



COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No:36/AM/Apr12

In the matter between:

Kenilworth Racing Pty (Ltd)

Acquiring Firm

And

Gold Circle Pty (Ltd)

Target Firm

And the matter between:

The Thoroughbred Horseracing Trust

Acquiring Firm

And

Kenilworth Racing Pty (Ltd)

Target Firm

Panel	:	Norman Manoim (Presiding Member)
		Yasmin Carrim (Tribunal Member)
		Merle Holden (Tribunal Member)
Heard on	:	10 – 29 and 31 October 2012
		Final written submissions on 5 November 2012
Order issued on	:	15 November 2012
Reasons issued on	:	07 February 2013

Reasons for Decision

Introduction

- [1] This merger involves the sale in two transactions of the Western Province horse racing assets of a company called Gold Circle to a newly formed shelf company known as Kenilworth Racing.
- [2] The two transactions considered are: first a demerger of the Western Cape assets and operations of Gold Circle Pty (Ltd) ("Gold Circle") from Gold Circle to Viacor Trade 72 trading as Kenilworth Racing Pty (Ltd) ("Kenilworth Racing"); and, secondly, a sale of the shares of Kenilworth Racing to the Thoroughbred Horseracing Trust ("the Trust").
- [3] Gold Circle is one of only two horse racing operators in the country, the other being Phumelela. At present Gold Circle operates all the racing assets in KwaZulu Natal and the Western Cape, whilst Phumelela controls all the racing assets, such as they are, in the remaining seven provinces.
- [4] Post merger Kenilworth will be owned by a Trust known as the Thoroughbred Horseracing Trust which is also a 35.26% shareholder of Phumelela. Kenilworth will, if the merger is approved enter into a management agreement with Phumelela to manage its business.
- [5] A key question in this transaction is whether Phumelela will post merger control the Western Province assets and thus whether the merger is in reality one between Phumelela and Kenilworth.
- [6] The issue underlines a key point of difference between the Competition Commission which prohibited the mergers and the merging parties who have brought this consideration application and seek approval without conditions.
- [7] The transaction also involves licence transfers. These transfers are not subject to our approval, but where appropriate, of the respective regulatory authorities that granted the licences. At the time of writing we do not know of the outcome of these applications.

The Hearing

- [8] The factual and expert evidence in this merger was heard from the 18th to the 29th of October 2012 with closing arguments heard on the 31st of October 2012. The Tribunal issued its order on 15 November 2012 approving the merger subject to conditions. Our reasons for the approval are set out below.

[9] The factual witnesses called by the Commission were:

- Jeremy Marshall – CEO and owner of Marshalls World of Sport
- Charles Savage – CEO of Purple Capital
- Gary Van Dyk – Corporate finance specialist at Purple Capital

[10] The Commission also called James Hodge, an economist from Genesis Analytics, as an expert witness

[11] The Factual witnesses called by Kenilworth Racing and the Trust were:

- Johannes Hattingh Van Niekerk – Director of Phumelela Gaming and Leisure, a trustee of the Trust, and director of Kenilworth Racing post merger
- Vidrik Lionel Thurling – Chairman of Gold Circle Western Cape and a director of Kenilworth Racing
- Adriaan Du Plessis – CEO of Phumelela Gaming and Leisure

[12] The Factual witness called by Gold Circle was:

- Michel Laurence Nairac – CEO of Gold Circle.

[13] Kenilworth Racing and the Trust, together with Gold Circle, called Patrick Smith, an economist from RBB Economics, as a joint expert witness.

[14] Two interested stakeholders in horseracing also made representations. These were:

- Chopela Simoto – Grooms' Association
- Phindi Kema and Ian Jayes – Africa Race Group

Background to the consideration

[15] On 19 March 2012 the Commission prohibited two linked transactions that had been notified to it as intermediate mergers.

[16] In terms of the first transaction termed the 'demerger transaction' by the parties, Gold Circle sells its assets and operations in the Western Cape as a going concern to Kenilworth Racing – which has as its sole shareholder the Western Province Regional Racing Association ("WPRRA"). In terms

of the second transaction the WPRRA sells its shares in Kenilworth Racing to the Trust.

[17] The Trust is thus the ultimate acquiring firm. The initial seller and the ultimate acquirer were not always in agreement as to whether the transactions were inextricably linked. They have now confirmed that they are. It is therefore not necessary for us to view the transactions separately.¹

[18] Both transactions were the subject of consideration applications and hence the matters came before us through this procedure. We were thus not confined to the record before the Commission and we heard additional evidence from all parties as well as having the benefit of hearing witness testimony.

[19] Although separately represented, Gold Circle and the ultimate acquirers made common cause on the core substantive issues that we must consider in terms of section 12A.

[20] The Western Cape racing assets comprise a license and various properties that make up two core businesses: the race track operating business at Kenilworth and Durbanville, the only two horse racing tracks in the Western Province; and, a betting business via tote license, the only license of its kind operative in that province.

[21] More specifically these assets are:

- Kenilworth Racecourse – the premier racecourse in the Western Cape
- Durbanville Racecourse – a secondary racecourse in the Western Cape
- Milnerton training centre – the larger thoroughbred training centre in the Western Cape housing approximately 800 horses
- Philippi training centre – the smaller thoroughbred training centre in the Western Cape housing approximately 300 horses
- A Helderberg tote property – Gold Circle owns the property on which the Helderberg tote is located rather than renting the premise themselves or co-locating with a bookmaker which they do for their other off-course tote outlets.
- Modderivier farm – a farm on the West Coast which is to be sold.

¹Adv Gordon closing argument, page 2340 – 2341 of the transcript for the 31st October 2012.

[22] Historically this business operated independently and was run by Western Province Racing an organisation of racehorse owners and other stakeholders. Western Province Racing experienced financial difficulties in the 1980s and again in 1993 requiring assistance from the government in both instances. By 2000 it was again running into financial problems. Western Province Racing concluded that the only solution was to merge with another operator in the industry. Two choices were open to them at the time; a merger with Phumelela, then a new entrant which had corporatized, or the three KZN turf clubs who had recently (1998) reorganised themselves into Gold Circle.

[23] They chose their KZN counterparts, Gold Circle, which operated as a section 21 company. The company had local chapters running racing locally but a board of directors at the top responsible for running the company as a whole composed of directors appointed by each of the chapters according to an agreed formula. In this process Western Province Racing became the WPRRA and formed a local chapter within Gold Circle. It is for this reason that the merging parties regard the first transaction as a de-merger: it directly reverses the transaction that occurred in 2000.

[24] To run the company executives were appointed with staff reporting to them. The governance of the company has been fractious; over time board composition has changed often sometimes dramatically and chief executives have reigned powerfully for a short period of time and then been ousted.

[25] Underlying some of its problems and the one relevant to these proceedings has been that Cape racing has underperformed in relation to KZN. The merger far from settling the Cape's financial woes seems to have exacerbated them, with perceptions that KZN was subsidising the loss making Western Cape.

[26] Conversely Phumelela has had a spectacular trajectory in its short history. Formed in 1997 in Gauteng it emerged from a deal struck between Gauteng horse racing clubs and the newly formed provincial government of Gauteng. The horse racing industry said it would fail with devastating social and economic consequences if it was not given tax relief. An agreement was reached allowing the clubs to form themselves into a profit making entity that would list on the Johannesburg Stock Exchange. The quid pro quo was that part of the company's profits would be ploughed back into the horse racing industry and sport more generally. This accounts for the structure of Phumelela today. It currently has as its major shareholder the Trust which holds 35.26% of its shares with 5% going to SASCOG, indirectly via Gride Investments.

[27] We discuss Phumelela's structure in greater depth later.

