IN THE COMPETITION APPEAL COURT

HELD AT CAPE TOWN

	Competition Appeal Court Case No: 58/CAC/DEC05
	Competition Tribunal Case No: 87/LM/SEP05
In the review application between:	

MOMENTUM GROUP LIMITED	First Applicant
LAURITZ LANSER DIPPENAAR	Second Applicant
JOHAN PETRUS BURGER	Third Applicant
and	
THE CHAIRPERSON, COMPETITION TRIBUNAL	First Respondent
THE ACTING COMMISSIONER, COMPETITION COMMISSION	Second Respondent
AFRICAN LIFE HEALTH (PTY) LTD	Third Respondent
and the appeal	
in the large merger between	
MOMENTUM GROUP LIMITED	Appellant
and	
AFRICAN LIFE HEALTH (PTY) LTD	Appellant

Judgment

[2006] ZACAC 1

Malan AJA :

1 The applicants/appellants ("the applicants") seek a review of the decision of the Competition Tribunal of 12 December 2005 and appeal against it. The Tribunal approved the large merger between Momentum Group Limited ("Momentum Group") and African Life Health (Pty) Ltd ("ALH"). The applicants object to the conditions to which the approval was subjected to by the Tribunal. Neither the application for review nor the appeal is opposed. There is no cross-appeal. The only issue is whether the conditions were properly imposed. This court ordered that the merger be approved unconditionally on 2 February 2006. The reasons for the order are set out in this judgment.

2 On 2 September 2005, Momentum Group and ALH applied for the approval of a merger between them in accordance with Chapter 3 of the Competition Act 89 of 1998 ("the Act"). The Competition Commission investigated the proposed merger and recommended its approval without conditions to the Tribunal on 9 November 2005. The merger application was referred to the Tribunal in terms of s 14A of the Act for approval.

3 After hearing the parties on 8 December 2005, the Tribunal approved the merger on 12 December 2005, but made the approval subject to certain conditions that it considered appropriate. The conditions impose on persons

holding certain dual directorships an obligation to resign from one of those directorships by 12 January 2006.

4 The order made by the Tribunal reads as follows:

> A The merger is approved in terms of section 16(2)(b) of the Act subject to the following conditions:
> 1 Any person who presently serves as a director on both a Momentum Group and a Discovery Group board must resign from one of these Group's boards within one month of the date of this order.
> 2 The acquiring firm must ensure, for so long as a firm in the FirstRand Group (ie FirstRand Limited or any firm that is controlled by FirstRand Limited) owns a controlling interest in both the Discovery Group and the Momentum Group, that a person who is a serving director or executive of a company in the one of the Groups, is not appointed to a board in the other Group.
> 3 For the purposes of this order;
> A 'Discovery Group' includes Discovery Holdings Ltd, Discovery Health (Pty) Ltd or any subsidiary of these firms;
>
> B "Momentum Group' includes Momentum Group Limited, Momentum Healthcare (Pty) Ltd or any subsidiary of these firms.

5 On 23 December 2005, both a notice of appeal and an application for review of the Tribunal's order were filed. The review application included an application for interim relief suspending the conditions attached to the order pending the outcome of the hearing of the review and appeal, which application was heard and granted on 10 January 2006.

6 The review application is based on the fact that conditions were imposed by the Tribunal in circumstances where neither the Commission nor any other party to the merger proceedings disputed that the merger should be approved unconditionally; is no proper evidential basis by reference to which the conditions might rationally be

justified (*inter alia*because there is no substantiated risk that cross-directorships would create or aggravate a risk of collusion); the parties affected by the order, being the directors holding dual directorships, had not been heard by the Tribunal; and the conditions are too broad.

7 The two individual applicants involved in the Tribunal's order were not joined but are now joined in these proceedings and are willing to submit to the decision of this court. It is thus not necessary to express an opinion on the question whether they should have been joined in the proceedings from the outset.

8 The grounds of appeal are, first, that there was no *lis* the parties before the Tribunal in that neither the Commission nor any other party to the merger proceedings disputed that the merger should be approved unconditionally. It is submitted that the Tribunal exceeded its jurisdiction by imposing conditions in these circumstances. Secondly, the Tribunal acted unreasonably or irrationally by imposing conditions in circumstances where the evidence presented should have led it to approve the merger unconditionally. Moreover, there was no evidence to suggest that the cross-directorships which the conditions seek to cure created or aggravated the risk of anti-competitive consequences resulting from the merger.

