BEFORE THE COMPETITION APPEAL COURT

CASE NO: 20/CAC/Jun02

In the appeal of:

Mondi Limited 1st Appellant

and

Kohler Cores and Tubes
(a division of Kohler Packaging Limited) 2nd Appellant

against the decision of the Competition Tribunal in Case No. 06/LM/Jan02

SUBMISSIONS BY *AMICI CURIAE*

R O Petersen SC and J Wilson

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1 We make these submissions at the request of the Court. The traditional role of the *amicus curiae* seems the applicable one in this case.[1] This is an appeal and not a review: the Competition Tribunal is not a party to the proceedings. Although the Competition Appeal Court may on occasion find it appropriate, in terms of Rule 28, to allow interested persons other than the parties to appear or be represented at the hearing of an appeal as *amici curiae* in order specifically to support the decision of the Tribunal,[2] the ordinary principle is surely that the latter body has itself no

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[1] See *Connock's (SA) Motor Co Ltd v Pretorius* 1939 TPD 355.

[2] Cf *The* Merak *S: Sea Melody Enterprises SA v Bulktrans (Europe) Corporation* 2002 (4) SA 273 (SCA) at 276F-G.

interest in the outcome and is ‘represented’ in an appeal solely by the reasons which it has given in support of its decision, read with the record. If an *amicus curiae* is appointed by a court of appeal for its own assistance,[3] this must mean that the *amicus* is required to approach the task not as the tacit representative of the tribunal below but with the object of applying his or her mind independently, in the public interest, to the issues as they arise from the record, from the reasoning of the tribunal and from the arguments of the parties to the appeal. This is what we have attempted to do here.

2 We have come to the conclusion — and submit — that there is a sufficient basis in the record for a finding that the merger is likely to substantially prevent or lessen competition within the meaning of section 12A of the Competition Act, No 89 of 1998 as amended. We shall set out our reasons for this conclusion before proceeding to deal with the further issues that would arise if it were held to be correct.

POLICY CONSIDERATIONS IN THE REGULATION OF VERTICAL MERGERS IN SOUTH AFRICA

3 South Africa’s Competition Act (“the Act”) must be interpreted primarily with reference to its own language,[4] its preamble and

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[3] Such an appointment would, we submit, be consistent with the inherent powers of this Court and falls in any event within the powers of the Judge President under Rule 34(1).

[4] Cf *Standard Bank Investment Corporation Ltd v Competition Commission and others; Liberty Life Association of Africa Ltd v Competition Commission and others* 2000 (2) SA

stated purpose,[5] and in the light of South Africa's particular economic and social circumstances. While, in interpreting and applying the Act, appropriate foreign and international law may [6] (and very often ought) to be considered, it is nonetheless important to emphasise that generalisations drawn from the competition jurisprudence of advanced economies such the US and Europe should not simply be transposed to our conditions without careful scrutiny and qualification where required.

4 The Act itself records the recognition of the people of South Africa that apartheid and other discriminatory laws and practices of the past resulted *inter alia* in excessive concentrations of ownership and control within the national economy, and that the economy must be open to greater ownership by a greater number of South Africans. The "efficient, competitive economic environment" which the Act aims to promote is one in which there is a "balancing" of the interests of workers, owners and consumers together with a focus on development. The policy of the Act is *inter alia* to regulate the transfer of economic ownership in keeping with the public interest construed in this broad and exceptional way.

5 Every prevalent social attitude reflects a stage in historical and socio-economic development, and has its corresponding legal reasoning. In the United States, the advance of the ideas of the

797 (SCA) at 814F-815A.

[5] Section 2.

[6] Section 1(3).

"Chicago School" in regard to vertical mergers marked a move away from earlier policies which sought to protect small businesses against the greater efficiencies and other advantages achievable by the big players through vertical concentrations. Hence the attack on the *Brown Shoe* judgment as protecting competitors rather than competition.[7] In that case the court had found that the tendency of manufacturers to become an increasingly important source of supply for their acquired retail outlets had as a necessary corollary the foreclosure of the independent manufacturers from markets otherwise open to them. The tendency of such vertical mergers to bring ever greater numbers of retail outlets within fewer and fewer hands was held *per se* to produce "anti-competitive" effects on the horizontal plane, and was accordingly condemned. Such a standpoint faced towards the golden age of the small proprietor and small-scale entrepreneur. As a practical matter, it could not be sustained under US and global competitive conditions as they were actually developing. Conditions change law more than law changes conditions. The big corporations lean on the interests of "consumers" for their justification — and they are often right.

[7] See para 26 of the Tribunal's Reasons, pp 936G-937. *Brown Shoe Co Inc v United States* 370 US 294. Cf also *Ford Motor Company v United States et al* 405 US 562, cited by the appellants..

6 As Riordan and Salop observe in their article cited by the Tribunal[8] and by the appellants,[9] the Chicago School's critique of vertical merger policy precipitated a more refined analysis of vertical mergers.[10] Post-Chicago theories have applied a newer and more realistic methodology in considering whether vertical mergers can indeed have anti-competitive effects. The outcome must lie in the detail of each case.

7 So far as South African competition law is concerned, having regard to the language and purpose of the Act, two distinct and equally fundamental points need to be observed:

7.1 The question whether a merger is likely to substantially prevent or lessen competition has to be approached by taking fully into account the historically entrenched levels of concentration and oligopoly[11] (or even duopoly[12]) in the affected markets. In such conditions even small structural

[8] "Evaluating Vertical Mergers: a Post-Chicago Approach" *Antitrust Law Journal*, Vol 63, 513 at 515. See Tribunal's reasons page 937 footnote 22.

[9] See appellants' heads, footnote 55.

[10] Unfortunately such refinement is not evident in the sweeping generalisations in *Alberta Gas Chemicals v E I du Pont de Nemours and Company* 826 F.2d 1235 at 1244-1245 (a case on which the appellants seek to rely).

[11] "Oligopoly" is defined in *Webster's Third New International Dictionary* as "a market situation in which each of a limited number of producers is strong enough to influence the market but not strong enough to disregard the reaction of his competitors… ."

[12] "Duopoly" is defined as "a market situation in which two competing sellers hold the controlling power of determining the amount and price of a product or service offered to a large number of buyers… ."

rearrangements which increase the likelihood of compliance by existing smaller competitors or raise barriers to new entrants in future at any affected level may properly be considered likely to “prevent or lessen” competition within the meaning of section 12A(1).

7.2 The preservation and encouragement of opportunities for small businesses or for firms owned or controlled by historically disadvantaged persons (whether alone or in joint ventures with domestic or foreign investors) to enter and become competitive within the markets concerned — and thus a disapproval of any strengthening of barriers to such a development in future — forms a distinct policy consideration (among other public interest grounds) which may in a proper case lead to the prohibition of a merger even where the merger is determined to be unlikely to substantially prevent or lessen competition.[13] The undiluted spirit of “competition” is not the be all and the end all of the Act.

8 The task which the Act has laid before the Tribunal (and ultimately this Court) is to regulate mergers in such a manner as to achieve where possible the transformation objectives without retarding the real achievement of greater competitive efficiencies (something which would have long-term deleterious effects). This extremely

[13] See section 12A(1)(*b*).

difficult balancing task involves a mix of policy considerations under the Act which are not identical to those on which the attention is focused in the US or Europe.

9 Viewed against this background, it was appropriate in this case for the Competition Tribunal, and it would be appropriate for this Court, to be vigilant in regard to any facilitation or strengthening of joint market power between Mondi and Sappi, and in regard to the likely effects of such a strengthening at any level, within the South African paper industry. As we shall submit further below, the fact that the merger is a vertical one does not afford any reason for a relaxation of vigilance in this regard.

THE INITIAL DETERMINATION IN TERMS OF SECTION 12A(1)

10 Whenever the Competition Tribunal is required to consider a merger (as in this case), Section 12A(1) of the Act requires it initially to determine —

> **whether or not the merger is likely to substantially prevent or lessen competition…**[14]

It is important to stress that, on a proper construction of this provision, the question has to be definitely answered one way or the other — assuming it is possible to do so.[15] It has to be answered on evidence reasonably available to the Tribunal, having

[14] Emphasis added.

[15] The same applies to the determinations referred to in section 12A(1)(*a*) and 12A(1)(*b*).

due regard to the Tribunal's inquisitorial powers[16] and the expectation that the merging parties make a full disclosure, as may be required, of all relevant information. There is no *onus* as such on the merging parties or any other participant to satisfy the Tribunal or else face an adverse result. At the same time, a paucity of information cannot mean automatically that the merger is given the green light. Whatever the Tribunal determines must have an adequate foundation in evidence. Where the Tribunal is obliged (as in this case) to forecast a likelihood, i.e. to make a "predictive judgment" (to use the expression of Judge Richard Posner, quoted by the Tribunal in para 23 of its Reasons), its conclusion must not be

> **based on speculation of the kind which cannot be attributed to any evidential foundation placed before the Tribunal.**[17]

There must at least be a plausible — i.e. fair-seeming and apparently reasonable and acceptable — basis for the determination.[18] But such a basis is just as much required for a determination that the merger is not likely to substantially prevent or lessen competition.[19] If necessary, at the appeal stage, if there

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[16] See footnote 17 of the Tribunal's Reasons, p 936F.

