COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 27/CR/Mar07

In the matter between:

Competition Commission	Applicant
And	
Netcare Hospital Group (Pty) Ltd	First Respondent
Community Hospital Group (Pty) Ltd	Second Respondent

In re the large merger between

Netcare Hospital Group (Pty) Ltd	Acquiring Firm
And	
Community Hospital Group (Pty) Ltd	Target Firm

Panel	:	N Manoim (Presiding Member), U Bhoola (Tribunal Member) and Y Carrim (Tribunal Member),
Heard on	:	05 December 2007
Order Issued	:	10 March 2008
Reasons Issued:		**10 March 2008**

Failure to notify

DECISION

1] This is an application for the Tribunal to confirm a settlement agreement reached between the Commission and the respondents in terms of section 49D of the Competition Act (the 'Act').The agreement purports to settle two alleged contraventions by the respondents. The Commission alleges that the respondents:

a) implemented a merger without the approval of the Competition authorities in contravention of section 13 A(3) of the Act; and

b) contravened section 4(1)(b) of the Act, in that whilst not being members of a single economic entity, and being instead competitors, they adopted the same pricing structure for the tariffs charged by the hospitals in their respective groups

2] The respondents have agreed to pay a penalty of R6 million as an administrative penalty to settle both matters.[1] The penalty is treated as a lump sum and thus it is not clear from the agreement what proportion of the penalty has been allocated to the respective contraventions. In oral argument Ms Mkhwanazi, who appeared for the Commission, said that for their internal purposes the penalty had been allocated as follows:

Failure to notify – R500 000.00

Section 4(1)(b) – R5 500 000.00

Total - R6 000 000.00

3] The respondents have not done a similar exercise, but regard the quantum as a reasonable settlement figure.[2]

4] The facts of this case appear more fully in our decision in respect of the merger

1 Clause 7.1 of the agreement read with clause 7.5

2 As we discuss later, the respondents do not think that the Commission can proceed against them under both sections for the same conduct, but as they consider the amount reasonable in respect of the contravention of section 13A(3) they do not contest the point.

and need not be repeated in full here.[3] In brief, the Community Healthcare Hospital Group (CHG), is a company that owns 5 private hospitals. CHG arose out of the ashes of the former Malesela Group of hospitals that was liquidated in 1999. In the first phase of its existence CHG, then nominally owned by an attorney acting for the future shareholders, pursued a strategy of securing the erstwhile Malesela hospitals and rights from the liquidators. In this it was partially successful. Once these rights were secured, the nominee transferred ownership to the current shareholders who then held shares in the following proportions: Netcare (with a 43.75% shareholding), Community Hospital Group (with a 43.75% shareholding), Duelco Investments 65 (Pty) Ltd ("Duelco") (with a 6.25% shareholding), and Private Preview Investments 27 (Pty) Ltd ("Private Preview") (with a 6.25% shareholding).

5] We are advised that the shareholders' agreement was concluded in 2002 and in terms of this agreement, Netcare and CHG Holdings, the latter the investment vehicle of two erstwhile Malesela shareholders, - Anna Mokgokong and Joe Madugundaba - enjoyed joint control of CHG. It is common cause that this acquisition of joint control by Netcare was not notified to the Commission and hence the sanction contained in the consent agreement. What is not clear either to the Commission or the respondents is whether joint control may have already been acquired before this date. The reason for this difficulty is that Netcare was active both in the implementation of strategy around the rescue efforts, lent money to CHG, and, once the hospitals were rescued, introduced some of its systems into the hospitals and took over their pharmacies. Thus Netcare is more than likely to have exercised joint control over CHG for the period preceding the conclusion of the shareholders agreement. This period was probably about 24 months. Netcare continued to exercise joint control over the group until its decision to acquire the entire shareholding in CHG from the other shareholders. This latter transaction to acquire the full equity, was the subject of a notification by the respondents on 14 August 2006, and was approved by us without conditions on 2 August 2007.

