

**THE SIGNIFICANCE OF MERGER REGULATION IN ENSURING EFFECTIVE  
AND EFFICIENT ECONOMY IN SOUTH AFRICA: WITH PARTICULAR  
REFERENCE TO HORIZONTAL MERGERS**

**By**

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I WOULD LIKE TO EXTEND MY SINCERE GRATITUDE TO PROF CORLIA VAN HEERDEN OF THE UNIVERSITY OF PRETORIA FACULTY OF LAW (DEPARTMENT OF MERCANTILE LAW). I THANK HER FOR CONSTRUCTIVE CRITICISM AND FOR LISTENING TO MY OPINIONS AND SUGGESTIONS, MOST IMPORTANTLY FOR HANDLING THIS PROJECT WITH PASSION AND HIGH LEVEL OF PROFESSIONALISM. WHEN I READ THROUGH IT, I RECOGNISE ALL THE SUGGESTIONS EVERYWHERE. I WILL ALWAYS REMEMBER HER WHEN SHE SAYS "THABO THERE IS STILL LOT MORE TO BE DONE BEFORE WE GET TO THE FINAL PRODUCT, BUT DO NOT WORRY IT WILL HAPPEN EVENTUALLY".

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“South Africa has a well developed and regulated competition regime based on best international practice. South Africa’s economic system is predominantly based on free market principles. However, as in most developed economies, competition is controlled.”<sup>1</sup>

## CHAPTER 1: INTRODUCTION

### 1.1 Introduction

This chapter provides a brief, non-technical introduction to the concept of mergers and acquisitions as well as the significance of merger regulation in South Africa.

Mergers and Acquisitions are not foreign in our corporate law and more in particular in competition law. They play a crucial role in the corporate environment, especially, in the structuring and transformation of business entities and their activities that take place on a daily basis. It may be argued that this type of corporate transaction is a determining factor in the company’s growth, profit as well as its day to day functioning. Therefore, in order for companies to be well established and to be fully functional entities that compete effectively in the economy, regulatory processes and measures must be properly adhered to by those involved in economic activities either with government or the private sector.

Mergers and acquisitions often derive many benefits for the market such as low prices, high quality products, a wide selection of goods and services, enhanced efficiency, innovation, and an increase in consumer welfare.<sup>2</sup> They may however also have negative consequences as some transactions may weaken competition by providing a vehicle to segment markets or to achieve significant market power.<sup>3</sup> They subsequently may result in increased concentration, decreased economic efficiency, decreased innovation, higher prices, lower quality and decreased consumer welfare.<sup>4</sup>

### 1.2 Concept and definition

The Competition Act 89 of 1998 (“the Act”) which is the founding legislation for merger control in South Africa does not define a merger. However, for the purposes of the Act, section 12(1)(a) states that a “merger occurs when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of

<sup>1</sup> <<http://www.southafrica.info/business/investing/regulations/competition-policy.htm>>, accessed on 23 February 2012.

<sup>2</sup> Ezrachi A, *EU Competition Law: An Analytical Guide to Leading Cases*, 2010 2<sup>nd</sup> ed, p 308.

<sup>3</sup> Ibid.

<sup>4</sup> Ibid.

another firm.” Sutherland thus argues that a merger takes place where the business or part of a business conducted by a firm or firms is transferred to another firm or firms.<sup>5</sup>

According to the Concise Oxford Dictionary the expression “merger” or “amalgamation” means “combining of two commercial companies into one” and “merging of two or more business concerns into one” respectively. A merger is however just one type of acquisition. One company can acquire another in several other ways including purchasing some or all of the company’s assets or buying up its outstanding share of stock.<sup>6</sup>

As such a merger involves a marriage of two or more entities. Gaughan indicates that a merger is as blending of two or more entities into a single entity. The shareholders of each blended entity will substantially become the shareholders in the entity which is to carry on the blended entity.<sup>7</sup>

Machiz is of the view that a merger entails a combination of two or more companies into a single company where one survives and the other loses its corporate existence.<sup>8</sup> He indicates further that the survivor acquires the assets as well as liabilities of the merged company or companies.<sup>9</sup> A merger is thus a combination of two companies where one corporation is completely absorbed by another corporation. The less important company loses its identity and becomes part of the more important corporation, which retains its identity.<sup>10</sup> A merger extinguishes the merged corporation and the surviving corporation assumes all the rights, privileges, and liabilities of the merged corporation. A merger is therefore not the same as a consolidation in which two corporations lose their separate identities and unite to form a completely new corporation.<sup>11</sup>

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<sup>5</sup> Sutherland *et al*, *Competition Law of South Africa*, 2011 p 8-3.

<sup>6</sup> QFinance, “Mergers Regulations: A Global Overview” <<http://www.qfinance.com>> accessed on 5 June 2012.

<sup>7</sup> Gaughan P, *Mergers and Acquisitions*, (2002) p 5.

<sup>8</sup> Machiz, R, “The Money Soft Mergers & Acquisitions outlook for 2008: Friction in the market place.” *Acquisition Marketplace Review* (May 2007). <<http://www.mergerdigest.com/MAOutlookfor2008.htm>> accessed on 5 June 2012.

<sup>9</sup> *Ibid*.

<sup>10</sup> *Ibid*.

<sup>11</sup> Gaughan (n7) p 5-6.



### 1.3 Rationale for merger control

The transfer of control of business between firms may affect the structure of markets.<sup>12</sup> Sutherland remarks that these changes in structure may have important consequences for competition in the relevant market.<sup>13</sup> He points out further that it is difficult for competition authorities to change market structures once they are established.<sup>14</sup> Accordingly, competition authorities worldwide supervise mergers.<sup>15</sup>

To have a successful and efficient mergers and acquisition regulatory practice requires some form of control and regulation in order to ensure that merger transactions are in line with economic and competition law standards. The main purpose of merger regulation is to avoid the establishment of market structures which may create or strengthen a dominant position and not need to control directly possible abuses of dominant positions.<sup>16</sup>

Merger regulation is thus an attempt to proactively regulate the structure of the economy and markets in order to ensure that markets function optimally.<sup>17</sup> Neuhoﬀ remarks that:

...the rationale for merger regulation stems from the proposition in economic theory that the likelihood of anticompetitive market conduct and bad economic performance is greater in markets that exhibit certain structural characteristics such as few participants, high barriers to entry, customers with little bargaining power and little product innovation. Accordingly, merger regulation is an attempt to prevent market structures from developing that may enhance the ability of firms to abuse either unilateral or cooperative market power to the detriment of consumers.<sup>18</sup>

When dealing with mergers and acquisitions one needs to be mindful, as indicated hereinafter, of the fact that there are different types of mergers and as such different outcomes are expected in these mergers.

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<sup>12</sup> Ibid.

<sup>13</sup> See Sutherland (n5) p 8-3.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid.

<sup>16</sup> See *Gencor Ltd v Commission* [1999] ECR II-753.

<sup>17</sup> Neuhoﬀ *et al*, "A Practical Guide to the South African Competition Law", 2006, p 179.

<sup>18</sup> Ibid.

## 1.4 Types of merger

### 1.4.1 Horizontal mergers

A horizontal merger is a combination of two or more firms in the same area of business. The main purpose of this merger is to obtain economy of scale in production by eliminating duplication of facilities, reducing of competition, reduction of costs, increase in share price and market segments.<sup>19</sup>

Horizontal mergers raise three basic competition issues. The first is the elimination of competition between the merging firms, which, depending on their size, may be significant.<sup>20</sup> The second is that the unification of the merging firm's operations may create substantial market power and could enable the merged entity to raise prices by reducing output unilaterally.<sup>21</sup> The third problem is that by increasing concentration in the relevant market, the transaction may strengthen the ability of the markets remaining participants to co-ordinate their pricing and output decisions.<sup>22</sup> The fear is not that the entities will engage in secret collaboration but that the reduction in the number of industry members will enhance co-ordination of behaviour.<sup>23</sup>

It is worth noting that horizontal mergers<sup>24</sup> are the most popular mergers as they seem to take place more than other types of mergers.<sup>25</sup> As far as horizontal mergers are concerned, these mergers are treated very seriously by the competition authorities due to the fact that they raise the most serious competition concerns.<sup>26</sup> Neuhoff states that this type of merger reduces the number of competitors in the market, increasing the market share of the merged entity and market concentration, and reducing customer choice.<sup>27</sup>

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<sup>19</sup> Davies *et al* "Efficiencies – a Changing Horizon in Horizontal Merger Control, Freshfields Bruckhaus Deringer, Getting the Deal Through – Merger Control" 2007 <[http://www.gettingthedealthrough.com/narrative\\_pdf?id=11](http://www.gettingthedealthrough.com/narrative_pdf?id=11)> accessed on 14 August 2012.

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

<sup>22</sup> Ibid.

<sup>23</sup> Ibid.

<sup>24</sup> Neuhoff states that a "horizontal merger" is a merger between firms operating at the same level of the supply chain selling supply chain selling substitutable products in the same geographic area. She points out further that "A horizontal merger, accordingly, is a merger between direct competitors, such as two retail clothing chains".

<sup>25</sup> Namely; vertical and conglomerate mergers.

<sup>26</sup> The Competition authorities main concern is the fact that horizontal mergers will lead to a decline in service levels and a rise in prices.

<sup>27</sup> See Neuhoff (n17) p 179.

#### 1.4.2 Vertical Mergers

Kekelekis argues that a vertical merger is a combination of two or more firms involved in different stages of production or distribution of the same product.<sup>28</sup> It is a merger of one company with another having different stages of production/ distribution process of the same product/service.<sup>29</sup> The main objective is to increase profitability by the previous distributor.<sup>30</sup>

A vertical merger may take the form of a “forward” or “backward” merger.<sup>31</sup> When a company combines with the supplier of material, it is called a “backward merger” and when it combines with the customer, it is known as a “forward merger”.<sup>32</sup> Such mergers yield two benefits: first, the vertical merger internalises all transactions between a manufacturer and its supplier or dealer thus converting a potentially adversarial relationship into something more like a partnership.<sup>33</sup> Second, internalisation can give the management more effective ways to monitor and improve performance.<sup>34</sup> Vertical mergers may however also be anticompetitive because their entrenched market power may impede new business from entering the market.<sup>35</sup>

It may be argued that vertical integration by merger does not reduce the total number of economic entities operating at one level of the market, but it may change patterns of industrial behaviour.<sup>36</sup> Whether a forward or backward integration, the newly acquired firm may decide to deal only with the acquiring firm, thereby altering competition among the acquiring firm’s suppliers, customers, or competitors.<sup>37</sup> Suppliers may lose a market for their goods, retail outlets are blocked. This raises the concern that vertical integration will foreclose competitors by limiting their access to sources of supply or to customers. Vertical mergers may also be anticompetitive because their entrenched market power may impede new business from entering the market.

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<sup>28</sup> Kekelekis M, “The EC Merger Control Regulation: Rights of Defense, A Critical Analysis of DG COMP Practice and Community Courts’ Jurisprudence” 2006; p 73-74 *Kluwer Law International*, the Netherlands.

<sup>29</sup> *Ibid.*

<sup>30</sup> *Ibid.*

<sup>31</sup> Lindsay A, “*The EC Merger Regulation: Substantive Issues*”, 2006, p 18, 2<sup>nd</sup> edition; Sweet & Maxwell, London.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid.*

<sup>34</sup> *Ibid.*

<sup>35</sup> *Ibid.*

<sup>36</sup> *Ibid.*

<sup>37</sup> See Lindsay (n31) p 19.

