COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 13/X/Feb11

In the matter between:

CAXTON AND CTP PUBLISHERS AND PRINTERS LIMITED	Applicant
and	
THE COMPETITION COMMISSION	First Respondent
PAARL MEDIA (PTY) LTD	Second Respondent
PRIMEDIA (PTY) LTD	Third Respondent

Panel	:	Y Carrim (Presiding Member), M Madlanga (Tribunal Member), and M Holden (Tribunal Member)
Heard on	:	31 May 2011
Reasons issued	:	25 July 2011

Decision and Order

Introduction

1.1. This case concerns an application brought by Caxton and CTP Publishers and Printers Limited ("Caxton") to review and set aside the decision of the Competition Commission ("the Commission") of 25 January 2011 to unconditionally approve the small merger between Paarl Media Limited ("Paarl Media") and a division of Primedia (Pty) Ltd, Primedia@Home ("P@H"). The merger was notified to the Commission on 3 November 2010.

1.2. In terms of the transaction Paarl Media, the primary acquiring firm, sought to acquire the business of Primedia@Home. Paarl Media is an indirect subsidiary of Media 24 Ltd ("Media 24") which is ultimately controlled by Naspers Ltd ("Naspers"). Media 24 in turn controls On the Dot ("OTD") which distributes among other things, leaflet advertising by way of knock and drop distribution. Paarl Media is a commercial printing operation which prints a wide variety of printed material including magazines, newspapers and leaflets, and also produces and distributes a branded advertising jacket called Shoppers Friend.

1.3. Although post-merger the target firm was to remain a subsidiary of Paarl Media, and according to the merging parties was to be managed separately from OTD in accordance with a management agreement between Paarl Media and Media 24, the Commission analysed the transaction as if the entities would be controlled and managed by Media 24.[1]

1.4. P@H is a competitor of OTD in the knock and drop distribution market, and together they have a market share of over 80% of this market.

1.5. Caxton is a competitor of Paarl Media and a supplier to the merging parties. It had shown interest in purchasing the target firm at the time of its sale. After Primedia elected to sell P@H to Paarl Media, Caxton advised the Commission of the transaction. The Commission is currently investigating a complaint against Media 24 in which it is alleged that Media 24 is engaging in predatory pricing to exclude Berkina Twinting's community newspaper in the Free State Province.[2] After receiving Caxton's submissions that this transaction had taken place, the Commission wrote to Media 24 requesting further information and raising several concerns. In response to the enquiry by the Commission the merging parties decided to voluntarily notify the Commission of the merger.[3]

1.6. During the Commission's investigations Caxton had made submissions to the Commission in which it had raised various concerns regarding the merger. The

1 The Commission was initially concerned about possible co-ordinated effects arising from the transaction by the relationship between Media 24 and Paarl Media. It then rejected the merging parties' argument that the management agreement between Paarl Media and Media 24 was adequate to address these concerns. It accordingly analysed the competition effects of the transaction on the basis that the target, Primedia@Home and On the Dot would constitute a single firm post- merger.

2 According to the Commission it is investigating allegations of predatory pricing in the print industry against both Caxton and Media 24.

3 We return to this issue later in our discussion on remedies.

Commission conducted its investigation in a period of about three months in which it consulted a number of industry participants including competitors, customers, distributors and printers. After receiving further submissions from the merging parties' economist[4] the Commission finalised its report and concluded that the merger was not likely to result in a substantial lessening of competition.

1.7. Caxton filed its review application on 22 February 2011 in terms of which it challenged the manner in which the Commission arrived at its conclusion. It argued that the process followed by the Commission in its decision was tainted with errors and irregularities, and that the Commission's decision was irrational and unreasonable. Furthermore that notwithstanding some strongly held objections from various firms, including Caxton's, the Commission dismissed the concerns raised without any reason or justification, but decided to approve the merger unconditionally on grounds that are entirely unreasonable and irrational.

1.8. Caxton argues this first on the basis that the Commission's market definition analysis was irrational, incoherent and contradictory. Secondly, that the Commission's reliance on supply-side substitution was unsound and resulted in reaching entirely irrational conclusions on anti-competitive effects. Thirdly that in assessing the market shares, the Commission failed to carry out its own investigations but instead unreasonably and irrationally relied on fundamentally flawed and misleading data supplied to it by the merging parties. Caxton also argues that the Commission was biased in favour of the merging parties. In support of the bias allegation the Commission was accused of non-disclosure of relevant evidence in the merger record. Finally, Caxton contends that the Commission's conclusions on anti-competitive harm was unsupported and ignored relevant available evidence.

1.9. The merging parties defended the Commission's decision and opposed the relief sought by Caxton. The Commission also elected to defend its decision in the review proceedings and to this extent filed a series of affidavits explaining its reasoning. This decision of the Commission also drew criticism from Caxton namely that the Commission could not seek to adduce facts and information or an analysis thereof beyond that which it had or had conducted at the time its decision was made.

1.10. The Commission's decision is quite unusual. While regulators are not in principle or

4 RBB Economics.

in law prevented from participating in review proceedings,[5] the customary practice is for them to abide the decision of the reviewing authority. This is because review applications can result in their decisions being set aside and the matter being remitted to them for reconsideration.

1.11. The relief sought by the applicant is that the Competition Tribunal ("Tribunal") set aside the Commission's decision and prohibit the merger, or if the Tribunal decides to remit the matter to the Commission for further investigation, to order that a different team within the Commission be directed to investigate the merger.

1.12. The matter was heard on 31 May 2011 where the Tribunal was called upon to decide whether or not any of Caxton's grounds for review hold water.

