FIGURE 2. LEADING SECTORS: COMPLAINTS – FOURTH QUARTER 2000



Most of the complaints lodged involved a claim of abuse of dominant position (Section 8). In particular, Section 8 complaints centered on exclusionary acts, (8(c)), as well as claims that respondents have induced suppliers or customers not to buy from a particular competitor (8(d)). The fourth quarter saw relatively more Section 5 complaints, i.e. restrictive vertical practices. In this regard, complaints were lodged by pharmaceutical distributors at the retail and wholesale level against the manufacturers of pharmaceuticals.

COMPETITION CONFERENCE ON 29 AND 30 MARCH 2001:

The Impact of Globalisation and New Technology on Competition

A new competition law regime was introduced in South Africa at the end of 1998. The new institutional framework, consisting of the Competition Commission (the investigative arm), the Competition Tribunal (the adjudicative arm) and the Competition Appeal Court (the appeal body), became effective on 1 September 1999.

The Competition Commission and Competition Tribunal jointly hosted their first conference on the role of a competition authority in a developing economy in April 2000. The second annual conference has been scheduled for 29 and 30 March 2001.

This year's conference theme, the Impact of Globalisation and New Technology on Competition, aims to provide a platform for dialogue on Competition and Trade Policy; Regulation and International Business Practices; and Competition and Technology.

A comprehensive report on this year's conference will be available on the Competition Commission's website at the end of April 2001.

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 rules and amendments to the Act. The Competition Commission website has been revised and relaunched during November 2000 and includes new features such as downloadable forms and electronic forms lodgement. You may also forward enquiries, comments and letters to:

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Towards a free and fair economy for all