[17] *Schumann Sasol (South Africa) (Pty) Ltd and another* (Case No. 10/CAC/Aug01), p 18.

[18] *Ibid*. Cf *Freuhauf Corporation v Federal Trade Commission* 603 F.2d 345 (1979) at 351.

[19] In the rare case where no conclusion can be reached either way on a balance of probabilities, it may be that the word "otherwise" in section 12A(1)(*b*) will have the effect that the Tribunal then moves on to the assessment of public interest grounds. With

is insufficient evidence for a proper determination either way, the appropriate course might well be for the Court to remit the matter to the Tribunal for further hearing on the particular issue (in terms of section 37(2)(*b*)).[20] In our submission, however, the evidence in the present case does suffice for a decision on a balance of probabilities to be reached.

11 The critical evidence is that relating to the structure and interrelation of the markets affected by the merger, the presence of significant joint power on the part of Mondi and Sappi, and the scope for parallel conduct between these entities. Resort to conspiracy theories and the divination of motives should ordinarily be unnecessary (although if such evidence were present it might

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respect, however, it does seem to us that the following *dictum* in the Court's judgment in the *Schumann Sasol* case (*supra*) p 9, goes too far and ought to be qualified: *"As* Mr Unterhalter *who appeared on behalf of appellants contended, the requirements set out in section 12A capture the central premise of merger control, being that transactions* ***should be permitted unless it can be shown*** *that the threshold requirement [that the merger is likely to substantially prevent or lessen competition] has been met on the basis of evidence placed before the Tribunal."* [Emphasis added.] In US antitrust law the FTC does bear an *onus* of showing a likelihood that the future effect of a merger may be to substantially lessen competition. (*Freuhauf, supra*, at 354.) This is so because the enforcement of a prohibition is entailed under § 7 of the Clayton Act, and the failure to discharge the *onus* simply results in the denial of an enforcement order. Our legislation is different.

[20] Whether that means that the Tribunal's decision is then itself reopened for reconsideration in the further proceedings before the Tribunal is not altogether clear. Section 17(2) would seem to limit the Court's powers once a decision of the Tribunal on a merger is "set aside". However, section 37(2)*b*) seems to contemplate remittal for further hearing as an alternative to setting aside a decision or order of the Tribunal. In our submission, the reopening of the Tribunal's decision would seem to be the effect intended.

obviously reinforce a case of 'likelihood'). It requires no special proof to justify concluding that a business is likely to adjust its behaviour to the competitive environment in which it operates. Parallel conduct between two 'competitors' who are together sufficiently dominant in a market or set of markets requires no active conspiracy to collude (even the expression "tacit collusion" may carry an unwarranted implication). Parallel conduct may involve no more than following suit, and abstaining from any attempt to out-compete, because greater gains are to be expected from not doing so.

12 Nor is the parties' evidence of their good intentions, albeit uncontested, likely to be of much help. Present intention is a notoriously poor guide to future conduct. Merger regulation would be in a parlous predicament if, whenever the merging parties testified to a benign intention, that were to dispose in the absence of evidence to the contrary of the question of whether anti-competitive effects of the merger were "likely" or not. Intentions change under the impact of material pressures and emerging incentives. It is the structural situation, and the tendencies inherent in it, which must count most persuasively towards the determination of what is "likely".

13 The question is whether the structure and relationships shown to exist at the various levels affected by the merger taken together raise the likelihood of a substantial prevention or lessening of

competition. In our submission, in this case, they do. Accordingly, where the Tribunal's reasoning with reference to the motive and intention of the acquiring party is open to criticism (which it is), this should not lead the Court to a conclusion that anti-competitive effects are unlikely.

THE EFFECTS OF VERTICAL MERGERS IN CONDITIONS OF OLIGOPOLY

14 It is unwarranted under the Act to begin the consideration of a vertical merger with any bias either for or against such mergers as a type. The appellants' contention that *"vertical mergers are presumptively regarded as efficiency enhancing"* [21] and therefore intrinsically pro-competitive[22] and socially beneficial is an idea which should not be encouraged to take root as a general principle in South African competition law.

15 It may be true that vertical integration usually occurs because a firm believes it can reduce costs by supplying a service or product to itself.[23] But it does not follow that this must be presumed to be the object or effect of a vertical merger in any particular case. A notable feature of economic change internationally since at least

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[21] Appellants' heads, para 11.5.

[22] See p 613 lines 5-6.

[23] See Sullivan and Harris Understanding Antitrust and Its Economic Implications 3 ed (1998) p 345, citing *inter alia* Bork "Vertical Integration and the Sherman Act: The Legal History of An Economic Misconception" 22 University of Chicago Law Review 157 (1954).

the mid-1990s has been the increasing extent to which vertically integrated firms, especially in highly flexible and competitive markets, "outsource" the supply of key inputs because by doing so they expect to improve managerial focus, enhance efficiency and reduce costs. Thus even a presumption that vertical integration will save net costs by eliminating or reducing the transactional costs of dealing with independent suppliers or customers must today be open to question.[24] The matter must surely depend in each case upon the actual facts.[25]

16 The standard generalisations in regard to vertical mergers appear from these passages by Sullivan and Harrison:[26]

> By merging with a customer or supplier, a firm integrates into different stages of the production process. On its face, this type of merger leaves competitive levels unchanged in each market. …
>
> Competition may be affected in other ways by vertical integration. Two firms in the distribution chain have now become one. Each is assured a source of supply and demand for its production. The integration may produce advantages over nonintegrated firms, such as economies of scale, distribution efficiencies, and reduced transaction costs. To remain competitive, the nonintegrated firms may have to integrate, as well. …
>
> Vertical integration can result in what courts call "foreclosure." This occurs when the patronage or custom of the acquired firm is no longer available to competitors of the acquiring firm. If the acquiring firm supplies the acquired firm, other suppliers may be deprived of

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[24] Cf Hovenkamp *Federal Antitrust Policy: The Law of Competition and its Practice* 2 ed (1999) p 372, citing the 1937 work of Coase.

[25] See Mr Unterhalter's submission to the Tribunal, pp 913-914, which is to this effect.

[26] *Op cit* pp 340-341.

> the ability to sell to that firm. Similarly, if the acquiring firm purchases from the acquired firm, competitors of the acquiring firm will be deprived, to a greater or lesser degree, of the ability to obtain needed supplies from the acquired firm. Whether or not this actually occurs, and to what extent this harms consumers by increasing the monopoly power of the firm will be discussed [below].

In the course of their further discussion the authors say:[27]

> In the past, courts often condemned vertical mergers because increased efficiencies can be used to increase market power. Increases in market power allow firms to charge monopoly prices, to foreclose other rivals by restricting their source of supply, or to erect barriers to entry in either or both levels of the market.
>
> Economists have attacked these theories on several grounds. They point out that increased efficiency most often results in benefits to the consumer. Even a monopolist may decrease prices and increase supply when its costs are reduced.
>
> Economists also point out that in even modestly competitive markets, vertical acquisitions do not really foreclose transactions. Unless both firms involved have substantial market power and the ability to expand production, or supply, a certain amount of readjustment takes place. If a manufacturer has 10% of the market and merges with a purchaser taking 50% of the manufactured market, the purchaser will still need to purchase 40% of its supply from others. Even if the manufacturer originally sold nothing to the purchaser, the 10% it now sells to the purchaser will no longer be available to other purchasers. Unless the manufacturer can significantly expand production, those other purchasers will go to other manufacturers for their supply.

17 It is not difficult to see that qualifications are needed when applying such reasoning to South African conditions.

[27] Pp 346-347.

17.1 For example, the idea that even a monopolist may decrease prices when its costs are reduced depends on the assumption that the monopolist can preserve or increase profit via increasing the volume of sales at the lower price. It is a common-sense idea in the context of a vast continental market with masses of affluent consumers. In a less developed economy, with a limited market afflicted by monopoly or oligopoly, the generalisation is far less likely to hold.[28]

17.2 Even where efficiencies and cost-savings are demonstrated, it by no means follows that these benefits would be passed on down to the ultimate consumers where a few producers have substantial collective market power at several inter-connected levels.

17.3 As to whether a vertically integrated firm may be expected, as a result of the integration, to raise the prices of the upstream enterprise in supplying downstream, Bork is credited with having observed that such a firm cannot profit by selling to itself at an inflated price.[29] But this generalisation comes unstuck in conditions where the inflated price can be passed on further downstream. We

[28] The situation in the South African paper market is expressed in the fact that, when one paper mill blows up it is “panic station in the market”. (Mr Bouzaglou, p 853.)