Incomplete record

2. This case was characterised by a series of supplementary papers which were filed belatedly just prior to the hearing of the matter. It seems this stems from the fact that at the time Caxton filed its founding affidavit both in the review application as well as the application for an interim interdict on 22 February 2011, it had not yet been provided with a copy of the Commission's confidential record. Caxton therefore at the time it filed its founding affidavit had reserved the right to supplement the review application once the confidential record was made available to its advisors.[6]

3. At the prehearing conference held on 10 March 2011 the Tribunal directed the Commission to furnish Caxton with the confidential merger record by 15 March 2011. On 18 March after Caxton had received the confidential merger record, it addressed a letter to the Commission claiming that there were documents missing from the confidential merger record. The Commission responded via email on 22 March 2011 and provided Caxton with additional documents, which had been received from the merging parties and which the Commission admitted to have mistakenly left out of the confidential merger record.

4. The merging parties filed their answer in relation to the review application on 3 March

5 TWK Agriculture Limited v The Competition Commission and Others Case Number 67/CAC/Jan07; AC Whitcher (Pty) Ltd v The Competition Commission and others [2009] 2 CPLR 291 (CAC).

6 Para 43 of FA.

2011.

5. Caxton filed a supplementary affidavit on 1 April 2011 to deal with various aspects of the confidential merger record made available to Caxton on 15 March as well as the additional documents provided by the Commission.

6. On 15 April 2011 the merging parties filed their supplementary answering affidavit following Caxton's supplementary affidavit.

7. When the Commission filed its answering affidavit on 18 April 2011 it attached summaries of alleged telephone conversations with third parties, annexed as TRI, which had also not been included in the confidential merger record provided to Caxton. It was not clear whether TRI purported to be a comprehensive record of the Commission's interviews with third parties and Caxton therefore requested in a letter dated 19 April 2011, that copies of the underlying notes should be provided. Caxton had also requested the Tribunal to issue a subpoena in respect of the Commission investigator's handwritten notes. The Tribunal declined to do so.

8. On 4 May 2011 Caxton filed its replying affidavit in response to the Commission's answering affidavit and the merging parties' supplementary affidavit which had been filed in answer to Caxton's supplementary answering affidavit. In its reply Caxton dealt with the selective manner in which the Commission provided documents in this matter, as well as the merging parties' failure to provide documents to the Commission during the Commission's investigation. Caxton further raised the concern that the Commission had not filed the handwritten notes taken by its investigators during the course of oral interviews conducted by them which notes, Caxton said ought to have been included in the confidential merger record.

9. Caxton filed a further supplementary replying affidavit on 13 May 2011.

10. The merging parties also filed a further affidavit (the date on this document is 25 May

2011).

11. The Commission also filed a further affidavit on 26 May 2011 wherein they attached the annexure TR4.

12. While we have not expressly rejected the filing of these affidavits we have given consideration only to those that have direct relevance to the Commission's investigation at the time when it took place, the evidence before it at that time and its treatment of it in its merger report. To this effect we have taken into account the affidavit filed by Ms Lerm of Quick Feet (procured by Caxton) simply because it constitutes a complaint – not completely unsubstantiated as we see later – of the Commission's representation of her evidence in its report. But the evidence submitted by CRA on behalf of Caxton and that of any number of other deponents which was not before the Commission at the time of making its decision, is not taken into consideration by us in this decision.

Background

12.1. The merger constitutes a small merger in the market for distribution of advertising leaflets. Leaflet advertising entails printed material such as flyers, brochures, pamphlets, samples, packaging, customised publications or any form of physical advertising capable of delivery to specific individuals ("leaflets''). Large chain retailers and parties who wish to promote particular goods and services tend to advertise their range of products in leaflets. Leaflet advertising is distributed in several ways. Where advertisers seek to target particular LSMs, suburbs, high impact areas like high traffic intersections and taxi ranks, or individual consumers and businesses they tend to utilise knock and drop (K&D) distribution. Leaflets are also distributed as "inserts" into different types of newspapers and magazines such as; free community newspapers which are primarily distributed locally in metropolitan urban areas; paid for community newspapers which are primarily distributed locally in urban areas; paid-for daily newspapers (i.e. dailies); paid for weekly newspapers (i.e. weeklies); and Sunday newspapers. Newspapers are generally less flexible than K&D as they are distributed according to set delivery schedules, their area of distribution and market penetration which an advertiser wishing to distribute an insert via this method must accept. By contrast, knock and drop distribution is flexible as it is tailored to meet the needs of the advertiser.

12.2. In a nutshell, the Commission's findings in respect of its competitive analysis of the merger were as follows. The Commission found that there was an overlap in the merging parties' activities for the distribution of printed advertisements directly to customers. In defining the relevant market the Commission considered the product overlap between different distribution methods for free printed advertising, and looked at whether printed advertisements (inserted and printed) in free newspapers are considered as substitutes for printed advertisements distributed using the knock and drop method. From the demand side perspective, the Commission found that the merging parties compete with each other in terms of offering knock and drop distribution of leaflets. It found that from the demand side, leaflet distribution such as inserts through community newspapers and other printed media were not substitutes for K&D distribution. However from the supply side, the Commission concluded that firms currently distributing free community newspapers can easily expand into the knock and drop market, and thus found that there is supply side substitutability between free community newspaper operators and knock and drop distributors. Accordingly the relevant market was not limited to the market for K&D distribution but was expanded to include community newspaper publishers and distributors.

12.3. According to the Commission new entry into the knock and drop distribution market is likely and sufficient to discipline the merged firm's monopolistic behaviour. The Commission found that based on its assessment of the evidence from customers and competitors, customers would be able to exercise countervailing power and that the merged entity would not be able to foreclose its competitors.

