COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 37/LM/May06

In the matter between:

African Oxygen Limited Acquiring Firm

And

Refrigeration Investment Company (Pty) Ltd Target Firm

Panel:	Y Carrim (Presiding Member), M Moerane (Tribunal Member) And T Orleyn (Tribunal Member)
Heard on:	22 November 2006
Decided on:	22 November 2006
Reasons issued on:	08 February 2007

Reasons for Decision [NON CONFIDENTIAL VERSION]

APPROVAL

[1] On 22 November 2006, the Competition Tribunal conditionally approved the merger between African Oxygen Limited and Refrigeration Investment Company (Pty) Ltd. The reasons for approval follow.

THE MERGER TRANSACTION

[2] In terms of the proposed transaction, the acquiring firm, African Oxygen Limited ("Afrox")[1] will acquire the entire issued share capital of the target firm, Refrigeration Investment Company (Pty) Ltd ("Rico") from Danfoss AS ("Danfoss"), a

[1] Afrox is directly controlled by British Oxygen Company plc ("BOC"), a British company which holds approximately 50.47% of its issued share capital. A list of the companies controlled by Afrox can be found on page 88 of the Commission's record.

Danish company. Rico is an investment company, which holds the entire issued share capital of Refrigeration Equipment Company (Pty) Ltd ("Reco").[2]

[3] [redacted].[3]

[4] The parties submit that the transaction will enable Afrox to extend its product offering by entering the refrigeration equipment market. Afrox customers will have a "one-stop-shop" for a full range of refrigeration products. For Rico, its shareholder Danfoss wants to dispose of their worldwide refrigeration wholesale businesses.

COMPETITION ANALYSIS

[5] Both parties operate as importers and suppliers of various types of refrigerant gases.[4]

The Relevant Product Market

[6] In South Africa, all refrigerant gas is imported. The majority of refrigerant gas sold in SA comprises R134A, R22 and R404A. [5] Refrigerant gas is imported in iso-containers and disposable cylinders. Gas imported in iso-containers (18-20 tonnes)

[2] RICO also holds the share capital of Refrigeration Equipment Company (Namibia) (Pty) Ltd, a company that conducts business outside the Republic.
[3] See Sale of Shares Agreement from page 89-258 of the Commission's record.
[4] Afrox is a vertically integrated gas manufacturing, distribution and retailing company with a national distribution network and 90 retail outlets located throughout SA. Its *Industrial and Special Products* division offers *inter alia* the following products to industrial and ordinary customers: refrigerant gas, cylinder and liquid fabrication gas, scientific gas, medical gas, hospitality gas, handigas, helium and packaged chemicals; gas equipment manufacturing and welding equipment manufacturing. Reco is involved in wholesaling and distributing refrigerant and air-conditioning equipment, component and spares and related services. 70-80% of Reco's components are imported - although Reco does manufacture certain refrigeration equipment. As part of its business, Reco supplies various types of refrigerant gases.
[5] R22 and R134A represent approximately 90% of total volume of refrigerant gas sold in SA. R134A and R22 are commonly used for household and commercial refrigeration, automotive air-conditioning, mine cooling, food cabinet and soft-drink fridges, water chillers and blowing agents for various foams and propellants. R404A is used in low temperature refrigeration, medium temperature refrigeration and supermarket freezers. A full list is listed on page10-11 of the Commission's report.

are bulk-broken (i.e. decanted) into refillable cylinders (about 60kg) or refillable drums (about 1 tonne).

[7] The smaller disposable cylinders (approximately 13kg) known as "disposacans," are imported in the country ready-filled.[6] Numerous participants in the market other than bulk-breakers import and distribute refrigerant gas in the form of disposacans. According to the parties, it is estimated that approximately one third of the South African market is supplied in disposacans.

[8] Both merging parties import gas in disposacan form and in bulk form and therefore operate as bulk breakers. Their main customer segments are large end-users (which purchase refrigerant gas directly from bulk-breakers in 1 tonne drums), original equipment manufacturers (OEM) such as automotive manufacturers (who also often purchase in bulk 1 tonne drums but may purchase in other sizes), installers and service customers, supermarket contractors and industrial contractors.