### 1.4.3 Conglomerate merger

Neuhoff remarks that a conglomerate merger is a type of merger that covers all other types of mergers that are neither horizontal nor vertical in nature.<sup>38</sup> She indicates further that these are transactions that take place between parties that have no apparent economic relationship.<sup>39</sup> An example of a conglomerate merger would be if a mining company acquire a motor manufacturer.<sup>40</sup>

Conglomerate transactions take many forms, ranging from short term joint ventures to complete mergers.<sup>41</sup> Whether a conglomerate merger is pure, geographical or a product line extension it involves firms that operate in separate markets.<sup>42</sup> According to Neuhoff, conglomerate transactions ordinarily have no direct effect on competition.<sup>43</sup> They can supply a market or demand for firms thus giving entrepreneurs liquidity at an open market price and with a key inducement to form new enterprises.<sup>44</sup> Conglomerate mergers also provide opportunity for firms to reduce capital cost and overhead and achieve other efficiencies.<sup>45</sup>

It is clear that this type of merger may also reduce the number of smaller firms and increase the merged firm's political power, thereby impairing the social and political goal of retaining independent decision making centre guaranteeing small business opportunity and preserving democratic process.<sup>46</sup>

### 1.5 Scope of dissertation

Whish argues that merger regulation is not simply about preventing future abuses, it is also about maintaining competitive market structures which lead to better outcomes for consumers.<sup>47</sup> He argues further that there are many reasons why government, firms, shareholders, and individuals might object to mergers. He reasons as follows:

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<sup>38</sup> See Neuhoff (n17) p 178.

<sup>39</sup> Ibid.

<sup>40</sup> Ibid.

<sup>41</sup> Ibid.

<sup>42</sup> Ibid.

<sup>43</sup> Ibid.

<sup>44</sup> Ibid.

<sup>45</sup> Ibid.

<sup>46</sup> Whish R, *Competition Law*, 6<sup>th</sup> ed, 2008, p 806. Reference can also be made in the case of *Gencor v Commission* [1999] ECR II-753, [1999] 4 CMLR 971, par 106.

<sup>47</sup> Ibid.

...A government may object to a merger on a number of grounds: for example it might disapprove of a foreign firm taking over a native one, or of a merger that does not fit with its own industrial policy, or of a transaction that would lead to production facilities being closed down leading to unemployment. A firm might object to being the target of a hostile bid, or to a merger between two rivals that might give them a competitive edge...<sup>48</sup>

Rosenthal argues that the aim of merger regulation is the prevention of the concentration of previously independent companies that results in lasting damage to competition.<sup>49</sup> He further points out that merger regulation ensures the prohibition of concentration that meets certain jurisdictional thresholds if they would significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position.<sup>50</sup>

A lot has been written and argued on the issue of mergers and acquisitions. It is clear from the academic literature that merger regulation plays a significant role in the stabilisation of economy, maintaining competition and most importantly in the prevention of prohibited practices such as “abuse of dominant position.”<sup>51</sup>

As indicated, the debate and attention in the economic literature often arise in the course horizontal mergers, the reason being that they are regarded as the ones which give rise to the most serious competition law concerns. By their nature, they involve the removal of one competitor in the market share of the merged entity and market concentration, and reduces customer choice.<sup>52</sup>

The purpose of this dissertation is firstly, to examine the significance of merger regulation, in particular, in respect of horizontal mergers and secondly, to examine the factors that must be taken into consideration in the regulation of mergers. Thirdly, the manner and approach which the competition authorities have adopted in ensuring effective and efficient regulation will be examined. This will entail looking at some landmark horizontal merger

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<sup>48</sup> Ibid.

<sup>49</sup> Rosenthal *et al.*, “*European Merger Control*”, 2010, p 6.

<sup>50</sup> Ibid.

<sup>51</sup> The ECJ in *United Brands v Commission* 27/76 [1978] 1 CMLR 429 stated that “the dominant position thus referred to by Article [82] relates to the position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave on an appreciable extent independently of its competitors, customers and ultimately of its consumers.” – see also Whish R, *Competition Law*, 2008 p174 for a detailed discussion on dominant position.

<sup>52</sup> See Neuhoff (n17) p 193.

decisions of the South African Competition Tribunal, Competition Appeal Court and cases from other jurisdictions.

This dissertation is thus divided into four sections: Chapter one introduces the reader to the field of study. Chapter Two comprises a review of relevant legislation and policy. Chapter Three examines the structure and the role of the South African competition authorities in ensuring effective and efficient merger regulation. Chapter Four deals with the objectives and importance of merger regulation. Chapter Five concludes with a brief comparison to the European Union merger regulation system.

### **1.6 Research methodology**

This study is largely based on desktop research. I analysed primary sources such as text books, journal articles, case law and legislation relating to competition law in particular, mergers and acquisitions and the adjudication by the South African competition authorities of *Wall mart Massmart* merger<sup>53</sup>. Secondary sources such as websites, discussion forums and government information were also reviewed to extract relevant information and to determine the nature of relevant issues.

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<sup>53</sup> CT 73/LM/Nov10, CAC 110/CAC/Jun11 and 111/CAC/Jul11.

## CHAPTER 2: LEGISLATIVE AND POLICY OVERVIEW

“One of the elements of South Africa’s peaceful revolution over the last decade was reform of its competition policy institution. The previous system had supported the previous economic system, characterised by protection, government direction, and high concentration. The new system promised to use competition policy to correct the faults of the old system and to promote policy goals of employment and empowerment. South Africa aspires to a modern competition policy regime, to deal with the well-resourced sophistication of much of the South African economy. *Its new institutions, whose novelty responds in large part to the post-1994 imperative for fundamental restructuring of government institutions, have shown a capacity to deal confidently with complex structural issues in deciding dozens of mergers cases.*”<sup>54</sup> [my emphasis]

### 2.1 Introduction

There are several legislative instruments that deal with merger regulation in South Africa. The 1998 Competition Act<sup>55</sup> and all the Regulations made in terms thereof regulate the competition aspect of mergers and acquisitions. In this section of the dissertation, the relevant legislation that governs mergers and acquisitions is examined. The reason for this examination is to determine the role that such legislation plays in the control and regulation of mergers and acquisitions and most importantly to determine how legislation impacts on the control and regulation of mergers.

The discussion of legislation will focus on the Competition Act, a brief background and overview of the Act in particular and the examination of the provisions that deal with mergers. The Companies Act<sup>56</sup> will also briefly be examined to the extent that it makes provision for mergers and acquisitions transactions.

### 2.2 The Competition Act 89 of 1998

The enactment of the South African Competition Act, was undoubtedly an important historic event. South Africa is one of the few developing countries in the world that recognises the significance of competition law and in particular the supervision and regulation of mergers. It is worth mentioning that the South African Competition Act incorporates familiar elements that are found in the antitrust laws of many other jurisdictions. Remarkable about this

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<sup>54</sup> See Organisation for Economic Co-operation and Development (OECD), Peer Review, “Competition Law and Policy in South Africa”, 2003, p 7 <<http://www.oecd.org/dataoecd/52/13/2958714.pdf>> accessed on 30 March 2012.

<sup>55</sup> Act 89 of 1998 (Hereinafter referred to as an Act).

<sup>56</sup> Act 71 of 2008 (hereinafter referred to as the new Companies Act).

legislation is its public interest objectives that are incorporated in the Act.<sup>57</sup> The unique provision on public interest has been one of the most important provisions of the Act and draws a high level of attention in all the matters that comes before the competition authority, in particular, mergers and acquisitions. Chetty remarks that “it is deduced that the objectives of a country’s competition laws have a significant impact on the degree of convergence that developing countries may see as desirable.”<sup>58</sup> She also indicates that in South Africa however, despite the incorporation of non-competition factors, convergence is still achievable by utilising sound economic analysis and other realities peculiar to South Africa.<sup>59</sup>

In order for one to have a clear understanding of the legislators’ attitude in drafting South Africa’s Competition Act, which came into effect in September 1999, it is crucial that one understands both South Africa’s political and economic history.

Prior to 1999 South Africa’s Competition Board (“Competition Board”) operated under the provisions of the Maintenance and Promotion of Competition Act<sup>60</sup> (“the old Act”). The old Act provided for the review of mergers and acquisitions, restrictive practices and monopoly situations by the Board.<sup>61</sup> However, the Board was an administrative body lacking executive authority and had to make recommendations to the Minister of Trade and Industry.<sup>62</sup>

When one looks at the old Act, it is clear that the Minister had a discretion whether to accept the Board’s recommendations and take action.<sup>63</sup> Chetty argues that the Board’s powers to review acquisitions which restricted competition was seen as limiting it to considering only horizontal transactions.<sup>64</sup> In addition to this, no pre-merger notification was required and therefore the Board relied on complaints from other parties or voluntary notification.<sup>65</sup> As a result, the Board assessed only very few of mergers.<sup>66</sup>

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<sup>57</sup> See sections 2 and 12 of the Act.

<sup>58</sup> Chetty V, “*The Place of Public Interest in South Africa’s Competition Legislation: Some Implications for International Antitrust Convergence*”, ABA Section of Antitrust Law 53<sup>rd</sup> Spring Meeting Washington D.C March 30 – April 1, 2005, p 4.

<sup>59</sup> Ibid.

<sup>60</sup> Act 96 of 1979.

<sup>61</sup> See Chetty (n58) p 4.

<sup>62</sup> Ibid.

<sup>63</sup> Ibid.

<sup>64</sup> Ibid.

<sup>65</sup> Ibid.

<sup>66</sup> Ibid.



The African National Congress (“ANC”) stated, when it came to power in 1994, that its economic objective was to create and sustain an adaptive economy characterised by growth, employment and equity.<sup>67</sup> The new government comprising the ANC, mainly through its Department of Trade and Industry (“DTI”) outlined several strategies in order to pursue effective transformation of the economy. These strategies were incorporated into different forms of legislation, the Competition Act being one such example.

Reyburn remarks that when the ANC came into power it was critical of existing competition legislation since it did not address the problem of concentration of ownership.<sup>68</sup> As a result, negotiations for new legislation commenced in 1998.<sup>69</sup> When discussions and negotiations during the course of the drafting of the Competition Act took place, the legislature took cognisance of the problems associated with the old Act.<sup>70</sup> There was also much interaction between business, labour and the government prior to the drafting of the legislation.<sup>71</sup> One feature of the new Competition Act was that it introduced compulsory pre-merger notification. The 1998 Competition Act thus heralded a new era of competition jurisprudence for South Africa.<sup>72</sup>

Neuhoff indicates that the South African Competition Act draws heavily from developed countries’ experience and practice in the area.<sup>73</sup> As a consequence, precedent in jurisdictions such as Canada, Australia and Europe have influenced its content, application and interpretation.<sup>74</sup>

The 1998 Competition Act applies to all economic activities within or having an effect in South Africa.<sup>75</sup> Section 2 of the Act provides that it aims to promote and maintain competition in order to:

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<sup>67</sup> Ibid.

<sup>68</sup> Reyburn L, *Competition Law of South Africa*, 2004, Butterworths: Durban, p 3-40.

<sup>69</sup> Ibid.

<sup>70</sup> See Chetty (n58) p 5.

<sup>71</sup> Ibid.

<sup>72</sup> Ibid.

<sup>73</sup> See Neuhoff (n17) p 12.

<sup>74</sup> Ibid.

<sup>75</sup> S 3 of the Act. The following matters are exempted from the application of the Act:

- (a) “collective bargaining within the meaning of section 23 of the Constitution, and the Labour Relations Act, 1995 (Act 66 of 1995);
- (b) a collective bargaining, as defined in section 213 of the Labour Relations Act, 1995; and
- (c) ...