6] The non-notification of the prior merger was only brought to the Commission's

3 See our decision reported as Netcare Hospital Group (Pty) Ltd and Community Hospital Group (Pty) Ltd Case No. 68/LM/Aug06.

attention in July 2005 when a third party, Pro Sano Medical Scheme, brought a complaint to the Commission alleging that CHG had adopted the Netcare tariffs for the purpose of determining its fees and that this amounted to a contravention of section 4(1)(b) of the Act which states:

> 1) *An agreement between, or concerted practice by, firms, or a decision by an association of firms, is prohibited if it is between parties in a horizontal relationship and if –*
>
> a) *...;*
>
> b) *it involves any of the following:*
>
> i) *directly or indirectly fixing a purchase or selling price or any other trading condition;*
>
> ii) *dividing markets by allocating customers, suppliers, territories, or specific types of goods and services; or*
>
> iii) *collusive tendering.*

7] When confronted by the Commission, Netcare's response was to say that:

> ".. after consideration of the relevant facts in the context of section 12(2)(g) of the Act, it appeared that Netcare had acquired control over Community, and accordingly that Netcare and Community failed to notify this acquisition of control."[4]

Did the Commission give due weight to all the facts concerning the section 13A(3) contravention.

4 See paragraph 3.2 of the consent order.

8] No explanation for the failure to notify is made in the papers nor was one given to the Commission during negotiations in respect of the present consent agreement.[5] We can only surmise from the record in the merger hearings that due to the limping manner in which the group was reconstituted, no 'crystalline moment', to quote Netare's counsel, emerged during the period prior to the conclusion of the shareholders agreement at which it appeared that joint control had arrived and hence animated the shareholders attention sufficiently to consider notification. Even if one gives the merging parties the benefit of the doubt due to the murky nature of legal relationships during this embryonic period, no explanation is given to account for the period after the conclusion of that agreement, when clarity as to the parties' legal relationships must at last have crystallised.[6] Given hospital groups history of interest in one another's mergers that has manifested itself in hearings before us it hardly seems likely that Netcare at least, was ignorant of these considerations. Where matters of this nature appear to have been discussed in the minutes of Netcare, the relevant portions have been excised by the attorneys on the basis of alleged privilege.[7]

9] A fair reading of the minutes suggests that Netcare had an interest in not appearing as a controlling shareholder of CHG during its formative years. The motive for keeping CHG's real control structure opaque was not to escape competition scrutiny, but rather to present CHG to the outside world as an emerging empowerment company, an image that would have been compromised if it was known to be subject to the control of one of the three large private hospital groups. This appears to have been important for several reasons not least of which was to ensure that the group acquired transfer of the licences from the erstwhile Malesela group as the following passage from Netcare's memorandum to the board of directors dated 22 March 2001

5 According to Commissions' counsel, *"The explanation wasn't absolutely clear as to why the notification did not occur."*

6 Interestingly in the opinion of one of the shareholders and the chief executive of CHG who was commenting on control of hospitals in an earlier and unrelated merger proceeding and who stated that in his experience *" a company gets controlled by two ways. The one is by knowledge and the other is by capital."* If this thesis is correct, Netcare which provided both know-how and capital to CHG after it emerged from liquidation, probably enjoyed joint control prior to the conclusion of the shareholders agreement. See record of Business Venture Investments and Afrox Healthcare Ltd Case number 105/LM/Dec04, page 32

7 See record of merger proceedings pages 365 and 1053 for examples.

suggests:

> "Netcare also recognised MHG's potential strategic appeal in that a closer association with MHG would increase Netcare's network of referral and cooperative hospitals. Having committed to the project as consultants to Malesela, the strategy was to develop and promote a contest between Malesela and Afrox Healthcare, *a contest which was politically far more easily manageable.*
>
> *I will not herein dilate on the details of the fascinating contest and exchange that has taken place between Malesela, the Macmed liquidators, Afrox Healthcare, the bondholders in each case, the bank's creditors involved, save to record that Malesela are emerging with a degree of credibility and honour far greater than they previously enjoyed and have developed a groundswell of support for their re-entry into the private healthcare industry (Afrox excluded).*[8] (Our underlining)

