IN THE COMPETITION APPEAL COURT OF SOUTH AFRICA

Case No. **08/CAC/MAY 01**

In the matter between:

DISTILLERS CORPORATION (SOUTH AFRICA) LIMITED First Appellant

STELLENBOSCH FARMERS' WINERY GROUP LIMITED Second Appellant

and

BULMER (SA) (PROPRIETARY) LIMITED First Respondent

SEAGRAM AFRICA (PROPRIETARY) LIMITED Second Respondent

JUDGMENT DELIVERED ON 27 NOVEMBER 2001

<u>DAVIS, JP</u>:

1. **INTRODUCTION**:

On 20 September 2000 first and second appellants entered into an agreement in terms of which first appellant would acquire, subject to the approval of the shareholders, the assets and liabilities of the second appellant for a purchase consideration of R515 157 950,31 which amount was to be discharged by the issue of 55 580 000 ordinary shares in the share capital of first appellant.('the agreement of 20 September')

The shares in each of first and second appellant are listed on the Johannesburg Stock Exchange ('JSE'). Shares in each of the Appellants were owned as follows: 60% of the share capital by Rembrandt-KWV Investments Limited ('Rem-KWV'). Rem-KWV is a joint holding company of Rembrandt and KWV in which each holds a 50% interest. KWV's interest in Rem-KWV was held through a listed subsidiary, KWV Investments Limited, in which KWV owned approximately 54%. An additional 30% of the shares were owned by South African Breweries Limited ('SAB') and the remaining 10% by the general public.

A voting pool agreement existed between Rembrandt, SAB and KWV in respect of each of first and second appellant pursuant to which Rembrandt, SAB and KWV exercised control over each of first and second appellant.

The Competition Commission adopted the approach that the transaction as set out in the agreement of 20 September (the terms of which were amended on 9 October 2000) did not constitute a merger as defined in the Competition Act 89 of 1998 as amended ("The Act"). In the event that the transaction did constitute a merger, appellants were, in terms of section 13 of the Act, enjoined to give prescribed notice of the transaction to the Competition Commission. Appellants adopted the approached that they were under no such obligation as the transaction did not lead to a change in the ultimate control of either company. Two of appellants' competitors, being respondents in the present dispute, adopted a contrary view and brought an application to the Competition Tribunal ("The Tribunal") in terms of s62(1) of the Act on the basis that appellants had failed to notify the transaction.

The Tribunal found that the agreement of 20 September constituted a merger as defined in section 12 of the Act and ordered that appellants be given a period of 10 business days from the date of their decision to notify the merger to the Competition Commission in the manner prescribed in the Act and rules for large mergers to be so notified. It is against this decision of the Tribunal that the appellants now appeal to this court.

FACTUAL BACKGROUND TO THE AGREEMENT OF 20 SEPTEMBER 2000.

In 1979 the consent of the then government was granted for a restructure of the liquor industry. A new entity Cape Wine and Distillers Limited ('CWD') was formed out of an arrangement between SAB, second appellant, the Oude Meester Group Limited ('OMG') and KWV. The basis of this restructure rested on the purchase of the Rembrandt Group's beer interest by second appellant in exchange for its agreement to limit its involvement in wine and spirits to its 30% investment holding in CWD. The Rembrandt Group duly undertook to desist from any involvement in the beer industry. CWD was then listed on the JSE with ownership of its shareholding as follows:

a. 30% held by the Rembrandt Group;

b. 30% held by SAB;

c. 30% held by KWV; and

d. 10% held by the public.

The structure can be illustrated diagrammatically thus:

30%
KWV
SAB
30%
CWD
PUBLIC
RG
10%
30%
OMG
SFW

At a later stage Rembrandt and KWV formed a jointly owned holding company, Rembrandt KWV Investments Limited in which they consolidated their respective shares in CWD to an agreement of 60% of the shares of the latter company. In 1998 second appellant and OMG were separately listed on the JSE. CWD retained the activities of second appellant which was renamed accordingly while the OMG's interests were transferred to a new entity, namely first appellant.