[28] Phumelela has had a mixed relationship with Gold Circle. Despite this it has entered into two significant arrangements with Gold Circle. The first is Phumelela Gold Enterprises ("PGE"), a joint venture with Gold Circle that broadcasts horse racing coverage on a dedicated DSTV channel known as Teletrack. Secondly, it has an agreement to amalgamate its tote betting with Gold Circle, an arrangement known in the industry as 'commingling'. Both these agreements and the concept of commingling are discussed further in these reasons.

[29] At one point in time, before this transaction was finalised, Phumelela had given serious consideration to a merger with Gold Circle and had also considered merging with the Western Cape business of Gold Circle. Neither occurred, instead we have the present transaction where the Trust as owner of Kenilworth has purchased what was once the Western Cape Gold Circle business whilst at the same time entering into a management agreement with Phumelela to manage its business. Although the new company has yet to have its first board meeting its only two directors have already procured its entry into an agreement with the Racing Association concerning stakes and it is anticipated without much doubt that it will become a party to newly signed substitute partnership agreements and commingling agreements between Gold Circle and Phumelela. These new agreements were only finalised during the course of our hearings.

[30] The Commission's case is that Phumelela, will post merger, be able to control the Kenilworth business. Its ability to control derives from several sources; for this the Commission relies on the management agreement that has already been concluded and is conditional on the approval of the merger, several industry agreements to which Kenilworth will post merger become party to and which regulate its most crucial industry relationships and finally the fact that the Trust is a common shareholder. Thus if the transaction is to be properly analysed, it must be considered as one between Phumelela as an acquiring party and Kenilworth as target despite the fact that Phumelela has not been notified as party to the merger. The Commission argued that if Phumelela acquired de facto control over Kenilworth and hence the Western Cape racing industry, then given that it already operates race tracks in four provinces and controls tote licenses in seven, coupled with the fact that it has industry agreements with Gold Circle who post merger will control the same in the only other province, this will lead to a substantial lessening or prevention of competition in the horse racing operating and betting markets.

[31] The merging parties offered an array of alternative defences to this theory of harm. In the first place, they contended that even if Phumelela is

deemed to control Kenilworth, the merger does not lead to an increase in concentration as the race tracks they administer form discrete geographic markets and thus compete neither for punters nor horse owners, whilst in the betting market, even at its narrowest construction, the relevant products constitute complements, not substitutes. Accordingly the merger, even if Phumelela is deemed to be in control of the target, would not lessen or prevent competition. However their first contention is that Phumelela is a manager and not a controller of the Kenilworth business.

[32] If these two defences cannot pass scrutiny they contend that Kenilworth is a failing firm with no other realistic prospects for survival than this merger. Finally if they fail to pass muster on competition and failing firm grounds, they argue that the merger can be justified on public interest grounds; the argument here is that if the Western Cape exits the horse racing industry, this will adversely affect the wider economy of the region whilst also, nationally impacting on the horse racing industry as a whole.

The Racing Association

[33] The Racing Association ("RA") was established to represent the interests of race horse owners in the Phumelela provinces. It is run by a board of directors of seven elected from the ranks of its members in their respective regional chapters. The RA is not a party to the merger, but is structurally linked to parties that are, making it a vital component of the complex web of inter-dependent institutions that run the horse racing industry. The RA appoints five of the seven trustees to The Trust; SASCO appoints the other two. The Trust in turn is Phumelela's largest shareholder currently holding 35.26% of its equity.

[34] But this is not the only connection. The RA is party to a stakes agreement with Phumelela in terms of which it negotiates what percentages of Phumelela's take out will be contributed to the national stakes pot.

[35] At present horse race owners in the Western Cape are not members of the RA, as theirs is not a Phumelela region. However in terms of the present transaction they will become eligible for membership. The demerger agreement and the sale of business agreement are subject to the condition that the Racing Association adopts the necessary resolutions to create a Western Cape Chapter. The consequence of this is that it allows the Western Cape Chapter to appoint one director on the board of the RA and also provides that one trustee nominated by the RA to the Board of the Trust, is a person nominated by the Western Cape Chapter.

Activities of the parties

The Thoroughbred Horseracing Trust

[36] After the implementation of the second transaction, the Trust will become the sole shareholder of Kenilworth Racing.

[37] The Trust was formed in 1997 to become the vehicle to hold the shares of the former Turf Clubs in Phumelela and to distribute dividends accrued on that investment back into the industry. This merger extends the role of the Trust even further. In terms of Kenilworth Racing's articles of association, the Western Cape chapter of the Racing Association will have the right to make nominations to the board of Kenilworth, and the Trust will do what is reasonably in its power to ensure that one third of the directors to the board of Kenilworth come from these nominations. The Commission's interest in the Trust stems from the fact that the Trust also holds shares in Phumelela, and with a 35.26% shareholding is the latter's largest shareholder.

[38] If Phumelela and Kenilworth are considered competitors it means the Trust has the power to appoint directors to both boards. This has in fact happened. Two trustees of Kenilworth, Johannes Van Niekerk and Marcus Jooste, are also directors of Phumelela and have been nominated by the Trust to serve on the Kenilworth board. Their tripartite role is partly what led to the Commission to suggest that Phumelela is the controller not merely the manager of Kenilworth. Van Niekerk, who testified at the hearing, was cross examined by the Commission on this relationship. He testified that his fiduciary obligations remained to that of the entity on whose board he sat and it was possible to serve all three masters at the same time without conflicts of interest arising. The Commission did not accept this. Partly as a response to this criticism, the merging parties offered certain conditions for the approval of the merger which we discuss later.

[39] The Trust, apart from these holdings, exists largely to further the interests of the industry. That is, it uses income from its holdings to redistribute to advance public interest purposes that relate to racing.

[40] The Trust is of modest means; it has no staff and makes use of office space in the RA premises as well their secretarial staff.

[41] The Trust is precluded by its deed from carrying on business itself. It is thus not the activities of the Trust itself that concern the Commission but its role as a conduit pipe between the RA, Phumelela and Kenilworth.

Kenilworth Racing

[42] At present Kenilworth Racing is a shelf company with no assets or operations and an incomplete board. It is to be the company which will purchase the Western Cape assets and operations of Gold Circle, and will then have its shares fully purchased by the Trust.

[43] On its own Kenilworth's purchase of the Western Cape racing assets would be uncontroversial from a competition perspective. What changes the equation is the fact that the Trust becomes its sole shareholder with the right to control the appointment of the majority of its board.

[44] Kenilworth currently has two board members and has signed a number of transaction agreements² and agreements that come into force contemporaneously with the transaction³. There are also a number of agreements that Kenilworth is expected to become a party to once they have a fully constituted board⁴.

Phumelela Gaming and Leisure

[45] In June 1997 the Gauteng Provincial Government and the three horse racing clubs then operative in Gauteng, entered into a memorandum of understanding, the main purpose of which was to restructure the horse Racing Industry in the Gauteng Province to ensure its sustainability.⁵ They agreed to re-organise and restructure the business of the racing industry into a single corporate entity listed on the JSE with a broad base of shareholders, including previously disadvantaged communities.

[46] In giving effect to this agreement the parties agreed to merge the assets and activities of the racing clubs, the totes and the Highveld Racing

² Revival Agreement between Gold Circle (Pty) Ltd and Viacor Trade 72 (Pty) Ltd; Sustainability Agreement between Western Province Racing Club and Viacor Trade 72 (Pty) Ltd and The Racing Association (Pty) Ltd; Share Sale Agreement between Western Province Regional Association and The Thoroughbred Horseracing Trust and Western Province Racing Club and the Racing Association (Pty) Ltd and Viacor Trade 72 (Pty) Ltd; Second Revival Agreement between Gold Circle (Pty) Ltd and Kenilworth Racing (Pty) Limited (Previously known as Viacor Trade 72 (Pty) Ltd); Third Revival Agreement between Gold Circle (Pty) Ltd and Kenilworth Racing (Pty) Limited (Previously known as Viacor Trade 72 (Pty) Ltd); Fourth Revival Agreement between Gold Circle (Pty) Ltd and Kenilworth Racing (Pty) Limited (Previously known as Viacor Trade 72 (Pty) Ltd); and, Fifth Revival Agreement between Gold Circle (Pty) Limited and Kenilworth Racing (Pty) Limited (Previously known as Viacor Trade 72 (Pty) Limited).

