COMPETITION TRIBUNAL

REPUBLIC OF SOUTH AFRICA

Case No: 82/AM/Dec10

In re request for consideration of a small merger:

Softline (Pty) Ltd	First Applicant
Netcash (Pty) Ltd	Second Applicant
and	
The Competition Commission of South Africa	Respondent

In re the small merger involving:

Softline (Pty) Ltd	Acquiring firm
Netcash (Pty) Ltd	Target firm

Panel	:	Y Carrim (Presiding Member)
		A Wessels (Tribunal Member)
		M Holden (Tribunal Member)
Heard on	:	21 June 2011
Reasons issued	:	30 September 2011

Reasons for Decision

Introduction

1.1. This case concerns an application by Softline (Pty) Ltd and Netcash (Pty) Ltd, the parties to a small merger, for the Competition Tribunal ("Tribunal") to consider their merger in terms of section 16(1)(a) of the Competition Act, 1998 (Act No. 89 of 1998, as amended) ("the Act"). This application arises from a decision of the Competition Commission ("Commission") to conditionally approve the merger.

1.2. The conditions that the Commission imposed relate to a set of behavioural conditions that sought to address certain identified competition concerns arising from the transaction. Subsequent to the Commission's decision of 07 December 2010 the merging parties on 21 December 2010 filed their request for consideration.

1.3. However, the Commission on 13 June 2011, prior to the Tribunal hearing, informed the Tribunal that it reached an agreement with the merging parties in regard to a proposed revised set of behavioural conditions that differed in certain respects from the Commission's imposed conditions. These revised conditions in the Commission's view were sufficient to address the competition concerns.

1.4. Since the Commission and merging parties were in agreement in regard to the proposed revised set of conditions, the Commission did not call any witnesses at the Tribunal hearing of 21 June 2011. However, a representative of Softline, Mr Rob Wilkie ("Wilkie"), the Chief Financial Officer of Softline, gave his perspectives on the transaction, relevant markets and effects on competition. A competitor of Netcash (Pty) Ltd, BDB Data Bureau (Pty) Ltd, represented by its Chief Executive Officer Mr Hendrik Pelser ("Pelser") also made submissions.

Merging parties

1.5. The primary acquiring firm is Softline (Pty) Ltd ("Softline"). Softline is a private company incorporated in accordance with the laws of the Republic of South Africa. Softline is a subsidiary of the Sage Group Plc ("Sage"), a public company listed on the London Stock Exchange. Sage is a global software company which controls numerous companies worldwide.

1.6. The primary target firm is Netcash (Pty) Ltd ("Netcash"), a company incorporated in accordance with the laws of the Republic of South Africa. It does not control any firm.

Transaction

1.7. The transaction concerns the acquisition by Softline of 100% of the issued share capital of Netcash thus post merger giving Softline sole control of Netcash.

1.8. The transaction constitutes a small merger in terms of section 11(5)(a) of the Act as notified to the Commission on 13 September 2010 pursuant to the

Commission's instruction under section 13(3) of the Act. We were informed that the merging parties however had already taken steps to implement the merger before they received the aforesaid instruction from the Commission.

Rationale for transaction

1.9. Softline submitted that the potential synergies of the transaction include (i) both businesses predominantly serving SMMEs, albeit in different areas of business processes; and (ii) Netcash's offering to the Softline group of products affording Softline's customers a wide range of service offerings under a single banner. In Softline's words, the transaction enables SMMEs to transact directly from their back-office accounting and payroll applications.

1.10. The merging parties furthermore submitted that the integration of Netcash into Softline's product suite will add real value to the Softline product suite, in terms of both functionality and convenience - Softline anticipates that this will assist in the growth of new licence sales and "stickiness" within the existing customer base. Wilkie (representing Softline) at the hearing explained that "*[t]he value add is really in terms of convenience from our perspective. It's not a pricing issue .... We intend to allow our customers, whilst they are working in the accounting or payroll application, to have a link directly to the Netcash platform in order that they may process their payments, whether to creditors or for payroll purposes, immediately and conveniently*."[1]

Merging parties' activities

Softline

1.11. Softline is active in the provision of business management software, services and support to small, medium and micro enterprise businesses (SMMEs). This includes accounting, payroll, human resource (HR), enterprise resource planning (ERP)[2] and customer relationship management (CRM)[3] system solutions and application software[4]. It also develops software solutions to meet the needs of specific industries and larger enterprises. Softline's leading brands include Softline Accpac, Softline Pastel

1 Transcript pages 37 and 38.

2 Encompasses applications that manage the optimal use of enterprise resources such as employees, assets and finances.

3 Encompasses applications that automate customer-facing business functions (such as sales, marketing, customer service and support, call centres and all the processes related to the automation of sales: order processing, information sharing, inventory monitoring and control, order tracking, sales forecast and analysis).

