Speech :- The Competition Act 1998 – Merger Regulation

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I have been asked to lay out the essential features of the transition from the late, and unlamented, Maintenance and Preservation of Competition Act to the new Competition Act ('the Act'). The Act covers, of course, the gamut of competition issues – merger regulation as well as prohibited anti-competitive practices – and it puts in place the institutional framework necessary to administer the Act. I will obviously focus on merger regulation today – on thresholds, on notification, on the process of investigation and adjudication.

However before doing that I want to take a large and important step back. Merger regulation is part of the much broader tapestry that is competition policy, or, as it is more popularly known, anti-trust policy. It's important that you view merger regulation against the backdrop of the major global resurgence in anti-trust. Wherever one cares to look – in the USA, in the EU, in the emerging market economies of Eastern Europe, in developing economies, in the concerns of institutions like the World Bank, the WTO and the OECD, anti-trust has once again established itself as a major instrument of economic policy and regulation. New laws are being put on the statute book; old laws are being ramped up and enforcement is being strengthened; names that evoke great power – Microsoft, British Airways, Hoffman la Roche, Coca Cola – are being successfully challenged by competition authorities across the world.

South Africa is no exception. Our competition legislation has been modernized and strengthened and the resources devoted to enforcement have been significantly upscaled. We witnessed increasingly robust application of anti-trust even before the new act was on the statute book particularly in the area of merger control – the former Competition Board's blocking of the proposed SASOL-AECI and Pharmacare-Adcock mergers are the best known examples.

Why is this so? I'll not go into the reasons for this in any greater detail but, in the hope that it will help you to better appreciate why your business decisions are subject to regulatory scrutiny, I want to list the most important reasons for the resurgence of anti-trust.

First, consistency with trade liberalisation. As cross border barriers to international trade have come down potential exporters and foreign investors are beginning to find that internal barriers still effectively exclude them from lucrative national markets. Competition law is principally designed to deal with these internal barriers to trade and commerce.

Second, underpinning privatisation and deregulation. After two decades of proclaiming the virtues of the free market and its victory over central planning, its proponents, at least its intelligent ones, have come to recognise that truly free markets – free, that is, of any regulation - look more like a contemporary Russian horror than a Silicon Valley nirvana. The fact is that markets need rules if they are to perform to the best of their undoubted abilities. And anti-trust rules are a large part of the framework that, of necessity, governs the conduct of the participants in a market economy.

Third, some of the traditional values and concerns that drove anti-trust policy in its earlier incarnations are back on the agenda. The nimble, innovating entrepreneurs of the seventies have become the domineering corporate titans of the 'nineties – Microsoft is to 2000 what

Standard Oil was to 1900. They are stifling innovation and entrepreneurship and imposing considerable barriers to entry particularly in the way of small firms.

The relative weight given to each of these – and other – drivers of competition policy naturally differs from country to country. But you'll recognise the presence of each of these considerations in our government's decision to strengthen the legal framework governing competition policy and its enforcement. Our trade policy demands a strengthened anti-trust policy; the retrenchment of the state from direct involvement in the economy and the policy decision to submit state owned enterprises to commercial disciplines requires new rules of the game; the need to raise productive efficiency and lower barriers to entry underpins concern with the structure of the economy and the behaviour of its major actors.

The take-home message and the point of this long digression is simple: don't imagine that the strengthening of competition policy is a capricious whim of the South African government. It is firmly entrenched, it is part of the way of the world. So instead of ignoring it or imagining that fancy legal footwork will see it off, rather think seriously about how you adjust business behaviour in the context of this new reality.

How does merger regulation fit into all of this?

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 concerned with structure, with preventing the sort of structure that is likely to lead to anti-competitive behaviour.

There is no presumption that merging is anti-competitive; rather there is an assessment of the structure that will emerge post-merger and of its likely impact on competition. On this assessment the vast majority of mergers pass unscathed through the investigative and adjudicative process. However, if an investigation concludes that it is likely to impact negatively on competition then it will be prohibited or conditions designed to ameliorate the anti-competitive impact will be imposed – merger regulation is pre-emptive; restrictive practices regulation, on the other hand, is concerned with behaviour, in particular with the behaviour of dominant firms.

There are a number of key features of merger regulation under the Act that you should appreciate upfront – firstly, it incorporates vertical, horizontal and conglomerate mergers; secondly, it is about acquisition of control and the mechanisms for acquiring control are broadly defined; thirdly, control itself is broadly construed. In short the merger definition is inclusive – there are few business combinations that would fall outside of the definition of merger. This contrasts markedly with the previous act that essentially dealt with horizontal mergers only – that is, mergers between competitors only.

That having been said I want to look at the essential features of the merger evaluation process – these are the notification requirements, the thresholds, the investigation, and the adjudication.

In a major departure from previous practice, the new act provides for compulsory notification to the Competition Commission of all mergers above a defined threshold. Most jurisdictions provide for compulsory notification above defined thresholds. In some – as in ours – the competition authorities have no jurisdiction over firms falling below the threshold. These are jurisdictions that, like our own, tend to set relatively low notification thresholds. Other jurisdictions set notification thresholds but retain jurisdiction over mergers falling below the thresholds – here thresholds tend to be set at somewhat higher levels.

