

**COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA**

Case No: 12/LM/FEB04

In the large merger between:

Inzuzo Furniture Manufacturers (Pty) Ltd

and

PG Bison Holdings (Pty) Ltd

Reasons for Decision – non-confidential version

Conditional Approval

On 22 June 2004 the Tribunal conditionally approved the merger between Inzuzo Furniture Manufacturers (Pty) Ltd and PG Bison Holdings (Pty) Ltd. The reasons for this decision follow.

Procedural Background

The Commission filed its recommendation in this merger to the Tribunal on the 14 May 2004. It recommended that the merger be unconditionally approved.

A pre-hearing meeting was convened on the 21 May 2004, at which we requested additional information from the merging parties as well as from the Commission. On the 9 June 2004 the parties requested that we convene an urgent second pre-hearing meeting. At this meeting, Mr Danie van der Merwe, the MD of Steinhoff, requested that the merger be considered as a matter of urgency in order that a decision could be made by the Tribunal prior to 30 June 2004. The urgency related to a commercial deadline that PG Bison and Steinhoff were required to meet in respect of a forestry development which we outline more fully below. Mr Van der Merwe testified that the parties could not meet the deadline without knowing the outcome of the merger.

At that stage the Commission was awaiting further responses from a number of industry participants, who had earlier highlighted their concerns regarding the merger to the Commission. In order to assist the merging parties but also to ensure that we had heard from all interested parties, we decided to expedite this process by subpoenaing the relevant industry representatives, to provide oral evidence at the hearing of the merger.

Only the three furniture manufacturers that had responded to the Commission's questions and which had raised some of their concerns about the merger, were subpoenaed to attend the hearing. The hearing was held on the 17 and 18 June 2004.

During the course of the hearing it became evident that the concerns raised by Steinhoff's competitors could be addressed by the provision of an appropriate undertaking from the merging parties. Accordingly, the merging parties negotiated an undertaking with those furniture manufacturers that had raised concerns, and proposed that it be imposed as a condition to the merger. After some refinement, in consultation with the various parties, including the Commission, the condition as it stands in the order, was arrived at.

During the course of the hearing we heard oral testimony from the following witnesses -

Witnesses called by the merging parties:

Mr D van der Merwe – Managing Director of Steinhoff Africa
Mr C van Niekerk – CEO of PG Bison

Witnesses called by the Tribunal:

Mr C MacMurray – CEO of Sonae Novobord
Mr P Leoni – Managing Director of Chipboard Industries (Pty) Ltd
Mr R Pritchard – Managing Director of Pilot Furniture Manufacturers (Pty) Ltd
Mr J B Coffin-Grey and Mr G C Cornwall – Members of Furniture Perfection CC
Mr L Weinstein – Managing Director of Harfred Products

The transaction

Steinhoff Africa Holdings ("Steinhoff") will acquire the remaining shares in PG Bison Holdings (Pty) Ltd ("PG Bison"), which it does not already own. Steinhoff currently owns 34.9% of the shares in PG Bison and will acquire sole control of PG Bison in consequence of this transaction.

The parties

The primary acquiring firm

Inzuzo Furniture Manufacturers (Pty) Ltd (“Inzuzo”) is a special purpose company, wholly owned by Steinhoff and ultimately by Steinhoff International Holdings. Steinhoff is the largest furniture manufacturer in South Africa, with interests in forestry, saw milling, wood processing, textiles, furniture manufacturing, and logistics¹.

The primary target firm

PG Bison is a private company, jointly controlled by various shareholders, including Steinhoff, Investec, the Industrial Development Corporation and a number of trusts, including an employee share trust.² It is a holding company, trading only through its operating subsidiaries.

