

COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA

Case Number: 17/AM/Mar01

In the matter of

FOOD AND ALLIED WORKERS UNION Applicant

And

THE COMPETITION COMMISSION First Respondent

McCain Foods (SA) (Pty) Ltd Second Respondent

HEINZ FROZEN FOODS (PTY) LTD
Represented by HEINZ SA (PTY) LTD Third Respondent

REASONS

APPROVAL

1. On 11 April 2001 we approved the intermediate merger between McCain Foods (SA) (Pty) Limited (“McCain”) and Heinz Frozen Foods (Pty) Limited (“Heinz”) subject to conditions as listed in our order at the end of this decision.
2. This merger was approved by the Competition Commission (“Commission”) subject to conditions in terms of section 14(1)(b)(ii) of the Act. The Food and Allied Workers Union (“FAWU”) has requested us to consider the Commission’s approval of this merger in terms of section 16(1)(b) of the Act. Our approval of the merger effectively confirms the decision of the Competition Commission. The reasons for our decision follow.

BACKGROUND

The Merger Transaction

3. McCain is acquiring the entire issued share capital in Heinz. Heinz is controlled by Heinz South Africa (Pty) Limited who holds 65% of the issued share capital in Heinz; Sentraalwes Limited owns the balance of the shares. Heinz South Africa

(Pty) Limited is a subsidiary of HJ Heinz Company which is incorporated in the US. Heinz is involved in the procurement, processing and sale of frozen potato chips to the retail and catering industries in South Africa. As part of the transaction all employees of Heinz will continue to be employed on the existing terms and conditions of employment. This is the transaction presently under consideration.

4. McCain is a wholly owned subsidiary of McCain Foods based in Canada. Its business in South Africa is in the procurement, processing and sale of frozen vegetables and potato products to the retail and catering industries. McCain entered this market last year through an acquisition of the vegetable and potato processing businesses of Irvin and Johnson (“I&J”). This latter transaction, an intermediate merger, was unconditionally approved by the Commission. For reasons that will become apparent below, it is important to record that in its evaluation of the McCain/I&J transaction the Commission was not made aware of potential consequential employment losses, a public interest aspect that, in terms of Section 12A(3)(b), must be considered in the process of merger regulation. In notifying a transaction it is incumbent upon the parties to disclose any potential employment losses.

The Decision of the Competition Commission

5. The merger presently under consideration was filed with the Commission in December 2000. This is an intermediate merger and, as such, in terms of Section 14(b), the Commission is empowered to prohibit the transaction or to approve it, conditionally or unconditionally. FAWU, the Union representative of a great many of the employees of both parties, participated in the proceedings before the Commission. FAWU submitted that the merger should be prohibited on the grounds that it will lead to a reduction in competition and will also have a detrimental effect on public interest.
6. The Commission did not accept the arguments submitted by FAWU and accordingly approved the transaction. It did however attach a condition to its approval, viz., it required that the merged entity restrict the employment loss consequential upon the transaction to no more than seven employees and that for the next eighteen months it submit a monthly report to the Commission detailing its employment totals.
7. FAWU has, in terms of Section 16(1)(b) of the Act, asked the Tribunal to consider the Commission’s decision to approve the merger. In line with the Union’s submissions to the initial merger review procedure it presents two grounds for consideration. Firstly, it argues that the merger will lessen competition. It argues that the Commission has erred by defining the relevant

market too broadly. Second, it presents public interest grounds for consideration. In particular it argues that the employment loss consequent upon the transaction justifies prohibition of the transaction.