An innovation in our act is that it actually provides two thresholds – the first, a relatively low threshold, delineates notifiable from non-notifiable mergers. Those falling below the first threshold are not subject to the Act. The second threshold – a considerably higher threshold – delineates intermediate mergers from large mergers. In terms of the current thresholds all mergers where the combined value of the parties is above R50m and the value of the target exceeds R5m must be notified. Mergers with a combined value of R3,5 billion or greater and where the value of the target exceeds R100 million are designated 'large mergers'. Those falling between these thresholds are 'intermediate mergers'. The significance of this delineation will become apparent when we talk about the adjudication process.

Several important points about the thresholds and the notification process:

- In calculating the value of the merger, the acquiring party includes the value of the parent company and naturally of all subsidiaries while the value of the target only incorporates all subsidiaries.

- The purpose of the notification process is to enable the investigators to complete their work as quickly and as accurately as possible and this task is enormously facilitated by the parties providing all the required information. On the other hand providing truckloads of irrelevant information does not help the cause of the merging parties but simply serves to overload the investigators thus prejudicing the prospect of a speedy decision.

- There are fees to be filed with each merger notification and these vary with the size of the transaction. Merger adjudication is a complex and time consuming task that involves high-level professional staff. An effective process is in everybody's interest particularly those who make use of the service. This is why all competition authorities levy merger fees - our fees are low at the small and intermediate end and relatively high at the large end, but overall they are in step with agencies elsewhere.

- Merging parties are also required to notify unions representing their employees of a proposed merger.

Intermediate mergers are investigated by the Commission which is empowered to approve the merger with or without conditions, or to prohibit the merger. This must be completed within 30 days of notification or it may elect to extend the period up to a further 60 days. Decisions of the Commission with respect to intermediate mergers may be appealed to the Competition Tribunal.

Large mergers must be notified to the Commission and are investigated by the Commission. On receipt of notification of a large merger, the Commission must inform the Tribunal and the Minister. Within 60days – or up to 20 days longer if the Tribunal agrees to an extension of the period – the Commission must forward a recommendation to the Tribunal and Minister. The Tribunal must then decide whether to approve the merger conditionally or unconditionally or prohibit it. Although, in contrast with the previous act, the Minister has no decision making powers, he may elect to make representations on public interest grounds to the Commission, the Tribunal and the Competition Appeal Court.

How are mergers evaluated?

Peculiarly enough, this may be the aspect of merger evaluation in which there is considerable continuity from the previous regime. There is a fairly standard set of criteria for evaluating mergers across competition jurisdictions – however, although the questions are fairly standard,

the answers are immensely affected by the character of the particular economy in question.

Section 16 of the Act lays out reasonably clearly the criteria to be employed in the merger evaluation process. There are three key steps. First, the investigators, and where appropriate the Tribunal, must consider the impact of the merger on competition. This is not simply a matter of calculating present market shares and imputing future market shares. It is a sophisticated analysis in which a range of factors must be considered – the nature of the product, the state of international trade in the product, past inter-firm relations, the prospect that, in the absence of the merger, one of the firms may fail, are some of the factors that have to be accounted for. Once this analysis is done it is wholly possible that a merger that leads to large market share might be approved whereas one that results in substantially smaller market shares might be rejected. One word of advice here: the definition of the market is a very important prior step in conducting the competition analysis. Predictably, the parties tend to define their market very widely; competition authorities tend to rather narrow definitions of the market. Taking patently ridiculous views of market definition is not helpful to the evaluation process.

If the first question is answered in the affirmative, that is, if it is found that the merger will impede competition, the investigators and tribunal must ask whether there are not efficiency gains from the merger that may counter-balance the negative impact on competition. Here again, try and avoid presenting extreme ideas or analyses based on anecdotal evidence alone – don't exaggerate the efficiencies expected from the merger and bear in mind that the evidence regarding the efficacy of mergers as a corporate strategy is skeptical at best. Or if, as appears inevitable, you're going to use the economies of scale argument for a merger then present evidence don't simply assert it, and don't simply claim that because there are significantly bigge firms in the same industry elsewhere in the world that this somehow means that the continued existence of your firm demands that you be permitted to merge. And related to this, if you're going to insist that turning down the merger will result in the death of one or even both parties tc the merger, then again be prepared to support this with data and sound analysis. Assertions ar cheap and we've heard them all before. Your problem with efficiency defences is that they need to be evaluated upfront before the merger has been consummated. This means that the claims are inherently speculative as parties are not yet in a position to demonstrate their existence.

The final step is the assessment of the impact on public interest. An anti-competitive merger may be permitted in the face of strong public interest reasons in favour of the merger; by the same token a merger that is judged to have no negative impact on competition may be disallowed on public interest grounds. This is a difficult and controversial step. It's eased somewhat by the fact that the Act specifies the public interest grounds that may be considered, but it will always be a difficult judgement call. Again, cynicism and vastly exaggerated claims do not help anyone's case or promote the effective administration of the law.

I want to end this by emphasizing a point made at the beginning of my discussion of mergers. There is no public policy presumption against mergers. On the contrary it is recognized that these transactions are frequently an aspect of corporate restructuring that is inevitable and productive. I would expect the vast majority of mergers to be easily approved. And even those that do run into objections from the competition authorities are generally susceptible to a negotiated resolution that allows a form of the transaction to go through without offending competition requirements. But mergers that are devised for dominating markets will fall foul of the Act. Better to recognize this upfront, in other words, to factor this regulatory hurdle into your calculations right from the beginning. It will save time and money and considerable frustration down the line.