

Unclassified

DAF/COMP/AR(2010)6



Organisation de Coopération et de Développement Économiques  
Organisation for Economic Co-operation and Development

01-Oct-2010

English - Or. English

Directorate for Financial and Enterprise Affairs  
COMPETITION COMMITTEE

DAF/COMP/AR(2010)6  
Unclassified

**ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN SOUTH AFRICA**

-- 2009 --

*This report is submitted by South Africa to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 27-28 October 2010.*

JT03289242

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## Executive Summary

1. The annual report for the 2009/10 financial year records the activities that took the Competition Commission to its first decade of existence. The Commission's tenth anniversary is a significant milestone in the trajectory of steady growth that the South African competition authorities have enjoyed. This milestone was celebrated at the third annual competition conference, held in early September 2009. The conference was of wider scope than in previous years and hosted delegates from a broad base of interest groups. These included: competition authorities from across the globe, including from Africa; scholars and academics; government departments; legal practitioners and other professionals; and former staff members of the Commission. It was an appropriate time to pay tribute to the work of the founders of the competition authorities, who provided the solid foundation from which it has been able to grow.

2. The Commission's three-year strategies are carefully devised to give direction and vision to the organisation's activities, and to use its resources intelligently. The 2006-2009 strategic plan, which had guided the Commission through a significant growth phase, came to an end in the year under review. A key measure of a resilient organisation is its ability to deal with change and, in the dynamic and challenging business environment over the past few years, the Commission has shown that it is more than able to respond. The importance of the strategic plan was to ensure a more proactive approach to our work and a conscious effort to introduce, manage and steer change. We began the new year with another medium term strategic framework. Key priorities identified in the reviewed strategic plan include prioritisation for impact, increased stakeholder engagements and building a high performance competition authority.

3. During the 2009-2010 financial year the Commission continued its focus on proactive enforcement work with a focus on cartel behaviour in the identified priority sectors. To manage this more effectively, we are in the process of setting up a dedicated cartels unit. We received 79 applications for leniency in terms of the Commission's corporate leniency policy in the year under review, a substantial increase from the 13 applications in the previous year. The increase shows that firms are becoming more aware of competition law and of the fact that the Competition Commission has teeth, and they are using the leniency process to voluntarily comply with the law.

4. The Commission has been very active in its priority sectors. (infrastructure and construction, food and agro-processing, intermediate industrial products and financial services). This is evident in its completing its prosecutions with all members of the bread cartel. Pioneer Foods, the last member of the cartel, was fined a hefty R195 million, the equivalent of 10 percent of the bread division's turnover for 2006. The Commission also reached a settlement with Sasol for its collusive conduct in relation to fertiliser products, in which Sasol agreed to pay R250 million for its role in the fertiliser cartel. Investigations into other members of the cartel are still ongoing. In the intermediate industrial products sector, the Commission uncovered cartels in various markets for steel products and referred four cartel cases to the Tribunal. The referrals involve some of the major players in the steel industry such as Arcelor Mittal and Aveng. In the financial services sector, the Commission's work continued to focus on implementing the recommendations of the Banking Enquiry. The Commission has been working with National Treasury, the South African Reserve Bank and the Department of Trade and Industry to take the Banking Enquiry panel's recommendations forward, with the major banks agreeing to implement 19 of the 28 recommendations. This is a significant step towards a more transparent and pro-competitive banking system that will operate to the benefit of the consumer.

5. Measuring the impact of our activities on consumers and the economy requires the Commission to increase its engagements with government, stakeholders and policy makers to influence economic policy and decision making that will be consistent with the principles of pro-competitive practices. Increased

engagement with government includes our bid-rigging seminars, the public sector consultative forum and our involvement with National Treasury on the Banking Enquiry over the past three years.

6. An increase in the merger threshold for intermediate and large notified mergers, combined with a weak economic environment resulted in a drop in the number of notified mergers (190 in the year under review compared to 415 in the previous year). The Commission also witnessed an increase in the number of notifications affecting firms in financial distress. While job losses are an inevitable part of merger activity, where possible, the Commission has tried to mitigate the effects by approving mergers on condition that mechanisms are implemented to minimise the impact of job losses. In particular, the Commission called on merging parties to invest in the training and skills development of affected employees to enable them to access other jobs in the economy.

7. In terms of our international focus, we have become more involved with competition authorities from the African continent. An example is our participation with the Zambian and Egyptian competition authorities in the Joint Food Project, which is examining anticompetitive practices in food products. Our work with other competition authorities in forming a joint competition forum for African authorities will provide a platform for sharing experiences and strengthening our capacity.

