

**COMPETITION TRIBUNAL  
REPUBLIC OF SOUTH AFRICA**

**Case Number: 06/LM/Oct99**

**In the large merger between**

**Highveld Steel and Vanadium Corporation Ltd**

**Van Leer South Africa**

**and**

**Steelbank Merchants (Pty) Ltd t/a Drumpak**

---

**Reasons for Competition Tribunal's Decision**

---

**Approval**

The Competition Tribunal approves the merger without conditions. The reasons for our decision are set out below.

**The Transaction**

1. The transaction under consideration is the acquisition of the assets of Drumpak, a division of Steelbank Merchants ('Steelbank'), by Rheem South Africa ('Rheem'), a division of Highveld Steel and Vanadium Corporation Limited, a subsidiary of the Anglo American Corporation of South Africa Limited, and by Van Leer South Africa (Pty) Limited ('Van Leer'), a wholly owned subsidiary of Royal Packaging Industries Van Leer NV, a company incorporated in the Netherlands. The parties to the transaction all manufacture steel drums that are principally used for transporting and storing products of the oil, chemical and food industries.
2. The transaction originated in an approach by Steelbank to Rheem. Rheem initially rejected a proposal that it purchase the assets of Drumpak whereupon Drumpak approached Van Leer. Van Leer avers that it elected to purchase the assets of Drumpak because it did not want them to fall into the hands of its competitor, Rheem, and because certain of the assets in question could be profitably applied in conjunction with Van Leers existing assets. Van Leer and Rheem ultimately agreed to jointly

- purchase the assets of Drumpak.
3. The assets in question comprise certain plant and machinery and the intellectual property rights of Drumpak. The total consideration is R 9 642 525. According to the sale agreement between the parties, the consideration was structured to reflect a value on the material assets of R781 486, a further R2 000 000 in respect of intellectual property and R 1 461 039 for goodwill in respect of a restraint by Steelbank. In addition, the agreement provides for the payment of a further R5 400 000 in exchange for non-compete agreements with four executives in respect of the manufacture of a variety of industrial container products. However, in the course of hearings before the Tribunal, the parties, in response to queries regarding the striking premium paid on asset value, insisted that their valuation of the assets was, in reality, considerably higher than that reflected in the formal structure of the deal. We will return to this point below.
  4. The acquiring firms then entered into a separate side agreement between themselves. They agreed that Van Leer will export certain of the assets to Nigeria and will present proof of this to Rheem. Rheem and Van Leer will reach agreement with respect to the division of the remaining assets between them, failing which they will be scrapped. The assets that will be shipped to Nigeria include a welder and corrugator, key pieces of equipment in the manufacture of new steel drums.
  5. Steelbank avers that it elected to sell the assets because of the depressed state of the steel drum market and growing competition from the increased availability of substitute products. Its profitability is further threatened by the removal of a decentralisation grant that effectively enabled it to subsidise the price of its product and, hence, its market share.

### **The Relevant Market**

6. The parties have defined the relevant product market as the industrial containers market which includes bulk containers, plastic drums, reconditioned drums, bags, bulk tanks, bulk road tanks and fibre drums. The parties aver that, in the main, these are substitutes although they acknowledge that there are minor circumstances where the products in the relevant market may not be substitutable.
7. The Commission contends that the relevant market is somewhere between new steel drums and industrial containers, that is, the Commission acknowledges a degree of substitutability between new steel

drums and other industrial containers. Accordingly the availability of containers other than new steel drums will play a role in disciplining the pricing decisions of producers of new steel drums, but to a rather limited extent. However, the Commission has not been able to provide evidence that would specify more precisely the degree of substitutability between new steel drums and other industrial containers, and, therefore, the extent to which the availability of the latter disciplines the prices of the former. In fact, at the hearing of this matter, counsel for the Commission informed the Tribunal that the question whether 'arbitrage' would take place between new steel drums and the proposed alternatives had not been investigated by the Commission. In addition, it is far from clear where the Commission considers the boundaries of the market for industrial containers to be. Its calculations of market concentration in Annexure I to its recommendations imply a rather limited market for industrial containers, comprising only plastic and steel containers (Scenario 4 in Annexure I), while section 2 of the report contains a more extensive list of possible substitutes, which suggests a rather wider market for industrial containers.

8. The Commission further holds that the geographic market is confined to Kwazulu-Natal. The merging parties did not seriously take issue with the Commission's definition of the geographic market. Although Rheem criticised the Commission's conclusion in this regard in its written submissions to us, it failed to put forward a convincing argument for a wider geographic market. We therefore accept the Commission's recommendations on the geographic market.
9. In essence, the merging parties' interpretation of the evidence is that the opportunities for substituting alternative products for steel drums are considerable thus supporting a market definition that incorporates a wide range of alternate products. Indeed the target company attributes the decline, since 1994, in the volume of sales of steel drums, '...largely to an increase in the demand for and availability of substitute products.' In support of this claim the various parties argue that
  - Technological developments in the plastic industry have improved capacities, manufacturing costs and product performance resulting in a competitive product;
  - 1000 litre plastic intermediate bulk containers are the fastest growing industrial packaging container worldwide;
  - Reconditioned drums are substitutes for new steel drums. It is pointed out that 4 200 chemical drums enter South Africa each and every day and that these are reconditionable;
  - Actual substitution is already occurring. A plastic drum

manufacturer is tendering for contracts from large oil companies and that most of the oil industry is already using 1000L IBCs and reconditioned drums.