Assessment

12.4. In previous decisions of the Tribunal we have set out our approach when reviewing the Commission's decisions.[7] We find it unnecessary to traverse that jurisprudence here save to say that while the test of reasonableness may have blurred the line somewhat between appeal and review the two enquiries are different. In an appeal we would be concerned with whether a decision of the Commission was right or wrong. In a review we are concerned with the manner in which the Commission has arrived at its decision. Notwithstanding this distinction the reasonableness of the Commission's decision is evaluated when we consider whether or not its

7 See Tribunal decision in *AC Whitcher* Case No. 69/AM/Jul07. See also *TWK Agriculture Limited v The Competition Commission and Others* Case Number 67/CAC/Jan07; *AC Whitcher (Pty) Ltd v The Competition Commission and others* [2009] 2 CPLR 291 (CAC).

conclusions are justified by the evidence before it.

12.5. In our enquiry we do not ask whether the Commission's conclusions are right or wrong but ask whether there is a proper application of its mind to the facts or evidence before it. Did the Commission take into account irrelevant factors and ignore relevant factors,properly applying the theory and principles of competition law so that its decision was not unreasonable or unjustified.[8]

12.6. The applicant has levelled criticism against almost the whole of the Commission's decision. Our approach has been to engage only with those aspects of the Commission's decision which raise material concerns for us.

Omitted relevant facts

12.7. During the course of this application the Commission, in its answering affidavit, attached a summary of the results of its interviews with market participants such as large retailers who utilise K&D and community newspapers for distribution of their advertising leaflets, distributors themselves, the merging parties and printers. This summary was annexed as TR1 to the Commission's answering affidavit. The Commission then subsequently filed a supplementary affidavit together with annexure TR4. TR4 is in fact an amended TR1.

12.8. A copy of TR4 is attached as **annexure A** to our reasons. The underlined text is the additional information that was not contained in TR1. A comparison between the TR1 and TR4 shows that a large portion of Caxton's views and some significant facts in relation to market definition and barriers to entry were omitted from TR1. Hence TR4 contains information that ought to have been included in TR1 but was for some reason omitted. No explanation is given by the Commission as to why the additional information had been omitted in TR1. All it states is that TR1 was "never intended to be a comprehensive summary of all the information provided during the relevant interviews and that TR4 amounts to a more complete record".[9]

12.9. The Commission's behaviour raised concerns as to whether or not all relevant facts were placed before the Commission's Exco who was responsible for making the

8 See *AC Whitcher* supra fn 5; *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs* 2004 (4) SA 490 (CC).

9 See Commission's Further Affidavit para 11 at pgs. 1656 - 1657.

final decision in this matter. We know for a fact that TR4 itself was not put before the Commission's Exco because it had been prepared specifically for this review application. We do know that the Commission's merger report, compiled by its merger division would have been placed before its Exco for approval. But we do not know whether or not the omitted information contained in TR4 was placed before Exco at the time when it was required to apply its mind to the Commission's recommendation.

12.10. A comparison between the Commission's report (which was placed before its Exco) and TR4 reveals that a significant amount of information that is relevant to the merger was not dealt with in the merger report. A summary of this is attached as **annexure B**. By way of example we see that three large customers of K&D distribution services consider quality of service as an important consideration in their choice of distributor, a fact relevant to barriers to entry. Likewise some regional distributors consider barriers to expansion (as opposed to entry) to be high. Given that the Commission has relied upon a finding of low barriers to entry to justify its expanded market definition which has resulted in a presumption of absence of market power, these facts become even more significant.

12.11. We have no way of ascertaining whether or not the information contained in our annexure B, may have led Exco to a different conclusion at that time. However the fact that this information was not put before it at the time when the decision was taken means that Exco could not apply its mind properly to all the relevant facts or evidence gathered in the investigation.

12.12. In our view this irregularity on its own is a basis for setting aside the Commission's decision.

Relevant market definition

12.13. The Commission's approach to relevant market definition also raises cause for concern.

12.14. The Commission's analysis commences at page 803 of the record (para 6 of its report). It first identifies that there is an overlap in the parties' activities for the distribution of printed advertisements directly to customers.

12.15. The Commission then makes a distinction between the distribution of advertisements via free printed media (e.g. loose leaflets via K&D and community

newspapers) and distribution of advertisements via paid-for printed media and concludes that they are in separate markets. The Commission justifies the distinction between "free printed media" and "paid-for" printed media distribution markets on the basis that they are *different models because they target different customers and have different reac*h. The Commission concludes that these markets are complementary. However this "difference" is not explored further. Such differences in target markets and reach also apply in relation to community newspapers & K&D.[10]

12.16. The Commission then proceeds to define a narrower market and concludes that from a demand side the relevant market is the market for printed advertising distribution and specifically for the knock and drop distribution market. It states –

"*We believe from the evidence above that distribution via community newspapers and via knock and drop are not generally seen as substitutes by advertisers based on the following factors-*

- *The cost difference between knock and drop distribution of printed advertising via other methods such as community newspapers – if the price of knock and drop increased by 5-10% customers questioned would not switch to using community newspapers;*
- *The unique flexibility in terms of market segmentation and access to different geographic areas afforded to advertisers using knock-and-drop distribution;*
- *The value-added features provided by community newspapers and Shopper's Friend which further reduces the extent to which community newspapers and knock-and-drop may be considered as substitutes*."

12.17. The merging parties are seen as the main national players in the K&D market. The merged entity would have market share of approximately 80% in the national K&D distribution market, a figure which would certainly raise alarms for any competition agency.

12.18. A review of the views of respondents in the merger record, TR1 & TR4 indeed confirm that from a demand side, customers of distribution services consider K&D, community newspapers, dailies and weeklies as complementary services. Community newspapers are estimated to be 100-300% more expensive than K&D. Customers would use a particular distribution method depending on their campaign

10 See for example submissions from Shoprite, Lewis, P le Grange, and Caxton.

objectives. K&D is flexible, targeted at lower LSMs or particular types of customers and cheaper. Community newspapers which are used to target higher LSMs or cash customers, are more expensive and less flexible in terms of distribution times and focus.[11]

12.19. However the Commission concludes that these factors notwithstanding, because of the characteristics of the market, it is necessary to consider supply side substitution. In particular it focuses on whether barriers to entry in the K&D market are "*high enough to prevent providers of distribution services outside of K&D distribution from switching to providing services within this market*."