[9] While the merging parties defined the market as that for the bulk-break and disposacan supply of refrigerant gas nationally, the Commission, defined a broad market for the distribution / (whole)sale of refrigerant gas.

[10] The Commission also submitted that the market might be further delineated based on (1) method of distribution/supply viz. by Tonnage/drums; Refillable cylinders; and Disposacans, and on (2) individual gas type. The Commission's view was based on submissions from several users of refrigerant gas in various quantities.

Method of distribution/supply

[11] From a demand-side perspective, several customers interviewed by the Commission indicated that they could not switch between different methods of supply i.e. different container sizes, because of several factors, which influenced the input cost of refrigerant gas in their operations. These factors include consumption, manoeuvrability, working capital considerations, site access and security. Pricing information submitted to the Commission confirmed significant differences in the per kilogram price of R22 and R134A for the different container sizes.

[6] Bulk-breakers (i.e. competitors who import large iso-containers and decant them into smaller containers) supply the end-user market by means of intermediaries such as wholesalers as well as directly. According to the Commission, some wholesalers have also imported filled 60kg refillable cylinders.

[12] From a supply-side perspective, the Commission found that small-scale bulk breakers are limited to selling smaller volumes of gas (13kg and 59kg cylinders) while medium to large-scale bulk breakers can supply small and large volumes (one ton drums). Suppliers informed the Commission that margins are dictated by the respective segment into which one sells refrigerant gas.

Gas Type

[13] In respect of submarkets according to gas type, the Commission found that although each gas is homogenous in nature and therefore indistinguishable from the same gas sold by any other supplier, from a demand-side perspective the various refrigerant gases are for the most part neither substitutable nor interchangeable with each other. For this reason, the Commission was of the view that each gas may constitute its own product market segment depending on its application.

The Relevant Geographic Market

[14] Even though the Commission recognised the possibility of regional markets, their analysis was limited to the national market due partly to the fact that market share information was not readily available for the narrower geographic markets, but largely because it found significant competition concerns even on a national geographic basis.

[15] While we do not find it necessary to make a definitive finding on the precise ambit of the markets, we will accept for these purposes, that the relevant market should be defined broadly as the competition concerns, which arise from a broadly defined market, are likely to arise from the possible submarkets.

Impact on Competition

[16] In the broad national market for the distribution / (whole)sale[7] of refrigerant gas (all distribution types), an examination of the 2005 market shares provided by the Commission reveals that pre merger, there are four very large players viz. A-gas (35-

[7] Henceforth referred to as the sale of refrigerant gases.

40%), Afrox(25-30%), Rico (20-25%) and Kovco (5-10%). Post merger the merged entity would be the largest player with a market share between 50 -55%.[8]

[17] An examination of the shares of the sub markets by method of distribution/supply as well as by gas type; reveal that, with the exception of the disposacans market, post merger the merged entity will consistently enjoy market shares in excess of 50%. In the disposacans market, the Commission found that there were currently numerous players in the market who imported and distributed disposacans. The Commission also found that the market was characterized by low barriers to entry, little sunk costs and easy switching between suppliers in response to price competition. The Commission's market enquiries revealed that this market would disappear in time, as the use of disposacans would in the future be prohibited in South Africa due to environmental and safety considerations. Market participants indicated that disposacans would be replaced in future with refillable cylinders of a similar size. In light of this, the Commission was of the view that the disposacans market did not raise any serious concerns.

[18] Having established *prima facie* concerns based on the existence of high post merger market shares in the broad market for the distribution/ sale of refrigerant gas, the Commission's proceeded to examine the ease of entry into the market, the degree of countervailing power in the market, the actual and potential level of import competition, the dynamic characteristics of the market, the history of collusion in the market as well as the possibility of cooperation post merger.