4 Application software enables a user or group of users to support and perform an operational or administrative process.

(accounting and payroll) and Softline VIP.

Netcash

1.12. Netcash is a third party payment service provider offering transaction processing services and also acts as a system operator.

1.13. Third party payment providers such as Netcash, commonly known as bureaux, are non-banks that participate in the payment system. Netcash does not have a banking licence which means that Netcash can only conduct its activities in partnership with a bank (the sponsoring bank). Netcash's sponsoring bank is currently FNB. The third party payment providers' main function is to provide software and hardware for the client, which is enhanced by its ability to forward instructions to Bankserv[5].

1.14. A third party payment provider typically obtains a user code and credit limit from the clearing bank involved. It can then sign up clients. It processes all the transactions under its assigned user code and receives funds or makes payment on behalf of its clients, using its own account and user code. However, none of the funds involved get transmitted directly into the third party payment provider account at any stage. The client is identified through user codes. The third party payment provider merely collects and collates electronic transactions on behalf of clients and submits them to system operators, including Bankserv.

1.15. Third party payment providers typically enable their clients to submit payment instructions such as payroll instructions or claims by clients for payment of services into the payment system. As a non-bank, Netcash in transmitting a payment instruction introduces into the clearing and settlement process an instruction issued by a participating bank's customer, and assuming that the instruction is cleared, is consequently able to obtain payment from the bank for the debit on the customer's account.

1.16. Netcash provides its transaction processing services in three primary areas:

5 Bankserv provides interbank electronic transaction switching services to the banking sector. Its role is to ensure that payment instructions are securely and rapidly switched between the various participants. Bankserv is currently wholly owned by banks.

a. debit order collections;

The Netcash debit order system automatically and electronically lodges debit orders on clients' accounts with the bank enabling payment of recurring and non-recurring debit order collections thus doing away with payments through the traditional paper and magnetic methods.

b. electronic funds transfer (EFT) payments; and

The direction in which interchange flows in EFT transactions differs according to the type of EFT transaction initiated. EFT therefore involves two types of transactions namely (a) EFT credit; and (b) EFT debit transactions.

EFT credit transactions

In the case of an EFT credit transaction, interchange flows from the paying side to the receiving side are facilitated. An EFT credit transaction is an electronic transfer of funds, initiated by the paying customer, instructing the paying bank to transfer funds from the account of the payer to the account of a beneficiary at the beneficiary bank. These transactions are mainly salary payments. This results in an interbank payment of interchange (homing fee) from the paying bank to the beneficiary bank.

EFT debit transactions

In an EFT debit transaction, the beneficiary "pulls" or draws the funds by prearrangement with the payer (again on each side assisted by the relevant bank). An example is a debit order obtained by a corporation from its customer for payment of services such as a cell phone contract. The paying client agrees that the value of the debit order will be pulled from his account periodically.

c. credit card transaction processing

Netcash, through the Netcash Terminal product, provides credit card processing services which allow merchants to process transactions without an electronic data capture terminal radio or telephone link to the bank. The merchant requires access to the internet in terms of infrastructure for this service. Netcash Terminal essentially allows the merchant to turn their computer into a point of sale credit card terminal. The Netcash Gateway product enables the merchant to direct credit card transactions from their web site or shopping cart to the Netcash payment webpage.

1.17.As is evident from the above the Netcash system is an internet based platform; it is an exponent of the software-as-a-service model, which is a form of cloud computing whereby software solutions are deployed on the web. It affords SMMEs a service in real-time, on a location-independent basis and the ability to transact directly with the banks through Bankserv.

1.18.Netcash offers these transaction processing services in particular to SMMEs. By aggregating the SMME transactions on behalf of customers it can create large transaction volumes which enable it to negotiate lower fees with the banks.

1.19.According to the Commission's report, independent EFT bureaus typically process transactions on behalf of a number of smaller companies who on their own would not have been able to obtain substantial per transaction discounts at their banks. Whether an EFT bureau succeeds in reducing the transaction costs of their customers depends *inter alia* on the volume of transactions that it can batch. It is for this reasons that SMMEs make up a large proportion of companies utilising EFT bureau services.