12.20. In the analysis that follows the Commission asks the question whether printing firms and community newspaper producers could enter the market for K&D distribution services at a *reasonable cost and within a reasonable time*. Caxton argues that this is the wrong standard by which to assess entry and that this alone should be the basis for setting the decision aside.

12.21. While the language of the report is loose, we assume in favour of the Commission and infer from the submissions made by respondents in response to this enquiry that the Commission sought to establish whether entry would be quick, effective and without the need for significant sunk investments.[12] In other words we understand the Commission's enquiry entails asking the question whether entry from a supply side is likely, timely and sufficient to constrain the unilateral exercise of market power by the merged entity.

Supply Side Substitution

12.22. Supply side substitution is always taken into account in merger analysis. However agencies have differed in their approaches as to the appropriate time when supply side factors should be taken into account. In the US the approach tends to ignore supply side substitution at market definition stage, but instead deals with it as part of the analysis of competitive effects. This has traditionally also been the approach of the South African Tribunal.[13]

11 See for example views obtained from Shoprite, Lewis, Cashbuild, JD Group, Ellerines, Massmart, P le Grange and Caxton.

12 The US merger guidelines examine entry by asking three questions; is it going to be timely, likely and sufficient.

12.23. The purpose of defining a relevant market is to assess whether post merger the merged entity will be able to unilaterally exercise market power in the form of increased prices in that product market.[14]

12.24. In Europe the general approach to market definition in merger investigations in the past has been to take into account both demand side substitution as well as supply side substitution. This approach has been supported by some case law. The EC decision in *Michelin* [1985] 1CMLR 282, at par 37 stated that "the Commission may define the relevant product market both in terms of the interchangeability of the product in question with other products and in view of the competitive conditions and the structure of supply and demand on the market". In *Tetra Pak* case O.J. L272/27(1988), at para 30, the Commission also recognised that the extent of the possibility of supply substitution was important in determining the relevant market from the point of view of the rules of competition.

12.25. However in recent times the UK Competition Commission and OFT joint merger guidelines suggest a different approach going forward which is to define markets on the basis of demand-side substitution, and to give supply side substitution appropriate weight when dealing with competitive effects analysis.

12.26. Some academics have supported the European approach of including supply substitutability at market definition stage. Motta is of the view that there is no reason to delay the moment at which substitutes on the supply side are considered as this will save time and help the investigation.[15] In his view drawing the borders of the market in a narrower way than supply considerations might force an anti-trust agency to spend time and energy in justifying why a firm with a considerable market share does not actually have considerable market power. In contrast, if immediate consideration of supply substitutability arguments leads to a correct wider market, and accordingly low market share, there will be an immediate presumption of absence of market power. Motta is also of the view that not considering supply substitution at the relevant market definition stage might distort an investigation.

12.27. Of course for any agency the challenge lies in defining a *correct* wider market.

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13 See *Xstrata South Africa (Proprietary) Limited and Egalite (Proprietary) Limited and International Carbon Holdings (Proprietary*) Case No: 54/LM/Jul04, *Massmart & Moresport* 62/LM/Jul05.

14 See the discussion in *Antitrust Law & Economics In a Nutshell* by Gellhorn, Kovacic &Calkin (Thomson West) pages 114ff entitled "The Monopoly Problem".

15 Competition Policy: Theory and Practice (2004) pgs. 104 – 105.

12.28. However others have cautioned against considering supply side substitution at the market definition stage arguing that this results in inconsistent outcomes and there is a risk of it being counted twice – both at the relevant market definition stage and at the effects stage. In their view the best practice in merger analysis would be to start with the narrowest possible product market (using analytical tools such as the SSNIP test) and then to consider supply side substitution at the competitive effects stage.[16]

12.29. On either approach – whether at market definition stage or at competitive effects/market power analysis, the enquiry must be the same. The investigator needs to ascertain whether firms are *likely* to reposition themselves into the K&D market *quickly* and without incurring significant sunk costs in response to a small but non-transitory increase in prices and that such entry would be *sufficient to effectively constrain the merged entity*.

12.30. When used at market definition stage this enquiry can be very wide and can lead to over-inclusion. Hence a better approach involves at the very least ascertaining from identified suppliers in close, related or adjacent markets whether in the first instance they would enter this market (likely) if prices were to increase by 5-10% and whether they could so quickly (timely) and effectively. In other words entry must be of such a nature that it must impose an effective constraint on the merged firm. By implication the enquiry also entails asking why they wouldn't enter the market if any of their answers to the questions are negative.

Commission's enquiry into supply side

12.31. In the section of its merger report entitled "Supply side substitutability for knock-and drop distribution"[17] the Commission couches its enquiry as follows: "In the evaluation of this merger it is particularly relevant to assess whether firms operating in the community newspaper sector could *constrain the ability* of the merged entity to raise prices owing to the *potential* for them to switch into the knock-and-drop market".

12.32. In answering this question the Commission obtains the views of rival printing firms and community newspapers. It faithfully reports that Seculo IT Web Printers considers the infrastructure (warehousing, staff, fleet of vehicles) required as the

16 Neven et al. (1993, 77).

17 Record p 812.

biggest barrier to entry in the K&D market. Paarl Media also makes the submission in justification of the acquisition that it would be difficult for a printing business to build a distribution business from scratch.[18]

12.33. The Commission goes on to report that it "*… considers (sic) that both Independent News and Media and Caxton which have a national presence in terms of community newspaper titles submit that they have no plans to expand into knock and drop distribution although both of these firms have their own distribution networks for their newspaper titles*."