[29] Cited by Sullivan and Harrison *op cit* p 356 n52; see also Hovenkamp *op cit* 382.

shall return to an analysis of this potentiality in the present case below.

17.4 In regard to "foreclosure", the illustration given by Sullivan and Harrison regarding "readjustment" explicitly assumes a situation in which neither firm has "substantial market power". In our submission, the facts of the present case show that substantial market power exists and is likely to be strengthened in relevant respects by allowing the merger.[30] We shall return to this and other aspects of the "foreclosure" problem below.

18 In the United States, with its vast continental consumer market, and its abundance and mobility of capital, vertical integration is no longer regarded as a "suspect category" under the antitrust laws.[31] Nevertheless, even in the United States, vertical mergers will be

[30] An *increase* in concentration, or the *reinforcement* of a dominant position, does not depend on an increase in market shares. (Contrast the assertion in Mondi's Competitiveness Report, p 126 para 1.2; also p 130 paras 4 and 5.) Any substantial reinforcement of dominance must substantially "prevent" competition within the meaning of section 12A. We cannot agree with the appellants that "market power" means simply the ability of a single firm acting unilaterally to raise prices or restrict output (cf p 145 para 6.6.1.2). Even the definition in the Act is not so limited. It is wide enough to include the ability of a firm acting in parallel with another, to control prices or otherwise effectively lessen or prevent competition. Moreover, the term "market power" (i.e. as defined) is not used in section 12A. The criteria for determining whether a merger should be approved (with or without conditions) or prohibited are more flexible, with many inter-related or potentially counter-balancing factors to be taken into account.

[31] *Reazin v Blue Cross & Blue Shield of Kansas Inc* 663 F.Supp. 1360 (D.Kan. 1987) at 1489 (cited by the appellants).

condemned under § 7 of the Clayton Act [32] where there are "facts tending to show that the merger will result in a significant increase in concentration in a relevant market or heightened barriers to entry in either market."[33] It all depends on the facts, and on a proper evaluation of the facts in their true context.[34]

19 Providing a glossary of antitrust terms in *Antitrust Law & Economics Review* vol 26 no 4, Charles E Mueller includes the following under the heading "Oligopoly":

> … Given a situation in which there are only a few sellers, a phenomenon called "oligopolistic interdependence" is expected. Whereas the individual firm in an atomistic industry has such a small share of aggregate industry sales that nothing it can do will perceptibly influence the overall marketwide price (e.g., the withdrawal of its entire supply from the market would not affect that market price), the individual firm in an oligopolistic industry is, by definition, sufficiently large that any substantial change in its output volume will have a perceptible effect on the overall market-wide price – and hence on the volume of sales, and price received, by each of its rivals. The latter are thus expected to notice these changes, recognize their source, and take appropriate measures to protect their respective interests.
>
> A price decrease, for example, will normally prove unprofitable for the price-cutter. The others will promptly match his lower price, thus

[32] § 7 prohibits acquisitions the effect of which "may be substantially to lessen competition, or tend to create a monopoly." See Reyburn *Competition Law of South Africa* p FD-30.

[33] *Reazin* (*supra*) at 1489.

[34] As Hovenkamp says, *op cit* pp 378, in oligopolistic markets "there is no easy way to generalize in a judicially administrable manner about the conditions that will make such vertical integration inefficient." What is clear is that it is accepted that vertical integration may well be significantly anti-competitive in oligopolistic conditions.

> removing any incentive for buyers to switch suppliers. With his market share unchanged, but price now at a lower level, the price-cutter's profits are presumably lower than before. Similarly, a failure to go along with a price increase will generally prove unprofitable, since the others will quickly drop back to protect their market share if there's a holdout still selling at the lower price, the result being that the holdout gets no increase in his market share and forgoes a higher per-unit price that all could have had if he had gone along with the change. By a series of such adjustments, rational oligopolists are expected to eventually arrive at the price level that will maximise their joint profits, i.e., the *industry's* profit-maximizing price level, the same price as that a single-firm monopolist would charge.
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> The possibility of this result actually being reached is dependent on other factors, however, particularly on (1) whether the industry in question belongs to the Tight Knit or Loose subcategory of oligopoly, that is, whether its concentration ratio is very high or only moderate, and on (2) whether its entry barriers are high enough to permit the exercise of that pricing power without inducing new entry.

Mueller defines a "Tight-Knit Oligopoly" as —

> A market structure so highly concentrated that prices are expected to be significantly above, and output significantly below, the competitive norm. In general, empirical studies suggest that this result is to be expected when the four largest sellers have 50% or more of the sales in a market or when the eight largest have 70% or more.[35]

20 The information on record is that Mondi and Sappi each produce about 38% of the requirements of the South African market for "coreboard", and that the remaining 24% is imported from various

[35] One can surmise that the empirical studies referred to were conducted in the US, or at least in large markets, where a "competitive norm" and the difference from that norm could be identified.

sources.[36] In other words, they have a half share each of domestic production for this market. As regards the requirements of the South African market for “pulp, paper and woodchips”, Mondi produces 33% and Sappi 51%, the remaining 16% being made up by three other (evidently domestic) producers.[37] As between Mondi and Sappi in particular, this represents a very high concentration of ownership in relation to the production and supply to the South African market of materials for cores and tubes.

21 At present, it seems, Mondi does not produce any cores and tubes. Sappi engages in in-house production of cores and tubes at its Tugela mill.[38] Both Sappi and Mondi appear in the picture again at the next level downstream, namely as major producers of products wound onto (in particular, heavy industrial) cores and tubes. They are clearly very important purchasers in the market supplied by the producers of such cores and tubes.[39] It is unfortunately not clear from the information on record exactly what the overall respective shares of Mondi and Sappi are at this level, and thus exactly what their combined weight at this level would be. Mr Silva (Diversified Cores & Tubes) testified that “the biggest users of cores in this country are the paper mills.”[40] Mr Davies (KC&T) described Mondi

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[36] P 133; p 152 para 6.7.2.4.1; pp 402-403.

[37] P 134; p 152 para 6.7.2.2; p 403.

[38] Mr Davies (KC&T) p 764.

[39] In regard to KC&T’s top ten present customers, see p 338.

[40] P 703.

and Sappi as “the two dominant users of cores”.[41] Each evidently purchases about 6 000 tons of cores and tubes annually.[42] It is evident, moreover, that Sappi and Mondi are both sufficiently strong to effectively impose upon cores and tubes producers the use of their own paper in the manufacture of cores for on-supply to themselves downstream.[43] There seems good reason to conclude that, in relation to products wound onto heavy industrial cores and tubes, they are not only the dominant purchasers of such cores and tubes but also the dominant suppliers to the next level of consumers downstream.

22 We attach a table which attempts to consolidate the main items of structural information available on the record. In this table, for ease of reference, four levels along the “stream” are indicated: **A**, **B**, **C** and **D**.

23 The important distinguishing feature of the present case is that it involves not merely a vertical integration between an (acquiring)

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[41] P 787 line 13.

[42] Mr Bouzaglou (Framen) p 879. This was not challenged.

[43] See e.g. Mr Bouzaglou (Framen) p 869 lines 19-20 re Mondi: “… you will make my core out of my paper”. In relation to Mondi there is also the evidence of the business withdrawn in the past from KC&T after it tried turning to imported materials. See p 375 para 8. See also p 340 (cited by the Tribunal p 952 para 77 as p 339.) Sappi are “adamant” that they want their own paper used: Mr Bouzaglou p 880. This is delicately described by Mr Jansen van Vuuren (Sappi) p 886 as a “request”. Compare, however, Mr de Sousa (Sappi) p 895 line 16 and p 896 lines 13-16: “we would insist”. See also p 414 para 6. For the contrary view, see Mr Davies (KC&T) pp 756-757: in our submission it is not convincing.

upstream producer (at level **A**) and a producer one level downstream (at level **B**). In this case the acquiring producer is situated in a powerful position both upstream and downstream of the target firm (i.e. at levels **A** and **C**)[44] — and the target firm itself is dominant in the market at the intermediate level (**B**).[45]

24 It is perfectly clear that the merger will entail a structural change in both the supplies to and purchases from KC&T, and to and from the other firms producing at level **B**. This conclusion requires no assumption or speculation about a likely conspiracy to limit supplies. The object of the merger is not merely to bring an additional source of profit into Mondi. It is presented as the alternative to the establishment by Mondi of its own cores and tubes production plant. The case about efficiency gains rests to a substantial degree on the conventional arguments about cost savings when a firm supplies to itself instead of buying from third parties.[46] Moreover, the Competitiveness Report stated:[47] (pp 152-153 para 6.7.2.4.2):

> Mondi Cartonboard **currently** do not have capacity to supply Kohler with **all** of its cardboard requirements. Accordingly, post transaction Kohler will **still** have to obtain coreboard from Sappi in order to

[44] The latter is an extremely important aspect of the whole matter to which the Competition Commission appears not to have given any attention.