The Merging Parties' submissions

[19] The merging parties appear to have acknowledged that the transaction would result in the increase in concentration in the broad and narrow markets. However in support of their contention that the transaction would nevertheless not result in a substantial lessening or prevention of competition in the relevant market/s, the parties in their competitiveness report argue that:

(a) There are low regulatory barriers, that the capital requirements and sunk costs for a new entrant to the bulk-breaking business are also

[8] See page 3 of the Commission's additional submission on market shares filed 15 November 2006. Prior to Afrox's entrance in the refrigerant gas market, there were two bulk-break operators in existence, viz. A-Gas and Rico. Since its entrance in 1994, Afrox has been growing its market share significantly over the period 2002 to 2005.

relatively low and that *"…a new entrant would be able to grow its business organically in much the same way as Afrox has, and could eventually supply the large individual end users in a manner akin to Afrox."*[9]

(b) Almost no lead time is required to enter the market when supplying disposacans and it takes approximately 6-8 weeks to set up a small-scale bulk-break facility and approximately 6-12 months to set up a medium to large-scale bulk-break facility;

(c) Over the past few years several new entrants have entered the refrigerant gas market as either importers of refrigerant gases or as re-sellers thereof;

(d) Competition in the refrigerant gas market is fierce and there is no history of collusion;

(e) All the product is imported and therefore anyone who wishes to be supplied with refrigerant gas is free to obtain such gas directly from one of the global manufacturers thereof;

(f) A-gas, who would remain a significant competitor and Kovco are alternate suppliers for end-users and wholesalers; and

(g) Countervailing power enjoyed by end-users and wholesalers coupled with the choice of suppliers and ease of switching available to smaller customers ensures that the increase in concentration is not problematic from a competition law perspective.

The Commission's investigation

[20] However, extensive market enquiries by the Commission revealed that:

(a) The transaction would inevitably result in the removal of an effective competitor in an already concentrated market. There are four players in the market and the proposed transaction seeks to merge the second and third largest.

(b) There would be an increase in the likelihood of coordinated effects/tacit collusion between the major players in this market due to *inter alia* the limited number of players present in the pre-merger market, the homogenous nature of refrigerant gases, increased

[9] Page 74 of the Commission's Record.

symmetry in post merger market shares, similar cost structures and high entry barriers;[10]

(c) Despite the parties assertions to the contrary, both competitors and customers of the merging parties lacked any significant countervailing power.[11]

(d) Several large industrial companies such as mines and automotive manufacturers indicated that they would not find it finically viable to invest in a bulk-break facility and would not import refillable cylinders and 1-tonne drums in the hypothetical scenario where the parties increase prices by 5% to 10% post merger. They also indicated that they were unlikely to switch between suppliers or import directly because of potential disruptions to their production schedules.

[21] In addition, the Commission received several submissions from third parties who raised concerns around the merged entity's significant market share and the possibility of price increases post merger. Some customers alleged that price collusion already existed amongst the main players and that in the long term there would be a negative impact on the market.[12]

[22] The Commission concluded that the transaction would remove an effective competitor from already concentrated markets and therefore result in a substantial lessening or prevention of competition in the relevant market/s.

The Divestiture condition

[23] In an attempt to address the Commission's concerns, the parties proposed an undertaking that it would divest Rico's gas business. [13] The parties however pointed

[10] The Commission found that the barriers to entry into the decanting of refrigerant gases at a scale that would effectively compete with the two largest players post merger viz. the merged entity and A-gas, were significant. According to the Commission, the merging parties had understated the costs of entering the refrigerant gas bulk-breaking industry in South Africa. Having considered various third party(customers) submissions on the cost and viability of investing in bulk-breaking facilities, the Commission formed the view that there were high barriers to entry.

[11] The Commission's market enquiries showed no evidence of any such countervailing power. According to the Commission, all customers questioned indicated that they in fact had no countervailing power. See third party submissions on page 1479-84 and 1496-99.

[12] See pages 36-7 of the Commission's report.

[13] Rico's "gas business" was defined as "the business of importing, decanting, distributing and selling refrigerant gases presently conducted by Rico and its subsidiaries." See Clause 2 of Annexure A to the Commission's Report.

out that this should not be regarded as a concession on their part that the Commission is correct in its conclusion.