12.34. It then refers to evidence from other respondents that having a credible database is crucial for doing business. The Commission then concludes that "Although this suggests that it may be <u>difficult to expand into knock and drop</u>, other evidence received casts serious doubt on this conclusion." The Commission concludes that barriers to entry or expansion are not prohibitive because databases can be bought, large customers have their own information, it is not necessary to own the infrastructure as it could be leased (so as to avoid sunk costs) and owner-drivers could be used to achieve scale.

12.35. The Commission then concludes that because entry barriers are low in the K&D market community newspapers can enter easily. It goes on to say " *In addition to the generally low barriers ...firms such as Caxton and Independent News that specialise in the distribution of newspaper titles (<u>paid- for and free community newspaper</u>) have existing distribution network which in the view of the Commission could be leveraged to expand into the knock and drop distribution market. Although the distribution model that these firms currently follow may be slightly different in terms of reach ("the last mile") the fact that they have existing warehouses and depots in the areas where they distribute, suggests that it would be less costly for these firms to expand*".

12.36. The Commission concludes its enquiry by including community newspapers and excluding paid for printed media distributors in the relevant market. The Commission's calculations of market shares in this broader market for the distribution of printed advertisements estimated that the post merger market share of the merged entity would be around 31%, a figure less than half of the demand side market share. This leads the Commission to conclude that the merged entity will not have market power, a factor critical to the assessment of competition effects.

18 Wilson Affidavit page 1592 para 40.

12.37. Several aspects of this reasoning raise concerns. The first is that the Commission's selection of the potential competitors (limited only to community newspapers) from supply side is inconsistent and irrational. The second is that the Commission's decision to include community newspapers in the market is not justified by the evidence before it. Third the conclusion by the Commission that barriers to entry in the national market are low, on which it justifies both supply side substitution and its assessment of effects, is itself susceptible to challenge because it has ignored relevant factors pertaining to that enquiry.

12.38. In identifying potential competitors from the supply side the Commission approaches printing firms and community newspaper publishers. Printing firms are not in the distribution market. Conceivably, although this is not explained in the report, the Commission has approached them because of the possibility of vertical integration between the upstream printing markets with the downstream K&D distribution market. Community newspapers are in the distribution market and the Commission's selection of them seems reasonable. However the Commission does not approach "paid –for" media distributors, who in any event distribute advertising leaflets as inserts. Unlike printing firms, these are distributors *already* in the market for distributing advertising leaflet materials albeit through different methods. They may have a different model in terms of reach and target from K&D but they have more in common with community newspapers in that they distribute advertising leaflets as inserts to households and commercial centres and target the higher LSMs.[19] Given this closeness the fact that the Commission excluded them in this enquiry is irrational.

12.39. Moreover the Commission is inconsistent in its reasoning. It excludes paid-for media at this point but then includes them when it makes the assertion that "*In addition to the generally low barriers ...firms such as Caxton and Independent News that specialise in the distribution of newspaper titles (paid- for and free community newspaper) have existing distribution network which in the view of the Commission could be leveraged to expand into the knock and drop distribution mark*et" (our emphasis). It then excludes them again – without any further justification - when it calculates market shares of participants in its expanded market.

12.40. Second the Commission's decision to include community newspapers in the relevant market is not justified by the evidence before it. Recall that the Commission arrives at its expanded market definition on the basis that barriers to entry are low

19 All community newspapers are not delivered door to door.

and that it would be easy to expand without sunk costs.

12.41. However this is not what community newspapers themselves say. Their evidence points to a different conclusion.

12.42. The evidence of both Caxton and Independent who have been included in the market is that they are *unlikely* to enter the K&D market.

12.43. Moreover Independent Newspapers, while it provides the Commission with estimated monthly costs of running a K&D operation (R158 000) points out to the Commission that despite the relatively modest operational costs, it would take between 5 - 10 years for its business to get to a level in that market to be competitive with the merging parties. This is hardly timely and effective entry.

12.44. The difficulty for the Commission here is that it has not completed its enquiry into supply side. In its reasoning it has relied solely on entry barriers in the K&D as the basis on which to assess supply side substitution. But the question to be answered is not whether suppliers could *easily* enter the market but whether such entry is likely, timely and effective.

12.45. Moreover the likelihood of entry cannot simply be inferred by whether barriers to entry are low or not. This is because a decision by a firm to enter depends not only on one factor. For example margins in that market may not be attractive enough for the firm post merger,[20] the market may be too labour intensive, perhaps too time consuming from a management perspective, the firm may not wish to alter its business focus or it may face capital constraints.

12.46. Caxton in fact points the Commission to all these other factors in its submission where it states–

"*Caxton's business is community newspapers where focus of business is reader-driven, distribution is buyer or client determined, vertical integration would require capital, infrastructure and change in business focus... Can't replicate knock-and-drop network because of distinction between readership focus of community newspapers ...different business models... Caxton would have higher costs and less experience ...Merged entity would undercut Caxton prices if they entered*."[21]

20 The fact that the price difference between K&D and community newspapers (100-300%) suggests that in fact there would be little incentive for them to enter K&D unless prices increased by a very high factor.

21 TR4 p1681 of the review record.

13. This is the evidence of both Caxton and Independents who state that they have no plans to enter K&D and yet it is completely ignored by the Commission. The decision by the Commission to include them in the expanded market is not justified by the evidence before it.

Barriers to entry

13.1. At first the Commission accepts the evidence of both community newspapers and local or regional distributors to conclude that "because this sector is characterised by low margins and high volumes, national distributors seem to be able to offer better deals at lower prices to customers than smaller players". Further that "it appears it may take longer for a new player to establish itself as a national distributor than as a regional or local player".

