COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA

Case no.: 08/LM/Feb04

In the large merger between:

LNM Holdings N V

and

Iscor Ltd

Reasons

Introduction

On 8 June 2004 the Competition Tribunal approved the merger between LNM Holdings N.V. and Iscor Limited. The reasons for approving are set out below.

Iscor was founded in 1928 by the South African Government and was privatised in 1989. Since the unbundling of Kumba (previously Iscor's mining division) in 2001, Iscor has become Africa's largest steel company. It produces iron and steel at four plants in South Africa, at Vanderbijlpark, Saldanha, Newcastle and Vereeniging.

Established in 1976, the LNM Group is the second largest steel maker in the world. It operates steel making plants in 13 countries and is a major supplier to the automotive industry and the appliance industry in the European Union and North America. It has a history of acquiring government steel facilities that under-perform and thereafter improving their operating performance. Since 1989 it has made 11 acquisitions in ten different countries: Algeria, Canada, France, Germany, Kazakhstan, Mexico, Romania, Trinidad Czech Republic and the USA.

The transaction

In 2001 LNM bought 34.8% of the issued shares in Iscor on the JSE and entered into a three-year Business Assistance Agreement ("BAA") with LNM. The BAA was concluded at the time of the unbundling of Iscor, with a view to assisting Iscor in improving efficiencies and cost-savings. By receiving new technology and skills from a global partner it was believed that Iscor could participate more effectively in the global steel industry. LNM, in terms of the BAA, provided business, technical, purchasing and marketing assistance to Iscor. As part of the BAA, LNM undertook to invest in Iscor shares and in February 2003, LNM increased its shareholding to 47%, following an offer to minority shareholders.

In terms of the BAA, Iscor remunerated LNM at the end of 2003 for its technical assistance in ensuring that Iscor achieved the specific threshold cost saving levels. [1] Pursuant to this remuneration LNM is, in terms of the BAA, acquiring a further shareholding in Iscor, which will result in LNM holding 50% of Iscor's issued share capital. The parties claim that LNM will control Iscor subsequent to this transaction.

The parties

The primary acquiring firm is LNM Holdings B.V. ("LNM"). LNM is a wholly owned subsidiary of Richmond Investments Holdings Ltd ("Richmond"), registered and incorporated in the British Virgin Islands.

The Mittal family owns the entire share capital of Richmond. The LNM group consists of LNM Holdings N.V., Ispat International and Ispat Indo.

The target firm is Iscor Ltd ("Iscor"). Iscor is a public company listed on the JSE securities exchange. The parties submit that no single shareholder currently controls Iscor. Its two major shareholders are LNM, holding 47.23%, and the IDC with 8.79%.

Rationale for the transaction

According to the parties the BAA is due to terminate at the end of 2004, and it is LNM's policy not to release its proprietary technological know-how to entities that it does not control. Once LNM controls Iscor, it is prepared to provide Iscor with proprietary technology as well as give access to certain proprietary marketing and procurement processes that will improve Iscor's competitive position in the international market. Iscor recognises that in order to participate in the global

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[1] LNM was initially remunerated in the form of Iscor shares but this was amended in December 2003 to provide for payment in either shares or cash. See Iscor Limited Group report 2003 page 98.

steel industry, it needs LNM's continued assistance as an international steel partner.

Relevant market

Both Iscor and LNM compete globally on the steel market. Both companies produce flat and long steel products, wire products and coke and both are involved in shipping services[2].

The largest competitors in the global steel market are:

Competitors	**Market Share Total Steel Production %**
Arcelor	4.8
LNM	**3.8**
Nippon	3.3
Posco	3.1
Shangai	2.2
Iscor	**Less than 1%**

Post the merger, the combined market share of Iscor and LNM would be less than 5% of world steel production. Iscor will represent 14% of the LNM Group's turnover post the merger.[3] According to Iscor's Limited Group Report 2003 of all the operations in the LNM Group its steel shipments are the largest. [4]

In 2003 LNM, through its European subsidiary Ispat Trefil Europe, made direct steel sales into South Africa of 155 metric tonnes and in 2002 indirect sales of 1299 metric tonnes through steel merchants. These sales represent less than 1% of total steel sales in South Africa and, according to Iscor, had no effect on its steel pricing policy.[5]

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[2] Ispat Shipping acts as shipbroker for LNM and does not provide services to third parties. Iscor through its associate company, Macsteel, does not provide any shipping services to LNM.
[3] The LNM Group consists of LNM Holdings Group, PT Spat Indo and Ispat International.
[4] This is not to suggest that we accept the merging parties view that the market is an international one. We do not need to decide that question here and we have proceeded to examine the merger from the point of view that the market may be a domestic one.
[5] LNM also sold 329 metric tons in 2001 and 47 MT in 2002 in the South African market.