[24] The Commission accepted the undertaking as adequately dealing with its concerns. In its view, the divesture would eliminate the horizontal overlap between the parties' activities. The Commission therefore recommended that the Tribunal approve the transaction subject to the divestiture conditions and procedures contained in Annexure A and Annexure B of its report. [14]

[25] While we were in agreement with the Commission that the divestiture of Rico's gas business effectively eliminates any horizontal overlap, we nevertheless asked the parties to address us on firstly the economic viability of divesting the gas business as a separate entity and secondly, the prospects of finding a buyer within the allocated time frame, including whether or not there has been any interest expressed by third parties to acquire the said business. [15]

[26] In written submissions filed on 10 November 2006, the parties argued that Rico's refrigerant gas business was indeed an attractive and economically viable opportunity, which had elicited interest from financially sound and independent prospective purchasers.[16] This view was based on a due diligence investigation in respect of Rico's refrigerant gas business conducted by Afrox in December 2005. The parties' submission took into account the nature of Rico's bulk-breaking assets, theoretical capacity, and available technical support, supply chain assistance which Afrox was willing to provide a new purchaser, Rico's market distribution channels and the financial assessment of Rico's business. The parties' also reported in their 10 November submission, that they were engaged in discussions with at least two prospective purchasers and based on the interest expressed by both prospective purchasers, were of the view that Rico's gas business would ultimately be divested in accordance with the undertaking.

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[14] Annexure A of the Commission's report sets out *inter alia* the nature of the divested business, the time periods relating to the divestiture, the merging parties' undertakings *inter alia* the appointment of the trustee, the purchaser and the duties and obligations of the parties during the trustee divestiture period. The specific details of the trustee's mandate are set out in Annexure B.

[15] See Tribunal's letter to parties dated 25 October 2006.

[16] See merging parties' submission titled "Economic Viability of the Refrigerant Gas Business of Refrigeration Investment Company (Pty) Ltd ("Rico") as a Separate Entity" filed 10 November 2006.

[27] At the time of the hearing held on 22 November 2006, the parties indicated that four parties had since expressed interest in purchasing Rico's gas business. [17] The parties also requested the Tribunal to extend the time periods set out in the original undertaking. [18]

[28] Annexure A to the Commission's report, which contained the original divestiture conditions, provided *inter alia*, that the merging parties would undertake to find a proposed purchaser for the divested business, to enter into a sale agreement and transfer ownership of the business within [redacted] from the merger clearance date (which we will refer to as the "initial period"). The condition also made provision for this period to be extended upon written application by the merging parties to the Commission for a further period [redacted](referred to as "further extension period") on good cause shown. If the merging parties were not able to transfer the legal title of the divested business to the proposed purchaser within the divestiture period, a trustee appointed by the merging parties (subject to the prior approval of the Commission) would have an exclusive mandate and power of attorney to sell the divested business within a further period of [redacted] (referred to as the "trustee's period").

[29] At the hearing, the parties argued that the initial period should be revised to [redacted] with a possible extension of [redacted] (upon application to the Commission) and that the trustee's period be extended to [redacted]. The parties argued that initial period of [redacted] as contained in Annexure A, was too short a period to find a purchaser especially in light of the impending Christmas period. They further submitted that the [redacted] trustee's period originally contemplated, would be insufficient time for a trustee to find a purchaser. They argued that there would be *inter alia* no prejudice caused by the extension as the divestiture condition contained a range of safeguards built in to ensure that the competitive environment endured during the divestiture period.

[30] The Commission opposed the extension of any of the time periods arguing that the international norm for a divestiture is 6 months and that it would be in the interests of the prospective purchaser to keep the divestiture period as short as possible.

[17] See Page 4 of the transcript of 22 November 2006.
[18] See Page 9 of the transcript.