[45] Mr Davies (KC&T) p 735: "Kohler is a very dominant player in this [the cores and tubes] industry."

[46] See e.g. p 156.

[47] Pp 152-153 para 6.7.2.4.2.

> manufacture cores and tubes. … However, even if post transaction Kohler were to obtain a larger supply of its coreboard requirements from Mondi Cartonboard than before, Sappi would still be able to sell its coreboard to the other core and tube manufacturers in the market, namely Framen, ITT and Envirocore CC to mention a few.[48]

25 To the extent that there is an increase in the supplies from Mondi to KC&T (without a corresponding increase in capacity), there will obviously be a reduction in supplies by Mondi to the other producers at level **B**.[49] For their continued supplies (**A ➔ B**), they would have to look to a greater extent to Sappi — or else to imports.[50] To the extent that Mondi increases (at level **C**) the proportion of its cores and tubes requirements obtained from KC&T, to the same extent must the other producers look (as matters presently stand) to Sappi as the customer needed to take up the difference (at least within the paper industry). Mr Bouzaglou's view is that, if Sappi were to continue to utilise KC&T for the production of its cores after the merger, he would "have to go to Shul".[51] The dependence of the other core and tube manufacturers upon Sappi cannot but be significantly increased as well, as a result of the merger between Mondi and KC&T.[52]

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[48] Emphasis added.

[49] Only Framen has a contract with Mondi for supplies (p 372 para 5.2); we are not told the term remaining on this contract.

[50] See p 372 para 5.1.

[51] P 880.

[52] Even at present availability of all suitable materials to all cores and tubes

Framen, in fact, has been engaging since January in a trial to establish that it can use Sappi paper[53] — obviously in preparation for the changes which will result from the Mondi-KC&T merger.

26 Leaving imports aside for the moment, one can surely at least advance this as a reasonable postulate: If (hypothetically) both Mondi and Sappi were to be vertically integrated all the way from the production of coreboard and other materials for heavy industrial cores and tubes (**A**), down through the production of such cores and tubes (**B**), and on down to the utilisation of heavy industrial cores and tubes in the production of paper products wound onto such cores and tubes (**C**), the effect would be to increase to some degree the existing barriers to entry by competitors at all these levels. The effect would also be to facilitate to some degree an anti-competitive manipulation of prices in future for the supply of coreboard and other such materials for domestic heavy industrial core and tube production, without existing independent cores and tubes producers or the independent purchasers of heavy industrial cores and tubes having the ability (or indeed cause) to resist.

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manufacturers is clearly not to be assumed. Mr Davies (KC&T) uses the expression on p 749: "…*depending on what has become available to those specific manufacturers*." On p 790 he says that "*the supply of Kraft is very dependent on the circumstances within the Kraft industry.*" See also p 793 lines 7-9. There is a clear capacity constraint in respect of Ndicore: p 795. See also the evidence of Mr van Breda (Mondi) pp 826-8.

[53] Mr Jansen van Vuuren (Sappi) p 887; Mr Bouzaglou (Framen) p 855.

27 The critical, interrelated questions in this case — in regard to the likelihood or otherwise of substantial anti-competitive effects from the proposed merger between Mondi and KC&T — are:

27.1 to what degree the availability of imported materials capable of being substituted for the products of Mondi and Sappi in the production of heavy industrial cores and tubes is likely to restrain uncompetitive conduct on the part of these firms (i.e. in supplying from **A ➔ B**);

27.2 whether, even in the absence of a similar vertical integration by Sappi, uncompetitive parallel conduct between Mondi and Sappi (at levels **A** and **C**) would be feasible and would be rendered more likely as a result of Mondi's merger with KC&T (the integration of the dominant firm at intermediate level **B**);

27.3 whether, assuming a likelihood of parallel conduct between Mondi and Sappi following Mondi's merger with KC&T, it is likely that significant price increases of Ndicore coreboard and other paper supplied by Mondi for the production of heavy industrial cores and tubes could be introduced, could be sustained and passed on down to consumers at level **D** without effective resistance, despite the continued existence of other producers of cores and tubes (such as Framen *et al*) at level **B**.

RELIANCE ON IMPORTS

28 The appellants' case is heavily dependent on the contention that, should Mondi post-merger withhold supplies (**A ➔ B**) from remaining independent producers of cores and tubes, or raise prices to a significant degree, the latter could turn to Sappi or imports.[54] In the analytical framework put forward above, the question must rather be posed whether, in the event of significant anti-competitive price increases by both Mondi and Sappi acting in parallel, the remaining independent cores and tubes producers can realistically be expected to substitute imports for the supplies ordinarily sourced from these companies.

29 Before proceeding with that inquiry, it is necessary to deal with the issue of **<u>product market definition</u>**.

29.1 In determining whether a merger is likely to substantially prevent or lessen competition in any relevant market one must avoid defining the market too broadly or too narrowly. As the point is expressed in Bellamy & Child <u>*European Community Law of Competition*</u> 5 ed (2001) p 386:

> If the market is defined too broadly, the market power of the parties may not become evident; if the market is defined too narrowly, concentrations that have pro-competitive effects (in a wider market) might be prohibited.[55]

[54] See e.g. p 153 para 6.7.3.1.2; p 372 para 5.1; also p 612 lines 9-25.

[55] It is appropriate in the context of merger regulation to adopt a forward-looking

29.2 In **paragraph 1.1** of their supplementary notice of appeal dated 10 July 2002 (hereinafter referred to simply as the "notice of appeal"),[56] the appellants say that the Tribunal erred in finding that there was limited substitutability of Ndicore. The appellants submitted that the relevant upstream product market was the supply of coreboard, paper and pulp to core and tube manufacturers, which market included both Ndicore and Kraft paper (such as Sappi's Spiralwind).[57] The Commission, on the other hand, concluded in its recommendation and reasons[58] and in its submissions before the Tribunal, that Ndicore core board constitutes a "*separate and distinct [upstream] product market for top-end cores and tubes*".

29.3 After considering the submissions and evidence, the Tribunal concluded that, despite Ndicore's superior qualities, substitution was technically and commercially feasible and, accordingly, the relevant upstream market was that for the provision of board utilized in the production of industrial cores and tubes, which included Ndicore, Sappi's Spiralwind

definition of the relevant market or markets: *ibid* p 387.

[56] This notice of appeal appears to incorporate and expand upon all the grounds of appeal noted in the original notice of appeal, making it unnecessary to have regard to the original notice.

[57] Pp 508-21.

[58] P 433.

and Mondi's Kraft paper.[59] In our submission that conclusion is correct.[60] The market definition contended for by the Commission is too narrow, and depends too heavily on the evidence of Mr Silva in regard to a matter on which his evidence was not satisfactory.[61]

29.4 It appears from the appellants' heads of argument (at paras 5.11 to 5.15) that their true point of complaint in relation to the substitutability of Ndicore is that the Tribunal did not regard <u>imports</u> as substitutes for Ndicore.

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[59] P 943 paras 48-49.

[60] Mr Silva (Diversified Cores and Tubes), who is clearly very experienced in the industry, accepted a qualitative distinction between the market for heavy tubes and that for the lighter type of tube (p 615). The distinction is not only physical. The lower end of the market has high margins and little volume; it is not lucrative (p 616). Mr Jooste (ITT) accepted the distinction between the high and low end of the market (p 718). Mr Bouzaglou (Framen) divided the market into "heavy, medium and light" (p 851). Mr Davies (KC&T) himself frankly described both paper mills and textile mills as high-end customers requiring high-end cores (pp 734-735). The argument that the market is simply a "continuous spectrum" from low end to high end is not well supported by the facts. Moreover it fails to recognise that quantitative differences have, at certain points, different qualitative effects. There is a continuum in the measurement of temperature between -10 degrees C and 110 degrees C. But water ordinarily passes through two dramatic changes between these points, so that in one part of the temperature 'continuum' it is properly called ice and handled as ice, while in another part it is properly called and handled as steam. Mr Unterhalter himself, in his submissions on p 611 (lines 11-14) confirmed that there are different "sections" of the cores and tubes market.

[61] Mr Silva, despite his considerable experience, and while preferring Ndicore, had evidently not considered the suitability of Sappi Kraft paper, and could not deny it that it could be used for producing heavy cores. (See pp 646-7.)

29.5 It appears to be common cause, and is accepted by the Tribunal,[62] that in the top-end of the heavy industrial segment in which the most technically demanding cores and tubes are produced with the highest crush strength, there is no substitute for imported paper.[63] This conclusion is well-established on the evidence and does not appear to be disputed by the appellants.

29.6 In the balance of the heavy industrial segment, in which local products like Ndicore and Spiralwind compete, it appears from the written submissions from core and tube manufacturers contained in the record that whilst imports have historically competed in the South African market, they do not currently do so for price reasons. Focus Tubes and Cones CC stated that it is not competitive to import because of "*exchange rate fluctuation and weakness*".[64] Tube Products (Pty) Ltd stated that it is possible to import paper into South Africa but that it is not cost-effective for it to do so due, *inter alia*, to "*price due to Rand Exchange*" and its inability to order quantities large enough to attract the best price.[65] Triumph Cores (Pty) Ltd stated that it was possible to import a few years ago but that in recent years it has

[62] P 941 para 41.