8. Becoming a high performance competition authority requires good governance and strong leadership within the organisation. The Commission identified its middle managers as a key tier of management in the context of severe resource constraints. A number of initiatives to develop the capacity of middle management were undertaken. In order for the organisation to continue to be effective, particularly in the face of the growing scale and complexity of enforcement, investigations and prosecution, our staff is set to grow over the next few years.

9. The Commission no longer reports to the Minister of Trade and Industry and will now report to the Minister of Economic Development.

Shan Ramburuth (Commissioner)

## **1. Changes to competition laws and policies, proposed or adopted**

### ***1.1 Summary of new legal provisions of competition law and related legislation***

10. *Increase of threshold of notifiable mergers:* In the year under review, the threshold for notifying mergers was increased. From 1 April 2009, the combined threshold for mandatory notification of intermediate mergers increased to R560 million from the previous R200 million, with the threshold for the target firm increasing from R30 million to R80 million. The combined threshold for mandatory notification of large mergers increased from R3.5 billion to R6.6 billion, with the threshold for the target firm increasing from R100 million to R190 million. The aim of the significant increase in merger thresholds is to decrease the number of mergers that require notification and to lighten the administrative load of the Commission.

### ***1.2 Other relevant measures, including new guidelines***

11. *Guide to small merger activity:* The Mergers and Acquisitions Division has improved its processes for tracking merger activity with the aim of ensuring not only that there is compliance with the Act, but also to review and consider small mergers that are likely to substantially prevent or lessen competition. To create awareness of this, the Commission published a guide to small merger activity, which indicates that firms that are subject to current enforcement investigation and/or prosecution are requested to inform the Commission of any small mergers that they are proposing, after which the Commission will inform the parties whether or not they need to notify the Commission. The reaction to the guide was slow at first, but with more firms coming forward, there is clearly a culture of compliance developing. The Commission received 16 requests in the year under review.

## **2. Enforcement of competition laws and policies**

### ***2.1 Action against anticompetitive practices, including agreements and abuses of dominant***

#### ***2.1.1 Description of significant cases, including those with international implications.***

- **Competition Commission vs Pioneer Foods Pty Ltd**

The Commission prosecuted the remaining member of the bread cartel, Pioneer Foods (Pty) Ltd over a period of six days in June 2009. In February 2010, the Tribunal handed down its decision, in which it found that Pioneer Foods had contravened section 4(1)(b) of the Act. In its decision, the Tribunal awarded a record breaking 10 percent of the relevant turnover of Sasko Pioneer's bread division in respect of one of the complaints. This is the highest percentage penalty that the Tribunal has awarded to date. Despite this, the Commission has appealed this decision as it concluded that the Tribunal misconstrued its powers when determining that the penalty should be based only on the firm's turnover from the bread division. The penalty it imposed was therefore not a sufficient deterrent and the Commission contends that it should rather be based on the firm's wider turnover. The appeal is pending before the Competition Appeal Court.

- **Competition Commission vs Telkom Ltd and another**

The Competition Commission appealed the decision of the High Court to review and set aside its decision to refer certain complaints of anticompetitive conduct by Telkom to the Competition Tribunal. In its application to the High Court, Telkom had challenged the Tribunal's jurisdiction to hear the complaint and had sought an order setting aside the decision to refer on the basis that it was vitiated by bias or prejudice and by other procedural irregularities. The Supreme Court of

Appeal held that the Tribunal had competence to adjudicate the complaint and that there were no grounds to review the Commission's decision to refer the complaint to the Tribunal. In terms of this decision, Telkom was obliged to answer to the merits of the Commission's complaint referral, which it had filed with the Tribunal in February 2004. This matter is pending before the Tribunal.

- Competition Commission vs Senwes & another

In December 2006, the Commission referred a complaint against Senwes, a dominant supplier of grain storage facilities, to the Tribunal. In its complaint, the Commission alleged that Senwes was engaged in exclusionary conduct as it had induced farmers not to deal with its competitors in the market for the trading of physical grain. In addition, through its differential pricing policy in which it charged farmers and traders a different price for the same service, the Commission alleged that the firm was engaged in price discrimination. The Commission further claimed that Senwes was engaging in a margin squeeze as it was charging grain traders a higher fee than its trading arm, Senwes Trading, paid for the storage of grain. All this resulted in the undermining of competition in the grain trading market.

In February 2009, the Tribunal found that Senwes' conduct did not constitute a contravention of sections 8(d)(i) and 9(1) as pleaded by the Commission, but instead constituted a margin squeeze in contravention of the general prohibition against exclusionary conduct contained in section 8(c) as it pleaded in the alternative. This decision is important in that it recognises margin squeeze, which is not expressly mentioned in the Act, as a class of exclusionary conduct that contravenes the Act under section 8(c).