13.2. The Commission then relies on the evidence of Primedia@Home and two regional players to arrive at the conclusion that barriers to entry are not high. The Commission argues that because regional players such as Quick Feet (Eastern Cape) and Sarel van der Merwe (Northern Cape) could enter the regional market easily they could expand into the national market easily. In other words they could leverage their existing infrastructure into other areas at a reasonable cost by renting vehicles and warehouse space and purchasing a database at a cost of R10 000 to R48 000 per year. The Commission also states that big retailers are willing to give small players a chance, as many of these smaller players are agents or sub-contractors for the larger distributors. On balance the Commission finds that barriers to entry into the K&D market are low and that they are even lower for the distributors of community newspapers who already have some infrastructure required to set up a K&D business. Because of this sub-contracting relationship the Commission argues that firms such as Caxton and Independent Media could easily enter this market and achieve national scale with a limited amount of investment.

13.3. However this conclusion is not supported by the evidence. Sarel van der Merwe obtains more than 75% of his revenue from OTD. To that extent he is more an agent than competitor of the merged entity. Noc n Drop relies on both OTD and Primedia for 30-35% of his business. Quick Feet also relies on sub-contracts as does Vibrant. Primedia itself submits that 60-70% of their national volumes are distributed by agents some of whom have been interviewed by the Commission. These smaller players rely on volumes from the large players to sustain their

businesses and from all accounts as long as they do not own their own credible databases (and thereby win larger contracts), expansion beyond their existing footprints would be difficult. Given their reliance on OTD & P@H there would be no incentive for them to compete with the merged entity.

13.4. Regional and/or local players such as Quick Feet and Noc n Drop also claim that barriers to expansion are high due to *high capital requirements, credible database and large volumes to sustain expansion*. P le Grange who the Commission alleges is a national player, has been in the market for a number of years but still only has 1% of the market.

13.5. In relation to the issue of a credible database, Noc n Drop, Vibrant Direct and Caxton confirm that having a database is "crucial to business". Shoprite, Lewis and Quick Feet also refer to a credible database as being critical or crucial. Quick Feet submits that one of the critical barriers to entry in this market is access to a reliable database and systems and that this cannot be achieved simply by purchasing data from marketing or research companies or obtaining free data from municipalities and the Census. Much work needed to go into updating the data and expansion required knowledge of the region. Ms Lerm submitted that the merging firms have the best databases. Vibrant Direct submitted that it was costly to develop and maintain one's own database. Indeed even the merging parties have had to spend a considerable amount of money updating Primedia's database.[22]

13.6. Hence it is not merely the possession of a database that was crucial to business but one that was credible and updated at regular intervals. The Commission itself concedes that while it is possible to purchase a database or obtain free databases from municipalities some work would need to go into making this data relevant to the business.

13.7. Not one of the regional distributors seemed to own databases and while some smaller players said they could handle larger volumes easily there was nothing to suggest that they would expand their businesses to such an extent so as to exert an effective constraint on the merged entity. In fact the evidence suggests the contrary.

13.8. Furthermore in making its assessment the Commission failed to deal with critical relevant facts. If we look at TR4 both customers and distributors talk about "quality of service" for doing business.

22 See Wilson affidavit at pg. 1570.

13.9. The Commission completely ignores this requirement despite the fact that large customers and distributors all see it as a factor in granting or winning contracts respectively.

Misrepresentation

13.10. In its merger report, the Commission placed great reliance on Quick Feet's entry into the Eastern Cape region at a cost of R1.2m within 2 months as an example of actual entry and low barriers. However it appears that the Commission's reconstruction of the interview with Quick Feet was inaccurate.

13.11. As evidenced by the comparison between TR1 and TR4, critical facts provided by Quick Feet had been omitted and were not reflected in the Commission's report. In both TR1 and in its report the Commission had failed to reflect the fact that Quick Feet said "*it would be possible but difficult to expand, that they could work on a network basis but this required capital which they did not have and that Shoprite won't use small distributors in the North areas,*[23] *that the merger may create imbalance in the market allowing the merged entity to dictate to larger clients*[24] *that big retailers usually split their contracts between OTD and Primedia@Home (but now that will be gone) and that OTD and Primedia@Home have been cutting prices at each other*".

13.12. In the course of these proceedings Quick Feet had provided an affidavit[25] in which Ms Lerm points out that the Commission had not accurately reflected the contents of the interview held with her. Contrary to the views reflected in the Commission's report Quick Feet only operated mainly in the Port Elizabeth area and not in the Eastern Cape region, it was only able to enter the market quickly due to the owners' extensive experience in knock and drop and because it had received a sub-contract from another knock and drop distributor to distribute Shoprite's leaflets in Port Elizabeth. But for these two facts – experience and a large sub-contract, Quick Feet

23 This supported Shoprite's concern that the merger will lead to problem in the Great North areas for it because there were no reliable or credible players other than the merging firms in that area. The Great North area for Shoprite includes Gauteng, Limpopo, North West and Mpumalanga provinces.

24 A fact relevant to countervailing power discussed later.

25 Obtained by the applicant.

would not have been able to enter the market with "any measure of success".[26]

13.13. The Commission's partial representation of its interview with Quick Feet on its own provides a separate basis for review on the grounds of perception of bias and/or disregarding relevant facts. Suffice to say that the evidence as supplemented in TR4 and in Ms Lerm's affidavit supports the conclusion that barriers to entry and expansion were both high in the national K& D market.

Ignored relevant factors in effects assessment

13.14. A further ground of review that emerges is the Commission's failure to consider and apply its mind to a few critical facts when assessing competitive effects. The first of these is its failure to deal with the evidence that OTD and Primedia@Home were engaged in a price war. Quick Feet had brought to the Commission's attention that OTD and Primedia were engaged in a price war. At the hearing Mr Wesley on behalf of the Commission says that the Commission was aware of the price war between the merging parties. Yet we find no mention of it in the Commission's report nor is there any evidence that this was brought to the attention of Exco.