9 Although there are some suggestions (I would put it no stronger) in the Act that a *lis*is required before the Tribunal may adjudicate a matter by, for example, imposing certain conditions where none were recommended (see eg ss 14A(3), 16(1)(a), 16(2), 16(3) and 53(1)(*c*)(v)) the structure of the Act as well as the composition of

the Tribunal militates against such construction. The argument of the applicants centres around the word “adjudicate” used in s 27 of the Act. Where a merger constitutes a large merger, the Commission is required to refer that merger to the Tribunal and to make a reasoned recommendation to the Tribunal on whether it considers it appropriate that the merger be approved unconditionally, approved with conditions or prohibited (s 14A(1)(*b*)). Section 27 defines the functions of the Tribunal on receiving the referral. After delineating the Tribunal’s power to “adjudicate” on prohibited practices, subs (1)(*b*) states that the Tribunal has the power to “*adjudicate*on any other matter that, in terms of this Act, [may] be considered by it, and make *any*order provided for in this Act”. The orders that may be made, it should be said, are set out in s 16(2) which enjoins the Tribunal to consider the merger in terms of the provisions of s 12A as well as the recommendation or request and then to “(a) approve the merger; approve the merger subject to any conditions; or (c) prohibit implementation of the merger”. There is no suggestion in the Act that the Tribunal may only exercise its powers where there is a dispute or *lis*. Other sections in the Act are destructive of the suggested interpretation: the Act allows the Tribunal to proceed in an inquisitorial manner (s 52(2)(*b*)). In so acting, the Tribunal can “direct or summon any person to appear at any specified time and place” (s 54(*a*)), question any person under oath or affirmation (s 54(*b*)), and summon or order any person to produce items necessary for the hearing (54(*c*)). These provisions emphasise the public nature of the Tribunal’s functions: it is no mere rubber stamp but has to exercise its powers within its own right (see s 27). The decision in *Special Investigating Unit and Another v Mfeketo and Twenty Similar Matters* 1 SA 1089 (Spec Trib) to which reference was made is entirely distinguishable and was concerned more with the meaning of the words “justiciable civil disputes” than “adjudicate” and is of no assistance in this matter. To my mind, the Tribunal was correct in its in *Coleus Packaging (Pty) Ltd*

and Rheem Crown Plant, a division of Highveld Steel and Vanadium Corporation Limited (Case 75/LM/Oct02 of 27 January 2003); [2003] 1 CPLR 51 (CT)) where it that s 16 of the Act, which provides for the Tribunal to "consider the merger in terms of s 12A, and the recommendation and the request", did not allow it to simply endorse the terms of a settlement agreement between the Commission and merging parties without exercising any discretion of its own. In coming to this conclusion, it distinguished merger cases from restrictive practices cases where, so it held, the Tribunal is not required to come to its own conclusion on the evidence when presented with a consent order (at 53CE). Of course, the very nature of the proceedings requires the issues to be formulated and the parties to be informed of them before a proper adjudication can take place. To ensure a fair hearing and clear evidential justification for its imposition of conditions, the Tribunal must afford the parties an opportunity to respond if they should wish, by the placing of evidence and /or argument before the Tribunal in respect of conditions that the Tribunal may consider imposing in such a case.

10 It is now necessary to consider the merits of both the review and the appeal, the grounds of which overlap. The acquiring firm is Momentum Group Limited, a wholly-owned subsidiary of First Rand Limited, which controls *inter alia*Momentum Healthcare (Pty) Ltd, Momentum Interactive (Pty) Ltd and Sovereign Health (Pty) Ltd. FirstRand consists of a large group of companies and holds approximately 65,6 % of the issued share capital of Discovery Holdings. Rand Merchant Bank is a subsidiary of FirstRand holding a 10 % interest in Life Healthcare (Pty) Ltd. The primary target firm was African Life Health (Pty) Ltd (ALH) which is controlled by African Life Insurance Company Ltd. The latter is owned by Sanlam (20,5 %) and Momentum (33,4 %). Momentum is acquiring the entire share capital of ALH from

African Life. Since FirstRand controls both Momentum and Discovery the Tribunal assessed the merger on the basis that the latter two entities belong to a single economic unit (§ 11). After the merger this single economic unit would command 34,62 % of the medical scheme administration market (§ 12).