THE REASONS FOR OUR DECISION

The Impact of the Transaction on Competition

8. FAWU argues that the Commission erred in its identification of the relevant market. By specifying the market too broadly the market power that would accrue to the merged entity had been significantly underestimated.
9. The parties have contended for a relevant market that includes frozen potato products, fresh-cut potato products and table potatoes. The Commission has, in its analysis, adopted the same definition of the relevant market. In its report the Commission considered that the relevant market could arguably be defined as comprising only frozen and fresh-cut potatoes. It appears however that it was not persuaded to exclude fresh potatoes from the market by the evidence before it because its analysis is based on the wider relevant market that includes fresh table potatoes. Fresh table potatoes refers to washed or unwashed potatoes that are unpeeled and uncut. The Union, by contrast, contended for a narrower definition of the relevant market. It argued that the relevant market is the market for the sale of processed frozen potato products to the retail and food services industries in South Africa. By this definition, argued the Union, the merged entity would enjoy considerable market power. Hence, averred the Union, the transaction should have been impugned on competition grounds.
10. It is common cause that on the Union's definition the market share of McCain would increase from its current 50% to approximately 75%. Indeed, in the McCain board papers at which the transaction was discussed a combined share of 85% of the frozen potato products market is mentioned. While market share on its own is not determinative of the outcome of a merger evaluation it is indicative of possible competition concerns and this would represent an extremely high market share indeed.
11. Conversely, if the relevant market contended for by the Commission is accepted – comprising both frozen potato products, fresh-cut potato products and table potatoes – then the pre-merger market share of both parties and the post-merger share of the merged entity decreases significantly to 11.11% relative to the share that emerges on the Union's definition.
12. As in relevant market definition generally, the outcome centers around evidence regarding the degree of substitutability between the products in the respective market segments. In support of its view the Union contends that frozen and fresh-

- cut potato products are not substitutable. The Commission and the merger parties hold otherwise.
13. Where the sale of these products to the food services industry is concerned compelling evidence of substitutability between frozen and fresh-cut potato products, on the one hand, and table potatoes, on the other, has been presented. The principal difference between frozen and fresh-cut potato products is the longer shelf life of approximately six months enjoyed by the frozen-cut potatoes. The main difference between fresh-cut and fresh table potatoes is that the fresh-cut potato products are always washed, peeled, sliced, have whitening agents added to them, chilled and packed while table potatoes are uncut and unpeeled.
 14. The Commission presented evidence that some fast food outlets use fresh table potatoes exclusively in the manufacture of their chips, for example, the Steers franchise, one of the largest sellers of chips in South Africa, which uses table potatoes only. In interviews conducted by the Commission customers and competitors of the merging parties in this industry expressed the view that were prices of frozen and fresh-cut potato products to rise significantly the customers could switch to table potatoes.
 15. The merging parties presented evidence to the Commission that the use by customers in this industry of frozen and fresh-cut potato products is varied. For example, almost 80% of the chips sold by Ocean Basket, a fast food outlet, are sourced from fresh-cut potatoes while the figure is approximately 40% for Spur Steak Ranches. Furthermore, it appears that these proportions – that is, of frozen to fresh – is not static. The price of potatoes naturally fluctuates seasonally and, although we were not presented with rigorous data to this effect, the inference is that when the price of potatoes increases, large customers move to frozen product.
 16. There is evidence that customers can and have switched between frozen and fresh-cut potato products. The Commission's investigations revealed, for example, that Nando's, a large player in the food services market, used fresh-cut potatoes for its chips until approximately three years ago when it switched to frozen potato products. However, the investigations also revealed that substitution from frozen to fresh-cut potatoes is easier than substitution from fresh-cut potato to frozen potato products. Even though the cooking equipment remains the same the customer making the switch from fresh-cut potato to frozen potato products has to acquire freezers and increase its storage capacity. While fresh potatoes are generally delivered everyday, frozen potato products are delivered about twice a week. Customers wishing to switch from frozen potatoes to fresh potatoes face none of these difficulties.
 17. Generally speaking it would seem that while there is evidence that it is open to a customer to switch between the two potato products, switching from fresh-cut

potato to frozen products is more onerous.