- promote the efficiency, adaptability and development of the economy;
- provide consumers with competitive prices and product choices;
- promote employment and advance the social and economic welfare of South Africans;
- expand opportunities for South African participation in world markets and recognise the role of foreign competition in the Republic;
- ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and
- promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.<sup>76</sup>

Notable about this statute is that it introduced into competition law a somewhat unusual element, namely public interest as mentioned above. Morphet significantly remarks that the concept of public interest is woven into the fabric of the Act.<sup>77</sup> Even in the preamble, it is noted that, given the injustices of the past, the objectives of the Act include providing all South Africans equal opportunity to participate fairly in the economy and regulating the transfer of economic ownership in keeping with the public interest.<sup>78</sup> This is reaffirmed in section 2 as stated above.

Morphet remarks that it is in relation to merger control that the concept of “public interest” comes into its own.<sup>79</sup> As discussed in more detail hereinafter, the first and most important step of a merger analysis is to determine whether a merger is likely to substantially prevent or lessen competition. This is done by assessing a number of factors, all of which are commonly accepted tools of competition analysis.<sup>80</sup> The competition authorities must then determine whether the merger can or cannot be justified on substantial public interest grounds, by considering the effect that the merger will have on the following: a particular industrial sector or region; employment; the ability of small businesses, or those controlled by

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(d) concerted conduct designed to achieve a non-commercial socio-economic objective or similar purpose.”

<sup>76</sup> S 2.

<sup>77</sup> Morphet, “*South Africa: South African Competition Law and Public Interest*”, 2007, p 1  
<<http://www.mondaq.com/article.asp?articleid=47176>> accessed on 25 March 2012.

<sup>78</sup> Ibid.

<sup>79</sup> Ibid.

<sup>80</sup> Ibid.

historically disadvantaged persons, to become competitive; and the ability of local industries to compete internationally.<sup>81</sup>

### 2.3 Considerations in merger analysis

One of the most important and fundamental provisions that plays a significant role in merger regulation is section 12A of the Act which provides as follows:

- (1) “Whenever required to consider a merger, the Competition Commission or Competition Tribunal must initially determine whether or not the merger is likely to substantially prevent or lessen competition by assessing the factor set out in subsection (2), and
  - (a) If it appears that the merger is likely to substantially prevent or lessen competition, then determine-
    - (i) whether or not the merger is unlikely to result in any technological, efficiency or other pro-competitive gain which will be greater than, and offset, the effects of any prevention or lessening of competition, that may result or is likely to result from the merger, and would not likely be obtained if the merger is prevented; and
    - (ii) whether the merger can or cannot be justified on substantial public interest grounds by assessing the factors set out in subsection (3);or
  - (b) Otherwise, determine whether the merger can or cannot be justified on substantial public interest grounds by assessing the factors set out in subsection (3).”

When considering the above provision on mergers, it is clear that competition authorities are tasked with a responsibility under the Act to ensure that the objectives of the new competition legislation are fulfilled.

The purpose of Chapter Three of the Act and in particular, section 12A, is to provide competition authorities and competition practitioners with guidance as to what needs to be considered in the assessment of merger transactions. This Chapter is broad and was drafted in

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<sup>81</sup> Ibid.

a manner that provides a clear logical process in dealing with merger transactions. Chapter Three deals *inter alia* with the aspects such as thresholds and categories of mergers, investigation of mergers and consideration of mergers by the competition authorities.<sup>82</sup> Chapter Three of this dissertation will examine the significance as well as effectiveness of section 12A of the Act and determine its impact on merger regulation.

It is worth noting that the Competition Act is not the only legislation that deals with the aspect of mergers and acquisitions but that it is dealt with by the Companies Act<sup>83</sup> as well.

## 2.4 The Companies Act 71 of 2008

The Companies Act of 2008 (“new Act”) replaces both the Companies Act of 1973 and Corporate Laws Amendment Act, 24 of 2006.<sup>84</sup> “It has been hailed as the most fundamental reform of company law for over 30 years.”<sup>85</sup>

Section 113 of the new Act provides that:-

- (1) “two or more profit companies, including holding and subsidiary companies, may amalgamate or merge if, upon implementation of the amalgamation or merger, each amalgamated or merged company will satisfy the solvency and liquidity test.”<sup>86</sup>
  
- (2) two or more companies proposing to amalgamate or merge must enter into a written agreement setting out the terms and means of affecting the amalgamation or merger and in, particular, setting out-
  - (a) the proposed Memorandum of Incorporation of any new company to be formed by the amalgamation or merger;

<sup>82</sup> The list mentioned above is exhaustive.

<sup>83</sup> See (n56) above.

<sup>84</sup> See Guide to Companies Act

<http://www.zurnamer.co.za/guide%20to%20companiesact%20no%2071%20of%202008.pdf> > accessed on 23 March 2012.

<sup>85</sup> Tshediso Matona, Director General of the Department of Trade and Industry (DTI).

<sup>86</sup> Section 4 (1) of the Act provides that “a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time –

- (a) the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and
- (b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of –
  - (i) 12 months after the date on which the test is considered’ or
  - (ii) In the case of a distribution contemplated in paragraph (a) of the definition of “distribution” in section 1, 12 months following that distribution.”

- (b) the name and identity of each proposed director of any proposed amalgamated or merged company;
- (c) the manner in which the securities of each amalgamating or merging company are to be converted into securities of any proposed amalgamated or merged company, or exchanged for other property....”

It is clear from the above provision that mergers form part of the daily functioning of business and are recognised and valued in our corporate legislation such as the Companies Act. Section 113 of the Act provides for the formalities that must be complied with when dealing or proposing merger transactions. For instance, the companies or parties in the proposed merger transaction are required to enter into an agreement setting out all the particulars regarding the parties involved in the merger as well as the directors thereof. In addition, the financial status of both companies must be disclosed and each amalgamated or merged company is further required to pass a stipulated solvent and liquidity test.<sup>87</sup>

Section 197 of the Companies Act further creates, empowers and clarifies the role of the Takeover Regulation Panel (TRP). This is a new body replacing the Securities Regulation Panel (SRP). The Takeover Regulation Panel is modelled on the London Takeover Panel, as was the case with SRP, and will perform the same functions of regulating mergers and acquisitions.

## **2.5 Concurrent jurisdiction**

The Competition Act recognises that the Competition Commission and other sector specific regulators enjoy concurrent jurisdiction.<sup>88</sup> The Act requires the Commission to enter into memorandums of understanding with the sector specific regulators to ensure that a consistent approach is adopted in the implementation of competition principles.<sup>89</sup> The Competition Commission and the Independent Communications Authority of South Africa (“ICASA”) have for example concluded such a memorandum of agreement. The memorandum of agreement sets out the application and investigation procedures to be followed where merging parties require the approval of both regulators.<sup>90</sup>

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<sup>87</sup> See section 4 (1) of the Companies Act.

<sup>88</sup> Hlatshwayo N and Versfeld M, “The International Comparative Legal Guide to Merger Control”, 2007, p 335 Global Legal Group Ltd, London.

<sup>89</sup> Ibid.

<sup>90</sup> Ibid.

In the banking sector, the Competition Act provides that if a merger falls within the parameters of section 37 or section 54 of the Banks Act, 94 of 1990 (“the Banks Act”), the Minister of Finance must be notified of the transaction before any decision may be taken.<sup>91</sup> The Minister may then issue a certificate stating that it is in the public interest that the merger be regulated by the Banks Act, in which case the competition authorities cease to have jurisdiction and are precluded from making any decision regarding the transaction.<sup>92</sup>

## 2.6 Conclusion

It is evident that the legislation mentioned above, was not only enacted to regulate competition but also to ensure that guidelines are provided for the purpose of monitoring the competition. Both the old and the new Competition Act are designed in a manner as to ensure that all the economic injustices of the past are being addressed and the objectives of the Competition Act fulfilled.

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<sup>91</sup> See Hlatshwayo and Versfeld (n88) p 335.

<sup>92</sup> Ibid.

## CHAPTER 3: THE STRUCTURE AND THE ROLE OF THE SOUTH AFRICAN COMPETITION AUTHORITIES

### 3.1 Introduction

The South African Competition authorities play a major role in the investigation and adjudication of competition matters. The Competition Act of 1998 fundamentally reformed the country's competition legislation, substantially strengthening the power of the competition authorities along the lines of the European Union, US and Canadian models.<sup>93</sup>

The Competition Act establishes three institutions that have jurisdiction over mergers and acquisitions. These are the Competition Commission ("the Commission"), the Competition Tribunal ("the Tribunal"), and the Competition Appeal Court ("the CAC"). It is worth noting that although they are all tasked with a responsibility to deal with competition matters that come before them, their assigned duties are not the same. Below is a brief overview of the structure of each of the competition authorities' as well as their duties and responsibilities.

### 3.2 The Structure of the South African competition authorities

#### 3.2.1 The Competition Commission

Chapter 4 of the Competition Act establishes the Competition Commission.<sup>94</sup> The Commission has a range of functions which include<sup>95</sup>:

- investigating anti-competitive conduct;
- assessing the impact of mergers and acquisitions on competition and taking appropriate action;
- monitoring competition levels and market transparency in the economy;
- identifying impediments to competition; and
- playing an advocacy role in addressing these impediments.<sup>96</sup>

<sup>93</sup> See <<http://www.southafrican.info/business/investing/regulations/competition-policy.htm>>, accessed on 13 February 2012.

<sup>94</sup> Section 19 of the Competition Act provides for the Establishment and Constitution of Competition Commission. This section provides that:-

- (1) "There is hereby established a body to be known as the Competition Commission, which-
  - (a) has jurisdiction throughout the Republic;
  - (b) is a juristic person; and
  - (c) must exercise its functions in accordance this Act.
- (2) The Competition Commission consists of the Commissioner, and one or more Deputy Commissioners, appointed by the *Minister in terms of this Act.*"

<sup>95</sup> See Hlatshwayo and Versfeld (n88) p 335.

<sup>96</sup> Ibid.

### 3.2.3 The Competition Appeal Court

The Competition Appeal Court (CAC) has a status similar to that of a High Court. It has jurisdiction throughout South Africa and is a court of record.<sup>103</sup> Neuhoff indicates that the Competition Appeal Court reviews any decision of the Competition Tribunal concerning legal error or jurisdiction, as well as considering the substantive merits of any final decision and any interim decision for which the Competition Act permits an appeal.<sup>104</sup> The Competition Appeal Court may also give any judgment or make any order, including an order to confirm, amend or set aside a decision or order of the Competition Tribunal.<sup>105</sup> In addition, the Court may remit a matter to the Competition Tribunal of a further hearing on any appropriate terms.<sup>106</sup>

Although all three competition authorities receive their funding from government, they enjoy independence from government. Section 20 of the Act states that they are subject only to the Constitution and the law. However, in respect of large mergers, notice of the merger must be forwarded to the Minister of Trade and Industry.<sup>107</sup> The Minister is entitled to participate in any intermediate or large merger proceedings but has no decision making ability.<sup>108</sup> The Minister's participation is limited to the public interest grounds articulated in section 12A (3) of the Act.<sup>109</sup>

Consideration will now be given to the role of the competition authorities in merger regulation.

### 3.3 The role of the competition authorities in merger regulation

Due to the importance of mergers and acquisitions in the corporate world they require a certain level of supervision. As mentioned above, the competition authorities namely, the

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<sup>103</sup> Section 36 of the Act provides for the Establishment and Constitution of Competition Appeal Court. This section provides that:-

- (1) "there is hereby established a court to be known as the Competition Appeal Court, which-
  - (a) is a court contemplated in section 166(e) of the *Constitution* with a similar status to that of a High Court;
  - (b) has jurisdiction throughout the Republic; and
  - (c) is a court of record.
- (2) The Competition Appeal Court consists of at least three judges, appointed by the President on the advice of the Judicial Service Commission, each of whom must be a judge of the High Court."