The rationale

The rationale for this transaction is primarily to facilitate PG Bison’s participation in a forestry cluster development project in the Eastern Cape. The project is intended to include participants at each level of the value chain, from forestry to finished timber products, so as to promote greater tree utilisation thus diminishing tree wastage. To participate in this development PG Bison required a capital investment of approximately R700 million³. When PG Bison’s institutional investors indicated that they were not enthusiastic to inject further investment into the company, Steinhoff expressed its interest in funding the project, particularly in light of its experience in the forestry and timber industries. However, it was only prepared to do so as the sole controller of PG Bison, hence, in December 2003, it made an offer to acquire the remaining shares from the other shareholders.

Background

The Steinhoff Group was founded by Mr Bruno Steinhoff in 1964 in Germany. During the early 1990’s the Steinhoff family invested in South Africa when they acquired a 35% interest in GommaGomma Holdings from Daun et Cie AG.

¹ Merging parties’ competitiveness report, pages 6-9 of the record.

² The current major shareholders of PG Bison are: Steinhoff 34.9%, Investec 11.4%, PG Bison Key Management Trust 10.9%, the IDC 8.4%, the Chris van Nierkerk Family trust 8.0%, and PG Bison Employee Trust 4.4%.

³ The parties submitted that the required investment would be R1 billion. However, Mr van der Merwe pointed out in his evidence that it would probably be about R700 million. See the transcript of 17 June 2004 at page 71.

GommaGomma Holdings then acquired Victoria Lewis and changed its name to Steinhoff Africa Holdings (Pty) Ltd. Steinhoff International incorporated all the European and South African companies and was listed on the JSE in September 1998. In 1999 Steinhoff acquired the Cornick group, which included the Afcol furniture manufacturing operations, and consequently became the largest furniture manufacturer in South Africa.

Steinhoff's growth has been strategically enhanced by a number of acquisitions that have resulted in a truly vertically integrated group. For example, in 2000 Steinhoff acquired an interest in the transport and logistics group, Unitrans Limited and, in 2002, it acquired a 34.9 % interest in PG Bison.

On the other hand, PG Bison's success is largely due to its strong management team. In 1998 PG Bison, then jointly owned by Mondi and SA Breweries Plc, was in fact, a loss making company. It required significant re-gearing, and since its shareholders did not wish to invest in the company, the management sought the assistance of BoE Bank in a management buy-out. A few months later management concluded a back-to-back agreement with Investec, which saw Investec holding 49% and management holding 51% of the shares. In 2001 the Industrial Development Corporation bought a 15% shareholding in the company and the current shareholding status was achieved in 2002.

The management team of PG Bison has successfully turned the company around and it is currently the dominant supplier of chipboard and related products in South Africa. The current transaction is structured so that the management will remain on board for at least three years, after which they will have the option to sell their shares according to the same price formula offered to the current shareholders.

Evaluating the merger

This is a vertical merger, in terms of which Steinhoff, the largest furniture manufacturer in South Africa will acquire sole control of PG Bison, the dominant supplier of important inputs used in the furniture manufacturing industry.

The relevant markets

The definition of the relevant upstream and downstream markets, as well as the national geographic dimension of the markets was not in dispute between the Commission and the merging parties. The witnesses subpoenaed also did not indicate any contrary view of the markets.

The upstream markets

Two relevant upstream markets were identified:

- i) the market for particle board, including upgraded particle board ⁴, and
- ii) the market for medium density fibreboard ("MDF"), including upgraded MDF.

Raw particle board consists of "chips" of wood which are bonded together to form what is commonly known as "chipboard". In its raw form it is used in interior applications in the furniture and building industries. In its upgraded form, that is when the surface has been decorated with melamine, it is used in the manufacture of kitchen and office furniture. MDF is made from refined wood fibres bonded with a synthetic resin that produces a smooth surface finish.

It can be upgraded with various decorative surfaces and is also used in the manufacture of kitchen and other furniture.

The markets for particle board and MDF constitute separate markets because the products have distinct characteristics and are used in different applications in furniture manufacturing. The average cost per square metre of MDF is significantly higher than that of particle board.⁵

The current structure of these markets is depicted below in Tables 1 and 2.