[31] In competition law, divestiture conditions are imposed in mergers and acquisitions as structural remedies by competition agencies in order to address a particular competition concern that has been identified. Hence a condition that is imposed, in order to be an effective remedy, must be designed so as not to be overly broad or too blunt. The effectiveness of the condition is also dependant upon the length of the time given to merging parties to comply with such divestiture. This is because markets are dynamic and can change over a relatively short period of time. A time period of a year or longer may well result in a situation where at the actual time of divestiture, the competition harm identified at the time of the imposition of the condition may have diminished, or could well have increased, thus rendering the condition ineffective. In addition, the value of the business to be divested could be eroded if the divestiture period is too long. Due to uncertainty about its status a business could suffer loss of custom and revenue, an exodus of skilled employees and a loss of reputation in the market place, thus placing the divested business at a competitive disadvantage in the market.

[32] The US Federal Trade Commission shortened their divestiture period as they found that extended time periods in divestiture conditions had undermined the effectiveness of the conditions imposed. In a speech to the American Bar Association, George S. Cary, then senior deputy director at the FTC stated that during a extended time period:

> *"the competitive value of the assets would often diminish -- sometimes substantially. This long divestiture period allowed respondents to treat their promised divestiture as a low priority. Respondents would routinely file divestiture applications in the eleventh hour and, more often than we care to remember, the application was deficient -- missing a signed sales agreement or filed without necessary supporting documentation."* [19]

[33] In response, the FTC shortened the standard divestiture period to six months, and in some instances even required divestiture within four months.[20] According to Mr Cary:

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[19] "Merger Remedies" remarks prepared by George S Cary 10 April 1997. http://www.ftc.gov/speeches/other/aba397.htm#N_4

[20] See *Wesley-Jessen,* File No. 961 0060, Docket No. C-3700 *Devro-Teepak, C-3650* on the FTC's website http://www.ftc.gov/ftc/antitrust.htm

"In retail cases where the value of assets can diminish very quickly and prompt divestiture is essential to the ongoing viability of the assets, we have sought and obtained even shorter divestiture periods."

[34] Thus, as a general principle, a divestiture condition, in order to be effective, must address the mischief, i.e. the possible harm to competition sooner rather than later.

[35] The merging parties would of course want to obtain the longest possible time period within which to identify the extent of assets and liabilities to be divested, to conduct valuations and to find willing purchasers. But in the vast majority of transactions, merging parties or at the very least the acquiring firm become familiar with each other's or the target firm's business pre-merger.[21] In most transactions, information is exchanged, due diligences are conducted and valuations are done. Even in hostile takeovers the acquiring firm usually has a fair amount of information about the business and financial health of the target firm. Hence, a period of [redacted] from the date of approval of the merger would be more than adequate time for merging parties to dispose of a part of their business.

[36] In this particular case, we find no reason to extend the time periods proposed by the Commission. The business to be divested had already been identified as an economically viable business. A list of the assets and liabilities to be sold had been drawn up and valued.[22] The merging parties had already four possible prospective purchasers who had signed confidentiality undertakings. Information had been exchanged and site visits had been undertaken. Negotiations were at such an advanced stage that it was anticipated that sale agreements might be concluded in the near future with two possible parties. [23] In our view, the initial period of [redacted] stipulated in the condition to divest Rico's gas business was ample time for the merging parties to dispose of the business. In the event that they require any further time, they are at liberty to apply to the Tribunal, who on good cause shown could grant a further extension of [redacted].

[21] This is why they choose to acquire or merge with another firm.
[22] See list of assets and liabilities on pages 3-4 of the parties 10 November submission.
[23] See evidence of Mr Wasielewski. Transcript pages 4-6

CONCLUSION

[37] For the reasons set out above, the time periods as contained in Annexure A of our merger clearance certificate apply. There are no public interest matters for us to consider. We accordingly approve this transaction subject to the conditions attached to the merger clearance certificate issued on 22 November 2006.

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Y Carrim

M Moerane and T Orleyn concurring.

Tribunal Researcher: M Murugan-Modise

For Afrox: Advocate A Cockerell instructed by Edward Nathan Sonnenburg

For Rico: D Dingley (Webber Wentzel Bowens)

For the Commission: M Van Hooven and A Wessels (Mergers & Acquisitions)