³ Management agreement between Kenilworth Racing (Pty) Limited and Phumelela Gaming and Leisure Limited; Commingling Agreement between Phumelela Gaming and Leisure Limited and Kenilworth Racing (Pty) Limited (it's marked draft for discussion purposes only); and, Licence Agreement between Kenilworth Racing (Pty) Ltd and Phumelela Gaming and Leisure Limited (Marked for discussion purposes only)

⁴ Telly Track Partnership Agreement (Kenilworth, Gold Circle & Phumelela); Commingling Agreement (Kenilworth and Phumelela); Substitute Sport Administration Agreement (Kenilworth, Gold Circle & Phumelela); and, Licence Agreement (Kenilworth and Phumelela)

⁵ The three clubs were Turffontein, Newmarket and Gosforth Park.

Authority. For the purposes of listing, the shareholders of the new company, which became Phumelela, comprised the following: the Trust (30%), BEE Groups (22.5%), Management (20%), employee share program (2.5%), general public (15%) and the racing public (10%).⁶

[47] Subsequently, over time a number of other turf clubs joined. Currently Phumelela operates all horseracing activities in Gauteng, the Eastern Cape, the Northern Cape and the Free State as well as the tote activities in these same provinces plus Mpumalanga, Limpopo and the Northern Province (there is no horseracing operation presently in these latter three provinces). At the time of the merger the only horse racing activities that do not fall under Phumelela are those of Gold Circle located in KwaZulu Natal and the Western Cape.

[48] Of relevance to this merger are three markets in which Phumelela currently does business as;

- i. a race track operator;
- ii. a provider of betting services specifically in horse racing and more specifically as a licensee of several totes; and
- iii. a partner in a TV horse racing channel known as PGE.

[49] Its horse racing operations comprise five race courses and training centres run out of its head office at Turffontein Racecourse.

[50] Its betting operations comprise seven provincial tote licenses, a bookmaking firm and gambling outlets through the operation of what are termed limited payout machines. The tote businesses offer over the counter (OTC) betting to punters either at racetracks or off course premises. But more recently totes have started to offer what are termed non-over the counter (non-OTC) betting opportunities for punters via call centres and the internet. The bookmaking activities are conducted through a wholly owned subsidiary Betting World, one of the largest bookmakers in South Africa. Gold Circle had previously built up Betting World, having acquired it from its founders. Gold Circle first sold a stake in Betting World to Phumelela, and recently sold the residual interest to Phumelela. Betting World provides fixed odds bets on sports, including horseracing and soccer amongst others.

[51] PGE is a joint venture with Gold Circle although it is managed by Phumelela. PGE owns a horse racing channel which viewers can access on the DSTV bouquet. The channel broadcasts live horse racing from

⁶The Trust currently holds 32,5%.

tracks in South Africa. As this is not sufficient to provide material to a 24/7 channel, PGE has also purchased the rights to broadcast racing from overseas tracks.⁷ PGE also sells its broadcasts of South African racing to overseas counterparts.

Gold Circle Pty Ltd

[52] Gold Circle is the only other race course and tote operator in South Africa. In KwaZulu Natal it is the only operator licensed to run a tote and to operate race tracks. In the Western Cape it is the sole licensed tote operator. Horseracing operations do not require a license in the Western Cape, however, it was common cause that it is unlikely for an operator to enter without also being licensed to run a tote.

[53] The three turf clubs in KwaZulu Natal have had a different approach to their counterparts in Gauteng. Instead of entrusting their operations to an administrator with a profit motive, the Phumelela model, they preferred to house their operations in a non-profit company and so ensure that all profits that accrued are ploughed back into the sport.⁸

[54] Race owners in the Western Cape have been ambivalent about which model would be best for them. In 2000, beset by financial problems the Western Cape Turf Club decided it needed to join up with either Phumelela or Gold Circle. They decided to merge with Gold Circle in 2000 and, as the fourth turf club in the non-profit company, received a 25% shareholding.

[55] The Western Cape assets of Gold Circle were set out earlier and include their racecourses, training facilities and other properties. Gold Circle owns fewer assets in KwaZulu Natal than in the Western Cape because of the recent sale of Clairwood and the fact that they lease from municipalities rather than own their race courses. The KwaZulu Natal facilities used by Gold Circle are:

- Greyville Racecourse in Durban: leased from the municipality on a long term lease.
- Scottsville Racecourse in Pietermaritzburg: leased from the municipality
- Clairwood Racecourse in Durban: recently sold for R430 million but it has retained a short term lease to allow it to continue racing at the venue.

⁷ E.g. include the UK, Dubai, Singapore, Hong Kong, Australia, France, Mauritius and the USA.

⁸Article 6.3 of Gold Circle's Articles of Association.

- Summerveld training facility: owned by Gold Circle and located in Shongweni
- Ashburton training facility: owned by Gold Circle and located in Pietermaritzburg.

Gold Circle is the other partner in PGE and receives 39% of the profits of PGE in accordance with the PGE Partnership Agreement.

Phumelela's relationship with Kenilworth Racing

[56] Once the two legs of the merger have been completed the Trust will own all the shares in Kenilworth, which in turn owns the assets and operations of horseracing in the Western Cape. Kenilworth has already, pre-merger concluded several significant agreements. Perhaps the most significant is the management agreement in terms of which Phumelela will manage its business operations. It has also concluded various industry agreements with Phumelela and Gold Circle regulating the tote betting, racing administration and television broadcasting aspects of its business. Some new agreements have recently been concluded between Phumelela and Gold Circle but provision is made for Kenilworth to become a party to these agreements post merger.

[57] The terms of the management agreement are couched in broad terms affording both the Commission and the merging parties the opportunity to credibly reach opposing conclusions over its implications for Phumelela's ability to control Kenilworth.

[58] The Commission argued that practical business realities would result in a lack of independence between Kenilworth and Phumelela. Amongst the reasons for this lack of independence apart from the terms of the management agreement are that: Phumelela has control over important industry wide agreements including PGE; Kenilworth has already, pre-merger, become a party to some of these agreements and there is little doubt it will become party to those that it has not yet become party to but which contemplate it as a contracting party; already prior to the merger Phumelela had taken over management of the Western Cape business through a contract with Gold Circle; and the widespread cross directorships and relationships that exist or will exist post merger that are glued together by the interrelated shareholding and the influence of the RA.

[59] But Phumelela's ability to control Kenilworth has a further dimension unknown prior to the hearing. It emerged at the hearing for the first time, that Vidrik Thurling, one of two initial directors of Kenilworth and a key

player in arranging the demerger and merger transactions, had reached an oral agreement with Du Plessis of Phumelela for any necessary bridging finance. The Commission was rightly critical of the fact that this evidence was never revealed before in the witness statements of the parties or their earlier submissions.

[60] The Commission also argued that the board of Kenilworth was effectively operating on a part time basis. Kenilworth would not have its own staff and would have to depend on Phumelela for everything including strategic direction and preparation of budgets. Given Phumelela's expertise in the industry and superior knowledge, it seems highly likely that its managers could persuade the part time directors of Kenilworth of what the latter's best interests were. Indeed, it is the Commission's position that Phumelela is acquiring control of Kenilworth Racing and they should have been notified as a party to the merger. Furthermore, the interim management agreement with Phumelela amounts to prior implementation of the merger.

[61] The merging parties had a completely different reading of the management agreement. Phumelela might be empowered to manage the day to day activities of Kenilworth, but this would be subject to the ultimate approval of the board. They rely on the fact that various decisions such as the sale of an asset or the entering into of an agreement greater than 12 months in duration will require board approval. They also argued that the board members will have a fiduciary duty to the company, irrespective of any other position a board member might also hold.