10] Ms Mkhwanazi referred us to an earlier merger involving a takeover of the Afrox group by a consortium. CHG, emerged as an objector and applied to intervene in those proceedings. In the course of the intervention application, the then chief executive officer of CHG, Dewald Dempers gave evidence and was cross-examined on the relationship between Netcare and CHG. He alleged that Netcare did not control CHG. This emerges from the following extract from those proceedings where counsel for Afrox is cross-examining Dempers:[9]

> "*ADV SUBEL: In other words, it would be fair to say, is it not, that Community Hospital Group (Pty) Limited and its various subsidiaries or hospital interest is a joint venture company between Netcare on the one hand and Community Healthcare*

8 See record of merger proceedings page 1398.
9 See Business Venture Investments and Afrox Healthcare Ltd, Case number 105/LM/Dec04, transcript of hearing dated 8 February 2005, pages 47-8.

Holdings on the other?

MR DEMPERS: It's jointly owned company. That's correct sir.

ADV SUBEL: Look colloquially it's a JV company.

MR DEMPERS: No I don't think so.

ADV SUBEL: Well, there is a common interest at both Netcare…

MR DEMPERS: There is a common equity holding. That's correct sir and that's it.

ADV SUBEL: Netcare and Community Healthcare Holdings each own 43.75% of the shares in Community Hospital Group (Pty) Limited.

MR DEMPERS: That's correct.

ADV SUBEL: And through that company both Netcare and the first applicant conduct these various hospital businesses.

MR DEMPERS: No sir.

ADV SUBEL: Not?

MR DEMPERS: No.

ADV SUBEL: Well why not?

MR DEMPERS: Through that company the hospital business is conducted. Netcare has got no control over Community Hospital Group. It has got one Board representative out of 6 members.

ADV SUBEL: It's represented on the Board of Community Hospital Group.

MR DEMPERS: One Board member out of six, that's correct sir.

ADV SUBEL: Yes, and it's as significant a shareholder in that company as is Community Healthcare Holdings.

MR DEMPERS: That's correct sir.

ADV SUBEL: Well does it have any more or less influence than

does Community Healthcare Holdings?

MR DEMPERS: It's got much less influence than Community Healthcare Holdings.

ADV SUBEL: Why?

MR DEMPERS: Because of the Board representation.."

11] For this reason in our present consent order hearing the Commission's counsel submitted that when the Commission commenced investigating the Pro Sano complaint, it did so on the assumption that Netcare could not control CHG. Netcare's representatives responded by alleging that CHG was in fact the subject of joint control and had been at the relevant time period to which the Pro Sano complaint related.

12] It is clear why it suits the respondents to allege joint control now faced with an allegation that there has been collusion between Netcare and CHG. In the past, the Commission has settled contraventions for unlawful implementation of a merger at penalties that are miniscule in relation to those for prohibited practices. By emphasizing joint control now, and de-emphasizing the aspect of collusion, Netcare tries to put the best face on an unfortunate set of facts. However, as the quote from Dempers (above) illustrates, this only underlines the cynicism with which this relationship has been used in the past. When it suited the respondents to allege that Netcare did not have control over the group it did so. When it became apparent that Netcare was taking sole control then the history was glossed in an entirely different manner. Contrary to Dempers testimony in Afrox Healthcare, Netcare now emerges as having, at the least, joint control over CHG and indeed being the most influential of the three shareholders.

13] There has been no change in the *de jure* or *de facto* relationship between Netcare and CHG, that is on record, that would reconcile the evidence of Dempers in Afrox Healthcare and the respondents' version in the present proceedings. In the absence of such an explanation it would appear that Netcare's role as a shareholder has been finessed to suit the legal exigiencies of the moment.

14] It may well be that such an explanation is possible. But it is a material issue in assessing the extent of the penalty in respect of non-notification as it is relevant to the consideration of whether the parties have " co-operated with the Commission and Tribunal" (section 59(3)(f)) and an assessment of "the behaviour of the respondents" (59(3)(c)). In other words, even though the respondents may have come clean when confronted at the time of the Commission's non –notification investigation, the Commission is entitled and indeed ought to have had regard to the history of inconsistent explanations on the same issues before the Competition Authorities to assess properly the firms' behaviour and degree of co-operation. If one or both of the respondents had been less than frank on this issue with the competition authorities this should be taken into account as an aggravating factor in assessing an appropriate quantum for the penalty.