Iscor's products are priced at import parity and it provides various discount programmes such as volume discounts, rebates for value added exports, and strategic rebates to its customers.

Analysis

The merger raises three possible concerns that we evaluate separately. They are whether -

1) LNM as a potential competitor of Iscor might have had an effect of constraining Iscor's pricing policy.

2) Iscor with LNM, as an owner and a global steel player, will have different incentives to an Iscor with no dominant shareholder

3) LNM, as the controlling shareholder, will embark on a policy of retrenchments that the existing Iscor would not have.

Potential competition

LNM cannot be considered a participant in the local market – from what we have seen above, its sales in South Africa over a three-year period are too erratic and too small. However LNM may still have had an effect on the domestic market if Iscor perceived it as a credible potential entrant and constrained its prices accordingly. There appears to be no evidence that this is the case. Whilst Iscor, as we discuss below, does have a policy of strategic discounts, which seems premised on discouraging imports, it does not appear to fear entry from any particular manufacturer. Rather, it appears more concerned that steel merchants will become a source for imported products on a sustained basis.

For its part LNM does not appear to favour grassroots entry. Rather, as its history illustrates, its strategy has been to acquire incumbent firms with the potential for turnaround. That suggests that other than through acquisition, it was an unlikely entrant. Would LNM if it wished to enter the South African market have acquired another firm that competes with Iscor? Given Iscor's size in the local market, and its own willingness to seek a strategic technology partner, it seemed the only likely target for LNM, if it was to consider a local acquisition.

For this reason we conclude that LNM presence in the international market had no constraining effect on Iscor in the domestic market and the merger raises no potential competition issues.

Change in incentives due to the change in control

Another possible way in which competition might be affected by the merger, would be if LNM had different incentives to the current Iscor management that might alter the manner in which the company behaved.

In order to explore this issue we called, as a witness, Simon Nash who is the executive chairman of Cadac, a manufacturing company who manufactures industrial gas cylinders, barbeques, cookers and various other appliances. Mr Nash has recently been an outspoken and articulate critic of Iscor's pricing policies and we felt that we would benefit from hearing his perspective on this point.

Cadac is one of the quintessential South African brand names. The word braai and Cadac have become inextricably coupled in the local culinary lexicon. Yet no longer, according to Mr Nash, will there be this association, for the proverbial cooking cylinder bearing that name has exited the market. Its demise, says Mr Nash, is due to high steel prices. Steel constitutes 60% of the retail price of a cylinder and his product is no longer competitive against rival imports. Cadac, which once had 100% of the cylinder gas market, now has none.

Mr Nash makes a number of interesting claims. Firstly, his domestic customers can purchase an imported, fully manufactured cylinder at a price lower than what he pays the steel merchants for the steel that goes into a cylinder. Secondly, that one competitor from Portugal is able to buy steel from Iscor, import it into Portugal and then sell its finished cylinder in South Africa at prices much less than he can achieve. These differences in price, he blamed on Iscor's policy of discriminating between its domestic and foreign customers.

Cadac's problems stem from a decision made by Iscor a few years ago to stop manufacturing steel in 5-ton coils and to sell only 20-ton coils. Since Cadac requires the steel it purchases to be in 5-ton coils it was forced to purchase from local steel merchants who purchase from Iscor and then cut the steel to the required size. Unfortunately for Cadac the price of the steel subsequently rocketed.

Mr Nash complained regularly and was led a merry dance by the merchants and Iscor, each of whom blamed the other. Nor were merchants any more forthcoming about importing steel. He says a request for another source was ignored for a year by one of the merchants.[6]

Even though his firm was eligible for an export rebate this was negligible and could not make him competitive with foreign rivals importing into South Africa.

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[6] Mr Nash testified that when he asked an executive of Trident Steel, one of the large merchants, why they wouldn't import steel for him he was told: "*Simon we only deal with Iscor*".

The question put to Mr Nash was whether the acquisition of LNM would make his firm's situation any different to what it was. His view was that it could. In conversations he had had with senior executives from the steel merchants he had been told that Iscor had become far more aggressive about the way in which it priced since LNM had acquired its interest.

We have no reason to doubt that this is what Mr Nash has been told. However, what we may be witnessing is an attempt by the merchants, and possibly incumbent Iscor management, to find a scapegoat for a pricing policy that the firm would adopt, regardless of the identity of the controlling shareholder. Iscor's pricing policy, warts and all, suits shareholders, whether they reside in London's most expensive home or a more modest local hovel. They are the actions of a rational profit maximising firm enjoying Iscor's position in the domestic economy.