Relationship between parties

1.20.The Commission concluded that there is no horizontal overlap between the activities of the merging parties since their respective activities are not interchangeable but complementary services in the supply chain, as explained in more detail below. The overlap in terms of customers is in relation to SMMEs that do not currently use the transaction processing services of banks.

1.21.A vertical relationship exists between the merging parties since Softline provides file formats to the Netcash system. As background to the origins of this vertical relationship the merging parties explained that Netcash conducted a customer survey which demonstrated to Softline the value that would be created by its integration with Netcash. Based on this justification, Softline allowed Netcash to receive its file formats into the Netcash system. The merging parties however submitted that this was not an exclusive arrangement and that Netcash did not pay for these file formats since there was reciprocal value to both parties. Softline continues to provide these file formats to Netcash.

1.22.More specifically, Softline develops payroll and accounting software which has the ability to generate a file format necessary to upload payment instructions into bank and/or third party payment provider systems for processing. A user of Softline's software products uses a third party EFT bureau (such as Netcash) either by instructing the bureau to process transactions manually, or by providing it with an output file produced by their accounting and payroll software products. This output file can be a bespoke file which is read directly into the systems of the relevant EFT bureau, or the EFT bureau can use an in-house team or third-party software developer to engineer a module that will convert the output file into one that can be read into its own system(s).

1.23. To summarise the relationship between the merging parties, whilst Softline can be seen as the back-office of its clients, Netcash is essentially a front-end service provider.

1.24. The Commission found that payment providers often need to interface with the payroll and accounting systems provided by companies such as Softline in order to carry out their transaction processing function for clients. According to the Commission, Softline as a software developer would want its products to enable its clients to do EFT payments and debit orders in bulk when paying their employees or collecting payments.

1.25. We provide the following example to illustrate this interface. Softline's payroll system interfaces with the EFT bureau services as follows: when using an EFT bureau the client effectively gives the EFT bureau authorisation to run debit orders on its account. Then the payroll system generates a file according to the bureau's specifications. The client can then either manually hand this file over to the bureau or ask the payroll system to do it for him/her. The EFT bureau then does a debit against the client's account and credits each individual employee.

Commission's decision

Relevant product markets, market positions and entry barriers

Softline: upstream market

1.26. In regard to the upstream market where Softline is active, the Commission concluded that separate relevant product markets exist for the provision of business management software in respect of (i) large enterprises and (ii) SMMEs. The Commission's market investigation confirmed that the participants in these markets design and provide separate software for large enterprises and SMMEs and that the time and cost involved in developing this software differ significantly. The

Commission therefore focussed its analysis on the market for the provision of application software to SMMEs since this is the market in which Softline interfaces with Netcash. The Commission focussed its analysis even more specifically on the provision to SMMEs of accounting and payroll software[6] as these two packages specifically interface with Netcash's product offerings. The Commission considered the geographic scope of the relevant upstream market to be national.

1.27. With regard to Softline's market position the Commission concluded that, based on third party submissions and the merging parties' own submissions in regard to their installed sites, as well as relevant research by SAICA, Stats SA and the Department of Trade and Industry in regard to SMMEs, Softline has a market share of approximately [70-80]% in its defined relevant market based on "installed base" data. Thus, Softline's market share in the upstream market is at a level that a presumption of dominance can be applied. It also found that this market share has remained relatively stable with a possible small increase over the last few years. According to the Commission this position of economic strength is derived from Softline's "*incumbency position sustained over time by an aggressive marketing strategy through the accounting profession and a provision of wide range of products which encompasses various aspects of enterprise application software ("EAS") and with gradual sophistication as the enterprise grows*".[7]

1.28. The Commission ruled out packages built on Microsoft Excel as an alternative to the use of Softline's accounting and payroll software. The Commission stated that although its investigation revealed that Microsoft Excel has indeed developed software that performs similar functions as software developed by companies like Softline, various market players who are customers and dealers in Softline products submitted that Microsoft's software has not managed to capture significant market share. It further stated that it was clear from its investigation that Microsoft's product has not gained popularity of use such that it can be seen as a significant competitor to business management software vendors that compete in the SMME segment of the market.[8]

1.29. The Commission further found that the upstream market is characterised by high barriers to entry because of significant economies of scale requirements and significant upfront fixed costs associated with the development of the technical

6 The Commission found that there is no need from an SMME perspective to distinguish narrower relevant product markets for the provision of respectively (i) accounting and (ii) payroll software.
7 Commission report, paragraph 8.2.2.1.1, page 58.
8 See paragraph 8.1.1.2 of the Commission's report, pages 31 and 32.

software.