[63] See e.g. p 370 para 4.1.6.

[64] P 384.

[65] P 387.

become expensive and Triumph does not do so.[66] ITT stated that it is possible to import paper but that one has to have a very good relationship with the supplier, buy substantial volumes and have a healthy cash flow position.[67] Framen Paper Products stated that imports would have an adverse effect on its pricing structure and manufacturing.[68] Sappi stated that South African core manufacturers have imported large volumes of paper over the last decade, but added: "*The sudden significant devaluation of the Rand has made imports less attractive but we would view this as temporary*."[69]

30 The data supplied by the merging parties take the matter no further. It is stated in table 4 of the Competitiveness Report that imports account for 24% of the coreboard market as a whole.[70] We have not seen validation for this figure, or a breakdown of its constituent parts. It is presumably accounted for by those instances at the top end of the heavy industrial segment where there is no acceptable substitute for the high crush strength offered by imported paper.[71]

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[66] P 407.

[67] P 414.

[68] P 538.

[69] P 553.

[70] P 133.

[71] Evidently 70% of supplies by KC&T to Hulett Aluminium involve a core which uses

31 Evidence given at the Tribunal hearing tends on balance, in our view, to support the conclusion that imports cannot at present be expected to play a significant competitive role in the South African paper market.

31.1 Mr Silva of Diversified Cores and Tubes testified that import prices are not competitive at the moment.[72] Mr Jooste of ITT testified that ITT does not currently import paper because of the exchange rate.[73] Mr Bouzaglou of Framen testified that Framen did not import much paper and that imports raised costs.[74]

31.2 On the other hand Mr van Breda of Sappi testified that imports were a possible low cost alternative and are a constant threat in the market.[75] Mr Davies of KC&T testified that imported paper is largely used for the export client base which requires a better performing core.[76] It has recently placed an order for 200 tons of imported paper at a

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only imported paper (p 371). Mr Davies of KC&T testified that, in relation to newsprint core, imported paper is largely used for the export client base which requires a better performing core (p 744).

[72] Pp 622 and 625.

[73] P 720.

[74] P 860-1.

[75] P 817-8.

[76] P 744.

competitive price from Finland.[77]

32 Where reliance on imports is concerned, it is not only price and the stability of price which presents an obstacle, but also the potential unreliability of supply.[78]

32.1 The facts stated by the merging parties themselves on page 375 of the record (para 8) are of great illustrative importance, showing the vulnerability of even a dominant player in the cores and tubes market such as KC&T. Briefly stated, KC&T secured a commitment from a supplier in Indonesia for material at a lower price than the equivalent material obtainable from Mondi. Mondi "responded" by purchasing a larger proportion of its core and tube requirements from Framen. Then the Indonesian supplier reneged on its commitment to KC&T. KC&T then decided that a supply agreement with Mondi was the route to follow.

32.2 According to Mr Bouzaglou, Framen is developing a supply relationship with a paper manufacturer in ******** as a possible alternative to dependence on Mondi and Sappi.[79] However, ******** evidently has no significant track record in

[77] P 745-6.

[78] As Sullivan and Harrison put it (*op cit* p 346): "Firms want to deal with reliable entities; they want to be assured of adequate future supplies and markets for their products."

[79] P 872-3.

this area[80] and we would submit that, at least in the present circumstances of ********, dependence on supplies from that country can hardly be considered a satisfactory option for South African cores and tubes producers in place of reliance on Sappi and Mondi.[81]

33 On balance, it appears to us that, at least currently and for so long as the South African Rand is weak and/or there is exchange rate volatility, imports cannot be expected to have a significant constraining effect on prices in the relevant market. This is not to say that the availability of imports would have no effect; simply that the effect would not be such as to constrain any substantial anti-competitive effects flowing from the merger. In our submission it cannot be expected that, following the merger between Mondi and KC&T, the availability of imported paper inputs suitable for the manufacture of heavy industrial cores and tubes will exert significant competitive pressure upon Sappi and Mondi in relation to the supply from **A ➔ B**.

INCREASED LIKELIHOOD OF AND VULNERABILITY TO PARALLEL CONDUCT BETWEEN MONDI AND SAPPI

[80] See Table 4 on p 133.

[81] Mr Bouzaglou of Framen was not prepared (p 877) to accept imported paper as a general substitute for Ndicore. For him, the alternative to Ndicore is Kraft.

34 There can be little doubt that the effect of the merger between Mondi and KC&T will be to make other cores and tubes manufacturers more dependent on Sappi than they were in the past. This follows from the structure of the market (discussed above), the fact that imports are not a realistic alternative to obtaining supplies from Mondi and Sappi, and the fact that Mondi's own supplies of key materials are likely to be devoted to an increased extent to KC&T, while the proportion of its cores and tubes obtained from KC&T is similarly likely to rise.

35 In **paragraph 1.2** of their notice of appeal, the appellants challenge, on various grounds, the finding that the merger is likely to raise the cost of doing business of rivals of KC&T in the downstream market. In **paragraph 1.2.1**, the appellants say that the Tribunal erred in finding that the merger was designed to foreclose inputs being utilised by larger manufacturers of cores and tubes.

36 There are indeed passages in the Tribunal's Reasons which suggest that an inference has been drawn that a conscious strategy of foreclosure lies behind the merger.[82] The basis of this seems to be the Tribunal's view that there is, on the part of Mondi, no credible business motive for the merger other than to create an opportunity for monopoly pricing through parallel conduct with Sappi. This was never put directly to any witness, nor was counsel

[82] See p 944 para 54 and p 949 para 68. See also p 954 para 86.

for the merging parties asked to address it. That is a defect. It seems, moreover, that the Tribunal's view in this regard was influenced by the fact that Mondi is apparently prepared to pay an inflated price of R37.5 m for a low-tech KC&T operation when it could have set up its own state-of-the-art plant for some R26 m.[83] This was a misdirection, as the appellants point out. Apples were not being compared with apples. In the first place, the cost of the new plant was worked out in 1998: today it would cost considerably more. In the second place, Mondi would expect to be able recover part of the price paid for KC&T by the intended sale of the latter's Cape Town plant.

37 In our view, furthermore, undue weight has been attached by the Tribunal to the "discrepancy"[84] between the explanation given for Mondi's plan to set up its own plant ("in order to ensure the quality of the cores and tubes it uses in certain of its own manufacturing processes"[85]) and the fact that no quality problem had been found with the cores and tubes that Mondi had been buying from KC&T.[86] First, it is by no means clear that these two different statements are incapable of being reconciled. Second, if they are contradictory, which of them is considered by the Tribunal to be in need of correction? If it is true that there have been no quality

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[83] See e.g. p 814; cf p 948 para 67 n 45.

[84] P 946 para 61.

[85] See p 368 para 3.1.1.

[86] See p 815.

problems with KC&T products, that would be a reason in favour of accepting a genuine business motive for the merger.

38 On the other hand, there obviously are grounds for suspicion as to the business calculations which lie behind the merger. For example, the failure of Mondi to provide any detailed substantiation for its claims regarding cost savings through the acquisition of KC&T (either within that firm or within Mondi as it presently exists) does suggest that the "business opportunity" presented by the merger was not carefully assessed at that level. At what level, then, and with what robust considerations in mind was it assessed? The basis of calculation of the substantial "goodwill" component of the purchase price remains a mystery.[87] It may well be that the acquisition of Kohler does represent the working out of a conscious plan to reduce the risk of a major foreign player such as Sonoco entering the domestic paper market; at the same time increasing the scope for monopoly pricing together with Sappi. However, it is a different matter to find all this as a fact by inferential reasoning. The Tribunal itself finds only "a possible inference" from the sparse due diligence.[88] Inferences should be conservatively drawn and not over-elaborated. Fact-finding is at the best of times a process fraught with the potential for

[87] Mr Bouzaglou's scepticism regarding the purely commercial soundness of the merger at the stated price (p 882) is very telling and was never satisfactorily answered. Mr Unterhalter abruptly ended his cross-examination of Mr Bouzaglou at that point.

[88] P 948 n 45.

misconception and error. The Tribunal's Reasons repeatedly lapse into the language of "will" when nothing more than a predictive likelihood on a balance of probabilities is called for.

39 Nevertheless, we do not think that the weaknesses in the Tribunal's Reasons detract from the soundness of the conclusion ultimately reached — that the merger is likely to have substantial anti-competitive effects. If all the weaknesses are stripped away, one is left with the overwhelming objective likelihood of uncompetitive parallel conduct between Mondi and Sappi, flowing from the structural relationships in which the merger takes place and the way in which they will be affected by the merger. To repeat: we do not believe that a finding as to anti-competitive motive or intention is necessary to a determination of anti-competitive effects under section 12A of the Competition Act. What is relevant is the objective effect of the merger on competition and not the subjective intentions of the merger parties. The latter, in our view, are only relevant insofar as they serve as reliable evidence in relation to the former.