Senwes appealed the Tribunal's decision of February 2009 to the Competition Appeal Court in November 2009. The Commission opposed Senwes' appeal and in turn cross-appealed the Tribunal's dismissal of the inducement complaint. In its decision handed down in November 2009, the Competition Appeal Court dismissed the appeal and the Commission's cross appeal. Senwes appealed the Competition Appeal Court's decision on merit and its application for special leave to appeal is pending before the Supreme Court of Appeal.

## **2.2 Mergers and acquisitions**

### *2.2.1 Statistics on number, size and type of mergers notified and/or controlled under competition laws*

12. In the year under review, two factors resulted in fewer merger notifications to the Commission. First, the threshold for notifying mergers increased; and second, the economy was just beginning to recover from the economic slowdown.

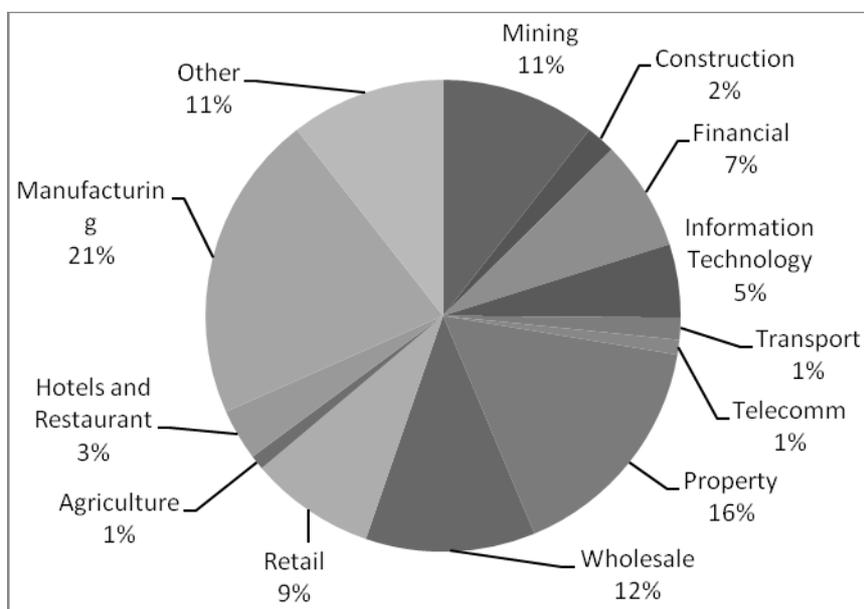
13. About 8 percent of the total number of transactions notified to the Commission related to firms in financial distress.

14. During the reporting period, 11 transactions were approved on the condition that the likely effect the transaction might have on employment be mitigated. In order to try and reduce the number of job losses occurring as a result of mergers, or mitigate their effects, the Commission restricted job losses by conditionally approving mergers and forcing parties to up-skill affected employees to enable them to get work elsewhere or become self-employed.

15. *Merger activity by sector:* Figure 1 (below) shows the industries in which the Commission decided on mergers and acquisitions. There was a marked increase in activity in the wholesale sector (increasing to 12 percent from 5 percent in 2008/09). A particularly active firm was Massmart. The only

transaction that the Commission prohibited in the reporting period was Massmart's proposed acquisition of Finro Cash & Carry. The Competition Tribunal subsequently approved the transaction without conditions (see summary of significant cases below).

**Figure 1: Merger decisions by sector**



### 2.2.2 Summary of significant cases.

- Nedbank and Imperial Bank: 464 job losses for skilled employees

The Commission approved this merger despite the retrenchment of 260 permanent employees and 204 temporary employees that would result from the merger. In approving the merger, the Commission took into consideration *inter alia* that the retrenchments affected less than 1 percent of the entire workforce of the merging parties. And out of the permanent employees that would be affected, most are skilled, qualified individuals with years of experience, and they would be able to find work at other institutions. The Commission was mindful of an agreement with the union to redeploy and re-skill staff to minimise the negative effects as far as possible. The Competition Tribunal made adherence to the agreement a condition on which the merger was approved.