Netcash: downstream market

1.30. As stated in paragraph 16 above, Netcash is a third party payment provider offering transaction processing services to SMMEs in three primary areas. The Commission concluded that a separate relevant product market exists for the provision of transaction processing services by third party payment providers to SMMEs.[9] The Commission considered the geographic scope of this market to be national.

1.31. The Commission was of the view that banks[10] do not compete closely with third party payment providers and therefore excluded them from this market. This decision was based on significant differences in the fees that third party payment providers charge for their services compared to banks, and the unwillingness of banks to deal with individual SMMEs because of their very low transaction volumes. The Commission suggested that banks tend to service larger clients and that the SMME sector is poorly served by them.

1.32. The Commission's investigation revealed that the South African market for the provision of transaction processing services to SMMEs, excluding direct processing via banks, is fragmented with a significant number of players. The merging parties submitted the names of some 40 third party payment providers in South Africa, excluding banks,[11] and the Commission at the hearing confirmed this large number of participants.[12] The Commission further found that Netcash has a market share of less than 10% in this market. However, considering the relative sizes of the major players in this fragmented market the Commission concluded that Netcash is one of the leading South African EFT bureaus: the four largest players being Sanlam Multidata, BDB Data Bureau, Real Pay and Netcash.

9 The Commission concluded that there is no need, from a supply-side perspective, to distinguish narrower product markets based on the different types of transaction processing services that third party payment providers offer.

10 According to the merging parties, banks currently are responsible for approximately 95% of the total transaction processing volumes.

11 Merging parties' Competitiveness Report, pages 29 and 30; record pages 73 and 74.

12 Transcript page 59.

1.33.The Commission further cautioned that Netcash's relatively low market share may not provide a correct view in regard to the competition effects of this transaction given Netcash's ability to absorb volume that will be released from its competitors due to likely post merger foreclosure (see the theory of harm described below). The Commission highlighted the merging parties' stated purpose to scale up Netcash by linking it with Softline's software. It also found that Netcash's system can support very high volumes of users and high volumes of transactions, i.e. that it has so-called scalability[13], and furthermore that the scalability of Netcash's system to accommodate the envisaged extensive growth is documented in the merging parties' *Technical and Commercial Due Diligence* report dated 22 February 2010.[14]

1.34.The market players contacted by the Commission confirmed that economies of scale are important in transaction processing. Furthermore, the Commission pointed out that the merging parties did not dispute that Netcash's web-based system has substantial economies of scale.

1.35.Reputational effects and the trust of customers in the platform provider could potentially also be an entry barrier as is evident from Wilkie's testimony when he was asked why Softline did not organically, independent of this merger, enter the downstream market. He stated "*we felt that it was a market we didn't understand. We didn't understand what the regulation required around providing for transaction processing. We wanted to acquire a brand that existed where there was some market trust in the platform and in the service that we provided*".[15]

1.36.However, despite these (potential) entry barriers, as pointed out in paragraph 32 above a large number of small firms are currently active in the relevant downstream market. The Commission was however concerned that this transaction may raise the barriers to entry in this market (see paragraph 39 below).

Commission's theory of harm

1.37.The Commission was primarily concerned that the merger would lead to a post merger bundling of services. It found that the strategy documents of the merging parties expressly confirm their intention of bundling and furthermore that their due diligence report provides details of how the integration of Netcash with the Softline

13 Scalability is essentially the capability of processing data. This depends on both hardware and software and on the volume of data being processed.

14 See pages 510 to 523 of the record.

15 Transcript page 57.

accounting and payroll packages is to be effected. It further found that the merged entity's intent to bundle services had in fact been implemented practically as evidenced by advertisements (flyers, billboards and mail box messages to existing customers of Softline) that seek to market the combined services.

1.38. According to the Commission the concomitant result of this integration of Netcash with Softline's product set is that independent EFT bureaus are likely post merger to lose to Netcash a significant proportion of their customers using Softline's software packages. The Commission in this regard noted that although the merging parties' due diligence report speaks of winning business from banks, a substantial portion of the merged entity's business could be won from other independent EFT bureaus that serve the SMME market since SMMEs on their own are unable to get competitive per transaction prices from utilising banks' own electronic banking divisions.