On 8 June 2000 appellant's attorney wrote to the Competition Commission seeking clarification as to whether a proposed merger between first and second appellants constituted a notifiable transaction. On 7 August 2000, the Commission addressed a letter to appellants attorney in which it said: '*the information submitted by Rand Merchant Bank indicates that the voting pool agreement will remain unchanged and that, while a new shareholders agreement will be drafted, it will remain materially the same but will exclude the "non-compete" clause contained in the existing agreement. Therefore, it would appear that after the transaction has been effected, there would be no change of control as envisaged in the Act.*

On the basis of the above information, the Commission therefore concludes that the proposed transaction would not constitute a merger as defined in section 12 of the Act. The proposed transaction will thus not be notifiable in terms of section 13 of the Act. It must further be highlighted that, should the voting arrangements change in any way, the above opinion may not apply'.

Appellants effected the transaction whereby first appellant was to acquire all the principle assets and liabilities of second appellant in terms of the agreement of 20 September 2000 as amended on 9 October 2000. On 10 October 2000 the Competition Commission again wrote to appellants attorney and informed him as follows: '*After such review, the Commission determined that the said transaction between SFW and Distillers constituted a merger as defined in section 12 (1) of the Competition Act no. 89 of 1998 as amended. The Commission's decision is based, inter alia, on the fact that in its view, the transaction does not constitute an internal restructuring as suggested by the parties.*

In the circumstances, the transaction must be notified to the Commission within 7 days of receipt of this letter, failing which the merger will be deemed to be in contravention of the Act.'

This letter did not prove to be the end of the Commission's role. According to an affidavit deposed to by appellants attorney, Mr. Katz, ' *a few days later the Commissioner telephoned me to advise me that he had considered the matter carefully and I made an appointment to see him. During the course of that appointment the Commissioner informed me that he and his* *colleague had carefully considered the matter and that they accepted the correctness of the interpretation of section 12 as advanced on behalf of the First and Second Respondents and that accordingly the transaction could proceed*.'

Thereafter respondents brought an application in the Cape High Court on 10 November 2000 for a declaration that that the agreement of September 20 constituted a notifiable transaction in terms of the Act. Respondent further sought an interdict restraining appellants from implementing the merger, alternatively an order to refer the matter to the Tribunal. Jali J found that section 65 (3) of the Act made it clear that the High Court did not have jurisdiction to hear a matter which concerned a question of law which pertained to the Act.

Respondents then approached the Tribunal for an order declaring that the agreement of 20 September 2000 constituted a merger as defined.

<u>THE TRIBUNAL'S FINDING</u>

The Tribunal was required to interpret sections 12 and 13 of the Act as they were prior to the extensive amendments in terms of the Competition Second

Amendment Act 39 of 2000 (‘the amending Act’). As the parties based their arguments on the legislative position which applied prior to the application of the amending Act, this court is not required to deal with the question of the application of the amending act to this dispute. The matter can thus be resolved in terms of the law which applied before the application of the amending Act.

Section 13(1) of the Act which is central to this dispute provides as follows:

‘Any party to an intermediate or large merger will notify the Competition Commission of that merger no more than seven days after the earlier of :

a) the conclusion of the merger agreement;

b) the public announcement of the proposed merger bid;

c) the acquisition by any of the parties to that merger, of a controlling interest in another.

Section 12 contains the crucial definition of merger:

(1) “*merger*” *means the direct or indirect acquisition or direct or indirect establishment of control, by one or more persons over all significant interests in the whole or part of the business of a competitor, supplier, customer or other person, whether that*

control is achieved as a result of:

a) purchase or lease of the shares, interest, or assets of that competitor, supplier, customer or other person;

(b) amalgamation or combination with that competitor, supplier, customer or other person, or

(c) any other means.

2) A person controls a firm if that person –

a) beneficially owns more than one half of the issued share capital of the firm;

b) is entitled to vote a majority of the votes that may be cast at a general meeting of the firm, or has the ability to control the voting of a majority of those votes, either directly or through a controlled entity of that person;

c) is able to appoint or to veto the appointment of a majority of the directors of the firm;

d) is a holding company, and the firm is a subsidiary of that company as contemplated in section 1(3)(a) of the Companies Act, 1973 (Act No. 61 of 1973);

e) in the case of firm, that is a trust, has the ability to control the *majority of the votes of the trustees, to appoint the majority of the trustees, to appoint or change the majority of the beneficiaries of the trust;*

f) *in the case of a close corporation, owns the majority of members' interest, or controls directly, or has the right to control the majority of members' votes in the close corporation; or*

g) *has the ability to materially influence the policy of the firm in a manner comparable to a person, who, in ordinary commercial practice, can exercise an element of control referred to in paragraphs (a) to (f)*".