[62] The merging parties further suggested that the management agreement was akin to having a firm serving the role of managing director and since no firm regards the change in the identity of the managing director as one worthy of constituting a change of control for merger regulatory purposes, why should they have considered Phumelela's role any differently. We need not consider now whether this argument has merit.

[63] Whether or not Phumelela is acquiring control of Kenilworth Racing is an issue that would have to be determined in other proceedings. In the present one we are confined to considering whether the merger as notified can be approved. If the Commission is correct and Phumelela should have been notified as an acquiring firm then it is still able to take enforcement action against it and the merging parties in a subsequent proceeding. So too, the merger parties could, together with Phumelela, resubmit the merger with Phumelela as a merger party. We cannot make a decision on a case that is not before us regarding parties who are not represented.

[64] The fact that we are not deciding whether there has been a failure to notify control, but leaving that to subsequent proceedings if they are

brought, does not mean the issue of control is irrelevant to this merger. Control, as a procedural issue, must be distinguished from control as a substantive issue. If a merger has as its effect the creation of an ability of a non-notifying party to control, then that issue must be considered as a part of the substantive enquiry into the effects of the merger.

[65] Because in a section 12A procedure, we are deciding a substantive not a procedural issue, we are able, as a matter of discretion, to approach the analysis by assuming that control exists and then examine whether it will lead to an anti-competitive effect; if it does, we then have to decide the issue of control as a substantive matter of fact, as this factual question will prove decisive in considering the merger.⁹ Conversely, we do not have to determine the issue of control conclusively, if assuming control does not lead to such a conclusion. It is this latter approach that we have adopted.

[66] Thus in this decision the merger will be analysed as one where we assume that Kenilworth will cooperate fully with Phumelela post merger. We will assume that while Phumelela is not a merger party, the change to the competitive landscape is equivalent to a scenario where Phumelela is a merger party; more specifically the acquiring party,

Competitive analysis of the relevant markets

[67] The merger will have an effect on three possible markets. One is relatively uncontroversial to define, the market for horse racing operations; so is another, the market for television and broadcasting rights for horse racing. The third is a betting market whose product boundaries are in dispute. The market may be narrowly confined to horse racing as the Commission suggests, or may be broader to include betting on other sports and other forms of gambling, as the merging parties suggest. We go on to examine each of these three candidate markets in turn. Since horse racing operations and betting are regulated markets – one cannot operate the service without the requisite license - we start each section with an examination of the legal regime and then go on to consider the economic issues.

Horseracing operator market

[68] In most provinces except the Western Cape an operator requires a license from the provincial gambling board to operate a race course. It also appears that some form of local authority permission is required, although at the hearing no one was particularly sure of the practice. What is

⁹We leave open the question as to whether the substantive test for control for 12A purposes is the same as that for procedural or jurisdictional section 12 purposes.

uncontroversial is that the practice adopted by the provincial boards is to grant only one tote license per province and to grant that to the race course operator. Thus whilst there may be no legal barriers to licensing new entrants as operators, unless regulatory authorities change their approach new entry in this market is unlikely in the short term. For this reason we conclude that as result of regulatory policy, at least as presently practiced, no new entry to this market is likely.

[69] Nor does the economics of becoming a horse racing operator suggest new entry is likely either. Being a racetrack operator requires owning or leasing a racecourse as well as stabling and training facilities. Personnel are required to operate the race. Critically it also requires access to funds in order to pay stakes which attract the racehorse owners to enter their horses into races.

[70] Horseracing operators seek to attract both race goers as well as high quality race horses to view and participate in their events respectively. In this sense the market can be regarded as two- sided; competition for race goers and competition for owners.

[71] We consider competition for race goers first. While some provinces in South Africa have multiple racecourses, there is only a single owner and operator per province. This results in large distances between any given racecourse and the nearest competing racecourse. Given these distances there is little possibility to compete for attendance. The only exceptions are for the occasional feature races such as the Durban July where punters nationally may be attracted by the glamour of the event. Because feature races are rare, and there is generally no overlap between racecourse operators for race goers, no likely potential harm is expected to result from the merger. Both the Commission and the merging parties were in agreement on this.

[72] A more contentious issue during the proceedings was whether horseracing operators competed with one another to attract quality racehorses. There is some evidence of movement of horses between seasons, although no agreement on its cause or extent. According to the Commission, whose expert's graphs exhibited a more exaggerated view of this movement than those of the merging parties, this was evidence of race operators competing over who offered higher stakes. The merging parties' witnesses testified that the majority of racehorse owners choose to domicile their horses where they lived, and would be unlikely to relocate their lives because of relative changes in stakes. The limited movement of racehorses between regions, their expert Patrick Smith argued, is better explained by feature seasons and the dynamics of the merit rating system than by competition over size of stakes

[73] Ultimately we were not presented with sufficient evidence to establish that a relative decrease in stakes in one province would result in a significant number of racehorses exiting that market in the short run. The more likely outcome is that a reduction in stakes would result in a reduction in the number of new racehorses being bought and trained for a region, and hence a long run reduction in the stock of race horses in a region. This reduction in quantity is not a substitution effect away from a relatively lower stake region to a relatively higher stake region, but rather a partial or complete exit from the market by a portion of racehorse owners.

[74] For these reasons horseracing operators are protected from competition between themselves for race goers as well as racehorses by the large distances that exist between competing race courses. These are effectively regional monopolies where the regions are constituted by provincial boundaries, because of the manner in which they are licensed by the provincial gambling boards. Given such a geographic market definition for these two horseracing operator products, a full competitive assessment becomes unnecessary.

[75] Additionally, however, there is also little possibility of harm to result from the merger through lower stakes in the Western Cape than would otherwise be expected because of the nature of how stakes levels are formulated. Stakes in the Phumelela regions are calculated by formula according to the Stakes Agreement. This is an agreement between Phumelela and the RA which requires Phumelela to allocate certain proportions of betting take-out and commissions to the stakes pot. Phumelela, because it has been bound to the terms of the Stakes Agreement from its inception, is not able to reduce stakes below the decided levels. Furthermore, Phumelela is incentivised to increase betting revenue in order to increase profits, and so is incentivised to increase stakes as a by-product of its profit motive. Gold Circle's stakes are not calculated by a fixed formula but instead by the fact that they are a non-profit organisation. As such Gold Circle revenues after operating expenses go to the sport of horseracing either as stakes or some other developmental or training endeavour. For these reasons, stakes are not, and are unlikely to become, a significant variable of competition between the horserace operators in South Africa.

[76] A final point on the stakes is that the current set up of the inclusion of the Western Cape to the Stakes Agreement, and the associated ratios, are at the instance of racehorse owners in the Western Cape. It is possible that stakes could have grown above this level in the future if betting on horseracing in the Western Cape grows faster than in other Phumelela regions over a long period of time, however, such a possibility would have

been balanced by racehorse owners in the Western Cape. While racehorse owners might have varying backgrounds, a large number of them are highly successful business owners or managers. They would have the ability to weigh up the benefits and certainty of being included on the Stakes Agreement against the possibility of higher stakes at some stage in the future, and choose the course of action which is most beneficial to themselves. A theory of harm that suggests racehorse owners are at risk of being harmed seems at odds with their revealed preference.

[77] The final competitive dynamic between horseracing operators that warranted investigation was the market for timeslots in the national race calendar. This is not to say that horseracing operators would want to stage additional (costly) races, but rather compete for more valuable races and reduce the number of less valuable races staged in their region. Specifically, Saturday races are preferred in most regions with KZN having a preference for Sunday Races. Weekday races are unanimously regarded as inferior because they make greater direct losses. While the markets for patronage at races and for quality racehorses was at a regional level, competition for preferred timeslots in that national calendar is at a national level.