<sup>104</sup> See Neuhoff (n17) p 21.

<sup>105</sup> Ibid.

<sup>106</sup> Ibid.

<sup>107</sup> Section 14A (1)(b) of the Act.

<sup>108</sup> See Hlatshwayo and Versfeld (n88) p 335.

<sup>109</sup> Ibid.



Commission, the Tribunal and the Competition Appeal Court are tasked with a responsibility of ensuring that healthy, effective and efficient competition is monitored and maintained in line with the objectives of the Competition Act. This is not an easy task, but a task that requires ability, demonstration of skills, commitment and cooperation amongst all those involved in the regulation of competition activities.

On several occasions, both academics and competition law practitioners observed the competition authorities' active involvement in mergers and acquisitions and the fact that the competition authorities play a major role in the assessment and analysis of merger transactions. It is required that such assessment and analysis be done in a manner so as to ensure that all South Africans are given an equal opportunity to participate fairly in the national economy and that an efficient, competitive economic environment, balancing the interests of workers, owners and consumers and focussed on development, will benefit South Africans.<sup>110</sup>

A detailed and high level of assessment needs to be done by the competition authorities when dealing with merger transactions, *inter alia*, the impact of the proposed transaction in the relevant market as well as public interest concerns (i.e. employment). It is the competition authorities' responsibility to ensure that when presented with any merger proposals, such proposed merger will not negatively impact on the economy taking into account the interests of other role players in the same market. Should the competition authorities be of the view that the merger in question poses a threat to competition, they have a legal duty to ensure that the merger is regulated and that certain conditions are imposed if necessary.

### 3.3.1 Likely to substantially lessen or prevent competition

The competition authorities must determine whether the merger "is likely to substantially prevent or lessen competition."<sup>111</sup> In the case of *Schumann Sasol (South Africa) (Pty) Ltd and Prices Daelite (Pty) Ltd*<sup>112</sup>, the CAC called this a "threshold test".

<sup>110</sup> See Preamble of the Competition Act 89 of 1998.

<sup>111</sup> S 12A (1) of the Competition Act.

<sup>112</sup> 10/CAC/Aug01.

It is worth mentioning that in determining the competitive consequences of a merger, the intention, motive or rationale of the merging parties is important.<sup>113</sup> In almost every merger case the competition authorities will attempt to establish what the business rationale for the transaction is. Nevertheless, it is not necessary to show that the merging firms intended to act anti-competitively.<sup>114</sup> The mere fact that the merging parties intended, or did not intend, to harm competition will however not be conclusive. Ultimately, it is the effect of the merger that matters.<sup>115</sup> But, where the stated business rationale of the merging parties is not persuasive, it will raise questions from competition authorities, while proof of a good business rationale for a transaction will give some indication that it is not anti-competitive.<sup>116</sup> The situation where competition authorities rely on evidence of a sound business rationale as proof that a transaction is not anti-competitive must be distinguished from an efficiency defence.<sup>117</sup>

If it appears that a merger is likely substantially to prevent competition, then the relevant adjudication body must consider whether the merger is likely to result in any technological, efficiency or other pro-competitive gain which will be greater than, and offset, the effects of any prevention or lessening of competition that may result or is likely to result from the merger. It must be unlikely that such gains would be obtained if the merger was prevented.<sup>118</sup> It should also be borne in mind that the authority must consider whether the merger can or cannot be justified on certain public interests grounds.<sup>119</sup>

Considering the above role of competition authorities in merger regulation, it is important to examine and understand the significance of merger regulation in ensuring effective and efficient competition in South Africa. The rationale for merger regulation will subsequently be discussed in more detail. Such analysis will also include a detailed review of case law in order to establish to what extent mergers are regulated and the factors to be considered during such regulation.

<sup>113</sup> See *Alpha (Pty) Ltd and Slagment (Pty) Ltd* 27/LM/Jun03 par 4.

<sup>114</sup> *Ibid.*

<sup>115</sup> *Ibid.*

<sup>116</sup> *Ibid.*

<sup>117</sup> *Ibid.*

<sup>118</sup> See section 12A(1)(a)(i) of the Act.

<sup>119</sup> See Section 12A(1)(a)(ii) and 12A(1)(b), read with section 12A(3).

## CHAPTER 4: THE OBJECTIVE AND IMPORTANCE OF MERGER REGULATION

“We are constantly told that the statute should not require notification of those mergers that raise no competition concerns. Every competition authority in the world would welcome this. However, no party to a merger ever appears to believe that its merger raises competition concerns so self-regulation is impossible.”<sup>120</sup>

### 4.1 Introduction

Bishop remarks that the overall purpose of a merger control system is to ensure effective competition.<sup>121</sup> In an effective competition market, high quality products are accessible at low prices.<sup>122</sup> In addition, a wide diversity of goods and services are offered and the market is innovative.<sup>123</sup> If a firm, through a merger, significantly increases its market power, it may be able to endanger effective competition in the market. Jones argues that mergers and acquisitions are regulated by competition laws because they may concentrate economic power in the hands of a smaller number of parties.<sup>124</sup> It is against this background that mergers require regulation.

Merger regulation is a key aspect of competition law in fact by helping to maintain competitively structured markets merger regulation limits the necessity for invasive intervention later on.<sup>125</sup> It may be argued that merger regulation simply prevents a firm from acquiring dominance through the process of acquisition.<sup>126</sup>

### 4.2 Objective and regulation of horizontal mergers

Lewis argues that merger regulation forms part of the much broader tapestry that is competition policy, or, as it is more popularly known, anti-trust policy.<sup>127</sup> It is important to view merger regulation against the backdrop of the major global resurgence in anti-trust.<sup>128</sup> Lewis remarks that merger regulation occupies a very special place in anti-trust enforcement because whereas all other anti-trust enforcement is directed at behaviour, merger regulation is

<sup>120</sup> See David Lewis (former chairperson of the Competition Tribunal), “Why merger regulation? – A response to our critics”, 2001, p 1.

<sup>121</sup> Bishop S, *The Economics of EC Competition Law*, 2002, p 228, 2<sup>nd</sup> ed, Sweet & Maxwell, London.

<sup>122</sup> *Ibid.*

<sup>123</sup> *Ibid.*

<sup>124</sup> Jones, *et al*, *EC Competition Law: Text, Cases and Materials*, 2005, p 388, 2<sup>nd</sup> ed, Oxford University Press.

<sup>125</sup> See Lewis (n120) p 5.

<sup>126</sup> *Ibid.*

<sup>127</sup> See Lewis “The Competition Act 1998 – Merger Regulation”, p 1

<<http://www.comptrib.co.za/assets/Uploads/Speeches/lewis9.pdf>> accessed on 19 May 2012.

<sup>128</sup> *Ibid.*

concerned with structure, specifically with preventing the sort of structure that is likely to lead to anti-competitive behaviour.<sup>129</sup> In *Commission v Tetra Laval C-12/03*<sup>130</sup>, the European Court of Justice held that merger control is essentially forward looking as “it involves a prospective analysis, not the examination of past events, and a prediction of future events which are more or less likely and ascertaining which of various chains of cause and effect is the most likely.”

As mentioned in Chapter One above, horizontal mergers are the most popular and dealt with very seriously by the competition authorities. Over the past few years in South Africa, there has been quite a number of merger cases that the competition authorities dealt with, some of which had drawn attention both locally and internationally.

South Africa is a developing country with a number of economic activities. Looking at the objectives of the Competition Act in ensuring that previously disadvantaged people also benefit from the country’s economy, it is crucial that such activities are regulated in order to ensure fair and equal benefits in the proceeds of the country’s economy.

With reference to horizontal mergers, there are sound economic reasons why such transactions are regulated and the reason why the laws and regulations governing mergers and acquisitions are complex and strict. At times it may be difficult to determine whether a merger is horizontal. In *Medicross Healthcare Group (Pty) Ltd and Prime Cure Holdings (Pty) Ltd*<sup>131</sup> Netcare held 80% and Netpartner 20% of Medicross shares. The shares in Netpartner controlled Netdirect. In terms of the management agreement, Medicross performed the activities of Netdirect.<sup>132</sup> In terms of the merger, Medicross obtained control over Prime Cure.<sup>133</sup> The businesses of Prime Cure and Netdirect overlapped.<sup>134</sup> The question was whether this could be regarded as horizontal merger on the basis of the unitary interests of Medicross, Netpartner and Netdirect. The Tribunal regarded the merger as horizontal on the basis of the “triangular symbiosis” between Netcare, Netpartner and Prime Cure.<sup>135</sup>

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<sup>129</sup> Ibid.

<sup>130</sup> [2005] ECRI-987.

<sup>131</sup> 11/LM/Mar05 pars 37-45.

<sup>132</sup> Par 3 of the judgment.

<sup>133</sup> Pars 6-8 of the judgment.

<sup>134</sup> Par 125 of the judgment.

<sup>135</sup> Par 244 of the judgement.

It should be borne in mind that horizontal mergers are categorised according to different phases and as such this assists in the determination of the level of regulation required for a particular proposed merger. These categories are named phases one, two and three ranging from non complex to very complex mergers.<sup>136</sup> These categories are briefly discussed below:

#### **4.2.1 Phase one cases (non complex)**

Cases in this phase are readily identifiable by the absence of competition issues and involve a merger where either one or more of the following criteria apply to the facts presented by the merging parties:<sup>137</sup>

- (a) There is no overlap between the activities of the parties;
- (b) In the event there is an overlap between the activities of the parties the combined market share is below 15%;
- (c) No complex control structures arise for the merger;
- (d) No public interest issues arise from the merger.<sup>138</sup>

#### **4.2.2 Phase two cases (complex)**

Phase two cases are complex mergers which involve transactions between direct or potential competitors (horizontal mergers) or between customers and suppliers (vertical mergers) where the parties hold market share in excess of 15% in their respective markets.<sup>139</sup> Phase two transactions generally involve challenges which include either of the following:<sup>140</sup>

- (a) Defining the relevant market;
- (b) Multiple product or geographic markets;
- (c) Markets which are subject to deregulation;
- (d) Public interest issues arise from the transaction.

#### **4.2.3 Phase three cases (very complex)**

Phase three cases are very complex cases which are likely to create or result in a substantial prevention or lessening of competition.<sup>141</sup> Mergers between leading markets participants in

<sup>136</sup> See (n17) p 179.

<sup>137</sup> See The Competition Commission South Africa, Mergers & Acquisitions Services Standards Report, 2010. <[Http://www.compcom.co.za](http://www.compcom.co.za)> accessed on 23 June 2012.

<sup>138</sup> Ibid.

<sup>139</sup> Ibid.

<sup>140</sup> Ibid.

<sup>141</sup> See The Commission's report (n137) p 7-8.

any one of the markets in which the parties compete fall within this category.<sup>142</sup> Phase three transactions will necessitate a thorough investigation including obtaining specific documents and information from the merging parties (not limited to the complete filing documents and information) and third party industry participants.<sup>143</sup>

Considering the above phases applicable to mergers and acquisitions, it is worth mentioning that high levels of expertise and specialist advice are required, and in most cases corporations use several expert lawyers and economists whose speciality is in mergers and acquisitions. Merger regulation requires an assessment of whether the proposed merger transaction will lead to a substantial lessening of competition.<sup>144</sup> If there is no substantial lessening of competition, then the next step in the merger review is to look at the public interest impact of the proposed transaction.<sup>145</sup> If there is a substantial lessening of competition, this may be countered by reference to efficiency gains that are specifically merger-related. The third step then involves a consideration of public interest considerations.<sup>146</sup> Consideration of the public interest impact of a proposed merger transaction is required in all cases.<sup>147</sup>

#### 4.3 Substantial prevention or lessening of competition

Section 12A of the Competition Act provides that the relevant competition authority must determine whether the merger “substantially prevents or lessen competition.”<sup>148</sup> The analysis of competitive consequences is divided into two stages. First it must be determined whether the merger is anti-competitive, and if so, it must be established whether the merger has pro-competitive consequences that outweigh those negative effects.<sup>149</sup>

Neuhoff remarks that in terms of economic theory, any market that structurally deviates from the perfectly competitive model constitutes a “structural” lessening of

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<sup>142</sup> Ibid.