TABLE 1: *The market for particle board, including upgraded particle board* ⁶

Market Participant	Volume m3	Market share
PG Bison	22 940	47.2
Sonae	18 947	39%
CIT	6 316	13%
Imports	379	0.8%
Total	48582	100%

TABLE 2: *The market for MDF, including upgraded MDF*

Market participant	Volume in m3	Market share
--------------------	--------------	--------------

⁴ Particle board is the industry name for what is commonly known as chipboard.

⁵ According to the Commission's report, particle board is R22.50 per m² and MDF is R35.00 per m².

⁶ Two of the witnesses, Mr MacMurray from Sonae and Mr Leoni from CIT stated that the market shares stated at page 13 of the Commission's report were slightly understated. The market shares reflected here have been adjusted according to the witnesses' submissions.

PG Bison	4 143	61%
Sonae	2 000	30%
Imports	600	9%
Total	6 743	100%

It is clear that PG Bison is the largest player in both the market for particle board as well as the market for MDF. Chipboard Industries (Pty) Ltd (“CIT”) only sells particle board, thus the market for MDF consists of only two producers, of which PG Bison is the dominant player. Entry into these markets appears to be prohibitive in terms of the cost of building a factory as well as in respect of access to raw materials.

However, there appears to be a large number of distributors, known as the board merchants or resellers. These merchants procure board, either from the three manufacturers or through imports, store the products in warehouses and supply various users of particle board and MDF.

The downstream markets

PG Bison estimates that between 24% and 40% of the total production of particle board and MDF are used as inputs in the domestic furniture market.⁷ These products are particularly used in the manufacture of case goods (examples of case goods are hi-fi, TV and wall units, and coffee tables) and in the manufacture of lounge furniture (also known as upholstered furniture), although to a lesser extent.

The furniture manufacturing industry delineates itself between the Steinhoff controlled manufacturers and non-Steinhoff manufacturers, which are widely known as the “*independents*”. Thus, any reference to the independent furniture manufacturers, in fact refers to Steinhoff’s competitors in the furniture manufacturing industry.

Steinhoff is active in both these markets, thus the relevant downstream product markets are:

- i) the market for non-solid case goods, and
- ii) the market for upholstered furniture, particularly lounge furniture.

The parties submit that Steinhoff’s market share in non-solid case goods is 13.0% and its market share in lounge furniture is 27.4%. None of Steinhoff’s competitors in these two markets has a market share of more than 10%.

⁷ As given at page 563 of the record, the merger report of Professor Yarrow.

The tables below depict the structures of the relevant downstream markets:

TABLE 3: *The market for case goods* ⁸

Market participant	Market share
Steinhoff	13%
Pilot Furnishers	3.57%
Furniture Perfection	3.03%
Taurus	3.00%
Harfred	3.75%
Donnely	3.21%

TABLE 4: *The market for lounge furniture* ⁹

Market participant	Market share
Steinhoff	27.4%
Motani	8.2%
Supercraft	3.3%
Cantoni	2.7%
Style	2.7%
Calgan	2.7%

The above lists are not exhaustive as the parties contend that there are numerous smaller manufacturers in both markets. Relying on its customer data, PG Bison estimates that there are approximately 250 case goods manufacturers.

The evidence that Steinhoff has supply agreements with major furniture retail groups suggests that there may be a narrower sub-market for the supply of furniture to the chain store or retail groups.¹⁰ Given that Steinhoff is the largest furniture manufacturer in the country and that it has supply arrangements with the retailers, it would have a disproportionately higher share of this market.

⁸ As stated in the Commissions recommendation, at page 13.

⁹ As submitted by the parties, page 565 of the record, in the report by Professor Yarrow. These market shares are also interpreted from the turnover figures provided at page 28 of the record, the parties competitiveness report.

¹⁰ See the transcript of 18 June 2004, pages 136, 159, 169 and page 200.