40 In **paragraph 1.2.2** of the notice of appeal, the appellants say that the Tribunal erred in finding that they will largely "self deal" post-merger, in the sense that " *the first appellant will largely confine its sales of Ndicore to the integrated second appellant and that the latter will largely confine its purchases of core board to that sold by the first appellant*."

41 Mr van Breda of Mondi testified before the Tribunal hearing that:

41.1 Mondi would permit KC&T to source paper from suppliers other than Mondi because KC&T would have to source at the cheapest possible price;[89] and

41.2 Mondi would continue to source cores and tubes from manufacturers other than KC&T.[90]

42 The appellants submit at paragraphs 13.5 to 13.7 of their heads of argument that it was never put to Mr van Breda whether Mondi would continue to supply Ndicore to non-integrated manufacturers after the merger and that there is no evidence that Mondi would stop supplying Ndicore to such manufacturers. Mr van Breda did however testify that:

42.1 there is a capacity constraint on the plant that manufactures Ndicore and that Mondi does not have sufficient capacity for the entire South African packaging and industrial needs market;[91] and

42.2 Those core and tube manufacturers that have a contractual supply relationship with, and have committed to purchasing certain volumes from, Mondi, namely, Framen and KC&T,

[89] P 809-10.

[90] P 810.

[91] Pp 821 and 826.

receive priority, while other manufacturers have to take their chances in the spot market.[92]

43 It appears to us to be a reasonable inference that post-merger KC&T, as a vertically integrated manufacturer, will continue to receive priority in supplies over other manufacturers. Mondi has nothing to lose and everything to gain from fulfilling KC&T's supply needs before those of its competitors in the downstream market.

44 We agree with the Tribunal's observation that self-dealing is the central objective of vertical integration in that it is precisely this that generates the efficiencies associated therewith.[93] The merger parties did not put up a credible alternative motivation for the transaction, and certainly not one inconsistent with self-dealing. See in this regard paragraph 24 of these submissions above.

45 There is moreover nothing to suggest that such self-dealing will apply only to Ndicore and not in respect of all Mondi's paper supplies to KC&T. Accordingly, we do not agree with the appellants' submission at paragraph 13.8 of their heads of argument that the Tribunal "forgot" about Mondi's Kraft paper.

46 Whilst the evidence does not suggest that the relationship between Mondi and KC&T will be exclusive on either side, we believe that they will certainly act as preferred partners. In the circumstances,

[92] Pp 829-34.

[93] PP 945-947 paras 59-62.

we agree with the Tribunal's finding that the merger parties will, post-merger, largely deal with each other.

47 In **paragraph 1.2.3**, the appellants say that the Tribunal erred in finding that, to the extent to which they do not engage in self-dealing, this would be designed to facilitate an exchange of pricing information with Sappi. We have not identified such a finding by the Tribunal, although it is probably true that the Tribunal's general reasoning as to motive would tend to have affected its thinking in this area also. However, as already discussed, we do not think a finding as to intention or motive is at all necessary. The transparency and co-ordination of pricing as between Mondi and Sappi is already a fact, as the evidence cited by the Tribunal in paragraphs 94 – 95 of its Reasons makes clear.[94] There is no reason why the flow of information between Mondi and Sappi should diminish as a result of the merger (the contrary is more likely, as we shall show further below). At the same time, elimination of whatever independence KC&T has been able to assert as against Mondi and Sappi as an independent dominant producer of cores and tubes, must increase the ability of both Mondi and Sappi to engage in parallel conduct in raising prices for materials — and to pass uncompetitive price increases down to the ultimate consumers (levels **C** and **D**), without resistance from cores and tubes producers (level **B**).

[94] Pp 956-7.

INCREASED SCOPE FOR PASSING ON PRICE INCREASES

48 The economists tell us that above normal returns can be extracted only once from the value chain. This is another way of saying that a company cannot enrich itself by charging high prices to itself: it can extract the differential only when it sells on to someone else. If a price increase is introduced in the supply from **A ➔ B**, can it be passed on from **B ➔ C**? If so, and if it can then also be passed on from **C ➔ D**, the effect must be that both Mondi and Sappi could then themselves reap the benefits of an uncompetitive price increase by passing it on all the way down to level **D**. This is what would provide the incentive to parallel conduct between them in particular in the prices charged from **A ➔ B**.

49 In **paragraph 1.2.4** of their notice of appeal, the appellants say that the Tribunal erred in finding:

49.1 that Sappi will increase the price of the core board it sells to tubes and cones manufacturers; and

49.2 that there would be little to prevent Sappi from charging a monopoly price for its core board.

For purposes of section 12A of the Competition Act, of course, it is not necessary for the Tribunal to find that there will <u>necessarily</u> be an anti-competitive effect or, for that matter, that this will reach the level of monopoly pricing.

50 Up to now, manufacturers of cores and tubes, and especially KC&T, have been able to play Mondi and Sappi off against each other and thereby obtain paper supplies at competitive levels. The merger is very likely to have the effect of substantially curtailing their ability to do so.

51 In our view, on the basis of the evidence on record, the self-dealing that will be intrinsic to the relationship between Mondi and KC&T post-merger will significantly reduce the ability of KC&T to extract competitive prices from other divisions of Mondi, and the ability of other manufacturers of cores and tubes to extract competitive prices from Sappi, to the detriment of the end-consumer. For the reasons previously discussed, we do not believe that imports will constitute any significant constraint on the pricing power of Sappi post-merger.

52 Support for this conclusion is provided by Mr Bouzaglou of Framen where he states that he is worried about being beholden to Sappi as a result of the merger and is accordingly developing an alternative source for his paper supplies outside South Africa at a higher price that will be passed on to the consumer.[95]

53 We do not agree with the appellants' submissions in paragraph 14 of their heads of argument to the effect that it will be irrational for Sappi to charge its clients at the cores and tubes manufacturing

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[95] Pp 870-74.

level a supra-competitive price because Sappi is itself a downstream customer of such manufacturers.

53.1 First, Sappi is just one of the customers of the manufacturers to whom it will be able to supply paper at an increased price, and it can reap the monopoly rents passed on to the manufacturer's other customers.

53.2 Second, Sappi will in turn be able to pass on any increased prices it is charged as a purchaser of cores and tubes to its own customers. Because Mondi, as the other duopolist in the market, will be able to do likewise, Sappi will suffer no risk of losing its market to Mondi as a result of this price increase. It should also be borne in mind in this regard that, because the price of cores and tubes is such a small component of the price of the composite products sold by Sappi, it will not face significant resistance from its customers for any pass-on of price increases in respect thereof. [96] We agree in this respect with the findings made by the Tribunal regarding the low price elasticities that characterize the cores and tubes market.[97]

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[96] See testimony of Mr Bouzaglou (Framen) at pp 873-74. Mr Davies (KC&T) himself gives the example of a newsprint core which is going to be exported with "R20 000 worth of paper on it." (P 735.) There is nothing more than bald assertion behind the claims that customer resistance at level **C** would deter higher than competitive price increases,

[97] P949 para 68.

54 The appellants submit, in paragraph 14.14.1 of their heads of argument, that Sappi will be constrained in its pricing behaviour by the prohibition on excessive pricing contained in section 8(a) of the Competition Act. We submit that this does not assist in determining whether the merger should be prohibited under the merger provisions of the Competition Act. If the merger is likely to result in a substantial lessening of competition, it is no answer to say that any exploitation of market power after the merger can be caught by other provisions of the Act. On this argument, there would be no need for merger clearance at all.

THE FURTHER PARAGRAPHS OF THE NOTICE OF APPEAL

55 In **paragraph 1.2.5** of their notice of appeal, the appellants say that the Tribunal erred in finding that:

55.1 Sappi was likely to require manufacturers of cores and tubes to utilise only core board supplied by Sappi in their manufacturing process; and

55.2 Sappi will charge a monopoly price.

We have already dealt with the latter allegation. Regarding the former, it is apparent from paragraph 73 of its decision that the Tribunal's finding related only to cores and tubes supplied to Sappi itself and not to cores and tubes supplied to other customers. This finding is supported by the evidence of Sappi itself at the Tribunal hearing and also by manufacturers who supply Sappi with cores

and tubes.[98] In the circumstances, we do not believe that the Tribunal erred in making either of these findings. In the circumstances, it is not necessary to pursue further whether indeed there is the likelihood to which the appellants refer.

56 In **paragraph 1.2.6** of their notice of appeal, the appellants say that the Tribunal erred in finding that Mondi would follow any price increase by Sappi, permitting Mondi to extract monopoly rents when supplying core-board to non-integrated manufacturers of cores and tubes. We have set out above why, in our view, Mondi and Sappi will be in a position to increase their prices to monopoly levels as a result of the merger, and why it is likely that they will do so. We have also explained why we do not believe that imports currently constrain local players to price paper at competitive levels. By acting in parallel, Mondi and Sappi would both be able to extract greater profits from the end consumer without suffering any serious risk that they will be undercut by the other.