11 The Tribunal, however, opined that FirstRand's relationship with Discovery raised concern (§ 16) despite the evidence, which the Tribunal apparently accepted (§§ 16-20), to the effect that there existed between the different entities within the FirstRand Group "vigorous competitive rivalry" (§ 20). Despite this the Tribunal concluded as follows:

"[31] [T]he administration market is one in which large, well-resourced firms and institutions compete, but in an ever-consolidating environment. The fact that both Discovery and Momentum are seeking to enter this lucrative lower income market, coupled with the increasing consolidation at the administration level, does not bode well for future competition in light of the fact that they share a common parent. Their size and market power under one umbrella could remove the competitive pressure from the market and thereby enable them to behave strategically and submit bids and tenders for large government projects. It is therefore imperative to maintain the rivalry between these entities and the concern raised by this merger would be that post merger there would be an enhanced incentive to co-ordination, rather than rivalry.

[32] At the present moment Discovery Holdings and the Momentum Group have two common non-executive directors Mr Laurie Dippenaar and Mr Burger, respectively the chief executive and financial director of FirstRand. We find cause for concern with respect to the level of cross-holdings and common directorships between Discovery and Momentum, even at non-executive director level. The possibility of exchange of sensitive information at board level becomes even more of a concern where conceivably a market division strategy could easily be entertained between Discovery and Momentum.

[33] For this reason our condition requires the elimination of cross-directorships between the Momentum and Discovery Groups …"

12 To overcome this concern, the parties in their competitiveness report offered to negotiate merger conditions (see § 34). This offer was repeated at the hearing (§ 35) and the merging parties' attorney indicated that they would have no objection to a prohibition of cross directorships at operating but not at holding company level (§ 36). The Tribunal continued:

"[40] We have previously observed the importance to consumers in ensuring that markets within the health sector remain competitive. We find that at present the medical administration businesses carried out by Discovery and Momentum compete in the market, irrespective of the fact that they are controlled by the same shareholder in the form of FirstRand. We find further that the FirstRand Group, if it was so inclined, is in a position to easily change its current strategy from a competitive to a co-operative one. Were this to occur, this would lead to a lessening of an important rivalry in the health care market between the largest present competitor in the form of Discovery, and the firm that itself asserts it is in a position, post merger, to be its most effective rival, Momentum.

[41] This change of strategy can be implemented at present without the need for a merger notification. The complete elimination of cross-directorships between the firms both at operating company and holding company level is necessary to preserve this rivalry, as whilst, post merger, the potential for greater competition between the firms exists, there is, conversely, also a greater temptation for the boards to collaborate as a means of overcoming th effects of competition.

[42] The merging parties acknowledge what they euphemistically call the 'corporate governance issue' and tender to do something about it. Yet their tender to eliminate cross-directorships at operating company level, but not holding company level, is contradictory insofar as it does not resolve the problem, but merely shifts it to a different level in the corporate chain – a level where on their own version, strategic decisions in relation to these ostensibly competing groups are taken. For this reason, that is our point of departure with the parties and hence, despite their tender of eliminating cross-directorships at operating company level, we require that they be eliminated at holding company level as well. The condition will not prejudice the interests of the shareholder, as given the size of the FirstRand Group and its abundance of executive talent, it can presumably find other suitable directors to replace those to the board the present incumbents elect to resign from."

It should be remarked at the outset that the conditions imposed provide no real safeguard for competition. Cross-directorships are prohibited without restricting the attendance of non-directors at board meetings. At board meetings of large companies non-directors are often present, and they include directors of other companies, executives of the holding and subsidiary companies and corporate experts and advisers. Nothing in the order prevents them in this case from sharing information. Moreover, the condition is too widely framed. As the founding affidavit shows, companies within the two groups provide services that go beyond those provided by Sovereign, Momentum Health and ALH. There is no reason why cross-directorship should not be permissible in the companies that provide these wider services within each group, but this is what the order prohibits. In addition, there seems to be no evidential basis for the Tribunal's statement in § 42 that "[t]he condition will not prejudice FirstRand as, given the abundance of executive talent in the group, it can presumably find other suitable directors to replace the persons who resign". As Mr Dippenaar has explained in his affidavit, the FirstRand centre is small and few have the required knowledge and expertise. Nor does the statement by the Tribunal "in the light of the need to keep groups separate, conditions must be imposed that have the effect of eliminating the cross-directorships" (§ 33) lend itself to easy comprehension: had it been the intention of FirstRand to consolidate the businesses of Momentum and Discovery it could have taken appropriate legal steps to do without resorting to a concealed abandonment of their management policy.

Mr Dippenaar describes the relationship between FirstRand, Discovery and Momentum in his affidavit. As a group, FirstRand espouses a strong entrepreneurial spirit in all its operating subsidiaries and promotes an "owner manager" ethos in their management. This means that management of its subsidiaries are given the freedom to set and pursue the goals of the companies concerned within the governance framework set by FirstRand. It also entails allowing these companies to determine their own cultures. Without abandoning this policy, there cannot be an "exchange of sensitive information at board level where a market division strategy could be entertained"; and no information pertaining to operational matters is exchanged. The parties have no intention to change this policy.