The ability of the independent manufacturers to expand depends on their ability to supply larger volumes to the retail chains, which would result in economies of scale. If, as is suggested, they are precluded from supplying the retailers that Steinhoff supplies, then their expansion in the case goods and lounge furniture markets will be seriously hampered.

Impact on competition

Our analysis of this merger follows the analysis employed in previous vertical mergers, particularly the Mondi/Kohler and Coleus/Rheem mergers.¹¹ The foundation for this analysis is to be found in the formative work of Riordan and Salop.¹² The authors identify three main potential competition concerns that arise in vertical mergers:

- i) raising rivals costs by means of input or customer foreclosure,
- ii) ability to promote co-ordinated behaviour between competitors, and
- iii) ability of a vertically integrated firm to evade price regulation.

The possibility of evading price regulation is not relevant to this merger. The evidence and therefore the analysis of this merger focused on the incentives for the merged entity to engage in foreclosure. Given that Steinhoff already owns the single largest shareholding in PG Bison, the incentives to engage in foreclosure need to be evaluated in light of this fact.

Customer foreclosure

The concern to be evaluated here is whether PG Bison's competitors could potentially be foreclosed from having Steinhoff as a customer.

CIT does not currently supply Steinhoff with particle board. In fact, Mr Leoni, the managing director of CIT stated that CIT does not supply any of the major manufacturers of case goods and lounge furniture. This appears to be largely attributable to a difference or a perceived difference in the quality of CIT's boards as compared to that of PG Bison and Sonae. With the exception of one, all of CIT's customers are board merchants or re-sellers, who buy board from the three manufacturers or import board for re-sale. Mr Leoni stated that in the past he preferred not to supply the furniture manufacturers, particularly because CIT operates on a strict 30 day payment term basis while most of the furniture

11 Mondi Limited and Kohler Cores and Tubes, a division of Kohler Packaging Limited, case no. 06/LM/Jan02 and Coleus Packaging (Pty) Limited and Rheem Crown Plant, a division of Highveld Steel and Vanadium Corporation Limited, case no.75/LM/Oct02

12 Michael H.Riordan and Steven C.Salop, "Evaluating Vertical Mergers: A Post Chicago Approach", Antitrust Law Journal Vol 63,1995, page 551.

manufacturers required longer payment terms. Nonetheless, he would be willing to supply any of the furniture manufacturers who are able to purchase the required industry minimum truckload volumes and meet the payment terms.¹³

Thus in the case of CIT, it is clear that there is no evidence to suggest that it would be foreclosed from having Steinhoff as a customer as a consequence of the merger.

On the other hand, Steinhoff's Pat Cornick and Victoria Lewis factories are Sonae's largest furniture manufacturing customers, accounting for approximately 4% of its combined sales of particle board and MDF. Mr Craig MacMurray, the CEO of Sonae, explained that during 2000 Sonae made a conscious decision to tender for a larger part of Steinhoff's custom by being competitive in terms of price, quality and service. This strategy proved to be successful, as the evidence shows a dramatic increase in Steinhoff's purchases from Sonae between 2000 and 2003.¹⁴ Mr MacMurray pointed out that Steinhoff's purchases from Sonae actually increased at the time that it acquired its current shareholding in PG Bison. Given that Steinhoff's current shareholding in PG Bison has not detracted its custom from Sonae in favour of PG Bison, Mr MacMurray was confident that the acquisition of a 100% shareholding would not alter Steinhoff's purchases from Sonae.

It appears that the Steinhoff factories purchase particle board independently of each other. Sonae believes that despite Steinhoff being a vertically integrated group, the purchasing methodology of the individual plants within the group is to buy from what is deemed to be the best supplier for that particular plant. Each plant's purchases of raw materials are also determined by the volume and mix of products required for that specific operation. For example, Highpoint which is a case goods plant would require larger volumes of particle board and MDF, than GommaGomma which is a lounge suite plant.