We are not here to decide whether Iscor is allegedly abusing a dominant position - we are only called upon to decide whether the acquisition of control by LNM will lead to a substantial lessening of competition from what it is now. In a nutshell, although they have of course not expressed it as such, Iscor and LNM's case is that it makes no difference since it cannot get worse. Iscor candidly states its prices at import parity ('IPP') while LNM candidly states that it:

> *"made its decision to invest in Iscor on the basis that Iscor prices steel consistent with the prevalent global steel markets. "*[7]

But there are some nuances to the import price parity model that we must consider. Firstly Iscor does not uniformly charge up to IPP and there are occasions for departure. Mr Charles Dednam, a senior executive at Iscor responsible for pricing and marketing policies, testified that Iscor offers a number of strategic discounts and rebates to its customers i.e. at prices less than IPP. It appears that the policy is premised partly on encouraging firms that beneficiate steel to enter export markets and partly to protect its back from other products or producers, hence the use of the word 'strategic' discount.

Will an independent controller still have the incentive to provide these discounts? Mr Dednam assures us that due to their strategic nature they are the type of discount policy any controller would adopt. In other words they are a function of Iscor's market position not some sentiment infused by patriotic jingoism that only a local controller would exhibit.

It is worth noting, that not only does the discount system extend to only a small fraction of the steel traded domestically, but also that when granted is of little substantial relief to the customer. Thus even if it were to be discontinued by LNM or drastically reduced, it would not have much effect on the market. As Mr Nash

[7] Record page 786

put it in his testimony when we asked him whether the R200 per ton rebate would have made him competitive with his Portuguese rival:

> *"No, we need R 2000 a ton, not R200."*[8]

Nevertheless, interesting in this regard has been the initiative of the Department of Trade and Industry (DTI). Concerned over complaints that it had received from downstream domestic purchasers that high steel prices from Iscor were making them uncompetitive, the DTI made overtures to LNM to enter into an agreement over what the DTI terms a 'developmental pricing model'. The DTI has explained its motivation. While it recognises that the investment of LNM will lead to much needed efficiencies in Iscor's operations it is also concerned over the competitiveness of the downstream industry. The DTI wants Iscor to pass through some of these efficiency gains to its domestic customers. It met with LNM in London in May this year to pursue discussions.

On 5 May 2004 a memorandum of understanding was entered into between the department and LNM. Although the terms were initially confidential, when asked to do so at the hearing, the parties agreed to make the contents public.

The DTI indicates that as a result of this agreement its initial concerns about the merger have been allayed.[9] The memorandum does not set out the developmental pricing policy model, but rather provides that:

> *"LNM commit themselves to – as soon as possible after attaining a majority shareholding:*
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> *a. To conclude an agreement with the Department of Trade and Industry on a sustainable, competitive pricing model to achieve the objectives as set out in 6. above, provided such model is compliant with World Trade Organisation rules and principles; and*
> *b. To the implementation of this pricing model.*
> *c. To ensure that Iscor service centres participate in achieving the objectives as set out in 6. above.*
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> Clause 6 states:
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> > *"Whereas LNM desires to develop its liquid steel capacity from about the existing 6m MT per annum to approximately 9m MT per*

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[8] Transcript page 29.

[9] In a letter to the Competition Commission dated 19 February 2004, the then Minister, Alec Erwin, had written *"Accordingly, we wish to advise the Commission that we support the merger between Iscor Ltd and LNM Holdings subject to agreement – between the companies applying for the merge,r and the Minister of Trade and Industry -on a suitable developmental pricing model for domestic purchasers of steel."* Record page 712.

annum, including the redevelopment of Saldanha to a level of approximately 2m MT per annum."

As this language makes clear the parties have not yet reached an agreement, but have only agreed in principle to do so. If the existence of this agreement was material to our decision we may have been concerned with the non-binding nature of the memorandum. However, we will consider the merger as if the agreement had not been entered into – i.e. as if Iscor via LNM as its new controller had not committed to a new pricing model of the kind envisaged by the DTI. This is not to suggest that either of the parties is not committed to the further process, and indeed there is nothing to indicate that they are not – but that for our purpose we must proceed in a spirit of pessimism and to see that if our darker vision prevails, there is any greater danger to competition in the absence of an accord.

Given what we have said above in our view it will not. At worst the status quo will prevail and that is not a situation created by the merger, but the present structure of the market.

LNM has, in terms of the BAA, been entitled to appoint two directors to the board of Iscor and was later given permission by the Iscor board to appoint a further nominee. Despite their presence on the Iscor board we are told that LNM's nominees recused themselves from discussions over pricing issues. Thus their future plans cannot be discerned from their conduct on the present board.