10. The parties do however acknowledge, without further elaboration, that each product will have its own advantages and disadvantages that will equate to a value which would be different to each customer.

11. The Commission's evidence, based on interviews with 24 of the 63 largest customers identified by the parties, conflicts sharply with that offered by the parties. Most pertinently, these customers point out that

- Toxic, high-hazard and flammable products can only be transported in new, 210 litre steel drums;
- Products including solvents, oil and chemicals can only be shipped and stored in new steel drums;
- Substitutability in the food industry is limited because a large range of food products are susceptible to contamination when stored in plastic containers;
- Plastic drums are considerably more expensive than steel drums and that they would not switch to plastic drums in response to a 5-10% increase in the price of steel drums;
- They would not readily switch to reconditioned drums because these products are not reliable or guaranteed and because of the poor image that they convey for the company;
- It is not economically viable to transport empty drums from suppliers in Gauteng and that accordingly they only purchase drums from suppliers in Kwazulu-Natal.

12. Drumpak challenged the validity of the Commission's representations based on interviews with the parties' customers, alleging that they were inaccurate and biased for a number of reasons. These included that –

- Drumpak had obtained written confirmation from customers contradicting some of the Commission's conclusions – for instance confirmation that other containers are substitutes for new steel drums for purposes of storing and transporting oil;
- many of the customers interviewed were insignificant players or did not buy steel drums in Kwazulu Natal.

13. Neither party has presented compelling evidence in support of their conflicting assertions on the degree of substitutability. While the Tribunal considered using its inquisitorial and other powers to generate more

conclusive evidence this would have caused a significant delay in the already prolonged evaluation of this transaction, a delay that has already caused considerable prejudice to a small party.

14. There are inferences that support either conclusion. On the one hand, the structure of the purchase price suggests that the parties themselves implicitly accept a narrower market definition than that asserted. A number of factors in the way the deal is structured have contributed to our scepticism:

- Although the parties conceded that the difference between the total contract price and the material assets was greatly inflated, they were unable to put a credible value to the assets, but assured us that the sale agreement considerably undervalues the assets. Yet the side agreement between the purchasers in which they *inter alia* divide the assets *inter se* seems to value the assets consistently with the valuation placed in the sales agreement when one would have considered the discrepancy to have manifested itself at this stage when the purchasers divide their spoils;
- Restraints on entering the market again are extensive and bind not only Steelbank, but its key executives, which is unusual in a transaction in a business not being sold as a going concern;
- Steelbank is further restrained from using certain productive capacity not part of the deal from competing in the container market or being sold to anyone who will use it directly or indirectly for the manufacture of drums;
- In their side agreement, the purchasers agreed to the division of the assets on the condition that the most productive assets were given to Van Leer to be used in the Nigerian market as we have outlined above.

The parties suggested that the purchase consideration was structured in the way that it was to suit the sellers and that the value put on the assets in that structure does not accord with their actual commercial value. However, absent a true commercial valuation of the assets, the Tribunal is unable to assess whether the premium is accounted for by the difference between the stated asset value and the actual commercial value, or whether the premium represents a payment for market domination thereby reflecting the capitalized value on the price and market share premium that they expect to glean in consequence of a diminution of competition. Given that this premium for market domination would not be generated if

- substitution occurred from producers of products alternate to steel drums, it may be inferred that the parties themselves implicitly accept a narrower market definition than that asserted.
15. Our skepticism of the transaction is further underlined by the resolution passed by the directors of Highveld Steel on 18 August 1999, in which they approved the transaction because it would give Rheem 'the opportunity ... to participate in an additional market of approximately 200 000 new drums per annum', which was the annual output of Drumpak directly prior to the transaction. This clearly suggests that Highveld Steel's directors viewed the transaction as an opportunity to remove the capacity of a competitor in the market for new steel drums. This would only be of value to the purchasers if the relevant market was constituted by new steel drums, that is, if new steel drums were not substitutable by other products in the industrial container market.
  16. On the other hand, given that the well-informed and well-resourced purchasers of steel drums have not approached the Commission or the Tribunal, we may draw the inference that they believe that there are substitutes in the market that will effectively discipline the price of new steel drums.
  17. In the event, the Tribunal is unable to make a conclusive finding on the relevant market – in the unsatisfactory characterization offered by the Commission, it falls 'somewhere between new steel drums and industrial containers'.