15] In our view, the Commission by failing to seek a satisfactory explanation on this aspect has given no consideration or insufficient weight to this issue in considering an appropriate penalty.

16] Another criticism we have of the Commission's approach is the fact that it entered into the consent order prior to the conclusion of the merger hearing. As a matter of law it could do so. However, by settling prematurely the Commission was not able to assess the degree to which the illegal implementation compromised its ability to investigate the merger. As we pointed out in the merger decision, the prior implementation had affected the

ability of the Commission to conduct its investigation.[10] Ms Mkwhanazi very candidly conceded this point in argument and stated

> *MS MKHWANAZI: Chair we fully accept, you know, that that is in fact the position and it presented the difficulties the Commission faced in making its case during the merger hearing and we did look at the reasons and did contemplate revisiting. Perhaps what we do accept in fact not perhaps we do accept that the agreement was concluded much earlier than the merger was finalized and at the time we may not have anticipated that the prime implementation would present the very difficulties that we faced during the merger hearing.*
>
> *This is basically you know the submission that I've made earlier that we you know gun jumping does pose you know a significant difficulty to the Commission and to yourselves as the Tribunal in evaluating the mergers and while we would like a message to be send out to firms that in fact this conduct cannot be accepted.*

17] We certainly cannot say that if the Commission had been able to overcome these difficulties the merger would have been prohibited, but what the prior implementation did achieve was to prevent the optimal adjudication of the

10 "... Many of the witnesses, including some solicited by the merging parties, seem concerned about the private hospital sector. What they have not been able to say is that the merger has contributed to this problem or whether it is a problem inherent in the present market structure, dominated as it is by the three major groups. Without such testimony it is difficult to impugn this merger. Whether such testimony might have been forthcoming if the merger had not been implemented already for some years, is one of those imponderables we cannot resolve. We can certainly say that many of the funder witnesses found it difficult to conceptualise and independent CHG – something they had never known – and then to hypothesise as to how it might have behave differently outside of Netcare's grasp. That this has redounded to the benefit of Netcare in defending the merger and to the detriment of the Commission in opposing it is also clear. It reinforces why under our system prior implementation is unlawful." See page 41 of our reasons for decision in the merger proceedings.

issues. Given that the Commission was of the view that the merger should be prohibited and that some industry representatives expressed concern during the course of the hearing – it is by no means a forgone conclusion that if the merger had been heard in the normal course i.e. at a stage before it was implemented that it would have been approved unconditionally.

18] The Commission pointed out in argument that historically contraventions of section 13A(3) had not attracted high penalties – certainly they are dwarfed by the size of penalties in prohibited practice cases. This observation is certainly correct. It may well be that reconsideration of this approach is long overdue. However in this case we have a failure to notify accompanied by implementation of the merger, a status that had already existed for a period of between six to seven years by the time of the adjudication of the merger in June 2007. The long duration of the implementation of a merger that was not without competition implications despite our eventual decision to approve it unconditionally, deserves a penalty that reflects the serious nature of this conduct.

19] If administrative penalties are about deterring wrongful conduct then the present penalties exhibit insufficient disincentive on firms not to notify – and indeed firms may well construe low penalties as an acceptable cost of doing business if prior implementation impedes proper adjudication.[11]

Was the Commission correct to regard this as both a contravention of section 13A and section 4(1)(b)?

20] Although not argued as a point of objection to the present consent order, Netcare has argued that it is artificial to allege that the firm has both implemented a merger without consent and contravened section 4. Were we to confirm the order it would not be necessary to consider this argument. Given that we have referred the matter back, it would be necessary for us to give the parties our *prima facie* view on this matter, should they choose to negotiate another consent order.

11 See our merger decision for more on the implications of why under our merger system prior implementation frustrates proper adjudication of a merger.

21] In our view, the approach taken by the Commission is correct. Jurisprudentially these are separate and distinctive contraventions of the Act. Not all unlawful implementations of a merger involve at the same time a prohibited practice. Thus a vertical merger or a conglomerate merger, or a merger between firms in the same line of production who were not competitors in the same market would typically not give rise to a prohibited practice even if implemented unlawfully.