1.39. The Commission was also of the opinion that the merger and likely expansion of Netcash through its association with Softline could exacerbate barriers to entry in the downstream relevant market (also see paragraph 36 above). It felt that if Softline post merger offered preferential interconnection terms to Netcash or if Softline embarked on a strategy that affects the connectivity of third party processors, barriers to entry could increase. The Commission ultimately concluded that barriers to entry in the relevant downstream market are likely to be significantly high if for some reason Softline's products are no longer available to third party processors.

Commission's conclusions

1.40. The Commission concluded that the merged entity would have both the ability to foreclose rivals in the identified downstream market and the incentive to do so resulting in a substantial prevention or lessening of competition.[16] Furthermore the Commission found that the merged entity is a dominant firm in the upstream relevant market (see paragraph 27 above) and that its bundled product is distinct.

1.41. The Commission's ultimate findings are summarised below:

a. the merger is likely to substantially prevent or lessen competition in the transaction processing market since the merged entity will have both the ability and incentive to create a bundle of Softline's accounting and payroll

16 See the Commission's report, paragraph 8.2.2.

software and Netcash's transaction processing system which rivals cannot replicate with their own competitive bundle(s). This would be to the detriment of other EFT bureaus active in the transaction processing market. This bundling of Softline and Netcash's products/services is likely in the long-run to result in a substantial prevention or lessening of competition since the merged entity will only face competition from fewer less efficient independent transaction processors.

b. The merged entity is likely to have both the ability and incentive to refuse, delay or limit interoperability of Softline's accounting and payroll software with independent transaction processors' systems to the detriment of the latter. In addition to this, the merged entity is likely to provide preferential treatment to Netcash at the expense of Netcash's rivals. The consequence of this is likely to be a further enhancement of the uptake of the Softline/Netcash bundle with similar long-run adverse effects on competition in the transaction processing market.

1.42. Although the Commission also found that the merger would give rise to certain fairly substantial benefits, in light of the significant technical foreclosure concerns (see below) it felt that this did not warrant an unconditional approval of the transaction. These benefits related to the convenience of one-stop-shopping offered to customers obtaining the combined products from a single supplier and cost savings due to economies of scale likely to accrue to Netcash from a widened customer base. The Commission found a further benefit to be the potential competition that the merged entity could bring to the transaction processing businesses of the banks given the merged entity’s ability to offer a Softline/Netcash package across different customer groups (i.e. to SMME and also larger enterprise level customers).

Tribunal proceedings and assessment

1.43. In light of the agreed position between the Commission and the merging parties on a proposed set of behavioural conditions to address the potential competition concerns, we need not in this matter deal in an elaborate fashion with all the Commission’s theories of harm and findings and the merging parties’ counter theories. Given the said agreed position we shall proceed on the basis that the merger raises likely foreclosure concerns and assess whether we regard the proposed set of behavioural conditions as an appropriate and proportionate remedy to the identified concerns. We also need not in these reasons deal in detail with each individual condition, but shall focus on whether they collectively address the identified concerns.

1.44. The Tribunal at the hearing requested the Commission to present its views and to specifically explain why the proposed set of conditions satisfies its concerns around the competition effects. The Commission stated that its potential competition concerns related to two types of foreclosure namely (i) technical foreclosure; and (ii) efficiency foreclosure:

a. technical foreclosure

The hypothesised theory of harm in regard to technical foreclosure is that the merged entity will seek to exclude rival transaction processors from serving Softline customers. Softline may for example make changes to the way that its software operates that will prevent the merged entity's customers from using rival service providers in the downstream relevant market.

Essentially Softline has two types of file formats which are required for the integration of the processing services i.e. a bespoke file format and a generic file format. The concern was centred on the potential post merger elimination of these file formats. Hence, to address this concern it would be necessary to ensure that a file format, either of a generic nature or alternatively a file format that is usable by bureaus, remains available post merger.

b. efficiency foreclosure

This in essence refers to the impact of improvements that may be made to the merged entity's product. Softline may for example provide customers a bundle that from their perspective is significantly superior to any alternative bundles of rival EFT bureaus. Thus, the Softline Netcash integration could convey such a competitive advantage to Netcash over its rivals that these rivals post merger will be unable to effectively compete.