[78] The theory of harm raised in relation to race scheduling is that there will be a shift in the balance of power from a relatively balanced pre-merger situation to one that would see Phumelela being able to dominate scheduling decisions post-merger.

[79] There are a number of reasons to suggest that the scenario is not as dire as the split in voting rights might suggest. The first is that all operators will want to continue to have 364 days of racing a year otherwise their tote revenues and stakes in PGE will suffer. For this reason, Gold Circle KZN's smaller number of races is very important to Phumelela.

[80] More importantly, this theory is a theory of harm to Gold Circle KZN and not to consumers. The majority of consumers (punters) place their bets away from the race course or online. There was no evidence to suggest that punters would be harmed should there be an increase in the ratio of weekday to weekend races in KZN. Also, if racehorse owners are being harmed by potentially lower stakes at weekday races, then Gold Circle KZN could divert the stakes that they were paying on weekend races to weekday races such that racehorse owners are no worse off. This process may or may not see Gold Circle losing some profits to the benefit of Phumelela, but this is a theory of profit division between firms and not a theory of harm to consumers.

[81] For these reasons we find that there is no reasonable expectation of a significant lessening of competition in the horseracing operating market.

Betting market

[82] The next major activity is that of betting. Horseracing operators operate totes and use the betting revenue to fund the loss making activity of horseracing operations. This was the case in earlier years when each racecourse was owned by a turf club, and continues to be the reality in the new industry structure of Phumelela and Gold Circle. While the provincial gambling boards are not obliged by their legislation to allocate only one tote license per province, and to do so to the horseracing operator, in practice the licenses are paired and no second tote license has been allocated. The closest alternative betting option to a tote bet, given that there is only one tote operator per province, is to bet on fixed odd bets or open bets available at various bookmakers in each region. These can be bets on horseracing or indeed on a plethora of other global sporting events. Other gambling options included casinos, limited payout machines and the lottery.

[83] Extensive arguments were made regarding the ease of switching between betting on horseracing and these various alternative gambling opportunities. The merging parties argued that punters desire a game where the outcome is sufficiently uncertain and the process to produce that outcome is credible. Thus they argued that all the alternatives listed above were legitimate constraints on horseracing betting products. The Commission and its expert James Hodge argued that there was specific knowledge necessary to participate in each type of gambling, and that there are large price differentials between different forms of gambling. Thus the product market should be narrow and only include tote and bookmaker horseracing betting product.

[84] Defining a product market is only necessary if there is some significant possible accretion in the geographic market. Because we will conclude that the geographic market for horseracing betting is regional (provincial), the exercise of product market definition in the betting market is unnecessary. As such we have left it open at this stage.

[85] While totes cannot have a physical infrastructure providing tote bets outside of the province for which they are licensed, they are able to compete for customers through electronic means. These would include telephone betting and internet betting. This non-over-the-counter ("non-OTC") sales channel is currently available to punters. Phumelela and Gold Circle split these revenues in a fixed ratio and hence, by agreement, do not use the non-OTC channel to compete with one another.

[86] The merging parties argued that the non-OTC market could not be national for legal reasons. A tote licensed in one province is not allowed to accept bets from persons not resident in that province. They base this legal argument on a case decided by the Supreme Court of Appeal ('SCA') in relation to a casino license.¹⁰ In that case, more popularly referred to as 'Piggs Peak', after the name of the casino in question, the SCA held that a casino licensed in Swaziland was not allowed to accept bets on the internet from South Africa as it was not licensed in South Africa. The merging parties argued that the so called 'Piggs Peak' principle applied by logical extension to totes. Since totes are licensed to accept bets in a particular province, by the regulator having jurisdiction in that province, they may not accept bets from punters outside that province. The Commission argued that the Piggs Peak principle did not apply to tote licenses. This is not something we have to decide. Indeed the merging parties do not appear to be that certain that 'Piggs Peak' applies. In their commingling agreement, an agreement concluded during the course of these proceedings they provide for alternatives depending on whether 'Piggs Peak' applies or not to tote licenses.

[87] We have decided the case on the assumption that it does not apply to tote licensing and that licensed totes may accept non-OTC bets on a national basis.

[88] The geographic market for OTC bets is provincial while, at a technical level, the geographic market for non-OTC bets is national. Despite the technical ability and hence potential for competition between totes using non-OTC channels, such competition does not exist pre-merger and is unlikely post merger.

[89] The reason for this relates to the incentives of the respective tote licensees. The first disincentive for a tote in one province to compete with a tote in another province via non-OTC channels is that it would result in a reduction in the OTC revenues to the instigating competitor. Access to non-OTC devices, particularly cell phones with internet access, will mean that a tote that reduces its price on non-OTC channels will have to offer a similar reduction on their OTC products. Failure to do so will see significant switching from OTC sales to non-OTC sales of either their own channel or their competitors'. This is the standard economic outcome of a firm that is unable to price differentiate between customers, it is not peculiar to the betting market. The important conclusion then is that it is the tote with the smallest relative OTC sales volumes that is most likely to

¹⁰Casino Enterprises (Pty) Ltd vs. The Gauteng Gambling Board and Others SCA [2011] ZASCA 155; 2011(6) SA 614 (SCA); [2011] 4 ALL SA 573 (SCA).

engage in price competition with other totes over non-OTC channels. In crude terms, they have the least to lose and the most to gain.

[90] The above dynamic is a pro-competitive dynamic that results in small firms being able to constrain the pricing behaviour of far larger firms. The facts of the South African tote market, however, undermine this mechanism. Punters have a strong preference for a commingled product in the largest possible pool; Phumelela's betting volumes from Phumelela regions and international punters are far larger than betting volumes in the Western Cape and KwaZulu Natal jointly; and, the South African betting market is not large enough for two commingled pools. The argument here, which was raised by Smith, is that if a tote were allowed to use non-OTC channels to compete with Phumelela and so reduced its take-out rate, Phumelela would react by excluding that tote from the commingling pool.

[91] Before continuing, the process of commingling and the importance of the commingling pool warrant explanation. Tote or totalisator bets are so-called because they add together all the bets of the same type into a single pool. From this pool the operator takes its take-out and the remainder is divided up evenly amongst the winning bets. Punters have a strong preference for larger pools because there is greater stability in expected payouts. Commingling adds together the betting pools of two or more totes to form one, larger, commingled pool.

[92] The rationale for the previous conclusion that Phumelela would exclude any tote that destabilises the commingled pool is that the alternative response is a similar or punitive take-out rate reduction by Phumelela. This price (Bertrand) competition in the long run would result in prices equal to marginal cost. The marginal cost of a punter placing a non-OTC bet is zero, and so prices would be zero and totes would make losses. It would not be in Phumelela's interest to compete on this basis and they would be able to continue operations, because of the size of their pool, without the competing totes' contribution to the commingled pool. Hence the conclusion that Phumelela would simply exclude the competing tote from the commingled pool in the first instance.

[93] That the smaller totes depend on the larger tote (Phumelela) for access to the larger commingled pool is known to them. They would never engage in such aggressive competition with a firm that they rely on to the lengths that they do. The conclusion is that Phumelela would set the price and other totes, acting in their own best interest, would not act to undermine such a price. This is indeed how the commingled pool currently operates with Gold Circle not having control over the take-out rate applied to commingled bets.

[94] Lastly, the betting market is a highly regulated market with gambling boards setting maximum take-out rates. This is effectively the price a punter pays for the bet and hence the market is a price regulated market. Hodge shows that the take-out rates for more 'complicated' type bets are close to or, in most cases, at their regulated maximum. The 'less complicated' bets have take-out rates below their regulated maximum because of competition from bookmakers.¹¹ Any potential reduction in competition between totes would thus not translate into increased take-out rates because they are either at their regulated maximum pre-merger or are being constrained by other forms of betting.