22] The respondents argue that because the merger not notified was about joint control, had the merger been approved, Netcare and CHG (jointly controlled by Netcare) would have been considered as a single economic entity and thus it would be artificial to say that it had both failed to notify and contravened section 4.

23] The problem with this argument is that it equates the consequences of joint control and sole control. Our jurisprudence and that of other jurisdictions has treated them as separate notions and for very sound reasons – a firm that is subject to joint control does not necessarily have controllers with the same incentives. [12] Thus Netcare in considering pricing or investment decisions may have regard for how those decisions in CHG in which it has only a 43.75 % interest impact on its much larger interests in Netcare which it wholly owns. CHG Holdings, which has no hospital interests outside of CHG, may have had a different view, and as a long as they both enjoyed joint control, an outcome may have been different from that of Netcare, as sole controller.

24] Thus without a full merger Netcare and CHG cannot be considered part of a single economic entity for the purpose of section 4. Absent an exemption in terms of section 10, firms setting prices together can validly be found to

12 See ICI/Tioxide 1991 (4) CMLR 854 where it was stated that: *"... because decisive influences exercised solely is substantially different to decisive influence exercised jointly, since the latter has to take into account the potentially different interests of the other party or parties concerned .. By changing the quality of decisive influence exercised by ICI on Tioxide, the transaction will bring about a durable change of the structure of the concerned parties."* (This statement was quoted with approval by the Tribunal in Iscor limited and Saldanha Steel (Pty) Ltd Case No. 67/LM/Dec01 on page 7).

contravene section 4 of the Act. This means that the Act of unlawful prior implementation and the contravention of section 4 constitute distinct contraventions, and the same set of facts may validly give rise to a contravention of both, without there being a suggestion that there has been a splitting of charges. However, and the Commission concedes this, to the extent of assessing the quantum of a penalty, it would be appropriate to have regard to the fact that the harm caused by one may overlap with the harm caused by the other, although they are not necessarily fully co-extensive. Thus if the harm caused by non-notification led to a collusive outcome and higher prices, then this would overlap with the harm associated with the contravention of section 4.

Was the assessment of the collusion penalty appropriate?

25] Although the Act does not require one to do so, it has been past practice of the Commission and Tribunal to fine a firm not on its entire turnover in the relevant financial year, but what has been termed the 'affected' turnover. By affected turnover we mean the turnover in the line of business in which the prohibited practice occurred. In this case the Commission has followed that approach and determined that the affected turnover was that of CHG only. There is no warrant for limiting the affected turnover in this restrictive manner in respect of either the section 4or section 13A(3) contravention. The Commission's rationale seems to be that the adverse affects of the collusion would only have been reflected by a rise CHG's price for its services – because it was the junior partner in the collusion – and completely dwarfed by Netcare which would have charged the same prices for its services irrespective of whether the collusion took place. This is a dangerous basis for assessing cartel penalties and takes the notion of affected turnover too far. Whilst a relevant limit to affected turnover may be to limit the firms to overlapping turnover in respect of section 4, it is wholly artificial and bad policy to limit the affected turnover further to that of the junior partner. We know of no precedent for treating firms involved in cartel activities in such a liberal manner.

26] In relation to calculating the affected turnover of the parties for the purpose of the section 13(A)(3) violation, there is even less warrant for determining the

turnover by reference to that of the one party only. This can lead to serious under deterrence. Of course once the correct affected turnover has been assessed, the Commission in deciding on an appropriate level for the fine can reduce the level of the fine by taking factors into account that seem to be common cause in this case for example:

a) the affect of the central bargaining process in the sector that was only prohibited by the Commission's enforcement of a consent order in 2003;[13]

b) the degree to which CHG's independent pricing power may have impacted that of Netcare.

27] However, one should not confuse the extent of the affect of conduct with affected turnover. In a collusion case all the turnover of overlapping activities is at the very least part of affected turnover. In a merger non-notification case the same would hold.