1.45. At the hearing the Commission however indicated that the identified potential efficiency foreclosure concerns would be largely offset by the merger-specific efficiency gains, in particular that the merger itself is likely to introduce competition with banks (also see paragraph 42 above). Thus, in the light of the anticipated pro-competitive gains resulting from the merger, the Commission concluded that only the technical foreclosure concerns remained.

1.46. In regard to the issue of technical foreclosure, the Commission indicated that it revisited condition 3 of its imposed conditions which dealt with a so-called "choice screen" to customers and how this would be utilized. This provision would give the users of Softline's accounting and payroll packages an opportunity to choose by way of a choice screen whether and which competing transaction processor to use in addition to the transaction processor(s) that they already use. The Commission submitted that this condition, on further reflection, went beyond what was strictly speaking necessary in order to address the particular anticompetitive concern since it went beyond addressing the question of the availability of a particular file format post merger. It submitted that the conditions in the proposed revised set of conditions that relate to technical foreclosure on their own are sufficient to address that particular concern.

1.47. The Tribunal however raised a concern that the terms of access, specifically the cost of the output files to transaction processors, were not sufficiently clear in the proposed set of conditions.

1.48. The final set of conditions, as amended in response to the Tribunal's queries (and agreed to by the Commission and merging parties), impose an obligation on Softline to continue to make file formats available to all transaction processors which are currently using any file formats created by Softline, as well as the obligation in relation to transaction processors which are currently not using file formats created by Softline to maintain standard file formats in respect of the relevant payment streams which Softline upon request shall make available to these transaction processors. These file formats shall be made available to the transaction processors without charge and in a complete, accurate and timely manner.[17]

1.49. In regard to application programming interfaces (API) or Software Development Kits (SDKs) that are necessary to enable transaction processors to provide transaction processing services, the merging parties submitted that Softline has always charged its customers for these products i.e. they were not provided free of charge pre-merger.[18] In terms of the imposed conditions Softline shall make these available in a complete, accurate and timely manner, and on reasonable, market-related terms.

1.50. The other condition that the Commission revisited related to the time period for

17 See condition 3 of the revised set of conditions.
18 Transcript page 68.

which the conditions are to be imposed.[19] The Commission imposed the conditions for a 10 year period, but recommended a period of 5 years in the proposed revised set of conditions. As motivation for this change the Commission at the hearing explained that this is an industry driven by innovation and that new players therefore over time might come into the market and replicate the merged entity's service bundle. On this basis the Commission considered a 10 year period to be disproportionate to the goal that it sought to achieve - hence that a period of 5 years was more appropriate.

1.51. In response to questions raised by the Tribunal in regard to this change the Commission further indicated that there is evidence that certain banks have already started a form of replication of the product(s) in question. In addition, SAP (a software provider to large business) has already indicated its intention to effectively render services that may compete in the SMME software segment.[20] The latter suggests some support for a general hypothesis that providers of more complex enterprise software may be able to switch to the supply of SMME customers in the event that the merged entity decides post merger to increase prices to SMMEs or to reduce the quality of its offering.

Third party objection

1.52. BDB Data Bureau (Pty) Ltd ("BDB"), a competitor of Netcash in the payment bureau market, did not formally intervene in the merger proceedings, but raised concerns in regard to the transaction during the Commission's investigation.[21] When the consideration proceedings were set down for hearing BDB requested that it be allowed to clarify the basis for its concerns. BDB in response to a request from the Tribunal to make written submissions clarifying its concerns summarised them as follows: [22]

a. in regard to access and functionality, Netcash's unique access to and subsequent integration with Softline's software will foreclose Netcash's equally efficient competitors from the market as these competitors will be unable to develop the same seamless integration and will therefore be hindered in their ability to develop functionally similar services for Softline's accounting and payroll customers; and

19 Condition 5, both in the Commission's imposed conditions and the proposed revised set of conditions.
20 Page 9 of transcript.
21 See merger record pages 884 to 893.
22 Letter to the Tribunal dated 20 June 2011.

b. in respect of exclusionary pricing, Softline could abuse its dominance in the upstream software market to unfairly capture market share and attain dominance in the downstream payment bureau market by a lock-in of customers. This the merged entity will obtain by making use of pricing strategies such as cross-subsidisation and bundled price packages for the services.