18. It should also be noted that post the merger there will still be three active competitors in the market for frozen potato products. It appears that as a result of the uncertainty surrounding this merger Heinz has been losing market share to Oceana, a relatively smaller competitor in the frozen potato product market. Oceana principally acts as a supplier to McDonalds in South Africa but has been recently increasing its market share at the expense of Heinz. As a result Heinz claims that its revenue has dropped by approximately 20% over the period December 2000 to March 2001.
19. The parties also aver that there has been a move towards imports in the frozen vegetables products - Heinz SA imports frozen vegetables for Shoprite Checkers and Wooltru. There is an import tariff of 20% on frozen potato products. The parties claim that if prices were to rise significantly in SA then their customers could not only switch to fresh potato products but also to imported potato products. The parties note that their customers in the retail trade are mainly large chain stores who could use their leverage to get competitive import prices despite the tariff.
20. It appears that barriers to entry into the fresh-cut potato market are very low, the Commission estimates that about R10 000 can secure a prospective entrant a small fresh-cut chip operation. The raw material, potatoes, are readily available in South Africa. In any event a prospective entrant into the market could conceivably grow its own potatoes. The manufactured products may then be sold to the small retailers and caterers who do not have the storage and stockholding capacity required to use frozen potato products. While the cost of entry into frozen potato is considerable the parties point out that there have been at least four new entrants in the past several years, including the merging parties themselves. Branding appears to play a very limited role in this market. In both frozen and fresh-cut potato markets the evidence is that competitive pricing, quality and efficient service is more important to customers than the brands. The food services customers buy the potato products for conversion into chips in accordance with their specification, which they on-sell to consumers under their own brand name.
21. In summary we accept the parties' arguments that frozen and fresh-cut potato products are substitutable for one another in the food services market where customers seem to shift between the two products quite easily. Substitution is somewhat less easy in the retail market. It appears that the retail industry, which sells the products largely unchanged, would prefer the frozen potato products because of their longer shelf life. However our concerns in this area are ameliorated by the sheer size of most of the buyers, who are chain stores, and their consequent countervailing buyer power. The size of these customers would

not only allow them to exert a disciplining influence on the pricing by the producers but, as is the case with the current arrangement between Heinz SA on the one hand, and Shoprite Checkers and Wooltru on the other, in the frozen vegetables market, they would be able to source products from abroad.

22. We therefore conclude that this transaction is not likely to substantially lessen competition in the relevant market.

The Impact of the Transaction on Employment

23. Section 12A(3) of the Act requires the relevant competition authority to determine whether or not a merger can be justified on specified public interest grounds. The public interest grounds specified include the transaction's impact on employment. The Union has asked that the merger be prohibited because of its deleterious impact on employment.
24. The Union's argument on this point is unusual. It is common cause that the transaction in question will lead, directly at any rate, to a minimal loss of jobs – seven jobs in all - and then only at the higher, more mobile and re-employable end of the workforce. Furthermore, the Commission has imposed a condition on its acceptance of the merger that limits employment loss to these seven positions and requires the company to report its employment figures to the Commission each month for the next 18 months. However the Union argues that the full extent of the job loss arising from the transaction incorporates the 362 retrenchments in McCain's frozen vegetable ('non-potato') division.
25. As explained above, McCain acquired its frozen vegetable business from I&J some 9 months ago. Essentially the Union argues that the transaction presently under consideration manifests a decision by McCain to move out of the production of frozen vegetable (non-potato) products into frozen potato products. It is this decision – concretely manifest in McCain's decision to purchase the Heinz potato products business – that accounts for the retrenchment of approximately one-third of the workforce employed at McCain's recently acquired frozen vegetable division.
26. McCain denies the existence of any link between this transaction and the retrenchments taking place in its frozen vegetable business. McCain strongly disputes the notion that it intends exiting the frozen vegetable products market. In support of its contention it points to the considerable capital investment that it has already made or committed to since its acquisition of the I&J division. In general it should be

noted that McCain has in the very recent past made a significant investment in the frozen vegetable market in this country. This purchase, it is common cause, gives it a very substantial share of the South Africa frozen vegetable market, a market considerably larger than the frozen potato products market. This investment complements McCain's significant involvement in the procuring, processing and distribution of frozen vegetables in a great many national and regional markets across the world. None of these incontrovertible facts accord with the actions of a party intent upon exiting the market. Moreover McCain also avers that it did not initiate the process that led to the purchase of the Heinz assets. On the contrary, it arose as a consequence of Heinz's wish to exit an unprofitable business. This sequence again does not reflect the actions of a party intent upon exiting one line of business in favour of another. It is clear to us that McCain's actions rather evidence the company's intention of establishing strong positions in the South Africa markets for both frozen vegetable products and frozen potato products.