<sup>143</sup> Ibid.

<sup>144</sup> Hartzenburg T, Competition Policy Review, Prepared for The Presidency “15 Year Presidential Review” Department for International Development, University of Cape Town, 2008.

<sup>145</sup> Ibid.

<sup>146</sup> Ibid.

<sup>147</sup> Although when the Act was first implemented, there was a discussion among legal professionals on whether the public interest test was required in all merger reviews (the language was carefully analysed); it has become clear that the intent of the Act is to as a matter of course, include the public interest test.

<sup>148</sup> See Sutherland (n5) p 10-7.

<sup>149</sup> See section 12A(1)(a)(i) of the Act.

competition.<sup>150</sup> In other words, economic theory avers that when a market structure is transformed from one with many participants to one with few, this structural change in itself could lead to higher prices or less choice for consumers and thus constitutes a lessening of competition.<sup>151</sup> However, both economic theory and economic reality suggest that the structural characteristics of a market are not the only determinants of effective competition: competition may be as fierce in a market with four competitors as in a market with a hundred competitors.<sup>152</sup>

The question arises as to how much structural change constitutes a lessening or prevention of competition that matters and what other indicators should be assessed when evaluating whether market conduct substantially prevents or lessens competition.<sup>153</sup> Neuhoff remarks that in answering this question, it is important to note that not only must the conduct under scrutiny lessen or prevent competition, it must substantially do so.<sup>154</sup>

In *Sasol Oil (Pty) Ltd and Nationwide Poles CC*<sup>155</sup> the Competition Tribunal ruled that when the legislature asks, whether the lessening or prevention of competition is substantial, it invites the court to distinguish “the trivial effect from the weighty.” Although the Competition Appeal Court did not specifically address the issue of what constitutes a substantial lessening of competition, it did make the following comment which indicates that, in this matter, the relative approach was adopted:

“On the evidence, this Court is not able to conclude that there is a reasonable possibility that competition has been significantly prevented or lessened. Putting the evidence in the best possible light for respondent, respondent suffers a disadvantage by way of an additional cost or purchases of creosote pursuant to applicant’s pricing policy. However, competition law does not protect the competitor, it protects competition. Evidence which goes no further than suggesting that one competitor maybe be prejudiced is insufficient to bring the impugned conduct within the scope of section 9(1)(a).”

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<sup>150</sup> See Neuhoff (n17) p 50.

<sup>151</sup> Ibid.

<sup>152</sup> Ibid.

<sup>153</sup> Ibid.

<sup>154</sup> Ibid.

<sup>155</sup> CT case 72/CR/Dec03 and CAC case 49/CAC/Apr05.

#### 4.4 Public interest

Merton remarks that the South African competition authorities have a very difficult tightrope to walk in relation to the question of public interest in merger analysis, which in South Africa falls under their purview, unlike many other jurisdictions, which need only focus on economic analysis.<sup>156</sup> This leads to a tension between pure competition analysis and public interest concerns, both of which have to be weighed up in reaching a decision in relation to a merger.<sup>157</sup>

South African competition law is unusual in requiring public interest issues to be considered. When the introduction of new legislation was mooted, it was considered necessary to adopt a uniquely South African approach, because of the challenges that follow from our legacy of economic distortions.<sup>158</sup> In defining public interest, the Department of Trade and Industry (“the DTI”) noted that “The Key to an understanding of the public interest in economic policy generally and competition policy more specifically is the combination of competitiveness and development.” In considering that competition policy had to be developmental, the DTI gave examples, including access to economic activity by those previously excluded, support of emerging black entrepreneurs, as well as job creation efforts to reduce the impact of job losses due to competitive efforts.<sup>159</sup> They nevertheless recognised that competitiveness was necessary, and noted that “a clear reflection of an economy’s competitiveness is how much foreign investment it attracts.”<sup>160</sup>

If a merger is found to restrict or prevent competition substantially, section 12A(1)(a)(ii) provides that it must then be determined whether “the merger can or cannot be justified on substantial public interest grounds” listed in the Act. Section 12A(1)(b) also states that competition authorities evaluating the merger must “otherwise determine whether the merger can or cannot be justified on substantial public interest grounds”.<sup>161</sup>

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<sup>156</sup> Thomas Merton “the tighter you squeeze, the less you have.” <<http://www.google.co.za>> accessed on 22 June 2012.

<sup>157</sup> Ibid.

<sup>158</sup> Department of Trade and Industry (“DTI”), “Proposed Guidelines for Competition Policy, A Framework for Competition, Competitiveness and Development”, November 1997, Executive Summary.

<sup>159</sup> Ibid.

<sup>160</sup> Morphet, “Heal the World: Competition Law and Public Interest issues” The Fifth Annual Competition Commission, Competition Tribunal and Mandela Institute Conference on Competition Law, Economics and Policy in South Africa and Celebration of 10 years of the Competition Act and Competition Authorities. 2010, p 2 <<http://www.compcom.co.za>> accessed on 26 June 2012.

<sup>161</sup> See Sutherland (n5) p 10-92.



Section 12A (3) of the Act provides as follows:

“when determining whether a merger can or cannot be justified on public interest grounds, the Competition Commission or the Competition Tribunal must consider the effect that the merger will have on –

- (a) a particular industrial sector or region;
- (b) employment;
- (c) the ability of *small businesses*, or *firms* controlled or owned by historically disadvantaged persons, to become competitive; and
- (d) the ability of national industries to compete in international markets.”

Neuhoff argues that the implication of the evaluation of issues that impact on the public interest is that a transaction with no anti-competitive consequences may be prohibited or approved subject to certain conditions where the competition authorities are of the view that it is likely to have an adverse effect on public interest as envisaged by the Competition Act.<sup>162</sup> Thus public interest should be considered regardless of whether a merger has an anti-competitive or pro-competitive effect.

In practice, the authorities have tended to place the greatest emphasis on the impact of a proposed transaction on employment.<sup>163</sup> The parties to the transaction may be required to disclose how they intend to deal with employees, and where the parties have not carefully considered the consequences of the transaction on employment, they are frequently required to project a worst case scenario.<sup>164</sup> In *Dawn et Cie AG and Kolosus Holdings Ltd*<sup>165</sup>, during the hearing, the relevant trade unions expressed concern and sought assurances that job losses as a consequence of the merger would be limited.<sup>166</sup> Despite indicating in their initial submission that the worst case scenario with regard to job losses would be 150, the merging parties acknowledged during the hearing that the ultimate number of job losses could potentially exceed this number.<sup>167</sup>

The Competition Act expressly requires the competition authorities to consider not only whether a proposed merger will lead to a substantial prevention or lessening of competition in

<sup>162</sup> See Neuhoff (n17) p 196.

<sup>163</sup> Ibid.

<sup>164</sup> Ibid.

<sup>165</sup> 10/LM/Mar03.

<sup>166</sup> Paras 121-124 of the judgment.

<sup>167</sup> Paras 133-134 of the judgment.

South Africa, but also the impact of the transaction on the “public interest”. Section 12A(3) of the Act specifically refers to factors like the effect that the transaction may have on a particular industrial sector or region; or employment; or the ability of small businesses and firms controlled by historically disadvantaged firms to become competitive and on the ability of national industries to compete in international markets.<sup>168</sup>

The preamble to the Competition Act envisages a competition regime in South Africa that is engaged with goals which go far beyond consumer welfare. The Act is also substantially concerned with creating opportunities for employment, broadening the basis of ownership and advancing the prospects of SMMEs. Such considerations are not unique to the South African context and many other jurisdictions in merging and developed economies have provisions in their legislation that address the potential negative effects of mergers within the context of the broader economic environment.<sup>169</sup>

Defending this approach of including public policy goals under a competition regime, the former chairman of the Competition Tribunal David Lewis remarked that “a competition statute that simply ignored the impact of its decisions on employment or on securing a greater spread of black ownership would consign the Act and the authorities to the scrap heap.”<sup>170</sup> He also pointed out that many jurisdictions allowed public interest issues to impact on their merger evaluation.<sup>171</sup>

The Competition Tribunal imposed a condition which required the parties to limit the number of job losses to 150 for a year post-merger. In its decision, the Competition Tribunal emphasised that:

...the notification requirements exist precisely to ensure transparent disclosure of all material aspects of the transaction at an early stage. This is intended to allow the competition authorities and, with regard to labour issues, the trade unions to react accordingly. It is improper for the notification forms to be “sugar coated” merely to ensure a favourable reaction, while later in the process, less favourable facts are disclosed, particularly when the number of retrenchments is as significant as in this case.

We also take cognisance that it is rather easy for companies to disguise merger related retrenchments so that it would appear that these would occur absent the merger. These practices are strongly discouraged and the importance of transparent and *bona fide* disclosure is once again emphasised.

<sup>168</sup> Ibid.

<sup>169</sup> Ibid.

<sup>170</sup> Lewis D, “The Role of Public Interest in Merger Evaluation”, International Competition Network, Merger Working Group, Naples, 28-29 September 2002.

<sup>171</sup> Ibid.

Reference can also be made in this regard to the case of *Tiger Brands Ltd and Ashton Canning Company (Pty) Ltd and Others*<sup>172</sup>, where a consequence of this merger was the loss of 45 permanent jobs and 1000 seasonal jobs.<sup>173</sup> For this reason, the Competition Commission sought to impose a condition that, amongst others, provided for the creation of a training fund to the value of R2 million to the benefit of retrenched workers and other members of the Ashton community.<sup>174</sup> The merging parties considered the amount of R2 million as excessive and instead offered an amount of R250 000 for re-training.<sup>175</sup>

The Competition Tribunal approved the merger subject to conditions which included<sup>176</sup> that the merging parties would not retrench more than 45 employees from the aggregate number of employees employed by both firms immediately prior to the order; and That the merging parties make available an amount of R2 million for the purpose of training all effected persons.<sup>177</sup>

Having discussed the above public interest considerations as part of merger regulation, it is clear from above analysis that “public interest” is one of the most crucial aspects in merger regulation and assessment. The issue of public interest was also given high level of attention and thorough consideration by the Competition Tribunal in the well known merger between Walmart Stores and Massmart Holdings as discussed hereinafter.<sup>178</sup>

#### **4.5 Walmart Stores Inc and Massmart Holdings Limited**<sup>179</sup>

The large merger between Wal-Mart Stores Inc. and Massmart Holdings Limited has arguably been one of the most controversial mergers since the inception of the Competition Act in 1998, because it focused on public-interest, rather than pure competition issues.

In this matter the primary acquiring firm was Walmart Stores Inc (“Walmart”), a company incorporated and listed on the New York Stock Exchange.<sup>180</sup>

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<sup>172</sup> Case 46/LM/May05.

<sup>173</sup> Par 132 of the judgment.

<sup>174</sup> Par 150 of the judgment.

<sup>175</sup> Par 145 of the judgment.

<sup>176</sup> See Annexure A, of the judgment (conditions), p 34.

<sup>177</sup> *Ibid.*

<sup>178</sup> CT 73/LM/Dec10.