According to Sonae, PG Bison is operating at capacity and would have to forego some of its other customers in order to meet Steinhoff's total particle board and MDF requirements. Mr MacMurray believes that they would not do this as it would alienate the entire furniture manufacturing industry. For these reasons Sonae is not concerned that it would be foreclosed from having Steinhoff as a customer in the post merger scenario.

The merging parties submit that Steinhoff's total particle board and MDF requirements would account for only 8.1% and 9.5% of PG Bison's total

¹³ See transcript of 17 June 2004, at pages 38-39 and 49-50.

¹⁴ See page 753 of the record, which contains a record of Steinhoff's purchases from PG Bison and Sonae for the period 2000-2003.

production of particle board and MDF, respectively.¹⁵ Thus, even if the merged entity were to self deal, at least 90% of PG Bison's production would still be available to third parties. Furthermore, the parties argue that the price differential between Sonae and PG Bison is such that for the period ended June 2003, Steinhoff benefited in the region of R3.8 million by purchasing from Sonae at the expense of PG Bison.¹⁶ It would therefore not be economically rational to forego this benefit by self dealing.

In conclusion then, there is no evidence to suggest that the merged entity would engage in customer foreclosure. PG Bison's competitors, in particular Sonae, are not concerned that the merged entity would self deal. In fact, Mr MacMurray anticipates a growth of approximately 5% in Steinhoff's purchases from Sonae for 2004.¹⁷

Input foreclosure

Essentially, input foreclosure encompasses the following concerns:

- i) that Steinhoff's competitors would be foreclosed from access to supply from PG Bison, and would therefore potentially be faced with Sonae as a monopoly supplier, and
- ii) that PG Bison would supply Steinhoff at cost, thereby engaging in price discrimination.

As noted earlier, during its investigation of the merger, the Commission invited Steinhoff's competitors in the case goods and lounge furniture markets, to provide information and to comment on the merger. In response three case goods manufacturers namely, Furniture Perfection CC ("Furniture Perfection"), Pilot Furniture Manufacturers (Pty) Ltd ("Pilot Furniture") and Harfred Products ("Harfred"), submitted their concerns to the Commission. None of Steinhoff's competitors in the lounge furniture market responded to the Commission's invitation. Representatives from the three case goods manufacturers were asked to attend the hearing in order for us to examine the validity of their concerns.

All three manufacturers expressed the concern that the merged entity would adopt a pricing strategy and a supply strategy that favoured Steinhoff, which would negatively impact on their ability to compete with Steinhoff in a market already characterised by low margins.

Furniture Perfection and Harfred purchase 100% of their particle board and MDF

¹⁵ See page 31 of the record.

¹⁶ See page 33 of the record.

¹⁷ See the transcript of 17 June 2004 at page 13.

requirements from PG Bison. Pilot Furniture sources between 75% to 80% of its requirements from PG Bison, having decided to spread some of its custom to Sonae when Steinhoff acquired the 34.9% in PG Bison. Thus all three manufacturers depend on PG Bison for the major part of their board requirements.

However, Mr Pritchard, from Pilot Furniture, stated that there have been times when he has imported board and the landed cost was *“literally within cents of the going PG Bison price”*.¹⁸ While imports are competitive in terms of price, it is not convenient in terms of delivery times, which are crucial in the furniture manufacturing industry.

The furniture manufacturing industry is cyclical, with production at its lowest during the first quarter of the year, slightly higher in the second quarter and peaking from September to December. It is vital for the manufacturers to operate optimally from September to December to ensure that they are able to survive the quieter times. It follows that any constraints on their ability to source raw materials efficiently and timeously during their busiest times, will severely hamper their profitability and could ultimately threaten their survival.

In light of the above, it is not surprising then that all three furniture manufacturers were concerned that the merger could potentially give Steinhoff, their dominant competitor, the ability to influence or manipulate the supply of an important input for which they depended heavily on PG Bison. Essentially, their concern was that the supply of board to them could be constrained in favour of Steinhoff factories, particularly during the peak season and in times of shortages.