The key to the present dispute turns on the interpretation of section 12, namely the scope of the definition of merger, the existence of which is essential for the application of section 13.

The Tribunal found that section 12(1) provides for a merger to be achieved through the acquisition or establishment of direct or indirect control. Given the inherent difficulty in ascertaining the nature of indirect control, it held that section 12(2) was introduced in order to give *"some examples of indirect control that might be exercised over a firm*".

The Tribunal concluded thus: '*when we want to understand what control means for the purpose of section 12 we must interpret the language of section 12(1) and see the instances of section 12(2) as ancillary to but not determinative of that inquiry. To put it in another way section 12(2) sets out the most commonly occurring situations to be found within the boundary of meaning of control but it does not set the boundary - that must be done by reference to section 12(1) alone'*.

In response to respondents argument before the tribunal that first appellant acquired direct control over the business of second appellant by way of an asset purchase, appellants contended that section 12(1) sought to ensure that notification only took place where a change occurred to "*ultimate*" control or "*effective*" control. As both appellants had been controlled by the same shareholders prior to the transaction, and first appellant would be so controlled after the transaction, no change in effective control had taken place. Accordingly the transaction did not fall within the definition of section 12. This argument was based upon the contention that where firms are located in a single economic entity, a rearrangement between a purchaser and a seller within this same economic family does not lead to a change of effective control and thus falls outside of the scope of section 12. As the two companies had always formed part of a single economic entity both prior to and subsequent to the agreement of 20 September 2000 no change of control had occurred.

In finding that the appellants did not constitute a single economic entity the Tribunal emphasized the following :

1. Appellant companies were separately legal entities;
2. they were controlled by separate boards of directors;
3. they operated separately;
4. they had separate listings on the JSE;
5. Appellants have publicly held themselves out in their own circulars to shareholders as being in a competitive relationship, which relationship was to the benefit of shareholders.

The tribunal concluded as follows: ‘*on the facts before us we find that there is no evidence to suggest the respondents form part of a single economic entity. Nor is there evidence that the shareholders direct the activities of either of the respondents let alone directing that they act in concert. On the contrary there is at least prima facie evidence that the two companies operated autonomously and were hold out as competitors to their shareholders’*.

The Tribunal found that first appellant had direct control over the business of second appellant and hence the transaction constituted a merger which was notifiable in terms of section 13.

<u>APPELLANTS CASE:</u>

Mr. Kuper, who appeared together with Mr. Bhana on behalf of appellant’s attacked the reasoning employed by the Tribunal on a number of different bases. Firstly he submitted that it was only partly correct to conclude that section 12(2) was not exhaustive of the definition of control. He contended that section 12(2) dealt with changes that occur in the structure or shareholding of a company or artificial person that owns a business. Where section 12(2) so legislates, it is exhaustive. Thus the threshold shareholding that the legislature determined to be relevant for the purpose of defining the change of control was 50,1%. If the change of shareholding was less than that threshold, such change would not be relevant in assessing any change of control. Were it intended to be otherwise there would have been little purpose in specifying with precision the quantitative criteria specified in section 12(2)(a), (b) and (c). Mr Kuper's second attack was that the Tribunal had employed an overly literalist interpretation of section 12(1) in disregard of the fact that ultimate control had not changed. To so illustrate this submission, he employed an example. Assume B(Pty) Ltd sold its business to C(Pty) Ltd. A(Pty) Ltd held a 100% of the shares in both B(Pty) Ltd and C(Pty) Ltd. On a literal interpretation of section 12(1), there would be a change of control. On the approach employed by the Tribunal, this transaction would entail a change of control. Recognizing that such a transaction could not be intended to fall within section 12(1), Mr. Kuper suggested that the Tribunal is constrained to employ a subjective test such as the single economic entity test to exclude such a transaction from the ambit of the section. By contrast the legislature intended the section to provide for a clear ascertainable set of criteria to determine whether the transaction was a merger for the purposes of s13.