- Harmony and Pamodzi Free State: 1,200 job losses for unskilled employees

This merger was approved by the Commission despite the resulting job losses of approximately 1,200. In approving the merger, the Commission was mindful of the fact that if the merger was not approved, a total of 3,606 employees of Pamodzi Free State would have permanently lost their jobs, as Pamodzi Free State was facing final liquidation. At the time the merger transaction was notified, employment contracts had already been suspended. The National Union of Mineworkers and Solidarity, the two unions representing the largest number of Pamodzi employees had signed agreements with Harmony Gold Mining Company Limited in terms of which Harmony undertook to re-engage 2,400 employees within 24 months. The unions provided letters of comfort in support of the merger. The Competition Tribunal made Harmony's undertakings conditions for the approval of the merger

- Massmart and Finro Cash and Carry

The Commission recommended to the Tribunal that it prohibit the proposed transaction between Massmart and Finro Cash and Carry. The Commission was of the view that the transaction would result in higher wholesale prices of grocery products to the detriment of low income consumers. The Tribunal subsequently approved the transaction unconditionally after the hearing that was held on the matter in August 2009.

The main focus of the Tribunal's decision was the analysis of the potential anticompetitive horizontal unilateral effects arising in the relevant market as a result of the merger.

The Tribunal found that Finro is undoubtedly an effective competitor to Massmart in the Port Elizabeth grocery wholesale market. However, the Tribunal stated that this factor and the fact that the market would be highly concentrated post merger must be assessed in the context of other evidence. This was on the basis that there is substantial differentiation in this market, with significant differences in individual firms in terms of product range and product mix, customer profiles, margins, location, delivery arrangements and credit terms. It stated that post merger there would still be significant competitors in the relevant market, including three large wholesalers effectively competing with the merged entity as well as four small competitors.

Evidence provided in the hearing and which the Tribunal accepted showing that a number of constraints that the Commission had disputed in its recommendations were in fact relevant and could collectively inhibit the merged entity's ability to raise prices post merger. These are: the ability of incumbent firms to expand and/or reposition their competitive offering in response to a price incentive (for example, rival firms may reposition or expand their product ranges; the significant direct supply of certain product lines by grocery manufacturers to grocery retailers; and retailers' procurement of suppliers through buying groups, which is a distinct alternative for the larger retailers).

The Tribunal concluded that the Commission's scenario of the merged entity's ability to unilaterally increase prices post merger was weak. It also maintained that there was no basis to conclude that consumers would be worse off as a result of this acquisition, either from a pricing or service delivery perspective. It acknowledged that there are indeed high barriers to entry in the relevant market, concluded that, based on the available evidence, the acquisition was unlikely to result in a substantial prevention or lessening of competition in the relevant market either from a horizontal or vertical perspective. In its decision, the Tribunal also provided some guidance on the future use of economic modeling and customer survey and statistical analysis.

**3. The role of competition authorities in the formulation and implementation of other policies, e.g. regulatory reform, trade and industrial policies**

- Comments on the South African Post Office Bill, August 2009:

The Commission supported the principles of the Bill to the extent that there are aimed at building an efficient post office. Also, the Commission supports the prohibition on cross-subsidization of the two-tiers of the postal services market.

The Commission has encouraged the South African Post Office (SAPO) to ensure access to its infrastructure as this is fundamentally important for the development of small businesses in the postal industry. Furthermore the Commission advised SAPO on the applicability of the dominant provisions of the Competition Act.

Taking into consideration the current postal regulatory framework, the Commission should engage with ICASA and DOC to explore the feasibility of completely liberalizing the reserved

postal service market. This would entail, amongst other things, getting insights as to why ICASA decided to retain SAPO’s monopoly rights in the reserved postal services market.

- Submission to the Parliamentary Portfolio Committee on Communications on high interconnection charges, September 2009:

The Commission made a submission to the Parliamentary Portfolio Committee on Communications on high interconnection charges. The Commission’s submission provided a brief explanation of the relationship between interconnection rates and competition in South Africa and comments on the role of the Competition Authorities in the communications sector and the role that the Independent Communications Authority South Africa (ICASA) should be playing in addressing this issue.

Mobile call termination prices appear to be high in South Africa, relative to call termination on fixed and fixed-wireless networks, and relative to mobile call termination rates overseas. There is some evidence that retail discounts, discounts for calls to the same network, and calls from CSTs and LCRs may limit the mobile operators’ ability to maintain excessively high prices for call termination. However, the outcomes we see in the case of South Africa - with mobile call termination rates set significantly above rates overseas and by other non-mobile operators in South Africa - suggest that these constraints are limited. This suggests the need for strong regulatory intervention in relation to mobile call termination.