This concern is not without foundation. The independent manufacturers have in the past experienced supply shortages during the most critical time of their production cycle as well as during the quieter times of the year. Mr van Niekerk from PG Bison and Mr MacMurray from Sonae confirmed that there were shortages in the board market in 2002. The reasons for this are not entirely clear – Sonae says it experienced shortages as a result of production downtime due to maintenance being carried out at its plants and that the perception of a shortage in the market was overstated, PG Bison says it underestimated the demand for that year and some of the furniture manufacturers believe that the shortage may have been caused from an increase in exports by both PG Bison and Sonae.

The independent furniture manufacturers were also concerned that in the event that PG Bison decided not supply them or to diminish its supply to them, they would be confronted with Sonae, to all intents and purposes, as a monopoly supplier. It is clear that the industry does not regard the quality of CIT's board as

¹⁸ See transcript of 18 June 2004, p202-203.

being of a high standard and therefore CIT cannot readily be considered as an alternative supplier. It was also explained to us that one cannot simply switch to a different supplier of board, as it is imperative to have consistency in the thickness, surface and quality of the boards. The use of substandard board could result in production problems.¹⁹ All three independent manufacturers indicated that PG Bison's board is of the best quality in the country.

Mr Coffin-Grey and Mr Cornwall from Furniture Perfection were particularly concerned that since they had not supported Sonae in the past, they would not be able to extract similar rebates as they had over the years negotiated with PG Bison.²⁰

These two witnesses also expressed the concern that the merged entity would engage in price discrimination in favour of Steinhoff factories. The merging parties contend that this would not be economically rational as the concomitant loss at PG Bison would exceed the benefit gained at Steinhoff. Mr Coffin-Grey conceded that it would not make sense for the merged entity to sell to itself at cost.²¹

However, they did testify that if PG Bison were to discriminate in its pricing in favour of Steinhoff, it would be difficult for Steinhoff's competitors to detect, they would only know this in the event that the furniture retailers informed them that Steinhoff's prices were more than 5 -7% lower than their prices.²²

The furniture manufacturers confirmed that the prices for particle board and MDF are generally negotiated annually and that the volume based discounts are integral in ensuring competitive pricing. Thus, if we were to impose a condition to the merger that sought to curtail price discrimination, the effect could in fact nullify these discounts and thereby erode the competitive pricing of the furniture manufacturers.

Mr Pritchard indicated that his broader concern was the increasingly dominant role of Steinhoff in the furniture industry. Not only is Steinhoff the largest furniture manufacturer, it also has significant interests in raw material operations and has entrenched supply arrangements with the major furniture retailers. Mr Pritchard's concern was that the independent furniture manufacturers have to source their raw materials from their largest competitor and that they are then excluded from supplying those retailers which have supply arrangements with Steinhoff.²³

¹⁹ See transcript of 18 June 2004, page 152 and page 206.

²⁰ See transcript of 18 June 2004, page 139.

²¹ See transcript of 18 June 2004, page 140.

²² See transcript of 18 June 2004, page 140 .

²³ See transcript of 18 June 2004, page 200-201.

We are of the view that there is at least prima facie evidence to support the concerns of input foreclosure. However, it is not necessary for us to reach a definitive conclusion on this aspect, as the undertaking which the parties proffered as a condition to the merger, will alleviate the concerns related to input foreclosure.

Co-ordinated behaviour

There is some evidence, though not conclusive, of co-ordinated behaviour between PG Bison and Sonae. It appears that in 2002, there was a shortage of board in the country. Both PG Bison and Sonae had to import board to meet the demand.²⁴ During his testimony Mr MacMurray said:

“ We had actually taken a certain amount of capacity out of the market following a very poor demand in 2001. The nett result is I think we got caught short as an industry and there was a bit of shortage towards the end of 2002, going to 2003.”²⁵

He later qualified this statement, as a reference only to Sonae. He then explained that Sonae

“ took a certain amount of commercial downtime to do quite a lot of maintenance and that took place in January 2002 and we possibly underestimated the demand that would take place a little bit later in the year.”²⁶

Messrs Coffin-Grey and Cornwall also stated the pricing of the two board producers was relatively on par and that historically, the prices of PG Bison and Novobord (which is now Sonae) moved at the same time. It is not clear that this is presently the situation.