27. Against this, what evidence does the Union offer for the link it draws between McCain's purchase of Heinz's frozen potato products business, on the one hand, and the retrenchment of employees at McCain's frozen vegetable plants, on the other? It suggests that the frozen potato products business is more profitable than the frozen vegetable products business. While this is not specifically denied (and it does appear to be a faster growing market) it does not follow that, even if this were so, that it would constitute evidence in support of the contention that McCain intends exiting the frozen vegetable products market, particularly when this is set against persuasive evidence to the contrary. It should also be noted that the Heinz frozen potato products business is clearly un.

28. The Union also invites us to infer the link that it seeks to make from McCain's decision to retrench approximately one-third of the vegetable products workforce barely 4 months after concluding the transaction with I&J. The Union contends that the investigations preceding the purchase – the due diligence - must have revealed overstaffing of the magnitude suggested by the retrenchment. If this was not so, that is if McCain was not acting on information available to it prior to consummating the transaction with I&J, then, concludes the Union, its actions can only reflect a subsequent decision to exit or downscale its involvement in the

vegetable products market in favour of a larger stake in the potato products market. However, we cannot understand why we should draw this inference particularly when set against evidence indicative of McCain's commitment to the vegetable products market.

29. The Unions are, we believe, entitled to draw a more direct inference. That is, we understand why it may wish us to infer from the scale and timing of the retrenchments that McCain had not discharged its obligation to reveal the employment consequences of its transaction with I&J. In this case the Commission, would have recourse in terms of Section 15 of the Act which provides for revocation of a merger decision made on the basis of false and misleading information.¹ McCain strenuously denies that it has misled the Commission and insists that the necessity for retrenchment was only revealed after the merger. The true facts would presumably be revealed on investigation. However, the merger under consideration would then be that between McCain and I&J and the Commission would not be obliged to link this merger with the retrenchments in the frozen vegetable products business. We should add that we refuse to draw an unfavourable inference from McCain's assertion that the Union's action is motivated by its desire to improve its bargaining position in the severance deal under discussion in respect of the vegetable products retrenchment.

30. Finally, we should note that the employment consequences of prohibiting the transaction are likely to be more severe than the consequences of approving the transaction. Heinz avers that, were the merger not to go through, it is likely to close its potato products plant with the loss of all the jobs and this in an area of the country dependent upon the plant for industrial employment. A glance at the Heinz's financial statements will verify that this must be considered a real danger. McCain, for its part, insists that its decision to retrench in its vegetable products branch will not change in consequence of a decision to prohibit the merger currently under examination. We accept this because there is, in fact, no evidence that the retrenchments in the vegetable products plant are linked to the merger in the potato products business.

¹ The Commission appears to believe that McCain has been less than candid. The unusual condition imposed on the current transaction – viz. the requirement to restrict retrenchments to seven people – appears to derive from a suspicion on the Commission's part that it had been duped by McCain in the previous merger. See transcript pages 42-3. If the Commission suspects this to be the case one wonders why they have not revisited the merger to decide whether McCain's conduct warrants any action on the part of the Commission.

31. We accordingly conclude that none of the public interest objectives provided for in the Act, including employment, will be furthered by prohibiting the transaction between McCain and Heinz.
32. In our view the decision of the Commission is correct and we order that the merger be approved subject to conditions similar to those imposed by the Commission. We believe that the previous conduct of the parties in the I&J merger warrants the conditions imposed by the Commission that the total number of retrenchments as a result of this merger not exceed seven. Furthermore, as a cautionary measure we think it is necessary that the parties, on a monthly basis, supply the Commission with their employment statistics for a period of 18 months after the date of approval of this merger. We are convinced that in the light of the retrenchment currently being carried out by McCain, which were not revealed to the Commission when it considered the I&J merger, the above conditions are justified.

IT IS THEREFORE ORDERED THAT:

1. the merger between Foods (SA) (Pty) Ltd and Heinz Frozen Foods (Pty) Ltd is approved subject to the following conditions:
 - a. that the number of employees retrenched as a result of this merger shall not exceed seven (7); and
 - b. McCain Foods (SA) (Pty) Ltd and Heinz Frozen Foods (Pty) Ltd shall, on a monthly basis, supply the Competition Commission with their post merger employment statistics for a period of eighteen (18) months from the date of this order.
2. each party must bear its own costs in this application.

D.H. Lewis

26 April 2001
Date

Concurring: P. Maponya; C. Qunta