The FirstRand holding company delegates its authority to its subsidiary boards. It is not possible to govern the group in a different manner. Certain FirstRand board members sit on the boards of the subsidiary companies in which appropriate policies are developed. This, it seems to me, is good corporate governance and in keeping with spirit of the *King Report on Corporate Governance for South Africa – 2002*(see Blackman Jooste & Everingham *Commentary on the Companies Act*Volume 2 (2005 Revision Service) at § 8-16.2 ff and §8-16.5). It is consistent practice across the FirstRand Group that members of the FirstRand board, including its chief executive and chief financial officer are non-executive directors on the boards of its major subsidiaries. This practice is not limited to the medical aid administration aspect of the business. The cross-directorships are generally limited to those people

concerned with the surveillance and accountability within the FirstRand group. By reason of their positions in the FirstRand group, Mr Burger and Mr Dippenaar are deputed perform this task on behalf of FirstRand and its subsidiaries. They are the appropriate people for the purpose and are seen as such. In the same spirit, it is the intention that the new CEO of FirstRand (Mr P Harris), already a member of the Momentum board, will become a member of the Discovery board as well. In these circumstances, it was deposed, an exchange of sensitive commercial information between the two groups will not be permitted.

It seems that the Tribunal's reservations in this regard were ill-founded and, in the absence of full evidence, unjustified. It is consequently clear why the parties tendered not to have cross-directorships at operating level but not at holding company level: the tender would have been quite consistent with the policy allowing subsidiaries operating autonomy but quite inconsistent with the position of the subsidiaries within the FirstRand Group. The kind of information that has to be considered at the level of the holding company is different: it encompasses issues of financial and investment policy, corporate governance and the like that must be filtered through to FirstRand itself. In the process of monitoring and assessing such matters, board members should be able to consider the issues in a proper perspective within the context of the policies of the group as a whole.

15 In view of the aforesaid the following statement of the Tribunal is not justified: "Current (pre-merger) cross-holdings and cross-directorships are a cause for concern, even at non-executive level, because there is a possibility of exchange of sensitive information at board level where a market division strategy could be entertained" (§ 32). Finance houses such as FirstRand are principally concerned with investment returns and growth on capital employed. For this purpose they make strategic decisions on the extent to which they will invest in companies and provide them with continuing capital

injections and technical support. These decisions entail the evaluation, assessment and monitoring of the current and future performance of companies within the group. Performance of this task requires a complete understanding of the position of each of the entities that require comparison. The consolidation of information in this way is crucial to the proper management of a group. This exercise will be undertaken within the top management of the holding company at the head of the group (FirstRand). Information will be submitted by the subsidiaries to the board of directors of the holding company for deliberation. Management of FirstRand (for example, the CEO and CFO) will be expected to be familiar with the facts of all group companies. This is the reason why they need to serve on the boards of the main subsidiaries. Directors on the boards of the relevant subsidiaries need to be present on the FirstRand board in order to ensure an understanding at FirstRand board level of the activities and positioning of the subsidiaries. They report back to the subsidiary boards. They represent the subsidiary in deliberations at FirstRand board meetings and promote its interests. It follows that there must be people on the subsidiary boards who are familiar with the overall policies and plans of the group and who can ensure that they are carried through.

16 Section 12A requires of the Commission or Tribunal to "initially determine" whether or not a merger is likely to "substantially" prevent or lessen competition, by assessing "the strength of competition in the relevant market" and "the probability that the firms in the market after the merger will behave competitively or co-operatively". In doing so, it must take into account "any factor that is relevant to competition in that market", including the factors set out in s 12A(2) (see s 12A(1)). This makes it clear that a specific market must first be assessed.

It is also clear that the list of factors that must be considered is not a closed list and any other factor that is relevant as to whether or not there will be a substantial lessening of competition can be taken into account.