However, there is no evidence to conclusively show that the merger will promote co-ordinated behaviour between PG Bison and Sonae.

The undertaking

During the cross-examination of Messrs. Coffin-Grey and Cornwall, Mr. Pretorius, counsel for the merging parties proffered an undertaking from PG Bison that

²⁴ See transcript of 18 June 2004, page 141 and page 151.

²⁵ See transcript of 17 June, page 23.

²⁶ See transcript of 17 June, page 33.

would remedy their concerns.²⁷ The hearing was adjourned to allow the merging parties, the Commission and the relevant furniture manufacturers the opportunity to consider an appropriate undertaking.

We then put the proposed undertaking to two witnesses, Mr Pritchard and Mr Weinstein, who had not yet testified and asked them to comment on the proposed undertaking as a condition to the merger. Both witnesses stated that the proposed undertaking would alleviate their concerns pertaining to the supply of particle board and MDF.

The merging parties were happy that the undertaking be made a condition to the merger.

The condition

The condition states that PG Bison must supply particle board and MDF to all independent furniture manufacturers, who are existing customers of PG Bison at the date on which the merger is approved, at a level no less than their respective purchases for the 2003-2004 financial year (the “base year”). This arrangement must prevail for a period of 3 years from the 1 July 2004.

Furthermore, the condition also states that in the event of force majeure, PG Bison may proportionately reduce its supply to the independent furniture manufacturers and as well as to Steinhoff, pro rata to what each firm received in the base year.

The condition effectively ensures that PG Bison’s customers will not be precluded from purchasing, at the least, the same quantities of particle board and MDF as purchased in the base year.

We have not made the condition overly specific by burdening it with exclusions that are in our view implicit in its spirit. By way of example, we would not expect PG Bison to supply customers who have not paid them. That is not a competition concern, rather it is a commercial concern. Similarly, if PG Bison were to supply the independent manufacturers the correct volumes, but decided to “squeeze” the volumes supplied to them during the peak periods, which the evidence indicates is crucial to their business, we would view this as a breach of the spirit of the merger condition.

Finally, the condition also provides that in the event of an alleged breach of the condition, the aggrieved party may approach the Commission for a remedy in accordance with its Rules.

²⁷ See transcript of 18 June 2004, page 177.

Efficiency and technological benefits of the merger

The parties claim that there are extraordinary efficiency and technological benefits that should be considered in terms of section 12A(1)(a)(i). It is anticipated that these benefits are to be derived largely from managing the proposed Eastern Cape cluster development on an integrated basis rather than as a series of separate, independent business units as is currently the situation.

The cluster development will consist of two forests, one is the forest currently held by the Hans Merensky Trust and the second forest is currently owned by Mondi in partnership with the IDC. In fact, the reason we were asked to hear this merger urgently was so that the parties could exercise an option on these forests before the 30 June 2004. These forests will provide the raw material input for saw milling, veneering and the production of value-added products, such as poles, door components and pine furniture. In addition the parties envisage the establishment of a particle board plant, which will “mop up” what would ordinarily go to waste, to make chipboard. This, say the parties, will make the cluster the most competitive cluster in the country. As a result of the total utilization of the tree, increased volumes, scale efficiencies and technological efficiencies are expected.

Steinhoff intends investing R700 million in the establishment of the particle board plant within the cluster, which is the reason for this merger. The parties are therefore of the view that these efficiencies are integrally linked to the merger. Steinhoff states that it would not make this investment if they did not wholly own PG Bison.