28] On the present figures, if Netcares' hospital turnover in SA was taken into account and added to that of CHG, then the present fine would constitute a tiny fraction of this figure - less than 1%.[14] This is miniscule indeed and pales in comparison with other penalties set in prohibited practice cases.[15]

29] For all these reasons whilst we do not take a view on what an appropriate

13 The central bargaining meant that for some period of the violation hospitals were charging uniform prices to funders.

14 This would be arrived at by taking a combined turnover of R6 824 686 337.00 being R298 286 337.00 for CHG, the present figure used by the Commission and the figure of R6 526.4m, the hospital turnover of Netcare in South Africa according to its Group Audited Results, page 21. The Group Audited Results do not show whether or not the turnover figure for Netcare's hospitals in South Africa also include the CHG turnover. See Netcare's Group Audited Results on page 7 of the record and CHG's Consolidated Annual Financial Statements on page 27 of the record.

15 See for instance Competition Commission v Federal Mogul Aftermarket Southern Africa (Pty) Ltd & Others Case 08/CR/Mar01, where the penalty was 4.97% of turnover, Harmony Gold Mining Company Limited and Durban Roodepoort Deep Limited v Mittal Steel South Africa and Macsteel International BV Case 13/CR/Feb07, where the penalty was 5.5% of turnover and Competition Commission v Tiger Consumer Brands (Pty) Ltd 15/CR/Feb07, a collusion case, where the penalty was 5.7% of turnover.

penalty should be, we believe that the present agreement is inappropriately low and that we cannot approve it. Whilst we encourage parties to negotiate settlements with the Commission and believe this is in both the public interest and the interests of affected parties, we cannot sanction agreements which fall far short of the standard of an appropriate penalty. For the reasons, given the Commission has failed to give due weight to certain considerations or taken them into account at all and has erred in calculating the affected turnover, an appropriate penalty, absent a satisfactory explanation to some of the concerns we have raised, should be substantially higher than the present one.

30] We also raise one technical issue which does not affect the substance of our analysis. Although the consent order has been brought in terms of section 49D of the Act, that procedure is only available for prohibited practices, i.e the section 4 contravention not the section 13(A)3 contravention. This is because section 49D is expressly limited to settlements in prohibited practice cases.

31] However, there is no bar on parties agreeing to the terms of a 'settlement order' to settle disputes over litigation concerning other contraventions of the Act over which we exercise jurisdiction. As the Competition Appeal Court held in the context of prohibited practice cases which get settled after the referral comes to the Tribunal:

> "*The Tribunal is entitled – at any time while it is seized with the matter – to make an order proposed and agreed to by the respondent provided only that it acts in accordance with the requirements of just administrative action that is lawful, reasonable and procedurally fair. And, of course, that it is thereafter satisfied that the order is appropriate*"[16]

32] The procedural distinction between a consent order and a settlement agreement, does not detract from the fact that in exercising our discretion to confirm the order or to refuse to do so, we exercise our discretion from the

16 See the decision of the CAC in Glaxo Smith Kline South Africa v David Lewis N.O. & Others Case No. 62/CAC/Apr06 page 24.

same vantage point – do the terms of the settlement adequately protect the public interest? (See American Natural Soda Ash Corporation and Another v Competition Commission of SA and Others (2005) 1 CPLR 1 (SCA).[17]

33] In this case for the reasons that we have given earlier, we do not believe that the present agreement- whether viewed in terms of our discretion to approve consent agreements in terms of section 49D or in terms of our more general powers to approve an appropriate settlement as an order of the Tribunal - adequately safeguards the public interest, and for that reason, we refuse to make the order sought. [18]

_____ **10 March 2008**

N Manoim **DATE**

Tribunal Member

U Bhoola and Y Carrim concur in the judgment of N Manoim

Tribunal Researcher : **R Kariga**

For the merging parties: D Unterhalter (SC) assisted by J Wilson, instructed by Webber Wentzel Bowens Attorneys

For the Commission : W Mkwanazi, M Worsely and N Mokuena

17 In that case the court held in the context of prohibited practice cases that the orders the tribunal can give *" are of a limited kind to be made in the pubic interest."*

18 See Glaxo Smith Kline South Africa v David Lewis N.O. & Others on page 19 where it is stated that: *"The Commission Acts on behalf of the South African Republic and, in particular, the South African consumers whenever it investigates a complaint, evaluates the results and determines whether or not to refer the matter to the Tribunal for adjudication".*