It has been difficult of course to predict the behaviour of LNM as a controller not least of which is due to the firm's own reluctance to make its intentions known. Whilst, after some prodding, we were given sight of the due diligence it conducted when it first invested in Iscor, this exercise did not prove particularly illuminating. The report was prepared by various consultants and manifested their view of the present Iscor business - it did not betray the mind of the putative controller. Asked at the hearing if there were any documents in existence, which might have been more revealing of their plans, we were informed by Mr Maheshwari, the Chief Financial Officer of LNM, that there were not.[10]

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[10] When asked whether there was any written recommendation, which informed the Board on what kind of an investment it was making Mr Maheshwari answered as follows: " *…at the level of LNM Holdings and we, for example, which is principally a private company, the process is slightly different than it would be in a publicly quoted company, for example. Although the essence of it is the same, the process engaged is as elaborate as it would be in a public company, but when it comes up to the Board, the executive team of the company, which also includes principally most of the Board members of the company, they have already participated in the deliberation and the decision making process. So at the end of the day when it comes up to the Board, there's basically a formalisation of the decision that has been made in order that any transaction document can be executed. So, when it comes up to the Board, it would not be as elaborate as it would be towards the building blocks, reaching to that level.*" See page 98 of the transcript.

We are thus in the situation where we know more of Mr Mittal's plans for his daughter's wedding than we do of his marriage with Iscor. Granted, LNM has provided us with documents stating its group philosophy and brief histories of how it has approached past investments, the suggestion being that its eventual plans for Iscor will be consistent with this overall approach. Unfortunately these policies are stated in the broadest terms and do not suggest how they may impact on the strategic behaviour of Iscor.

We are thus left to consider the merger from the point of view as to whether the change in identity of the controller to LNM will make Iscor more likely to behave in a manner likely to harm competition than it does presently. The short answer is no.

Effect on employment

We received submissions from two of Iscor's unions Solidarity and the National Union of Metalworkers of South Africa (Numsa). Both have understandably been concerned at the massive reduction in employment that has occurred at Iscor in recent years. According to figures from Numsa, Iscor's employment levels went from 44 000 in 1980 to 12 200 in 2004. Most of these jobs, on these figures, were lost between 1980 and 1997, thus preceding 2002, the year in which LNM acquired its first investment in Iscor.[11] Both unions allege that LNM has a reputation as a job cutter; part of its miracle cure of turning around ailing steel companies, they say, is to lower the wage bill.

For instance Solidarity states in its submission that it has undertaken:

> *"extensive research on the history of LNM's lay-offs world-wide and related matters within Iscor, and noted media reports on the interaction and relationship between the Mittal clique and LNM."*[12]

Numsa states that:

> *"LNM and Iscor collaboration has resulted in massive job losses to our members."*[13]

LNM denies this and argues that it has had a good relationship with organised labour when it has taken over. Indeed, LNM submitted much material to demonstrate the good relationships it develops with the communities where it has

[11] According to Numsa in 1997 employment was at 18 000.
[12] Record page 1259
[13] Numsa's submissions dated 3 June 2004, record unnumbered page.

plants.[14] But more importantly it argues that the unions have failed to show a nexus between the loss of jobs and the intentions of LNM.

One of the issues that the unions were initially concerned about was the BAA that LNM had entered into with Iscor that we referred to earlier in this decision. Recall, this was the agreement where LNM was to be remunerated with shares in Iscor in return for introducing cost savings. However, the agreement is clear that the savings exclude labour savings. The unions have had sight of the agreement since their initial representations and do not dispute this. LNM also maintains that it has not been involved in decisions around employment issues. As far as future employment is concerned it appears that there are no specific plans to depart from existing Iscor policies.

Neither Numsa nor Solidarity offered any oral representations at our proceedings relying instead on their written submissions.[15] For this reason LNM's submissions on the employment issues have not been refuted. The unions have alleged, but not established, any link between Iscor's current employment policies and the influence of LNM. Their absence from the debate at the hearing has not made their case any stronger.

Conclusion

Therefore, in our view the merger will not have a merger specific effect on employment policy at Iscor nor will it have an adverse effect on any other public interest the Act seeks to protect. Nor, for the reasons we gave earlier, will the merger lead to any substantial lessening or prevention of competition. For this reason the merger is approved unconditionally.

____________ 05 July 2004

N Manoim **Date**

Concurring: M Holden, U Bhoola

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[14] By way of example, in Romania where it acquired a plant following a privatisation, it has built a church near the plant for its workers earning it high praise from the local bishop who awarded Mr Lakshmi Mittal the Diploma of Great Founder of Holy places.

[15] It is worth noting that although the Unions both filed written representations neither chose to be represented at the hearing, although they were entitled to do so.