57 In **paragraph 1.2.7** of their notice of appeal, the appellants say that the Tribunal erred in not accepting the rationale provided for the merger and in finding that its real reason was to secure input foreclosure and an increase in costs for rival manufacturers. We have dealt with this aspect above, in which we set out some criticisms of the Tribunal's reasoning. In our view, there is insufficient evidence in the record to support a definite finding that

[98] See pp 880 (Framen), 886, 889-90, 896 (Sappi).

Mondi and KC&T had a consciously anti-competitive rationale for entering the transaction, as intimated in the Tribunal's decision. However, this should not in any way lead on to a conclusion that a likelihood of anti-competitive effects has not been shown. We would say moreover that, at best for the appellants, the rationales advanced by them do not provide strong support for a pro-competitive reason for the merger.

58 In **paragraph 1.2.8** of their notice of appeal, the appellants say that the Tribunal erred in finding that they would allow Sappi to charge monopoly prices for its core board, so as to permit Mondi to secure monopoly rents in the downstream business acquired in terms of the merger. We believe that this ground is essentially the same as that raised in paragraph 1.2.6 and we refer to what is said above in respect of that paragraph.

59 In **paragraph 1.2.9** of their notice of appeal, the appellants say that the Tribunal erred in discounting the interests of Mondi and Sappi as significant customers of cores and tubes manufacturers. Again, as we have attempted to show above, the appellants' argument fails in this regard by virtue of the likely ability of Mondi and Sappi, after the merger of Mondi with KC&T, to pass on price increases all the way on downstream.

60 In **paragraph 1.2.10** of their notice of appeal, the appellants say that the Tribunal accordingly erred in concluding that the merged entity and Sappi would, by tacit co-ordination, foreclose inputs and

raise the costs of doing business of rival manufacturers of cores and tubes. For the reasons set out above, we believe that the Tribunal was justified in concluding that the merger would likely have these effects.

61 In **paragraph 1.3** the appellants say that the Tribunal erred in various respects in finding that the merger is likely to raise the cost of doing business of rivals of Mondi and Sappi in the upstream market for the supply of core board to cores and tubes manufacturers. We will consider the grounds on which the appellants rely for this allegation in turn.

62 In **paragraph 1.3.1** the appellants say that the Tribunal erred in finding that the availability of imported core board would not undermine any attempt at input foreclosure. The appellants say that the Tribunal should have found that imports constitute viable alternatives to local suppliers of core board and will be purchased by South Africa core board manufacturers. We have addressed above in the context of **paragraph 1.1** the said role of imports in the upstream market for the supply of core board. For the reasons there stated, we do not believe that imports currently constitute a viable alternatively to local suppliers of core board and cannot be regarded as substitutes for the core board manufactured in South Africa by Mondi and Sappi.

63 In **paragraph 1.3.2** the appellants say that the Tribunal erred in finding that Sappi is likely to require manufacturers from which it

purchases cores and tubes to utilise only core board supplied in their manufacturing processes. This is the same ground as that set out in paragraph 1.2.5 and we refer to what is stated above in regard thereto.

64 In **paragraph 1.3.3**, the appellants say that the Tribunal erred in giving no weight to evidence of the likelihood of foreign investment in the market for the manufacture of cores and tubes in South Africa. We do not know what evidence is being referred to in this paragraph and the extent of the likelihood that such foreign investment will take place. We would submit that the likelihood of such foreign investment would have to be very high in order for it to be accorded any weight in the determination of the likely effect of the merger on competition in the relevant market. In order to be relevant to a consideration of custom or foreclosure, it would have to be clear that such foreign investment would be in new manufacturers who were willing and able to purchase core board in South Africa on a competitive basis. The mere fact that there might be an increased foreign shareholding in existing manufacturers of cores and tubes would not, in our view, affect the customer foreclosure that would otherwise result from the merger.

65 In **paragraph 1.3.4**, the appellants say that the Tribunal erred in concluding that the merger will effectively foreclose entry into the South African market by suppliers of core board or foreign investors. For the reasons set out above, we do not believe that

the Tribunal did err in concluding that the merger would result in customer foreclosure. As a result of the merger, KC&T, the largest core and tube manufacturer, is likely to source most of its supplies from Mondi while manufacturers who supply cores and tubes for Sappi are required to use Sappi paper alone for that purpose.

66 In **paragraph 1.4**, the appellants say that the Tribunal erred on various grounds in finding that the merger is likely to facilitate the exchange of pricing and other sensitive information and, hence, "*facilitated co-ordinated conduct*" between Sappi and Mondi. We have dealt with these issues generally above.

67 As regards the particular complaint in **paragraph 1.4.1** — that the Tribunal "*erred in finding that the merger is the centrepiece of a strategy designed to facilitate the exchange of pricing and other competitive sensitive information between Sappi and [Mondi]* " — we need merely note here that, in this regard, the Tribunal ultimately <u>finds</u> only that the structure of the upstream market, the characteristics of the product and the existing level of transparency will meet the requirements for successful co-ordination (para 96). At paragraph 99 the Tribunal concludes as follows:

> "*We accordingly find that this transaction will facilitate tacit or express co-ordinated conduct (and thus is likely to substantially lessen competition) by facilitating the exchange of pricing and other competitively sensitive information in both the input or output market.*"

68 In **paragraph 1.4.2**, the appellants say that the Tribunal erred in failing to identify:

68.1 what other competitively sensitive information it was referring to;

68.2 how the merger would increase the flow of pricing and other competitively sensitive information to Sappi and Mondi; and

68.3 how the merger would facilitate an exchange of information between the manufacturers of cores and tubes within the Sappi and Mondi stables.

This ground appears in the first instance to be a complaint regarding particularity rather than an objection to any particular findings by the Tribunal. It is moreover unclear to us that the Tribunal was required, in order for its findings to be valid, to provide the detail demanded by the appellants.

69 First, the Tribunal's central finding is that the merger will facilitate the exchange of pricing and other competitively sensitive information, whatever it may be. In our view, "*other competitively sensitive information*" is any information that provides the recipient with an anti-competitive advantage. This might include terms and conditions of trade, customer identities, quantities ordered and the like. The core question is, to our mind, whether the merger facilitates the exchange of such information and not what the content of such information may be.

70 In this respect, it appears from the record to be common cause that Mondi will sell a certain amount of its paper supplies to competitors of KC&T who purchase the bulk of their supplies from Sappi, and that Mondi will purchase some of its core and tube requirements from competitors of KC&T who also supply Sappi with cores and tubes. Mondi will thus be in the enviable position where, through KC&T, it has knowledge of the prices, terms and conditions and the like offered by its major competitor both in the upstream market for the supply of paper and in the downstream market for the purchase of cores and tubes. It is in our view clear that the merger will, in this manner, facilitate the exchange of pricing and other competitively sensitive information between Sappi and Mondi.

71 In **paragraph 1.4.3**, the appellants say that the Tribunal erred in giving insufficient weight to evidence that pricing and other information is, in any event, freely available to Sappi and Mondi. It is, in our view, clear from paragraphs 85 to 99 of the Tribunal's decision that it attributed much weight to the collusive structure and dynamics of the upstream market in reaching its conclusion that the merger would facilitate co-ordinated conduct between Sappi and Mondi. The point at which the appellants are driving in this paragraph seems to be the same as that in paragraph 1.4.2.2, namely that the merger will not increase what is already a free flow of competitively sensitive information between Sappi and Mondi. We have set out above how the merger will permit Mondi, through

KC&T, to have access to competitively sensitive information of Sappi both in the upstream paper supply market and in the downstream market for the purchase of cores and tubes. The structure, we submit, will certainly facilitate the existing flow of competitively sensitive information between Sappi and Mondi.

72 In **paragraph 1.4.4**, the appellants say that the Tribunal accordingly erred in concluding that the merger would facilitate tacit or express co-ordinated conduct between Sappi and Mondi. For the reasons set out above, we do not agree that the Tribunal erred in making this finding.

ERRORS OF LAW?

73 The second category of grounds on which the appellants rely in their notice of appeal is errors of law. The appellants say that the Tribunal erred in its interpretation and/or application of section 12A of the Competition Act in various respects. We consider these in turn.

74 In **paragraph 2.1.1**, the appellants say that the Tribunal erred in holding that it was unnecessary for the purpose of the enquiry to define the relevant markets with precision. We have already dealt with this issue to some extent above. Market definition is, in our view, relevant and necessary for the purposes of determining whether or not a merger would substantially lessen or prevent competition in that market. It does not follow from that proposition

that the relevant market or markets need, or can, always be defined with absolute precision. There is seldom, if ever, sufficient data to do this. What is necessary is that the Tribunal define the relevant market with sufficient precision in order to enable it to determine whether competition in that market has been substantially lessened or prevented as a result of the merger. Here, the Tribunal was, on the evidence available to it, to define:

74.1 the relevant upstream market as the market for the provision of board utilised in the production of industrial cores and tubes (para 49); and

74.2 the relevant downstream market as the market for heavy industrial cores and tubes (para 37).