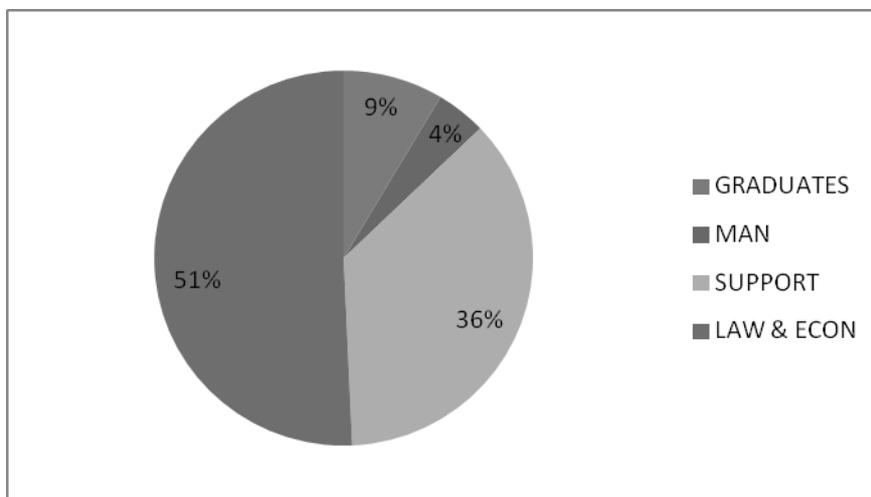
Any regulatory intervention in call termination rate setting should take into account the waterbed effects that might arise, whereby reducing call termination rates might increase monthly access charges to networks (which are currently effectively near to zero for pre-paid customers), and / or increase prices for other services such as data and SMS’s.

**4. Resources of competition authorities**

**4.1 Resources overall (current numbers and change over previous year):**

16. At the end of the period under review, the Commission’s staff complement was 138. This includes the 11 graduate trainees which had been recruited as part of the successful graduate trainee programme. Overall, the total number of staff number increased by 19 percent from 2008/09. The total numbers for 2007/08, 2008/09 and 2009/10 are 116, 132 and 138.

**Figure 2: Staff Complement**



#### 4.1.1 Annual budget (ZAR and USD)

17. The budget for the year 2009/2010 is as follows; the total budgeted revenue was R103 453 million (USD \$14 191 083.68), given by the Department, but the actual revenue was R111 305 million (USD \$15 268 176.58), the actual expenditure amounted to R128 673million(USD \$17 650 617.28), therefore we incurred a deficit of R15 381million(USD \$2 109 425.24). The cost of running the Commission is increasing annually due to increased activity resulting in the increase in the demand for the human resource capacity.

18. The Commission therefore received an additional R21 217million (USD \$2 910 452.24) and of that R5 834million (USD \$ 800 374.35) remains in the account.

#### 4.1.2 Staff turnover over the past three years

**Table 1: Staff turnover 2007/08 to 2009/10**

Year	% Turnover
2007/08	26%
2008/09	16%
2009/10	15%

#### 4.1.3 Number of Employees

- Economists – 27
- Lawyers – 43
- Support staff – 49
- Management – 8
- Graduates trainees – 11
- All staff combined – 138

**Table 2: Staff Compliment 2009-2010**

DIVISION	Economist	Graduate	Lawyer	Management	Support	Grand Total
Comm Office			1		2	9
Dep Comm Office			1		1	2
M&A	4	2	10		1	19
E&E	11	2	14		1	30
P&R	12	3			1	20
ASR		1	4			11
Cartel Unit			3			3
CSD					1	27
LSD		3	10		1	16
<b>Grand Total</b>	<b>27</b>	<b>11</b>	<b>43</b>		<b>8</b>	<b>138</b>

#### 4.2 Human resources applied to:

- Enforcement against anticompetitive practices – 30
- Merger reviews and enforcement – 19
- Advocacy efforts – 11

#### 4.3 *Period covered by the above information*

- April 2009 to March 2010.

#### 5. **Summaries of or references to new reports and studies on competition issues**

19. *The Joint Food Project*. In 2009, the Competition Commission joined forces with the Egyptian Competition Authority and the Zambian Competition Commission in a project that aims to evaluate competition issues in the production, supply and pricing of staple food products through collaboration and information sharing workshops. The project is funded by the International Development Research Centre (IDRC). It has been organised into three phases:

- initiating the project and building the team capacity in each competition agency;
- collating the available information and analysis related to food prices in each country leading to the compilation of an overview report;
- examining closely competition issues in a selected set of markets.

20. South Africa and Zambia carried out studies to examine the factors affecting the fertiliser and maize milling sector, and South Africa and Egypt looked at the edible oil sector. Egypt also examined competition issues relating to food supply in the informal sector.

21. These studies highlighted the importance of practitioners having a deep understanding of market dynamics, and the ways in which products are produced and sold. The project has also identified the need for greater collaboration between competition authorities in the southern African region to deal more effectively with anticompetitive conduct by companies operating across the region.