13.15. Price wars are highly relevant to the analysis of competitive dynamics in a market and therefore to merger analysis. They could be an indication that the merging parties were competing head on at a national level. More importantly they could also be evidence of predatory behaviour by the acquiring firm who seeks to remove a competitor by first engaging in a price war and then purchasing it, a fact highly relevant to merger analysis. The Commission failed to take this into account in its assessment.

13.16. The second relates to the concern raised by Shoprite that it would not have a reliable distributor in the Great North areas. This concern was echoed by players such as Quick Feet. At the very least this concern should have raised the possibility of investigating two regional geographic markets – the Great North areas on the one hand, in which there was no other competitor than the merging firms, and the rest of the country which had the presence of smaller players, with different competitive consequences.

13.17. This factor is also highly relevant to the determination of countervailing power. If there is only one reliable or credible distributor in the market how can a customer exercise countervailing power?

26 See Lerm affidavit at pg. 1321.

13.18. The third involves the Commission's dismissal of the concerns raised by other players in the market as to the conduct of the merged entity. The Commission had received complaints from P le Grange and Caxton, both of whom had concerns about the possibility of foreclosure. Quick Feet and Noc n Drop also raised concerns about the effect of the merged entity on their business or on customers. Some customers such as Shoprite and Lewis also raised concerns that the merger will remove the only alternative national player in the K&D distribution market. The Commission dismisses these concerns because "*it could not find sufficient evidence supporting these complaints*". What other evidence the Commission relies on is not made clear in the Merger Report.

13.19. Perhaps the failure by the Commission to give appropriate regard to the views of those who are likely to be affected by the merger in its assessment of competitive effects stems from the use of supply side substitution at the relevant market definition stage.

13.20. Recall that the relevant market from the demand side was the narrow market of K&D distribution. The merged entity post merger in this market would certainly have market power with an approximately 80% share of the market. Such a high share of the market gives cause for concern of unilateral or foreclosure effects. In fact the evidence of market participants reflects these concerns.

13.21. The Commission then expands the relevant market through supply side substitution thereby reducing the merged entity's share to roughly 31% and thereby creating a presumption of absence of market power. It is this presumption that the Commission then relies upon to assess the competitive effects of the transaction and dismisses concerns raised by market participants. Through the lens of an expanded market the Commission overlooks critical evidence provided by customers and distributors alike about possible anti-competitive effects.

13.22. An example of this is its treatment of the evidence of predatory pricing and foreclosure. The Commission concludes its enquiry into predatory pricing and entry barriers by first quoting the Tribunal in the Masscash and Finro merger decision[27] as follows:

"*Hypothetically speaking the merged entity could raise barriers to entry in the relevant market if it had a known predatory reputation or if the merger would allow it*

27 Case No:04/LM/Jan09.

to gain or enhance such predatory reputation."[28]

13.23. And then goes on to say:

"*However even if a firm has a predatory price reputation we have no reason to believe that it will be able to exclude potential competitors if it does not have market power in the relevant market*".[29]

13.24. While it is not clear which relevant market the Commission is referring to here, in the narrow market post merger the merged entity with a share of 80% will certainly have market power. The Commission arrives at this conclusion despite the evidence of market participants raising this very concern namely that the merger may result in foreclosure in the printing market (Caxton) or predatory pricing and exclusion in the K&D market (Quick Feet, Noc n Drop, Caxton, Vibrant) and its own alleged knowledge about allegations of predatory pricing in the print media market.[30]

Conclusion on Part B

13.25. As stated before the applicant challenged almost every aspect of the Commission's decision. However we have limited our reasons only to those aspects that we consider to be material. We have concluded that the Commission's decision is flawed for the following reasons –

13.25.1. It failed to place all relevant facts before its Exco at the time when the decision was made;

13.25.2. Its definition of the relevant market from supply side substitution is irrational and not justified by the evidence before it;

13.25.3. Its assessment of the barriers to entry at the national knock and drop market failed to take into account critical factors such as quality of service;

13.25.4. In its assessment of barriers to entry it disregarded the evidence of existing smaller players that barriers to expansion were high and that possession of a credible database was crucial for business;

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28 See pg 825 of the record.

29 Supra fn 28.

30 Indeed because the Commission is investigating allegations of predatory pricing by Media 24 in the Free State Province, Media 24 was required to bring this transaction to the attention of the Commission in accordance with the Commission's Small Merger Guidelines.

13.25.5. It misrepresented the evidence of Quick Feet in its merger report; and

13.25.6. It has overlooked or not dealt with critical evidence in its assessment of competitive effects.

13.26. For these reasons the Commission's decision of 25 January 2011 is set aside and the matter is remitted to the Commission for reconsideration on condition that the matter is reconsidered by an entire new team. While we have not expressed ourselves on every aspect of the Commission's decision, the Commission in its reconsideration is well advised to take heed of the criticism levelled against its decision by the applicant.

Interim Interdict

13.27. When Caxton first brought the review application it did so in two parts. In terms of Part A Caxton sought urgent relief for an interim interdict prohibiting Paarl Media from implementing or further implementing the merger pending the determination of the relief sought in Part B being the application for review and setting aside of the Commission's approval of the merger and remittal of the matter to the Commission for further consideration by a new investigating team. Alternatively they sought for the Tribunal to prohibit the merger. Caxton sought to separate the hearing of the merits from the interim interdict application.

13.28. However at a prehearing on 10 March 2011, the Tribunal declined to separate the applications and directed that the merits be heard as soon as possible and further directed that the parties could submit legal argument on the interim interdict if they so wished at the hearing. The hearing was held on 31 May 2011 rendering the urgent hearing of Part A superfluous.