1.53. Pelser made representations on behalf of BDB at the hearing where he clarified that BDB contested the proposed revised conditions as agreed to between the Commission and the merging parties. He articulated BDB's concern as follows: "*The issue here is not for us to have the same standard of file output .... The issue here is about Softline being able to use their market power of their very, very large percentage of software users, which they have, to then package that delivery, that convenience ..., to people who aren't skilled in the area of accounting, who aren't skilled in the area of processing payroll, to use that software to eventually pay their staff or their creditors. The problem is that those same people, if they are presented with a convenience that is now post merger only available to Netcash, ... , that those same people who aren't skilled enough to do these things by themselves will be presented with an unfair advantage that originates out of the very large market share that Softline enjoys*"[23]; "*we will post this merger be hit by the effect of the convenience that is now only made available to one of our direct competitors to the effect that they have a benefit which we can't match at all*"[24]*and* "*[b]y creating a level of convenience or technical advancement, which is not available to the other users of the system, it would have the same effect in my view of exclusion*."[25]

1.54. Pelser's main concern with the proposed revised set of conditions related to the fact that the "choice screen" option was no longer included (see paragraph 46 above). Pelser however conceded under cross examination that in the pre-merger environment neither BDB nor anyone else has the merged entity's post merger potential seamless integration which appears to be at the heart of his concern.[26] He also confirmed that the access that BDB pre-merger has with Softline will, in terms of the proposed revised conditions, continue post transaction.

1.55. Pelser further confirmed that he was aware that a number of banks have entered the payroll space, for example ABSA with I-Payroll, Nedbank and FNB with FNB

23 Transcript pages 16 and 17.
24 Transcript page 18.
25 Transcript page 21.
26 Transcript pages 23 and 24.

Payroll Innovations, but was of the opinion that these were not effective competitors to the Softline offering since they are provided only to the banks' own customers within a certain market.[27]

Merging parties' views and response to BDB

1.56. *Inter alia* the merging parties contested the market definitions of the Commission in regard to the relevant upstream market(s)[28], Softline's market position, the role of banks in respect of the market in which Netcash operates, as well as the Commission's conclusions in regard to the incentive and ability of likely post merger foreclosure of rivals.

1.57. Assuming possible post merger technical foreclosure concerns, the merging parties were of the opinion that the Commission's imposed conditions went beyond what could be considered necessary, and furthermore that the proposed revised conditions are sufficient to address any potential technical foreclosure concerns that may arise from the merger.

1.58. In regard to the issue of the choice screen option being left out in the proposed set of conditions, Wilkie stated that such a condition "*would take the strategic benefit of this acquisition away completely*".[29] The merging parties argued that this element appears to seek to go beyond maintaining rival transaction processors' current access to Softline customers and instead ensuring that the merged entity is unable to offer greater integration between Softline and Netcash than between Softline and any other transaction processor. They indicated that by reducing the scope for the merged entity to secure a competitive advantage over its rivals by pursuing such integration, this remedy would reduce the incentive for the merged entity to invest in that integration, limiting the scope for the merger to lead to product improvements that would benefit customers. The merging parties further argued that investment in product improvements in order to win customers is a central element of competition, even where improvements in one company's product may lead to it winning customers at the expense of rivals. They regarded it as a normal and necessary part of competition that one firm's competitive efforts place pressure on its rivals and act as a spur to those rivals in turn to improve their own offer.

1.59. The merging parties also argued that many existing transaction processors have

27 Transcript pages 29 to 31.

28 The merging parties held the view that SMMEs are able to use alternative solutions such as modified high-function systems, online systems and/or Microsoft Excel based systems.

29 Transcript page 39.

proven themselves able to compete successfully without a dedicated Softline output file; and furthermore that it will not be possible for the merged entity to discontinue the generic output files on which these transaction processors rely.

1.60. The merging parties were furthermore of the contention that the provision of accounting and payroll software to SMMEs by banks is an additional constraint on Softline's business model and that this is becoming increasingly significant. Wilkie expressed the view that the banks are a serious threat going forward. He further suggested that businesses like BDB are partnering with the banks, indicated that FNB is now offering an accounting system for free to their customer base and that Nedbank also started offering payroll services.[30]

1.61. The merging parties further submitted that the Commission did not fully investigate the scope for rival transaction processors to respond to the merged entity's integrated product by forming their own alliances with accounting and payroll software providers. They, more specifically, argued that: (i) transaction processors could invest in their own technology to integrate the generic output files that Softline would continue to offer post-merger with their own product to produce a similarly attractive integrated product; (ii) transaction processors could establish commercial arrangements with other existing accounting and payroll software providers; (iii) a third, and related, counter-strategy for rival transaction processors would be to sponsor entry by new providers of accounting and payroll software, in particular suppliers of mid/enterprise level software; and (iv) insofar as scale is an important element of the transaction processing business model, consolidation amongst rival transaction processors may allow these companies to maintain economies of scale even in the face of volumes lost to the merged entity.[31]