[95] Given the regional geographic market of OTC bets and the fact that totes do not and are extremely unlikely to start competing with one another through non-OTC channels, there is unlikely to be competitive harm in the betting market as a result of this merger. Expressed differently the merger is unlikely to adversely affect competition in the tote market, assuming against the merging parties that this is the relevant product market, because of a combination of a number of factors; the way legislation has structured this market, consumer preferences for commingling and price regulation. In addition, were there some potential increase in market power by the totes, they would be unable to profit from it given the price regulations that exist in the market.

Horseracing broadcasting market

[96] The third market for consideration is that for the broadcasting of horseracing events. The importance of this product to consumers was summed up by Jeremy Marshall, a bookmaker who testified for the Commission. Marshall testified that bookmakers would lose their customers if they did not have the races broadcast live in outlets.¹² This fact together with the fact that the majority of bets are placed at an outlet away from the track makes broadcasting the race a critical input to selling tote and bookmaker bets on horseracing.

[97] The downstream product used by South African outlets (totes and bookmakers alike) is called Teletrack. PGE televises the South African races together with international races alongside race specific information such as odds. Approximately 25% of the content on Teletrack is South African and 75% is international.¹³ The signal is broadcast on DSTV through a deal between PGE and Multichoice.

¹¹See table 2 and paragraph 18 of the Genesis Report.

¹²Marshall at page 154, 157, and 205 of the transcript.

¹³Du Plessis at page 1133 of the transcript.

[98] PGE also packages the races in other forms or languages to distribute internationally. These other downstream products contribute significantly to the profitability of PGE, and hence are important when considering the intrinsic value of track broadcasting rights and the need to maintain the number of races held in the Western Cape.

[99] There is also an upstream market for the sale of rights to broadcast horseraces held at each racecourse. Currently these rights vest with PGE and the racecourse owners are compensated through joint ownership and profit sharing from PGE.

[100] Thus there is a downstream market for the distribution of Teletrack in South Africa, and an upstream market for the broadcasting rights for each racecourse in South Africa.

[101] The downstream broadcasting market is currently a monopoly with PGE providing all the equipment at the racecourse, managing the partnerships with and amalgamation of the feed from international partners, and makes the feed available to individuals, totes and bookmakers from an agreement with Multichoice.

[102] The Commission argued that it would be possible for a truly independent Kenilworth to launch its own competing channel. This could be done by combining race broadcasts from the Western Cape with that of international partners.

[103] It is unlikely that Kenilworth will have sufficient South African content to provide a valuable proposition in competition with the Tellytrack channel currently available. More importantly it is not clear what the incentive would be to split from an efficient and highly profitable monopoly and launch a new competing channel, one with far less South African content and hence a competitive disadvantage. Such a strategy would be very risky with little or no upside as compared to a 14.04% stake in a very profitable monopoly.

[104] Ultimately we do not consider it likely that PGE will be dismantled or a new television channel would enter the market under any potential counterfactual. For this reason there is not expected to be any change to the functioning of PGE as managed by Phumelela. This would include pricing levels and policies.

[105] In the upstream market the Commission argued that the proposed PGE revenue split with Kenilworth Racing was inequitable when considering the percentage of South African races they host. This would be an important consideration for increased profitability under a failing firm argument.

Under the current transaction structure, the issue of a shift in the balance of power manifest by a disproportionately low profit share from PGE is an issue of division of rent rather than one with any consequences for end consumers. Whether Kenilworth Racing could extract greater than the proposed 14.04% from PGE should they negotiate independently, is a matter of speculation however, even if they could as the Commission contended, this is a commercial decision without any potential harm to consumers.

Failing firm defence

[106] In the absence of the likelihood of a significant lessening of competition to result from the merger, there is no need to consider the merits of the merging parties failing firm defence.

[107] Should there have been a likelihood of a significant lessening of competition, it is unlikely that the arguments raised by the merging parties would have met the requirements of the test set out in the Tribunal's decision in *Iscor/Saldanha*.¹⁴ This is because there was no convincing evidence that Kenilworth assets would exit the market, and also it did not seem that possible alternatives had been explored appropriately.¹⁵

The open bet and potential foreclosure

[108] The third and final competition concern is that the merger may enable the merged firm subject to the control of Phumelela to exclude bookmakers from offering a product known as the 'open bet' which competes with the products offered by the tote. Given the lack of the competition in the tote market we discussed earlier, the exclusion of any possible rivalry from a potentially competitive product, offered by other firms, is a relevant issue.

[109] First we need to explain what the open bet is. An open bet is a bet offered by a bookmaker which, unlike a fixed odd bet, has an unknown payout to the punter at the time of placing the bet. The specific type of open bet at issue is one which mirrors the tote payout on a certain event such that the punter would be indifferent to placing a bet into the tote pool and placing it with the bookmaker. After the race has taken place and the tote announces the payout on winning bets from the pool, each bookmaker

¹⁴*ISCOR Limited and Saldanha Steel (Pty) Ltd* case number 67/LM/Dec01.

¹⁵Considerable time during the hearing was devoted to whether Purple Capital, an investment company that was also interested in bidding for Kenilworth, had made a plausible, less anti-competitive, counter offer to that of the present merging parties. We do not for the reasons explained need to consider this dispute.

then announces a similar payout ('dividend') for winning open bets subject to adjustments for taxation.¹⁶

[110] Bookmakers can use the open bet to mirror the payouts from a pooled bet of the same type and in so doing replicate tote products. This then results in direct competition between totes and bookmakers, and has resulted in totes seeking to stop bookmakers from placing the open bet. At the centre of this grievance is the fact that tote operators, because they are also the horseracing operator, have to fund the large cost of staging the horserace, while bookmakers do not. For this reason, tote operators, in essence Phumelela and Gold Circle believe they are entitled to a monopoly over tote type bets.

[111] The merger specific issue at hand here, as argued by the Commission, is that Gold Circle is less likely than Phumelela to stop bookmakers from placing the open bet. As such, the transaction will result in reduced competition post- merger.

[112] Bookmakers make use of tote outlets under the control of Phumelela and Gold Circle to operate their businesses. Whilst not wholly dependent on them, the bookmakers and operators both benefit from this arrangement as it ensures more traffic through the door for both. Given that licensed premises are both expensive and scarce, due to licensing restrictions, bookmakers are dependent on these premises for their businesses. If they cannot offer the open bet as part of their license conditions according to Marshall, alternatives are expensive, time consuming and commercially unattractive.¹⁷

[113] The issue in this case which was only raised by Marshall and not any other bookmaking firm, was that in the Western Cape, post-merger, Phumelela would be more incentivised and hence more likely to enforce exclusionary lease provisions at tote outlets where his firm was offering the open bet.

[114] In the Western Cape, Gold Circle has a lease agreement with Marshall's firm, MWOS, that prevents it from offering the open bet on Gold Circle's premises. This lease restriction arose prior to the merger. However Gold Circle has yet to enforce this lease provision despite the fact that legally it could. The reason this arises as a question relevant to this merger is the suggestion that post-merger, Phumelela would, as an operator of a

¹⁶See Marshall at page 121 of the transcript where he states that "we actually inflate the dividend that is given out by the totes so that when we deduct the tax off the dividend it comes back to the original dividend that was released by totes."

¹⁷Licensing restrictions in Cape Town apparently restrict the proximity of betting outlets within a certain distance of schools, places of worship etc. Given that bookmakers require premises that are convenient for consumers this regulated restriction leads to a scarcity of available premises.

bookmaking firm Betting World (recall, acquired recently from Gold Circle) and according to the Commission, controller of Kenilworth, be more incentivised to ensure that Kenilworth evicted bookmakers who offer the open bet than would Gold Circle or another owner.

[115] The argument that Gold Circle is more amenable to the open bet arises out of an experiment that Gold Circle seemingly allowed MWOS to conduct. Gold Circle initially allowed MWOS to sell the open bet at one of its premises, in Parow Valley, for a period of four months, after which the situation would be re-evaluated. Following this initial period, Gold Circle agreed to extend the experiment to seven outlets for another four month period.¹⁸ Thereafter it was contemplated that a re-evaluation would again take place. It seems this re-evaluation never occurred and MWOS continued to place open bets.