<sup>179</sup> *Ibid.*

<sup>180</sup> Par 1 of the judgment-Walmart uses both the hyphenated and non-hyphenated versions of its name. It uses the hyphenated form to describe the acquiring firm and the non-hyphenated form to describe the business. No

Walmart, the largest retailer in the world, has three retail formats in the form of discount stores (stocked with a variety of general merchandise), supercenters (features products such as bakery goods; meat and dairy products; fresh produce; dry goods and staples; beverages; deli food; frozen food; canned and packed goods; condiments; and spices; household appliances; apparel and general merchandise)<sup>181</sup> as well as neighbourhood markets (which have a variety of products; stationery and paper goods; drive-through pharmacies and one hour photo centres).<sup>182</sup>

Walmart also has a chain of warehouse stores called Sam's Club, which sells groceries and general merchandise, often in bulk.<sup>183</sup> Customers buy an annual membership at Sam's Club in order to be able to purchase merchandise from the club.<sup>184</sup> Internationally Walmart currently operates in 15 countries, including Mexico, Puerto Rico, Canada, Argentina, Brazil, Costa Rica, El Salvador, China, Japan, Guatemala, Honduras, Nicaragua, Chile, the United Kingdom, and partnered with Bharti Enterprise in India.<sup>185</sup>

In South Africa, Walmart through ASDA controls International Produce Limited ("IPL") but IPL does not directly or indirectly control any other firm.<sup>186</sup> IPL purchases fresh fruit produce in South Africa for the export market and none of these products are sold back to the South African market. IPL is also responsible for giving practical advice to local suppliers relating to quality standards as well as communicating product information and shipping arrangements to ASDA.<sup>187</sup>

The primary target firm was Massmart Holdings ("Massmart"), a company incorporated under the company laws of the Republic of South Africa and listed on the JSE. No individual shareholder directly or indirectly controls it.<sup>188</sup> Massmart has in excess of 10

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individual shareholder directly or indirectly controls it. The only shareholder with a shareholding in excess of 5% is Walton Enterprises, LLC. The following terms are controlled by Walmart: Walmart Stores East, LP, Walmart Property Company; Walmart Real Estate Business Trust; and ASDA Group Limited ("ASDA"). All these companies, except ASDA, which is based in the United Kingdom, are located in the United States of America.

<sup>181</sup> Ibid.

<sup>182</sup> Ibid.

<sup>183</sup> Par 3 of the judgment.

<sup>184</sup> Ibid.

<sup>185</sup> Par 4 of the judgment.

<sup>186</sup> Par 5 of the judgment.

<sup>187</sup> Ibid.

<sup>188</sup> Par 6 of the judgment.

subsidiaries nationwide and around the African continent.<sup>189</sup> It is a wholesaler and retailer of grocery products, liquor and general merchandise.<sup>190</sup> Massmart has four divisions namely: Massdiscounters, Masswarehouse, Massbuild and Masscash.<sup>191</sup>

#### 4.5.1 The proposed transaction and the rationale of Walmart merger

On 27 September 2010 Massmart announced Walmart's intention to acquire a controlling interest in Massmart.<sup>192</sup> In terms of the proposed transaction Walmart intended to acquire 51% of the ordinary share capital of Massmart.<sup>193</sup>

In this matter Walmart wanted to enter emerging markets, especially South Africa and sub-Saharan Africa, accounting for approximately 20% of the consumer spending on the continent as a whole. Further, Walmart believed South Africa is sophisticated and has a stable economic, political and regulatory environment and South Africa therefore represented an attractive market on its own to Walmart.<sup>194</sup>

Massmart's strategy entailed a comprehensive planned investment in expanding its operation in South Africa and further on the African continent.<sup>195</sup> Walmart is renowned for its operating, retailing, marketing and merchandising skills and procurement and supply chain capabilities, and it was argued that it would enable the merged entity to implement its pre-merger expansion plans with more confidence and on an expedited basis, as the merged entity would be able to draw on skills, system and processes already developed, tried and tested by Walmart.<sup>196</sup>

Massmart also anticipated that *Walmart*, being a global leader in sourcing and retailing of fresh produce, would introduce new skills and technologies to assist Massmart in becoming a significant distributor of locally produced, perishable products, thereby complementing and supporting Massmart's emphasis on expanding its fresh grocery operations.<sup>197</sup> It was argued that the transaction would enable Massmart to gain access to

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<sup>189</sup> Par 7 of the judgment.

<sup>190</sup> Ibid.

<sup>191</sup> Ibid.

<sup>192</sup> Par 12 of the judgment.

<sup>193</sup> Par 13 of the judgment.

<sup>194</sup> Par 14 of the judgment.

<sup>195</sup> Par 15 of the judgment.

<sup>196</sup> Ibid.

<sup>197</sup> Par 16 of the judgment.

Walmart's procurement capabilities through a buying agency agreement and various other services (i.e. technology software and hardware, merchandise skills and other technical skills and services).<sup>198</sup>

Having dealt with the above Walmart's facts it needs to be mentioned that when considering the potential repercussions of a merger, the Competition Tribunal must carefully weigh such merger's propensity to prevent or lessen competition against "public interest" factors aimed at promoting equal economic opportunity and advancing social economic welfare. Merging companies need to give careful consideration to whether their transaction gives rise to public interest concerns, and if so, they should deal with these at an early stage of planning their transaction.

At the hearing of this merger the Economic Development Department ("EDD"), the Department of Trade and Industry (the "DTI") and the Department of Agriculture, Forestry and Fisheries ("DAFF") argued that the proposed acquisition would result in an increase in imports by Walmart/Massmart, which would harm local manufacturing, particularly in vulnerable South African industries like agro-processing, furniture, electronics, plastics, household goods, clothing and textiles.<sup>199</sup> On the other hand, trade unions, including the South African Commercial, Catering and Allied Workers Union (SACCAWU) argued that Walmart would discourage union participation. The Competition Tribunal agreed, and imposed a number of conditions that sought remedy these concerns.

The Competition Tribunal thus eventually approved the merger between Walmart and Massmart subject to a number of conditions<sup>200</sup> intended to address the substantial impact of

<sup>198</sup> Ibid.

<sup>199</sup> Menashe, M "Walmart Changes Landscape for Future Mergers", 2011, p 2, <<http://www.golegal.co.za/competition/walmart-changes-landscape-future-mergers>> accessed on 24 February 2012.

<sup>200</sup> Further to the recommendation of the Competition Commission in terms of section 14A(1) of the Competition Act, 1998 the Competition Tribunal approved the Wal-Mart/Massmart merger subject to the following conditions:

- (a) The merged entity must ensure that there are no retrenchments, based on the merged entity's operational requirements in South Africa, resulting from the merger, for a period of two years from the effective date of the transaction. For the sake of clarity retrenchments do not include voluntary separation agreements, voluntary early retirement packages, and unreasonable refusals to be redeployed in accordance with the provisions of the Labour Relations Act, 1995, as amended.
- (b) The merged entity must, when employment opportunities become available within the merged entity, give preference to the re-employment of the 503 employees that were retrenched during June 2010 and must take into account those employees years of

the proposed acquisition on South African manufacturing and employment in the local supply chain.

It is important to note that the merging parties are expected to address public interest issues in detail in their merger filings and that they must be prepared for a thorough investigation by the Competition Commission. The Walmart transaction was protracted by the merging parties' failure to propose adequate conditions at an early stage.<sup>201</sup> They only proposed their conditions (which were largely adopted by the Tribunal) on the last day of the hearing.<sup>202</sup> The proposed conditions remained the subject of much contention before the Competition Appeal Court. In its reasons for decision though, the Tribunal remarked that "[p]erhaps the merging parties may have spared themselves of some of the length of these proceedings had these undertakings been made earlier in the process".<sup>203</sup>

Menashe thus rightly remarks that a proper assessment of potential public interest issues is essential if investors need a swift clearance for their acquisition.<sup>204</sup> Engaging with union representatives over any potential rationalisation of employees that may arise as a result of a merger and liaising with contracted suppliers in a transparent manner at the preliminary stages of a merger application may mitigate some potential public interest concerns.<sup>205</sup>

It is thus clear that the regulation of mergers and acquisitions plays a major role in the country's economy in a sense that it ensures that no one is deprived of his right to

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service in the Massmart Group.

- (c) The merged entity must honour existing labour agreements and must continue to honour the current practice of the Massmart Group not to challenge SACCAWU's current position, as the largest representative union within the merged entity, to represent the bargaining units, for at least three (3) years from the effective date of the transaction.
- (d) The merged entity must establish a programme aimed exclusively at the development of local South African suppliers, including SMMEs, funded in a fixed amount of R100 million to be contributed by the merged entity and expended within three (3) years from the effective date of this order. This programme will be administered by the merged entity, advised by a committee established by it and on which representatives of trade unions, business including SMMEs, and the government will be invited to serve. The merged entity must report back to the Competition Commission annually, within one month of the anniversary of the effective date, about its progress. In addition, the merged entity must establish a training programme to train local South African suppliers on how to do business with the merged entity and with Wal-Mart.

<sup>201</sup> See Menashe (n199) p 3.

<sup>202</sup> Ibid.

<sup>203</sup> Ibid.

<sup>204</sup> Ibid.

<sup>205</sup> Ibid.

employment as a result of a merger. The competition authorities have made it possible to not only focus on competition issues when dealing with merger assessment but also to look beyond the merger itself and see what the consequences would be as a result of a merger. Usually, when doing merger analysis the competition authorities focus their full attention to the thorough investigation and critical analysis of pure competition issues. However, in the Walmart case they took a different approach, since the focus was more on public interest rather than competition issues. This raises the question as to the extent to which public interest should play a role in merger analysis and in the eventual approval of a merger. It should be borne in mind that all merger cases before the competition authorities are important and as such all the material aspects of each transaction must be properly dealt with. As indicated, the Commission sets out concentration thresholds that identify which mergers it believes may give rise to competition concerns and hence are likely to be subject to greater scrutiny.

#### 4.6 Conditional approval as part of merger regulation

The Competition Commission and the Competition Tribunal are empowered to impose conditions in merger cases to address competition concerns or public interest concerns that they identify. Of late the conditions imposed or recommended by the Commission have been vigorously challenged in the Tribunal. With the economic downturn of 2008, there has also been an increased focus on public interest concerns by the Commission and the Tribunal. This increased focus has given rise to a variety of conditions.<sup>206</sup> One may argue that some of the conditions may not be in line with the role of the competition authorities in attaching conditions to their decisions. Arguably, some merging parties may have had stricter conditions imposed on them than is necessary to address competition or public interest issues identified. Some of the conditions may also not have been merger specific. As seen in the recent *Walmart/Massmart*<sup>207</sup> decisions, the conditions imposed in merger cases are sometimes used, rightly or wrongly, to measure the friendliness of South Africa as an investment destination. With such great importance, Kariga submits that merger conditions have to be imposed after careful analysis of the dynamics of a market while taking cognisance of the existing legal framework.<sup>208</sup>

<sup>206</sup> See Kariga *et al*, "Is South Africa a Good Investment Destination? A Relook at conditions in Merger Cases". A Paper Presented at the 6<sup>th</sup> Annual Competition Law, Economics and Policy, 2012, p 1, at the University of the Witwatersrand, Johannesburg

<sup>207</sup> See *Walmart* (n53).

<sup>208</sup> See Kariga (n206) p 1.



As indicated, in practice, if it transpires that there are concerns as a result of a merger such as a possible loss of employment, certain conditions might be imposed by the competition authorities in order to ensure that the merger does not violate the provisions of the Competition Act. The authorities have tended to place the greatest emphasis on the impact of a proposed transaction on employment.<sup>209</sup> The parties to the merger transaction may be required to disclose how they intend to deal with employees, and where the parties have not carefully considered the consequences of the transaction on employment, they are frequently required to project a worst case scenario.<sup>210</sup> For instance, the merging parties may be required not to retrench any employees for a certain period of time after the approval of the merger. It may also be required that the merging parties invest in the employees future by ensuring that the merging companies provide them with training and skills development as part of the merger conditions. Conditional approval of mergers is regarded as one of the regulatory methods used by the competition authorities in merger regulation in order to ensure that the mergers and acquisition process is fair and transparent.