### **Market Power**

18. Unfortunately, however, arriving at a firm conclusion regarding the post-acquisition share of market power depends, in significant part, on knowing where on the spectrum 'between new steel drums and industrial containers' the relevant market is to be found. We hasten to add that it is near impossible to define relevant markets with absolute scientific precision. However, the evidence offered by the Commission and, alternatively, by the parties falls well short of the standard required for conducting a market power analysis.
19. In assessing market power, that is in assessing whether the merger will substantially prevent or lessen competition, the Act enumerates a number of factors that are to be taken into account. These factors are ease of entry into the market, the level, trends and history of collusion in the market, the degree of countervailing power in the market, the dynamic

- characteristics of the market, whether the business of a party to the merger has failed or is likely to fail, and whether the merger will result in the removal of an effective competitor.
20. The parties cite the activities of Sirco Systems as evidence of relative ease of entry into the market for steel drums in Kwazulu Natal. Sirco is a US based firm that produces new steel drums using a novel technology. Essentially the component parts of the drum are imported and the drums are built on the site of the customer. However, investigation by the Commission reveals that Sirco has been selling steel drum kits in South Africa for over two years in which time it has only been able to gain one customer. In that period it has sold about 9000 drums to the customer these being specialized resin drums that cannot be produced by any of the steel drum manufacturers in South Africa. Most of the customers interviewed by the Commission had not heard of Sirco, which does not have an agent in South Africa. Moreover it appears that Van Leer's parent company owns a controlling interest in Sirco. Sirco does not offer evidence of ease of entry into the market and, in any event, given its relationship to Van Leer, is not an independent competitor.
  21. While no evidence has been presented that suggests a previously collusive relationship between Van Leer and Rheem, the process of this transaction is a disturbing indicator of their ability to co-operate in the removal of a competitor. This experience certainly enhances their ability to collude and the post-merger structure of the market lends itself to collusion. The Tribunal earnestly recommends that the Commission closely monitor developments in this market.
  22. Demand for new steel drums is concentrated amongst a relatively small number of large companies in the oil, chemicals and food industries suggesting a high degree of countervailing power. While it is not clear how these admittedly powerful companies would exercise their power against a duopoly of producers of new steel drums, their silence during the course of this enquiry is conspicuous. Either they accept that there are substitutes for new steel drums or, alternatively, that their tendering process would maintain the requisite degree of competition between the two remaining producers of steel drums. Given the high cost of transporting empty drums the threat of international procurement does not seem significant.
  23. The manufacture of steel drums is an established technology and – Sirco's drum kits notwithstanding – there is no evidence suggesting that this is a dynamic or innovative market. However, there is, to be sure,

- evidence of innovation in alternative materials (plastics, most notably). There is evidence to suggest that producers active in plastic packaging are increasing their capacity. Given the uncertainty surrounding the definition of the relevant market, we are unable to reach a firm conclusion regarding the dynamism of the market – if steel drums are not substitutable then the technology is mature and the market is relatively ‘un-dynamic’; if other industrial products are substitutable for new steel drums then the market appears relatively dynamic and innovative.
24. The parties have made much of the failure of Drumpak. They point out that prohibition of the merger would not restore Drumpak and that, accordingly, the level of competition in the market would not be improved by prohibiting the merger. This argument is rejected. That the operational aspects of the transaction were completed precipitously by Drumpak cannot be advanced as adequate ground for the Tribunal to condone an anti-competitive acquisition. Furthermore, the Tribunal does not question Drumpak’s right to exit the market or to sell its assets. At issue is the sale of assets to a consortium of its competitors. Had the Tribunal been persuaded that these were its *only* competitors, that is, that the relevant market was steel drums rather than industrial containers, the fact that Drumpak had caused itself to fail by effective implementation of the merger would not have deterred the Tribunal from prohibiting the transaction.
25. All the evidence confirms that Drumpak has been an effective competitor in the market. It is common cause that Drumpak’s entry into the market coincided with a considerable softening of prices for new steel drums. It has been suggested that the softening of prices may have occurred in consequence of the availability of competing products. It has also been suggested that its ability to discount its price was dependent upon a state subsidy to which it no longer enjoyed access. Alternatively it may be argued that Drumpak’s recent troubles were, in common with many other small producers, a product of general economic malaise. Again, here, the evidence presented by both parties leaves much to be desired.
26. In summary, the Tribunal has been presented with a welter of inconclusive evidence. We stress that while transactions of this sort may have extremely harmful effects on competition and hence are subject to regulation, merger regulation is not intended to establish culpability on the part of any party; there is, in other words, no presumption in the Act that mergers are, *per se*, likely to inhibit competition and that they are to be discouraged, much less prevented. On the contrary they may be part of the necessary process of economic restructuring. Accordingly, when the

Commission recommends that a transaction be prohibited, the Tribunal will insist on a higher standard of evidence than that presented here. While the parties have failed to establish that their merger will not harm competition, this is not sufficient to prohibit the transaction.

### **Public Interest**

27. Drumpak employed some 32 workers, most of whom had secured alternative employment when Drumpak ceased operations. Employment loss is accordingly minimal. No other public interest issues are relevant in this case.

28. Accordingly, the Tribunal orders that the transaction be allowed to proceed unconditionally.

---

**D.H. Lewis**  
**Presiding Member**

---

**Date**

**Concurring: N.M. Manoim and P.E. Maponya**