[116] In June 2012 Marshall met with Michel Nairac who had returned as Gold Circle CEO. Nairac conveyed a message from du Plessis of Phumelela to the effect that du Plessis wanted MWOS to stop selling the open bet in the Western Cape and that this was in contravention of their lease agreements. Marshall asked that du Plessis contact him directly.¹⁹ In August 2012 MWOS agreed to stop selling the open bet in all their branches except Parow Valley (the latter an exception apparently because of a large punter who they feared they would lose).²⁰

[117] The merging parties downplayed the role allegedly played by Du Plessis in instructing Nairac what to do. Rather they allege that both firms were equally opposed to the open bet and hence the merger makes no difference. The fate of the open bet has been sealed they contend, with or without the merger. MWOS's alleged honeymoon period in offering the open bet, despite the contrary provisions of its leases with Gold Circle, were attributable to the actions of Nairac's predecessor who acted without his board's mandate in doing so.

[118] We do not know if this is correct since the predecessor was not called as a witness. It seems that it was as likely to make business sense to reach an agreement with bookmakers as to exclude them. It seems also likely that Phumelela was more incentivised to exclude bookmakers and that Du Plessis was able to exercise his influence over Gold Circle to achieve this. Noteworthy too, is that Phumelela had brought a court challenge to interdict bookmakers from offering the open bet although this challenge failed. Nevertheless this does not make the issue a merger

¹⁸Marshall's evidence was this was an oral agreement between him and Dinish Rajpaul the Commercial Operations manager of Gold Circle in the Western Cape sometime in 2010.

¹⁹See transcript at page 243.

²⁰See transcript at page 241.

specific one. It seems that Phumelela can flex this muscle without the merger given the arrangements that exist already between the two firms where Gold Circle is very much the junior partner.

[119] Further the "honeymoon" period apart, Gold Circle has had an ambiguous relationship with bookmakers over the open bet. When it bought the bookmaking businesses that would later become Betting World, and at a stage that it didn't wholly own this business, it took steps to ensure that it did not offer the open bet. Later an interest in this business was sold to Phumelela who now wholly own it. Does this mean that now that it no longer owns an interest in a bookmaker, its incentives to suppress the open bet might change again? It seems not. Nairac who testified during the hearing, clearly placed more value on his relationship with Phumelela than appeasing some bookmakers. Further, whilst Marshall was convinced of the advantages for Gold Circle of retaining bookmakers offering the open bet on its premises, Nairac seemed less convinced.

[120] We cannot conclude from these facts that Gold Circle is more amenable to bookmakers taking the open bet than would be Kenilworth under Phumelela's management. The experiment afforded to MWOS seems to be something of an anomaly which arose for very specific reasons and is not informative of likely future competitive dynamics. Thus there is no conclusive evidence that bookmakers are more likely to be foreclosed from offering the open bet as a result of this merger.

[121] Furthermore, were the merger to result in bookmakers being 'foreclosed' from offering open bets at venues where they sub-lease from the tote, it is not clear what the consumer harm is. These arguments were made using foreclosure terminology however, there was no real theory of foreclosure put forward by the Commission.

[122] It was not argued that bookmakers would be forced to exit the market. Furthermore, it seems unlikely that such a strategy by totes would force them to exit the market. This is firstly because bookmakers offer fixed odd bets which they were able to sell profitably. This is true before they started offering the open bet and also true for outlets where they co-locate with a tote and are not allowed to offer the open bet. Not being able to sell open bets does not turn a profitable business into a loss making business. The second reason is that totes have no power to stop bookmakers offering the open bet at locations owned or leased directly by the bookmaker. Bookmakers have the choice about whether to co-locate with a tote at a tote premise and perhaps be stopped from offering the open bet, or to invest in their own location and have complete freedom over what products they offer.

[123] It also does not seem that punters will be harmed by such a 'foreclosure' strategy by totes. Punters will not have reduced options at outlets where a tote and a bookmaker co-locate because they can place a tote type bet with the tote itself and fixed odds bets with the bookmaker. Likewise, punters will have access to both options at bookmaker-only outlets, because they will continue to offer the open bet alongside their fixed odds bets. Lastly, the strategy is unlikely to harm punters by resulting in a higher price than would otherwise be the case. This is because totes set the price and bookmakers simply replicate it with punters being no better or worse off. If bookmakers were to genuinely start competing with totes by offering better prices than the tote on open bets, they can do so through their outlets which are not co-located on tote premises.

[124] This conclusion is reinforced by Marshall's proposal which he wanted the regional bookmakers associations to take to the totes. This was that bookmakers receive a higher commission for diverting or 'repatriating' open bets back to the tote. As a quid pro quo their commission would have to be raised from 4%, to 7% or 8%. The end result would have been that bookmakers did not compete with totes because the bet was being placed in the tote pool rather than with the bookmaker.

[125] Ultimately the tension that exists between bookmakers and totes with respect to the open bet is purely about an appropriate division of the rent. Punters' welfare is independent of the outcome of this ongoing negotiation between totes and bookmakers.

[126] With respect to the open bet, there is insufficient evidence for us to conclude that Kenilworth under Phumelela's management will be more aggressive towards bookmakers offering the open bet than Gold Circle was. Furthermore, there is no consistent theory of harm resulting from the concern that bookmakers might be forced to stop selling the open bet for those premises where they sub-lease from a tote.

Competition for the market

[127] The competitive landscape has, to a large extent, been formed by the regulatory environment. In the early stages of South Africa's democracy it was decided that gambling should be regulated at a provincial level. Each provincial regulator thus decides how the horseracing market is structured in its province. It is technically possible to have very different models being applied in different provinces.

[128] In reality the provinces have broadly similar regulatory environments for horseracing. The tote license is paired with the horseracing license and

there is a provincial monopoly created by the regulator. There does not seem to be any appetite for multiple tote licenses, and this would in fact be problematic given the model of commingling adopted by the totes. The only competitive influence that the provincial regulators have allowed into the market is for multiple bookmaker licenses per province and for bookmakers to be allowed to sell the open bet. The regulators have chosen the level of competition in the market along with other factors such as the maximum tote price (take-out rate), tax rates and transfer rates (3% from bookmakers to horseracing operators).

[129] There was no suggestion by the Commission, or any other party, that the gambling boards have been incompetent in setting the limits on what firms are allowed to do in this market. It is important to reiterate that the gambling boards not only ensure proper functioning of the market, but they are a price regulator. To the extent that there are undesirable developments in the market, they can revise their price regulation to ensure socially optimal outcomes.

[130] Regulators which have decided that it is optimal for a market to operate as a monopoly still have the option to retain competition for the market. Such was done with the South African national lottery, where a single national operator license is allocated but is reviewed periodically. At each review firms compete for the monopoly.

[131] The option to have periodic renewal of horseracing and tote licenses was not raised as something that the regulators are currently considering. It does, however, remain an option available to regulators in order to ensure socially optimal outcomes in the provincial monopolies that they have created. There is a problem in pursuing such an avenue where the racecourses are owned by the licensee rather than the regulator. Specifically, it does not seem likely that firms will tender for the horseracing and tote licenses without some reassurance that they will have access to lease the racecourses. This is a possibility in KwaZulu Natal, where the racecourses are leased from various municipalities, however less likely to be the case in other provinces, where they are owned by the horseracing operator.

[132] An alternative regulatory model is to have multiple tote licenses in each province and in so doing introduce competition 'into the market' rather than 'for the market'. Horseracing operators that currently have the sole tote license will lose revenues as a result of this change. Should this undermine the sport the regulator can adjust the transfer fee from betting institution (tote or bookmaker) upwards from the current level of 3%.