With conditional approval, it will often be possible to save mergers that are problematic by imposing conditions on the merging parties. Mergers are frequently pro-competitive and a normal part of business. Therefore, the Commission and the merging parties are encouraged to find conditions by which the anti-competitive aspects of a merger can be remedied.<sup>211</sup>

It should be borne in mind that in merger proceedings, the Tribunal will usually be unable to develop a set of conditions to the required level of detail.<sup>212</sup> Conditions must be thrashed out between the Commission and the merging parties.<sup>213</sup> The Tribunal should justify the imposition of specific conditions.<sup>214</sup> Where conditions are proposed by the merging parties, or their proposals for conditions are amended, this must be done with due regard for the interests of others.<sup>215</sup> Where conditions affect persons who are not parties to the litigation, they must be given an opportunity to be heard.<sup>216</sup>

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<sup>209</sup> See Neuhoff (n17) p 197.

<sup>210</sup> Ibid.

<sup>211</sup> See Sutherland (n5) p 10-105.

<sup>212</sup> See Reyburn (n68) p 39.

<sup>213</sup> Ibid.

<sup>214</sup> Ibid.

<sup>215</sup> Ibid.

<sup>216</sup> Ibid.

Reyburn remarks that the adjudicating body, whether the Commission or the Tribunal, must attempt to find an appropriate remedy which would counter the anti-competitive effects of the merger.<sup>217</sup> He argues further that it should create the conditions for actual competition to subsist and potential competition to emerge. He indicates that the Tribunal has been prepared to impose conditions to promote competition in a monopolistic market, even if the merger did not contribute to the monopoly or a reduction in competition at all.<sup>218</sup> However, this will be possible only if the merging firms consent to such conditions.<sup>219</sup>

#### 4.7 Significance of merger conditions

The Commission receives extensive media coverage and the media tends to shape the thinking of the nation and potential investors.<sup>220</sup> What is clear is that with all the publicity that the Commission receives, merger conditions are sometimes used as a platform for fuelling perceptions that influence investor decisions. For instance, in the *Walmart/Massmart* merger the merger conditions and government involvement was used by the media to measure the friendliness of South Africa as an investment destination. It is therefore prudent for competition authorities and the government to critically look at the possible perceptions that maybe created by certain conditions imposed in mergers.<sup>221</sup> The Tribunal recognised the possible effects that merger conditions, particularly public interest issues, may have on investment when it stated that:

“The role played by the Competition authorities in defending even these aspects of the public interest listed in the Act is, at most, secondary to other statutory and regulatory instruments – in this case the Employment Equity Act, the Skills Development Act and the Charter itself spring to mind. The competition authorities, however well intentioned, are well advised not to pursue their public interest mandate in an overzealous manner lest they damage precisely those interests that they ostensibly seek to protect.”<sup>222</sup>

The above position was reinforced in the *Metropolitan/Momentum* decision<sup>223</sup> by the Tribunal. In the same vein Hawkins and Lockwood remarks that:<sup>224</sup>

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<sup>217</sup> Ibid.

<sup>218</sup> Ibid.

<sup>219</sup> Ibid.

<sup>220</sup> See Commission’s Annual Report 2010/2011. In the Commission’s financial year 2008/2009 the Commission received print media and electronic media amounting to 5861 times, and in 2009/2010 it increased to 7303 and in 2010/2011 it was 6632.

<sup>221</sup> See Kariga (n206) p 7.

<sup>222</sup> See *Shell South Africa (Pty) Ltd and Tepco Petroleum (Pty) Ltd* CT Case No: 66/LM/Oct01 at par 58.

<sup>223</sup> *Metropolitan Holdings Limited and Momentum Group Ltd* CT 41/LM/Jul10, par 109 – 111.

“A number of new legislation that impact directly on the business sector have been promulgated in South Africa in recent years. Because foreign investors in South Africa generally feel more insecure than their local counterparts, “subjective” elements in such legislation increase the risk associated with investment, and give rise to perception amongst them of being “unwelcomed” and “discriminated against”, a reduction in scope of subjective rulings and interpretations in such legislation would reduce the risks faced by foreign investors.”

In cutting the Commission’s rating the Global Competition Review noted that two of the 288 mergers filed in 2011 were blocked and that there are “increasingly adversarial approach to mergers, particularly ones involving foreign entities”. The report further stated that there is a marked increase in the use of remedies with 28 mergers that were cleared with conditions in 2011 compared to eleven in 2010.<sup>225</sup> Some of the Commission’s decisions have even been labelled as “bizarre”.<sup>226</sup>

The views of the global competition community clearly express the sentiments here. The issue is one of managing perceptions.<sup>227</sup> As noted earlier, reducing restriction on Foreign Direct Investment (FDI) has been found to be more potent than providing incentives in attracting FDI. Restrictions could be associated with risks such as the possibility of the expansive interpretation of the public interest provisions of the Act by the Competition Commission and Competition Tribunal to a terrain better dealt with using other policy instruments other than competition policy.<sup>228</sup> Indeed a few recent mergers involving foreign firms have attracted a lot of public interest considerations.<sup>229</sup> If the same attention is not given to mergers involving only local firms a perception could indeed be created of being “unwelcomed” and “discriminated against”.<sup>230</sup>

Kariga remarks that with such a potential to influence investor perceptions on their investments in South Africa and on perceptions on the effective implementation of the Act,

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<sup>224</sup> A Strategy for Attracting Foreign Direct Investment, A Paper Presented to the Economic Society of South Africa’s Biennial Conference, Glenburn Lodge (13 September 2001).

<sup>225</sup> Global Competition Review <http://www.globalcompetitionreview.com/features/articles/31877/south-africas-competition-commission/> accessed on 21 August 2012.

<sup>226</sup> See Business Day 5 June 2012, p 15.

<sup>227</sup> See Kariga (n206) p 8.

<sup>228</sup> Ibid.

<sup>229</sup> See *Walmart* (n53).

<sup>230</sup> See Kariga (n206) p 8.

and damage to the interests (like employment) that the Act seek to protect, it is imperative that conditions in merger cases should be imposed within the ambit of the Act.<sup>231</sup>

When a decision is taken by the Commission to attach conditions to a merger the Tribunal is required to consider whether the imposition of the condition is warranted on the basis of the evidence before it. As indicated the Act also has a very explicit public interest test that requires the Commission and the Tribunal to balance the substantial prevention or lessening of competition test against the proposed transaction's impact on a number of specified public interest factors. Section 12A outlines the legal framework for evaluating both substantial prevention or lessening of competition test and public interest test in mergers. It also discusses the Tribunal and the CAC's jurisprudence and approach to the assessment of both tests as this provides some insight on when it is necessary to impose conditions on mergers.

Regulation of horizontal mergers is significant and it cannot be by-passed by the competition authorities. It should be done not only for the benefit of the merging companies but for the benefit of the country's economy as well. It is worth noting that such regulation ensures that while companies engage in corporate restructuring, they should also be mindful of the consequences of their corporate transactions (i.e. merger) and ensure that they do not negatively impact in the economy. It may be argued that merger regulation on its own serves as an engine that creates duties and obligations to all those involved in dealing with mergers and acquisitions.

Having such control or regulatory framework in place brings assurance that no companies or individuals can abuse the corporate practice of mergers and acquisitions and furthermore, it ensures that the primary objectives of the competition legislation are properly observed and complied with.

It is clear from the above that the regulation and direct assessment of merger effects involves examining how the merger might affect competition and market outcomes.<sup>232</sup> A horizontal merger can have either unilateral or coordinated effects, and the economics underlying these two effects are discussed in detail below.

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<sup>231</sup> Ibid.

<sup>232</sup> Small I, "Introduction to the Economic Assessment of Horizontal Mergers", IBC EC Competition Law Summer School August 2009, p 14.

#### 4.8 Unilateral effects of horizontal mergers

Small argues that unilateral effects occur when a merger leads firms finding it individually profitable to increase their prices, due to the loss of competition between the merging parties.<sup>233</sup> Small remarks further that this mechanism does not rely upon any form of coordination between the firms remaining in the market post-merger, but is instead based on the individual profit-maximising responses of the firms in the market to the removal of the competitive constraint that the merging parties exercised on each other pre-merger.<sup>234</sup> The most direct unilateral effect is the impact of the merger on the pricing incentives of the merging parties, but the loss of competition between the merging firms is also likely to give rival firms an incentive to themselves increase prices.<sup>235</sup>

It may be argued that unilateral effects rely upon the firms in the market having some degree of market power, so that they can influence the market price. A firm with market power faces a trade-off between price and volume when deciding at what price to offer its products in the market: the higher the price the smaller its volume of sales.<sup>236</sup> This trade-off typically induces the firm to raise its price above the marginal cost of production, in order to earn higher profits on the remaining quantity offered in the market.<sup>237</sup> Small argues further that a firm will increase the price until the loss in profit on the production not offered to the market starts to outweigh the resulting increase in profits earned on the remaining output that is sold.<sup>238</sup>

#### 4.9 The coordinated effects of horizontal mergers

Small remarks that coordination rises when firms repeatedly compete with each other in a market over time and as a result of this repeated interaction are able to agree that it will be in their best interests to produce less and charge higher prices than they would choose to if they were competing strongly with one another.<sup>239</sup> Each firm realises that although, in the short run, it could make more money by setting a more competitive price and winning customers from its rivals (that is, following its *unilateral* best response), in the longer term its rivals would simply respond to any such behaviour ('punishing' the deviating firm), leading to

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<sup>233</sup> Ibid.

<sup>234</sup> Ibid.

<sup>235</sup> Ibid.

<sup>236</sup> Ibid.

<sup>237</sup> Ibid.

<sup>238</sup> Ibid.

<sup>239</sup> See Small (n232) p 18.

lower profits for all the firms in the industry.<sup>240</sup> It should be borne in mind that if the long-term profit from maintaining the collusion/coordination is greater than that from cheating (and facing the resulting punishment), then firms will choose to coordinate their actions.<sup>241</sup> Economically this is known as tacit collusion, but in antitrust it is known as coordination and it is the same mechanism that underlies explicit collusion (i.e. cartels), except there are no actual meetings or explicit communication between the parties.<sup>242</sup>

Elhauge argues that a merger will have coordinated effects when it changes the incentives of the remaining main market participants so that following the merger they all have an incentive to coordinate their behaviour.<sup>243</sup> He argues further that thus, coordinated effects differ from unilateral effects, in that they arise from the repeated competition interaction of a group of firms in a market, and may involve firms changing the way they compete with each other.<sup>244</sup> Another distinction between coordinated effects and unilateral effects is that the direction of price impact from coordinated effects arising from a merger is ambiguous: a merger could either enhance or undermine the ability of the remaining firms in an industry to coordinate their actions.<sup>245</sup>

In terms of merger assessment, the key question is whether a merger makes it more likely that the firms in an industry will be able to coordinate their behaviour post-merger, or if they are already behaving in this way which makes the existing coordination more stable and sustainable. To answer this question it is necessary to establish whether the necessary conditions for coordination are met in the market, and whether the merger makes it more likely that these conditions will be met. Thus, the approach to assessing whether a merger is likely to lead to coordinated effects involves two parts: first establishing whether the firms in the market are already coordinating their actions; and then, if they not, establishing whether the merger would make it easier for them to coordinate, and, if they are, whether the merger will make that coordination more stable, or more effective.<sup>246</sup>

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<sup>240</sup> Ibid.