The test of ultimate control represented such an objective, ascertainable test and obviated recourse to a subjective test such as a single economic entity test.

Applying this test to the facts, Mr Kuper submitted that the effect of the sale of the business from second to first appellant resulted in the transfer of the business from a firm controlled by either Rembrandt KWV Investments Limited or Rembrandt, KWV and SAB into another firm controlled by the same company/ companies .

Mr. Kuper also referred to section 12(2)(d) of the Act in which it is provided that a holding company controls a firm if that firm is a subsidiary of the former. No change of control had occurred by reference to this section in that the holding/subsidiary relationship remained unchanged after the agreement of 20 September. Ultimate control remained with the same holding company.

In the alternative Mr. Kuper submitted that even if the Tribunal was correct to adopt the test of a single economic entity, it had failed to apply the test correctly to the facts of the present case. Had it so applied the concept correctly, it would have found that appellants together with their common controlling shareholders formed a single economic entity.

In this regard Mr. Kuper relied upon a dictum of the US Supreme Court in Copperweld Corp v Independence Tube Corp 467US752(1974) at 771, namely:

'*A parent and its subsidiary have a complete unity of interest. Their objectives are common not disparate; their general corporate actions are guided or determined not by two separate consciousness but by one. If the parent and a wholly owned subsidiary do agree to a cause of acting, there is no sudden joining of economic resources that had previously served different interests*'.

In the present case, common control of the boards of each of the appellants ensured a unity of interest. The corporate actions of appellants were determined ultimately not by the independent actions of the two appellant companies but by the entities which control the directors and thereby controlled their boards.

Mr. Unterhalter, who appeared on behalf of first respondent submitted that, following an application of the plain words of section 12(1), first appellant had acquired direct control over the whole of the business of second appellant. All the elements of section 12(1) were present namely first appellant was a person within the meaning of one or more persons, the assets of second appellant constituted ‘all significant interests in the whole or part of the business the competitive, supplier, customer or other person’, first appellant acquired direct control over second appellant’s business as a result of acquisition of the assets of second appellant pursuant to the agreement of 20 September. Thus, on a plain application of the words of section 12(1) the transaction fell within the definition of a merger.

Mr. Unterhalter also attacked the unitary or ultimate concept of control adopted by appellants, namely once a person controls by reason of one of the circumstances provided for in section 12(2), such control is exhaustive of the question of control and thereby precludes any other form of control from being relevant for the purposes of s13. He submitted that this interpretation rested upon the postulate that, if the control of the ultimate shareholders is not altered by a merger, control cannot be acquired in any other form by another party.

Mr. Unterhalter submitted that this unitary concept of control was fundamentally flawed. If section 12(2) is dispositive of the meaning of control, it would then contemplate that one person may control a firm by reason of the fact that such person beneficially owns more than half of the issued share capital of the firm (section 12(2)(a)) while another person controls the firm because that person is able to veto the appointment of a majority of directors of the firm (section 12(2)(c)). Thus on appellants very argument, section 12(2) contemplates that, at one and the same time, different persons can control the firm by reason of different powers that they may enjoy and the recognition of one species of control does not oust the recognition of another.

Mr. Unterhalter also contended that section 12(2) did not refer to a change of control but simply defined the circumstances in which a person controlled a firm. According to this submission, there was nothing in the language of section 12(2) which suggested that once control resided with a person for the purposes of the sub-section, that for the purposes of s13, all questions of control had been determined. On the contrary, section 12(1) refers to the acquisition or establishment of control "*by one or more persons*" It was clear that section 12(1) provides a general definition of a merger and refers to a general concept of control. Section 12(2) does not exhaustively provide for circumstances in which a person acquires or establishes control but simply tabulates circumstances in which a person is deemed to control the firm.

Accordingly, section 12(2) does not operate to define circumstances which exclude the notion that other persons may acquire or establish control nor does it define how a change of control might take place.