[133] The underlying rationale of such an alternative model is akin to that behind the liberalisation of power generation in Europe and the United States. The real monopoly is the distribution network or 'grid'. Power generation and supply on the grid, however, is not a natural monopoly and so can be privatised. Likewise, one might think of the racecourse and horseracing operations as the natural monopoly with tote outlets not being a natural monopoly. Thus it would be beneficial to introduce competition into the area which is not a natural monopoly and set up a mechanism (appropriate transfers from totes and bookmakers to horseracing operators) to ensure the sustainability of the natural monopoly.

[134] These are merely alternatives available to the regulator should they deem it necessary either currently or in the future to alter market outcomes. It is not the expectation that the regulators are going to need to change the regulatory environment as a result of this merger as the Tribunal does not find a significant lessening of competition to be a likely result of this merger.

Interested Parties

The Grooms' Association: Chophela Simoto

[135] Chophela Simoto, national chairperson of the Groom's Association, raised a concern that Phumelela at the time of its inception had promised to invest R17.5m in training and housing of grooms and that this investment had not been made.²¹

[136] Simoto also argued that the proposed merger would not benefit the grooms in any way and would not aid black economic empowerment of the sport.

[137] Simoto's concerns appear to be grievances with Phumelela's management style and history in the industry. He does not locate his concerns specifically to the merger. The most that can be said for his argument is that any increase in Phumelela's influence over the racing industry is against the public interest. Unfortunately his argument lacked specificity and in particular, merger specificity and we cannot discern in what he propounded, a rationale for prohibiting the current merger.

²¹ Simoto's concern about investments was confirmed by Ian Jayes, Kema's advisor. He explained that Phumelela were given a tax benefit, part of which was for investing in grooms accommodation and training facilities. A very small proportion of these monies were used for their intended purpose, but the majority was given as a dividend to Phumelela's shareholders.

Perhaps these industry wide concerns are best raised with the provincial regulators.

[138] Similarly his employment concerns were not merger specific, As Simoto himself confirmed, in the racing industry grooms are employed by owners of race horses, not by racetrack administrators. Since the merger will not have an effect on owners, it is unlikely to have an effect on the employment of grooms. Whilst Simoto may have a valid public interest concern it is one related to the industry in general and not one that arises from the merger.

Africa Race Group – Phindi Kema and Ian Jayes

[139] Phindi Kema and her colleague Ian Jayes represent a firm called the Africa Race Group which we understand seeks to enter the market as an operator. Khema and Jayes both expressed concern over the affect that Phumelela currently has over the industry and its implications for diversifying ownership particularly to previously disadvantaged communities. They also suggested that Phumelela had been guilty of asset stripping and that its commercially driven agenda was bad for the industry. Underlying this presentation was an assumption that the Tribunal process could be used to ensure that Kenilworth was sold to a new entrant.

It is not our task however to tell Gold Circle who to sell to. We can only decide if their current choice of purchaser would lead to a substantial lessening of competition or not be justifiable on substantial public interest grounds. Again, like those of Simoto, these concerns were not relevant to the context of the merger. Rather they expressed a concern with the state of the industry. For this reason we believe that these concerns are best addressed by an authority charged with the responsibility of issuing licenses to operators.

Discussion of potential conditions

[140] The Commission recommended that the merger be prohibited. During argument at the end of the hearing the Commission suggested for the first time that it might support approval of the merger if conditions could be proposed that ensured that Kenilworth was not subject to the control of Phumelela, but rather had a “truly independent” board.²² The merging parties undertook to consider proposing such conditions. Subsequent to us hearing final argument the merging parties forwarded their proposals. These included:

²²See pages 2270 and 2271 of the transcript.

- *“Independent Kenilworth Racing Board*

Of the 6 (six) directors appointed by the Trust to the board of Kenilworth Racing, at least 3 (three) will be independent (i.e. not employees, directors, trustees or advisors of the Trust or Phumelela Gaming and Leisure Limited (“Phumelela”)). Therefore, 3 (three) directors will be appointed by the Western Cape Chapter of the Racing Association (“WCRA”) and 3 (three) directors will be independent. The majority of the board will be constituted by independent directors and directors appointed by WCRA.

The memorandum of incorporation of Kenilworth Racing will be amended to include a provision that the management and control of Kenilworth Racing’s business vests in the board of Kenilworth Racing, and that the shareholders of Kenilworth Racing may not limit or fetter the discretion of the board.

No director of Kenilworth Racing may hold shares in Phumelela.”

- *“Industry Agreements*

The draft industry agreements (i.e. the Commingling Agreement, the Substitute Sports Administration Agreement, the License Agreement and the Teletrack Partnership Agreement) to which Kenilworth Racing is to become a party, will afford to Kenilworth Racing the unilateral right to terminate any of those agreements on 90 (ninety) days’ notice.”

- *“Phumelela Management Agreement*

The duration of the management agreement concluded between Phumelela and Kenilworth Racing will be 5 (five) years, renewable for 3 (three) periods of 5 (five) years each at the instance of Kenilworth Racing.”

- *“Kenilworth Racing Branding*

The board of Kenilworth Racing will always have the right to adopt Kenilworth Racing’s own branding.”²³

[141] The Commission was not satisfied with these conditions and persisted in recommending a prohibition of the merger.

²³Paragraphs 1.1, 1.2, 1.3 and 1.5 from the letter to the Competition Tribunal from Roodt Inc on 1 November 2012.

[142] If the Commission is correct and that Phumelela through the merger will be able to control Kenilworth then the tendered conditions do little to alleviate that concern. They are largely window dressing and do nothing to inhibit Phumelela's ability to assert its influence over Kenilworth. On this issue we agree with the Commission. However, because there is no expected likely lessening of competition, even when effectively treating Phumelela as though it were a party to the merger, such conditions or an improvement on them are not considered necessary.

[143] Therefore we did not seek to make the merger conditional upon these conditions tendered by the merging parties.

[144] We take a different approach to the issue of conditions relevant to the public interest issue of employment.

[145] The possibility of retrenchments at Gold Circle Western Cape arose in the course of the hearing. It was argued that the management contribution by Phumelela extended far beyond the 7 or 8 executives necessary to head up the divisions, but also included a large number of support staff. Smith estimated this number at between 120 and 140 people who are currently at Phumelela and are supporting the executives currently involved in managing the Western Cape operations.²⁴

[146] The consequence of this is that there are duplications that might result from the merger and the management agreement with Phumelela. This will probably result in retrenchments.

[147] Prompted by the Commission, the merging parties proposed a condition to halt any merger specific retrenchments for a period of two years.²⁵

[148] We agree with the Commission that there is potential risk of retrenchments especially given the lack of consultation by Gold Circle with any unions or directly with employees. Thus we decided that the tendered condition was appropriate to address public interest concerns and made approval of the merger conditional upon it.

CONCLUSION

[149] We have found, for the reasons set out in this decision that the merger will not lead to a substantial lessening or prevention of competition even after assuming that Kenilworth will not act independently of Phumelela post-merger.

²⁴Mr Smith at 2033 of the transcript.

²⁵See para 1.4 of the letter to the Competition Tribunal from Roodt Inc on 1 November 2012.

[150] The merger may however adversely affect the public interest because it may result in a large number of redundancies and hence retrenchments post-merger. The parties tendered a condition to address this concern. The Commission was satisfied with the adequacy of this condition and so are we. For this reason we approved the merger subject to this condition on the 15 November 2012. The condition has already been made an order of the Tribunal and we attach it to these reasons again for convenience as Annexure A.



Norman Manoim

07 February 2013

DATE

Yasmin Carrim and Merle Holden concurring.

Tribunal Researcher: Thabani Ngilande and Andrew Sylvester
For the merging parties: Alfred Cockrell SC and Michelle le Roux instructed
by Roodt Inc.
For the merging parties: David Gordon SC and Matthew Swain instructed
by Barkers Attorneys
For the Commission: Michael van der Nest SC and Jerome Wilson
instructed by the State Attorney