<sup>241</sup> Ibid.

<sup>242</sup> Ibid.

<sup>243</sup> Elhauge *et al*, *Global Competition Law and Economics*, 2007, p 915.

<sup>244</sup> Ibid.

<sup>245</sup> Ibid.

<sup>246</sup> Ibid.

#### 4.10 Conclusion

Horizontal mergers may bring both socially detrimental and beneficial results, which makes it desirable to control merger activity of certain scale.<sup>247</sup> As argued above, horizontal mergers unlike any other types of mergers get a thorough consideration and assessment due to their nature and the manner in which they are likely to pose threat in competition. It is clear that the regulation of mergers and acquisitions is yet another form of method or a tool that is used in ensuring that an efficient, competitive economic environment, balancing the interests of workers, owners and consumers and focus on development benefit all South Africans. Most importantly, merger regulation provides all South Africans with an equal opportunity to participate fairly in the national economy as required by the Competition Act. It is against this background that mergers require regulation in order to prevent anti-competitive conduct from occurring.

Considering the above argument, it should be noted that the process of merger regulation differ globally. However, there is a common goal amongst antitrust authorities to ensure that competition is controlled. South Africa is a developing country which gets its inspiration and guidance from the developed jurisdictions such as the European Union (“EU”) in dealing with merger regulation. The subsequent chapter provides an overview on how the merger regulation process is done in the EU. The purpose of this comparison is to establish whether South Africa’s merger regulation system has made any progress in its merger regulation when comparing with other jurisdictions that it takes its inspiration from.

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<sup>247</sup> Ostrovskis V, “The New European Regulation of Horizontal Mergers: Did it Have Any Practical Effect?”, Master’s degree thesis, University of Rotterdam and University of Bologna, Bologna 2007, p 42.

## CHAPTER 5: EU MERGER REGULATION

### 5.1 Introduction and background

The drive to introduce legislation at the EU specifically focused on merger control was led by the European Commission.<sup>248</sup> The Commission believed that its inability to control mergers inhibited its capability to operate effective competition control and it adopted its first legislative proposal for a merger control regulation in 1973.<sup>249</sup> Jones argues that in 1996 it first acknowledged, in its publication of its Memorandum on the Concentration of Enterprise in the Common Markets,<sup>250</sup> that some form of EC merger control was necessary.

Jones remarks that regulation on merger control had to be passed unanimously by the European Council.<sup>251</sup> He indicates further that for a long time there was no consensus amongst the Member States that merger control was necessary at all and those that did recognise a need for merger control were reluctant to cede power over changes in industrial structure in their territories to the Commission.<sup>252</sup> In addition, early drafts of the Merger Regulation gave the Commission a broad discretion in assessing whether or not a merger was in the Community interest.<sup>253</sup> According to Jones Member States were divided on what substantive criteria should be used to appraise mergers and, in particular, whether only the effects on competition should be relevant, or whether social and industrial policy considerations should also be taken into account.<sup>254</sup>

The European Merger Regulation refers to the control of a concentration, which includes, *inter alia*, mergers, joint ventures and share acquisitions which lead to acquiring control over the target company.<sup>255</sup> Ezrachi remarks that these concentrations are subject to the exclusive jurisdiction of the European Merger Regulation when they are found to have a Community (Union) Dimension.<sup>256</sup>

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<sup>248</sup> See Jones and Sufrin (n124) p 855.

<sup>249</sup> *Ibid.*

<sup>250</sup> *Ibid.*

<sup>251</sup> See also Hawk and Huser *European Community Merger Control: A Practitioners Guide*, 1996, 2-3 (Kluwer Law International).

<sup>252</sup> See Jones and Sufrin (n124) p 855.

<sup>253</sup> *Ibid.*

<sup>254</sup> *Ibid.*

<sup>255</sup> See Ezrachi (n2) p 308.

<sup>256</sup> *Ibid.*



The EU merger regulation provides a mechanism for the control of mergers and acquisitions at the European level. The original Regulation was adopted in 1989.<sup>257</sup> After a wide-ranging consultation exercise initiated in 2001, it was revised and replaced by the current version of the Merger Regulation which came into force on 1 May 2004.<sup>258</sup>

Snelders indicates that within the 25-country European Union, the European Commission (“the Commission”) has exclusive competence to review mergers and acquisitions between parties that meet certain size thresholds.<sup>259</sup> Transactions that fall below those size thresholds are subject to national merger control legislation and the jurisdiction of national competition authorities.<sup>260</sup> This basic division of competence between the Commission and national competition authorities is fine-tuned through a mutual referral system designed to ensure that transactions are reviewed by the authority best-placed to do so and to maintain, as much as possible, a “one-stop-shop” for merger review within the EU.<sup>261</sup>

The Commission, the EU’s executive, is a collegiate body comprising 25 Commissioners supported by a civil service organised along 25 directorates-general.<sup>262</sup> A specific Directorate-General for Competition (DG Comp), under the responsibility of one of the Commissioners, is entrusted with the task of applying, *inter alia*, EU merger control legislation.<sup>263</sup>

## 5.2 Merger legislation in the EU

The merger control legislation at the EU level is set out in the Council Regulation<sup>264</sup> on the control of concentrations between undertakings (the Merger Regulation) and in the Commission Regulation<sup>265</sup> implementing the merger regulation (the Implementing Regulation).<sup>266</sup> Ahuja indicates that these legal instruments adopt a number of changes from

<sup>257</sup> See Council Regulation (EEC) 4064/89 (OJ 1989 L395/1), as amended by Council Regulation (EC) 1310/97 (OJ 1997 L180/1, 9.7.1997, corrigendum OJ 1998 L40/17, 13.2.1998).

<sup>258</sup> See Council Regulation (EC) 139/2004 (OJ 2004 L24/1, 29.1.2004).

<sup>259</sup> Snelders R and Piergiovanni M, “European Union”, ICLG to Merger Control, 2005.

2005 <<http://www.europa.eu.int/comm/competition/mergers/legislation/regulation/#implementing>> accessed on 15 August 2012.

<sup>260</sup> Ibid.

<sup>261</sup> Ibid.

<sup>262</sup> Ibid.

<sup>263</sup> Ibid.

<sup>264</sup> (EC) 139/2004.

<sup>265</sup> (EC) 802/2004.

<sup>266</sup> Ahuja G and Katila R, “Technological Acquisitions and the Innovation performance of Acquiring Firms: A longitudinal Study”, *Strategic Management Journal* 22, 2001, p 26.

pre-existing EU merger control legislation and entered into force on 1 May 2004. They have been complemented with various interpretative notices, guidelines and best practice rules.<sup>267</sup>

There are no sector-specific merger control or non-competition related to prior authorisation rules at the EU level.<sup>268</sup> Ahuja argues that where a transaction falls within the scope of the Merger Regulation, Member States may apply domestic prior authorisation regimes only subject to the constraints of Article 21(4) of the Merger Regulation.<sup>269</sup> This Article allows Member States to apply national legislation designed to protect legitimate national interests, such as public security, plurality of the media, and prudential rules, to the extent compatible with the general principles of other provisions of EU law.<sup>270</sup>

### 5.3 Transactions caught by merger control legislation in the EU

As indicated, the Merger Regulation applies to so-called “concentrations”, which are defined as transactions that lead to a lasting change of control resulting from the merger of two or more previously independent companies, or the acquisition of direct or indirect control of the whole or part of another undertaking (through the purchase of shares or assets, by contract, or by any other means).<sup>271</sup> Warrants, options, or other instruments that create future equity entitlements will not normally give rise to a concentration until such time as they are exercised and confer control over a company, unless it is clear from legally binding agreements that they will be exercised in the near future.<sup>272</sup>

Caves indicates that the Merger Regulation does not apply to acquisitions that do not confer control.<sup>273</sup> Control is defined as the ability (legally or *de facto*) to exercise “decisive influence” over the strategic commercial behaviour of a company.<sup>274</sup> Control may be exercised alone (sole control) or jointly with other companies (joint control).<sup>275</sup>

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<sup>267</sup> Ibid.

<sup>268</sup> Ibid.

<sup>269</sup> Ibid.

<sup>270</sup> Ibid.

<sup>271</sup> Snelders and Piergiovanni (n259) p 103.

<sup>272</sup> Ibid.

<sup>273</sup> Caves, R.E Mergers, Takeovers, and Economic Efficiency, *International Journal of Industrial Organisation* vol. 7, 1999, p 114.

<sup>274</sup> Ibid.

<sup>275</sup> Ibid.

#### 5.4 Merger investigation in the EU

Like South Africa, the EU has its own merger investigation process. This process is done taking into account the different phases of the merger. In the EU mergers are categorised according to their phases, as is the case in South Africa.

In the EU once the concentration has been notified, the Commission will start its Phase I investigation. At the end of this phase the concentration may be held to fall outside the jurisdiction of the Merger Regulation, cleared or cleared with conditions under Article 6.<sup>276</sup> When the concentration raises concerns, it will be subject to a Phase II investigation.<sup>277</sup> This stage involves a more detailed investigation and operates with longer time limits.<sup>278</sup> At the end of the second phase the transaction may be cleared, cleared with conditions or prohibited if it is incompatible with the internal market.<sup>279</sup>

Overall, the EU Merger Regulation allows in most cases for a swift appraisal of concentrations.<sup>280</sup> Ezrachi remarks that in the period between 1990 and December 2009, 4274 concentrations were notified to the Commission: 52 notified concentrations were found to fall outside the scope of the Merger Regulation, 3697 concentrations were found compatible and 190 found compatible subject to commitments at the end of the first phase investigation.<sup>281</sup> In this scenario it is noted that only 191 notified concentrations were not cleared at the first stage and have subsequently progressed to the second stage. Twenty of these concentrations have been prohibited.<sup>282</sup>

#### 5.5 Conclusion

Considering the EU mergers and acquisition practice, it may be argued that South Africa as a developing country with new competition laws and policies is regarded as one of the fast moving developing countries in the field of competition law.

Mergers and acquisitions seem to play an important role in the corporate world and in competition law as a whole. When looking at the above argument on merger regulation in the

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<sup>276</sup> See Ezrachi (n2) p 311.

<sup>277</sup> Ibid.

<sup>278</sup> Ibid.

<sup>279</sup> Ibid.

<sup>280</sup> Ibid.

<sup>281</sup> Ibid.

<sup>282</sup> Ibid.

EU, it should be born in mind that mergers and acquisitions are not only done in developed countries such as the EU, but also in the developing countries such as South Africa. It is clear that the EU is one amongst those developed countries that demonstrates to other countries involved in mergers and acquisitions how the merger transactions should be regulated by the regulators such as the competition authorities in order to ensure that corporate restructuring is in compliance with the relevant competition laws.

Looking at the manner in which the EU conducts its merger investigations as well as merger approvals, one may argue that the method used is more effective and results driven. South Africa on the other hand has effective merger regulation measures in place that are specifically designed to ensure that merger regulation materialise. It thus appears South African authorities are not far behind in meeting the standards of developed jurisdictions such as the EU.

As fully discussed above, the South African merger regulation system put emphasis on public interest consideration in all merger transactions. It may be argued that public interest component in its nature is also intended to deal and address the injustices of the past since it requires that interests of all those that might be affected by mergers and acquisitions are taken into consideration in dealing with merger cases.

Public interest component in our merger regulation system is a good thing to have in a sense that it ensures that no one suffers prejudice in the process of a merger. It also ensures that alternative measures are adopted to ensure that all merger transactions are analysed and considered in a fairly and transparent manner. It is against this background that South African merger regulation system is regarded as one of the most progressive systems as compared to other developing countries.

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