On the basis of this argument, the proper relationship between section 12(1) and 12(2) can be defined thus: section 12(1) refers to the means by which control can be achieved. S12(1)(c) provides examples of a residual class by which control may be achieved. This is indicative of and indeed, supportive of the general provision. Put another way, section 12(2) then instances circumstances of control but does not define nor limit the circumstances in which a person may acquire of establish control over a firm.

On this line of argument, in the case where a parent company makes use of a subsidiary company to acquire the assets of another business, there will simultaneously be a direct acquisition of control of the subsidiary over the business so acquired and an indirect acquisition of control by the parent company. Section 12(1) refers to both indirect and direct acquisitions of control and thus recognizes different but complementary ways in which control can be acquired. The indirect acquisition of control by the parent company as a shareholder of the subsidiary does not exclude the direct acquisition by the subsidiary over the assets of the business in question. For this reason, section 12(1) does not envisage a unitary concept of control.

Applying this approach to the facts of the present dispute, Mr. Unterhalter submitted that, prior to the transaction, the shareholders of first and second appellant exercised indirect control as shareholders over the assets of these two companies. The effect of the merger was that first appellant acquired direct control over the assets of second appellant. The acquisition by first appellant of the assets of second appellant constituted an acquisition of direct control by first appellant as between first and second appellant whether or not this transaction disturbed the control which the shareholders of first and second appellant may have continued to exercised. Thus, the acquisition falls within the meaning of section 12(1).

Mr. Newdigate, who appeared together with Mr. Butler on behalf of second respondent , submitted that the argument of appellant had failed to take account of the very facts of the case. There was no evidence to the effect that the shareholders of first and second appellants had in fact exercised control over the business of the companies. To the contrary, it was common cause that, prior to the transaction, appellants were separate companies, each having its own board of directors with the usual fiduciary duties towards the particular company of which they were directors. Each company was listed separately on the JSE. Each company competed with the other in various areas of the liquor industry. As an illustration of their operational practice, he referred to a circular to shareholders dated 21 October 1988 in which CWD set out proposals for the separate listing of CWD to be renamed second appellant and OMG to be renamed first appellant where the following appeared: '*Since its establishment in 1979 it has been Cape Wines firm policy that SFW and OMG operate as completely separate and competing companies. Each handles its own production, marketing and distribution and under separate directors and management they compete with all other producers in the market as well as each other. This policy stimulates healthy competition between SFW and OMG and the industry as a whole to the advantage of the public and the industry. The board of Cape Wine wishes to ensure that this position be further strengthened and has consequently decided to implement the proposals as set out in this circular."* The circular further stated that '*shareholders in Cape Wine will not be* *affected in any way in that their shareholdings in Cape Wine will be replaced by identical shareholdings in both SFW and OMG (via Distillers). This will afford shareholders the opportunity of assessing the performance of both companies in a competitive environment*'.

According to Mr. Newdigate these facts supported the argument that the shareholding of company A in company B did not exclude the acquisition of control of company B over the assets or interest of another company or entity. This would only occur, hypothetically, in the extreme example of the directors of company B being no more than puppets of company A who do its bidding without regard to the separate existence of company B or their fiduciary duties to it.

The approach to ss12 and 13

Chapter 3 of the Act deals with merger control. Section 11 empowers the Minister to determine the threshold for the classifications of mergers as either being large or intermediate which, in turn, regulates the size of the transaction which requires scrutiny by the Commission, Tribunal or Minister.

Section 13 obliges any party to an intermediate or large merger (as defined in terms of section 12) to notify the Competition Commission of that merger within the prescribed period. Section 14 empowers the Competition Commission to consider and approve such a merger save in the case of a large merger, as defined, where it must refer that notice to the Tribunal or the Minister and within the prescribed period must forward a recommendation as to whether the implementation of the merger should be either approved, with or without conditions, or prohibited.

Section 16 provides that, whenever required to consider a merger the Competition Commission or, where applicable, the Tribunal must initially determine whether or not the merger is likely to substantially prevent or lessen competition. A set of factors are then set out in section 16(2) which serve as guidelines in terms of which the Commission and Tribunal must assess whether or not a merger is so likely to substantially prevent or lessen competition. The factors listed in section 16(2) would appear to include a transaction between a holding and two subsidiary companies where such a transaction is likely to exhibit any of the factors listed in s16(2) such that the consequences of the transactions may prevent or lessen competition in a particular market. Such a transaction may remove an effective competitor in the relevant market and give rise to higher levels of concentration or increase the danger that barriers the entry in the market are extended.