This, in our view, is a sufficiently precise definition to enable the Tribunal to determine whether or not the merger has substantially lessened or prevented competition in these markets.

75 In **paragraph 2.1.2**, the appellants say that the Tribunal erred in holding that probabilistic and speculative hypothesis is sufficient when determining whether or not a merger is likely to substantially prevent or lessen competition. We do not understand the Tribunal as having made such a holding in its decision. What the Tribunal is required to do in terms of section 12A of the Competition Act is to determine whether, on the evidence before it, the merger is "*likely to substantially prevent or lessen competition*" and, if so, to determine whether or not the merger is "*likely to result in any*

technological, efficiency or other pro-competitive gain which will be greater than, and off set, the effects of any prevention or lessening of competition, that may result or is likely to result form a merger, and would not likely be obtained if the merger is prevented". The Tribunal is thus enjoined to engage in a certain degree of prediction of the results of the merger on the evidence of the facts before it. This predictive element cannot be avoided because, by definition, the merger has not yet been implemented. It is submitted that this is the correct way of interpreting the test to be applied in terms of section 12A of the Competition Act.

76 In **paragraph 2.1.3**, the appellants say that the Tribunal erred in making an *a priori* assumption that the merger was likely to substantially prevent or lessen competition and then seeking to establish that assumption at the hearing. We do not agree that the Tribunal's decision reflects such an assumption or a misunderstanding by the Tribunal that this was the correct way to interpret section 12A of the Competition Act.

77 In **paragraph 2.1.4**, the appellants say that the Tribunal erred in "*saddling the appellants with an onus of proving that the merger is likely to result in technological, efficiency or other pro-competitive gains*". We have not been able to identify in the Tribunal's decision a holding that the appellants bore the onus of proving that efficiency gains generated by the merger were likely to be greater than and offset its anti-competitive effects. It must be said,

however, that the appellants — who were uniquely well-placed to do so — in fact provided no evidence which, when added up, would be capable of leading to a determination that such gain or gains would be likely. They can hardly be heard to complain if, after they have been given the fullest opportunity to come forward with such evidence, the Tribunal concluded (or this Court were to conclude) that it is probable that such evidence does not exist. Actually, one can find in the Tribunal's Reasons no explicit determination in terms of section 12A(1)(*a*). That is a flaw (although it is not advanced as such in the notice of appeal). We return to it below.

78 In **paragraph 2.1.5**, the appellants say that the Tribunal erred in failing to determine whether the merger could be justified on substantial public interest grounds by assessing the factors set out in section 12A(3) of the Competition Act. As in regard to the lack of an explicit determination in terms of section 12A(1)(*a*), that would appear to be a ground of review rather than appeal — but this is not a review.

79 In merger proceedings before it, the Tribunal ought to explicitly make a determination in terms of section 12A(1)(*a*)(ii) and/or 12A(1)(*b*) as the case may be — with reasons to substantiate its conclusion. The determination should not be left implicit, as it is in the Tribunal's reasons. We note that the appellants do not appear, in their heads of argument, to press the issue. The appellants'

prayers ask the Court to approve the merger — thus implying that it is now for the Court to make any determination or determinations missing from the Reasons of the Tribunal. The Court may conclude that the more appropriate course would be to remit rather than make such determinations at first instance itself. Be that as it may, on the present record (we submit) there is no basis for a determination either that technological, efficiency and other pro-competitive gains would outweigh the anti-competitive effects of the merger, or that public interest grounds exist which are sufficient to justify it under section 12A(1)(*b*).

80 In **paragraph 2.2.1**, the appellants say that Tribunal erred in failing to put its *a priori* assumptions to witnesses and then deciding the merger on the basis of such assumptions and not the totality of the evidence led. There seem to be two distinct issues here. As far as the totality of the evidence is concerned, our submission is — for the reasons already advanced — that the totality of the evidence on the record is quite sufficient for the initial determination in terms of section 12A(1) to have been made by the Tribunal as it was. The other issue — whether more should have been put to the merging parties and the witnesses to define the issues present to the minds of the Tribunal members during the hearing — is a more difficult one to which we return below.

81 In **paragraph 2.2.2**, the appellants say that the Tribunal failed to determine the manner or the basis of an appraisal of all the

evidence led, and, in particular, that of its own witnesses. Again, this appears to be a ground of review rather than of appeal, and it is not apparent what error of law is sought to be appealed in terms of this paragraph.

BASIC FAIRNESS IN INQUISITORIAL PROCEEDINGS

82 Although this is an appeal and not a review, it does not diminish the seriousness of the issue of fairness raised by the appellants, namely that *audi alteram partem* were not observed inasmuch as the line of reasoning, the logical construction relied on by the Tribunal in coming to its decision as to “likelihood”, was not raised at the hearing in a way which would have allowed these parties a proper opportunity to deal with it.

83 It would, of course, not be fair to the Tribunal to suggest that it plucked the issues on which it focused in its Reasons out of thin air. Those issues do arise if one grapples thoroughly with the implications of the information provided and the contentions advanced in, for example, the letter from Mondi’s attorneys to the Competition Commission, dated 14 February 2002.[99] Moreover, the merging parties have been represented at all stages by highly skilled and experienced competition lawyers.

84 Nevertheless, we would submit that, generally speaking, an inquisitorial tribunal, when entertaining submissions from affected

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[99] Pp 365 and following.

parties, should not play its cards close to its chest. In merger proceedings nothing even approximating to pleadings are there to define the boundaries of the issues relevant to the case. Where reasonably possible, the concerns and *prima facie* views of the Tribunal members ought to be indicated so that they can be specifically addressed, in both evidence and argument.

85 At the same time, the Tribunal cannot be stultified in its decision-making task merely because some vital point, quite sustainable on the record, comes properly into focus for the first time only after the hearing. Even in judicial proceedings where the issues have been defined in pleadings, the penny sometimes drops only after the oral arguments have been concluded. In those circumstances, however, it is often thought appropriate to invite or allow further submissions from the parties. In a proper case, indeed, further evidence could be led.

86 Of course, inasmuch as this is not a review and the appellants seek a positive order from this Court on appeal, they have a hearing <u>now</u> in respect of the <u>issues</u> which, they say, were not clearly put to them by the Tribunal. But they have that hearing upon <u>a factual record which is already set</u>. Are there facts, is there evidence, which the appellants would wish to bring forward in regard to the matters in point, and which they would have presented had they known the line which the Tribunal's thinking took? If so, it may well be appropriate for this Court to exercise its

power to remit, rather than come to a final decision simply on the record as it now stands.

R O Petersen SC

Chambers
Cape Town

J Wilson

Chambers
Sandton

as *amici curiae*

22 September 2002

		Mondi / KC&T	Sappi	Others
A ↓	**Production of paper material suitable for use in production of heavy industrial ("high end") cores & tubes** [Note: percentage figures relate to more broadly defined markets. The evidence is that the "high end" of the market is where the profits are to be made.]	Mondi Cartonboard [38% of the total coreboard market] [sales of R18m of coreboard to KC&T] Mondi Kraft [33% of total market for pulp, paper and woodchips] [sales of R5m to KC&T – see p 134 and p 331]	Sappi [38% of the total coreboard market] Sappi Kraft [51% of total market for pulp, paper and woodchips] [Sappi supplies most of KC&T's paper requirements	None in SA [Imports 24% of coreboard market]
B ↓	**Production of heavy industrial cores & tubes**	KC&T [45% of total market for cores & tubes] [sales of R10m to Mondi Paper and R3.9m to Mondi Kraft – see p 151]	Sappi Tugela [in-house production of cores and tubes – see p 764. % not indicated]	Framen 11% [of total market. However, Mr Bouzaglou claims 35% (p 850)] ITT 6% Envirocore 2% Triumph 2% (Other) in-house manuf. [15% less % by Sappi Tugela] Various others [see p 131] [imported cores and tubes not significant]
C	(see next page)			

C ↓	**Production of products wound onto heavy industrial cores & tubes** (Paper, steel & textile industries, some plastics)	Mondi Paper [57% of its cores and tubes requirements bought from KC&T] [most of remainder from Framen? See pp841-842] Mondi Kraft [50% of its cores and tubes requirements bought from KC&T] ? Mondi Cartonboard [25% of its cores and tubes requirements bought from KC&T: see p 153 para 6.7.3.1.2]	Sappi (various) [currently 85-90% of its cores from KC&T]	Huletts Aluminium Columbus Steel SA Nylon Spinners [see p 329] Others [see p 338]
D	**Ultimate purchase of the products described in C**			