There was no such express initial determination of anti-competitive consequences by the Tribunal that must lead to a conditional approval of the merger. The Tribunal accepted that the market share of ALH was small and its acquisition would serve to increase the stake in the market of Momentum by 3% at most (§ 29). Generally, in the absence of a link between Momentum and Discovery, the acquisition of ALH would not have raised competition concerns (§ 15), and apparently this would be so even though ALH was of strategic importance to Momentum (§ 29). The Tribunal accepts that there is vigorous competition between the groups (§ 20), and, while appreciating that there might be some capacity to act co-operatively (§ 23), seems to accept that there is no such co-operation at present. In its view, there is accordingly a basis for aggregating the market shares of the two groups, making at least 31.32% pre-merger and 34.62% post-merger (§ 12). The Tribunal found that there is increasing consolidation in the medical aid administration market (§ 30). Whilst it is accepted that in the provision of medical services generally, especially in hospital services, there is a measure of concentration between the players, this is by no means obviously so in other fields. As the Tribunal accepted, the barriers to entry within the field of medical aid administration are low and significant countervailing power exists. Medical aid schemes come and go with some frequency, and the same is true of organizations that provide administrative services to such schemes. There are several fairly

large players and a significant number of smaller players within the market for the provision of medical aid administration services. Discovery is the largest, but it has several competitors of significant size.

17 On the basis of these findings, the Tribunal stated that “[t]he rivalry between the two groups is important, especially post-merger” (§ 25) and “it is imperative to maintain the rivalry between these entities” (§ 31). , the Tribunal accepted that it was impossible to ignore the fact that the two groups are members of a single corporate group (FirstRand) but that they must be forced to continue to operate as competitors. However, if they are separate entities, then there is no basis for concluding that the merger will create anti-competitive consequences. Momentum has a relatively small share of this market. Taken separately, it can be argued that the transaction is pro-competitive by enhancing Momentum’s presence in the market and enabling it to compete more effectively with the larger participants.

18 The Tribunal stated: “The concern raised by this merger is that post merger there would be an enhanced incentive to co-ordination, rather than rivalry” (§ 31). is no evidence to support this proposition and it is not borne out by the probabilities. The evidence shows that FirstRand has embarked upon a policy of “two horses in one race” and intends to adhere to it. The merger enhances this competition by strengthening Momentum's position in the market and provide it with the capacity to compete more effectively with the larger players, such as Discovery and Medscheme. As I have said, FirstRand could, if it insisted, depart from this policy. Through its majority holding in the two groups, it is notionally correct that it could, if it wished, have produced this result. There are, however, commercial reasons why it prefers not to do this, and these were placed in uncontested evidence before the

Tribunal. Besides the factors referred to above, they include the large investment, both in financial and emotional terms, of the founders of Discovery and their continued involvement in the management and leadership of the group.

The Tribunal never expressly rejected the evidence to this effect; it assumed, instead, that a convergence of the two groups is a notional possibility. But even on this approach there is still no basis for coming to the conclusion it did. Prior to the merger Momentum, through African Life, had a one third stake in ALH, which had a 3% share of the market. The effect of obtaining the balance of the equity in the company was to increase Momentum's penetration of the market by two thirds of 3% - ie 2%. By virtue of that interest, pre the merger, the FirstRand Group also had three representatives on the board of African Life . It is not clear why any increase of market share should encourage co-ordination between the two groups; and even less so where the small increase accrues to a participant in the market that is itself very small.

19 The Tribunal did not deal expressly with the reasons for its apparent conclusion that there will be a substantial lessening of competition in the relevant market. Discovery and Momentum have existed together as part of the FirstRand Group prior to the merger and the cross-directorships between them are historical and unrelated to the merger that was considered by the Tribunal. The Tribunal recognised this when it considered the acquisition by Momentum of Sovereign Health. It is consequently assumed for the purposes of this judgment that it is not the

combination of the Momentum and Discovery interests *per se*that leads to an inference of a future lessening of competition but rather the increase of market share from just over 31% to approximately 35%. Although a market share of 35% post-merger is not insignificant, the market power associated with such market share is diminished in a market that has a large number of competitors, is fiercely contested, exhibits relatively low barriers to entry and effective countervailing power, evidence of which was presented to and accepted by the Commission. A finding, if it has been made, that the approximate 3.3% increase in the aggregated market share of the FirstRand Group tip the scale cannot be correct in the face of uncontested evidence of the fact that no anti-competitive results would flow from the merger.

20 The conditions were imposed without the Tribunal fully having the benefit of the insights of the merging parties of their commercial effect. It follows that both the review application and the appeal should succeed. The following order was made on 2 February 2006:

The merger is approved unconditionally.

Malan AJA

Davis JP and Mailula AJA concurred

Applicants'/Appellants' counsel: MSM Brassey SC and MJ Engelbrecht
Applicants'/Appellants' attorneys: Brink Cohen le Roux Inc
Date of hearing: 2 February 2006
Date of judgment: 14 February 2006