The applicable sections of the Act thus provide a clear indication of the purpose of chapter 3, namely that transactions which are likely to substantially or lessen competition should be carefully examined by the competition authorities. This interpretation is supported by the preamble to the Act which provides, inter alia, that the Act '*restrain particular trade practices which undermine a competitive economy and establish independent institutions to monitor economic competition*'. Section 2 of the Act provides that the purpose of the Act is to promote competition in the Republic. It follows that the Act was designed to ensure that the competition authorities examine the widest possible range of potential merger transactions to examine whether competition was impaired and this purpose provides a strong pro-pointer in favour of a broad interpretation to section 12 of the Act.

By contrast, appellants contend for a narrow interpretation of the definition of merger. The basis of their argument is that when section 12(1) refers *to "the direct or indirect acquisition or direct or indirect establishment of control*" it refers exclusively to ultimate control. Unless ultimate control changes as a result of the transaction in question, such a transaction falls outside of the scope of section 12 and accordingly the provisions of section 13 are inapplicable. It follows that on the basis of this argument, only one form of a control is relevant, being ultimate control.

Such an interpretation is not mandated by the express wording of section 12(1). To the contrary, section 12(1) makes no express provision for the exclusion of transactions between a company and its wholly owned subsidiary, from the definition of merger.

The wording of section 12(2), clearly contemplates a situation where more than one party simultaneously exercises control over a company. This situation can be illustrated with the following example:

A beneficially owns more than half of the issued share capital of the firm. He concludes an agreement with B in order that the latter may run the business. B agrees provided that he obtains control over the appointments to the board of directors as well as of senior staff and marketing policy. In such a situation A would control the firm as defined in terms of section 12(2) (a) and B would exercise control as defined in term of section 12(2) (g). In short, while A would have ultimate control, B would have control of a sufficient kind to bring him within the ambit of control as defined in section 12.

A similar example to be found in Richard Whish Competition Law (4th edition) at 746 namely: '*were one undertaking acquires more than 50% of the voting capital of another, this would normally give rise to sole control unless, for example, the shareholders agreement gave the minority shareholder(s) joint control with the majority shareholders, for example, through rights of veto*".

As Whish notes at 742 "*merger control is not, or not only, about preemptively preventing a merged entity from abusing its dominant provision in the future; it is also about maintaining a market structure that is capable of producing the kind of outcome that follow from competition*."

For this reason the purpose of merger control envisages a wide definition of control, so as to allow the relevant competition authorities to examine a wide range of transactions which could result in an alteration of the market structure and in particular reduces the level of competition in the relevant market.

The facts in the present provide a good illustration of the importance of such a conclusion to the purpose of the Act in general and chapter 3 in particular. Prior to the proposed merger, appellants were separately listed on the JSE. They were separately legal entities, controlled by different boards of directors and had totally separate operating structures.

When the proposed merger was announced, Mr. Scannell, the managing director of first appellant issued a statement on 11 October 2000 in which he said that the marketing administration, IT and sales operations of the two companies would first be merged into a single structure. He then went on to state that the merging of the production bottling and distribution activities could take at least take 18 months to complete.

At best for appellants case, prior to the transaction, the shareholders of appellants might have exercised indirect control over the assets of the two companies. The effect of the transaction was that first appellant acquired direct control over the assets of second appellant and that two distinct business would effectively be merged into one. Thus, the acquisition of the assets by first appellant would bring about the acquisition of control as between first appellant and second appellant, irrespective of what effect the transaction itself might have on the ultimate control that the shareholders of the two appellants exercised.

For this reason, the transaction falls within the meaning of section 12(1) in that there was an acquisition of control pursuant to a transaction by which first appellant acquired the assets of second appellant. Accordingly appellant were required to provide notification in terms of section 13 of the Act.

For these reasons the appeal is dismissed with costs, such costs in the case of second respondent to include those of two counsel.

DAVIS, JP

Selikowitz AJA and Mailula A JA concurred.