13.29. In its replying affidavit Caxton states that following the Tribunal's prehearing decision, it agreed not to persist with its application for relief in terms of Part A,[31] so much so that Caxton does not deal with such relief in any detail in its heads of argument. The merging parties however made submissions to the Tribunal on the relief sought in Part A. At the hearing of legal arguments it transpired that Caxton had not abandoned the relief under Part A. We therefore deal with this issue in these reasons.

31 Applicant's replying affidavit para 4.

13.30. Caxton requires this Tribunal to grant an interim interdict against the further implementation of the merger.[32] Recall that this transaction constitutes a small merger and is governed by section 13 of the Competition Act, 1998 ('the Act'). The merging parties have already implemented the merger.[33] The primary reason for the interim interdict sought by Caxton is to prevent Paarl Media from (further) implementing the merger which potentially gives rise to anti-competitive effects pending the determination on the review application.

13.31. Sections 13(1)(a) and (b) state that a party to a small merger is not required to notify the Commission of that merger and may implement that merger without approval unless the Commission requires it to notify in terms of subsection (3). Subsection (2) makes provision for voluntary notification at any time by the parties to the Commission.

13.32. Section 13 (3) states that:

"Within 6 months after a small merger is implemented, the Competition Commission may require the parties to that merger to notify the Commission of that merger in the prescribed manner and form if, in the opinion of the Commission, having regard to the provisions of section 12A, the merger-

a) May substantially prevent or lessen competition; or

b) *Cannot be justified on public interest grounds*."

13.33. Section 13 (4) states that a party to a merger in terms of *subsection (3)* may take no further steps to implement that merger until such merger has been approved or conditionally approved.

13.34. The framework in respect of small mergers can thus be summarised as follows. In general parties are not required to notify small mergers and may implement these unless the Commission requires them to notify the merger. Once the Commission requires them to so notify, parties may not implement the merger any further until they have obtained the Commission's approval or conditional approval.

13.35. In contrast the framework regulating intermediate and large mergers under section 13A states that parties to an intermediate or large merger may not implement that

32 We do not deal with the question of our powers to grant such relief but assume for the sake of these reasons that we do enjoy such powers under s27(1).

33 See second that third respondent's answering affidavit para 34.

merger unless they have obtained the approval or conditional approval of the Commission. Therefore unlike intermediate and large mergers which may not be implemented without prior approval by the competition authorities, it is not illegal for parties to small mergers to implement the merger without approval. The only time that they are required to not take any further steps is when the Commission exercises its powers under section 13(3).

13.36. The merging parties object to the interdictory relief on the basis that section 13(4) of the Act does not apply to the present merger given that the merging parties voluntarily notified the merger to the Commission in terms of section 13(2). The Commission did not – even though it was encouraged by Caxton to so do – exercise its powers in terms of section 13(3). Hence section 13(4) cannot be invoked in the present circumstances and the merging parties are entitled to take all further steps in the implementation of the transaction.

13.37. The facts leading up to the voluntary notification appear as follows. In terms of the Commission's Small Merger Guidelines,[34] Media 24, because it was under investigation for predatory pricing behaviour, was required to advise (not notify) the Commission about this transaction. However it did not. Caxton wrote to the Commission advising it of the transaction. The Commission then wrote to the merging parties seeking further information. The merging parties then voluntarily filed the merger.

13.38. At no stage did the Commission exercise its powers under section 13(3).[35] Nor was any evidence put before the Tribunal that suggested the Commission had requested the merging parties to not take any further steps pending the outcome its investigation.

13.39. The consequence of the Commission not exercising its powers under 13(3) is that the merging parties were entitled to continue implementing their merger and such implementation is not illegal.

13.40. Caxton argues that we should refrain from adopting a formalistic approach. The merging parties only filed the merger voluntarily because the Commission had written to them. They had no intention to do so otherwise. That may well be so, but whether or not they intended not to notify, the fact that the Commission did not

34 Guideline on small merger notification, Notice 386 of 2009.

35 No evidence of this was put before us.

request them to desist implementation, despite its own earlier concerns, entitled the merging parties to implement.

13.41. We have been told that the merging parties have implemented the transaction and have taken great steps to integrate the businesses. They have done so in the belief that they were entitled to and the Commission has not requested them to desist. It would be improper to interdict that which in law they are entitled to do.

13.42. Furthermore in Part A of its application Caxton at that time sought an interdict only for the duration of the review application. Hence if granted, the interim relief would cease to operate at the moment when the review application was finally determined. This means that if the review were to succeed, the interim relief would not operate during the period when the matter would be remitted to the Commission for reconsideration. If the review application were to be dismissed, there would be no prohibition on implementation of the merger. Thus the relief sought would in any event be ineffective.

13.43. However given that the review has been successful on the merits, the Commission is well advised to exercise greater caution and utilise its powers under 13(3) in such matters. Whether it is still able to do so in this matter is not an issue we are required to consider.

The Order

In view of these considerations, we issue the following order:

14. The application for an interim interdict is dismissed.

14.1. The Commission's decision of 25 January 2011 is set aside and the matter is remitted to the Commission for reconsideration on condition that the matter is reconsidered by an entire new team.

14.2. There is no order as to costs.

25 July 2011

Yasmin Carrim **Date**

Concurring: Merle Holden and Mbuyiseli Madlanga

Researcher	: Londiwe Senona
For the Applicant	: Adv D Unterhalter SC and Adv J Wilson instructed by Nortons Inc
For First Respondent	:Adv M Wesley instructed by the State Attorney
For Second and Third Respondent	:Adv A Cockrell SC and Adv K Hofmeyr instructed by Webber Wentzel