Commission's response to BDB

1.62. The Commission was of the opinion that BDB's concern raised at the hearing may be a particular concern to one particular enterprise but that it is not a concern of competition in the broad sense. It summarised BDBs position in the following manner "*[t]oday a new concern was introduced, which is not the existence of a standard access file format, but rather the fact that whatever you give to Netcash must also be given to us*".[32]

30 Transcript page 38.
31 RBB Report, pages 31 and 32.
32 Transcript page 67.

1.63. As explained above, the concern from the Commission's perspective was the retention of the standard access files which it felt was addressed sufficiently by the proposed conditions. The original imposed conditions according to the Commission, specifically that dealing with the issue of a choice screen being provided to customers, would have removed the rationale for the acquisition in the first instance and in any event did not on its own address the underlying technical foreclosure concerns.[33]

Conclusion

1.64. The Tribunal accepts the Commission's reasoning that the ambit of its original conditions went beyond what was considered necessary and proportionate to address the main competition concern raised, being in essence the technical foreclosure issue. It is common cause that pre-merger neither BDB nor any other competitor of Netcash has the seamless integration which Softline and Netcash could create post merger. Providing customers with a choice screen therefore goes beyond preserving the pre-merger status quo. The purpose of the remedy is to maintain the degree of competition in the transaction processing market that would have existed absent the merger. By enabling rival EFT bureaus to compete for customers by making available the particular software that is necessary for the interface to occur the issue of technical foreclosure is effectively addressed. By requiring that file formats be made available to rival transaction processors would provide comfort that technical foreclosure could not occur, while at the same time it would not deprive customers of benefitting from potential efficiency benefits resulting from the merger.

1.65. The conditions that we have imposed are intended to ensure that Softline post merger continues to provide the same level and quality of interoperability it currently provides between, on the one hand, all of its accounting and payroll packages which provide file formats in respect of one or more payment streams, and, on the other hand, the systems of all current and future transaction processors which wish to interface with such packages using those file formats.

1.66. The conditions that address the technical foreclosure aspect are:

1.67. In relation to all transaction processors which are currently using any file formats created by Softline for its accounting and payroll packages in respect of one or

33 Transcript page 67.

more payment streams, Softline shall continue to make those file formats available in a complete, accurate, timely manner, and without charges, such as to enable these transaction processors to continue providing their transaction processing services in relation to such packages in the same manner in the future.

1.68. In relation to all transaction processors who are currently not using file formats created by Softline for its accounting and payroll packages in respect of one or more payment streams, Softline shall maintain standard file formats in respect of the relevant payment streams which it shall, upon request, make available to these transaction processors in a complete, accurate, timely manner, and without charges, such as to enable them to provide transaction processing services in relation to such packages in the future.

1.69. In relation to both categories of transaction processors referred to in paragraphs 66.1 and 66.2 above, Softline shall continue to make available in a complete, accurate and timely manner, and on reasonable, market-related terms, application programming interfaces (API) or Software Development Kits (SDKs) that are necessary to enable transaction processors to provide transaction processing services in relation to Softline's accounting and payroll packages in the present or in future.

1.70. The above conditions shall be in place for a period of 5 years from the date on which the Tribunal issued its order conditionally approving the merger.

1.71. For the full set of imposed conditions, see the attached **Annexure A**, which is the Tribunal's order dated 05 July 2011. Third parties affected by the imposed conditions may approach the Commission in regard to non-compliance by the merged entity with these conditions.

1.72. Furthermore, based on the evidence before us we found no cogent evidence to show that the proposed revised set of behavioural conditions as agreed to between the Commission and the merging parties (after amendment following specific issues highlighted by the Tribunal) are insufficient to address the technical foreclosure concern raised in this merger.

2. For all the above reasons we view the set of behavioural conditions as an appropriate and proportionate remedy to the identified technical foreclosure concerns.

30 September 2011

Andreas Wessels **Date**

Yasmin Carrim and Merle Holden concurring

Tribunal researcher	:	Londiwe Senona
For the First and Second Applicant	:	Adv J Wilson instructed by Bowman Gilfillan Inc.
For the Respondent	:	Adv T Nqcukaitobi