The documents pertaining to the Eastern Cape cluster development reveal that there is a great deal of negotiation still to be concluded and various subsidies and undertakings that need to be obtained from the government before the project will commence. In fact, the business development report prepared by Mr Stuart Wood, one of the directors at PG Bison, states that :

“The North Eastern Cape option is the only option that would dovetail with Steinhoff’s broader timber industry interests. Its viability is, however, still compromised by the higher cost of being a greenfields installation and the IDC’s expectation that the board plant can pay virgin log prices to sustain a premium price for Mondi’s share of NECF. No progress has been made with government on finding a basis for mitigating those costs. A task team established at the end of February has concluded without any meaningful contribution beyond a verbal undertaking to build the road and contribute 75% of the cost

of providing power to the area. Attempts to persuade government to be flexible in allowing Ferrostaal to invest in the project have been unsuccessful. It appears that government is assuming that PG Bison will undertake the project without any support. ^{28]} [paragraph contains confidential information]

At this point in time there appears much more work to be done to obtain the required financial support for the project. The project is, for now, a vision in the distant future and it would thus not be prudent to take account of any anticipated efficiencies.

In terms of section 12A(1)(a)(i),

“Whenever required to consider a merger, the Competition Commission or Competition Tribunal must initially determine whether or not the merger is likely to substantially prevent or lessen competition, by assessing the factors set out in subsection (2), and –

(a) if it appears that the merger is likely to substantially prevent or lessen competition, then 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 offset, the effects of any prevention or lessening of competition, that may result or is likely to result from the merger, and would not likely be obtained if the merger is prevented; and”

Given the provisions of this subsection, the proposed efficiency gain falls down in two respects. In the first place, as we have indicated, the still speculative nature of the cluster project means that it is at best a ‘possible’ outcome of the merger not a ‘likely’ one as the subsection requires.

Secondly, the subsection requires a showing that the efficiencies “*would not likely be obtained if the merger is prevented*”. We have previously held that this means that the efficiencies must be “*merger specific*” to be cognizable.²⁹ The evidence is that the expected efficiencies, will be realised as a result of the

²⁸ See page 801 of the record, document entitled “Business Development Report for the quarter ended March 2004.”

²⁹ Trident Steel (Pty) Limited / Dorbyl Limited, case no. 89/LM/Oct00, at page 19.

cluster development - not as a result of the merger. We are therefore of the view that they are not “likely” nor merger specific and cannot be taken into account in considering the merger.

However, since the undertaking given by the merging parties remedies the potential anti-competitive effects of the merger, we do not need to determine whether the efficiencies claimed outweigh the anti-competitive effects of the merger.

In any event there is no relationship between the undertaking and the efficiencies, thus even if we have to take account of the efficiencies, the undertaking does not detract from the efficiencies that are claimed. Since we were asked to accept the undertaking as a condition to the merger, any efficiency gains should they arise will also be passed on to other manufacturers.

Public interest

Employment

Once again the parties look to the Eastern Cape cluster development and submit that there are vital public interest benefits that must be considered in evaluating the merger.

The parties contend that the chipboard plant within the cluster development will create 280 direct jobs and approximately 1766 indirect jobs within the cluster development itself.

The same reasons for not taking account of the expected efficiencies apply in relation to the anticipated employment benefits. We are not convinced that the merger itself will result in the claimed employment opportunities. On the other hand there is nothing in the record to suggest that the merger offends the public interest.

Conclusion

We are satisfied that the condition to the merger suffices in remedying the potential anti-competitive effects of the merger. The merger is accordingly approved subject to the condition, as attached hereto .

N. Manoim

31 August 2004
Date

Concurring: D. Lewis, M.R Madlanga

For the merging parties:	Adv. W Pretorius instructed by Roodt Inc.
For the Commission:	Mr M Worsley, Legal Services Division, assisted by Mr M van Hooven, Mergers and Acquisitions division,