

## COMPETITION TRIBUNAL OF SOUTH AFRICA

**Case No.: 46/LM/May06**

In the matter between:

**Network Healthcare Holdings Limited**

Primary Acquiring Firm

And

**Netpartner Investments Limited**

Primary Target Firm

Panel : DH Lewis (Presiding Member), N Manoim (Tribunal Member), and Y Carrim (Tribunal Member)

Heard on : 24-25 August 2006

Decided on : 25 August 2006

Reasons Issued: 15 November 2006

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### Reasons for Decision

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#### Approval

[1] On 29 August 2006 the Competition Tribunal issued a merger clearance certificate conditionally approving the merger between Network Healthcare Holdings Limited and Netpartner Limited. The reasons follow.

#### The parties

[2] The acquiring firm is Network Healthcare Holdings Limited ("Netcare"), a company listed on the JSE Securities Exchange and not controlled by any single shareholder. At the hearing the parties submitted that Netcare's biggest shareholder is the Public Investment Corporation Limited, which holds 15% of Netcare's issued share capital, with the next largest shareholder holding less than 10%. Netcare controls various firms, including Netpartner Investment

Limited in which it has a shareholding of 46.3%, and Medicross in which it has an 80% shareholding.

- [3] The primary target firm is Netpartner Investments Limited (“Netpartner”), a public company listed on the JSE Securities Exchange. Netpartner is a subsidiary of Netcare with Netcare holding 46.3% of its issued share capital. Independent shareholders hold the remaining 53.7% of the issued share capital of Netpartner.<sup>1</sup> Netpartner’s only assets are an 18.7% shareholding in Netcare and a 20%shareholding in Medicross.<sup>2</sup>

### **Activities of the parties**

#### Netcare

- [4] Netcare, which comprises 70 hospitals with over 8 400 beds, is the largest hospital group in South Africa. In addition Netcare owns Medicross, which consists of approximately 50 medical centres providing primary healthcare services. Medicross has recently acquired Prime Cure, a network of 45 medical centres located countrywide.
- [5] Netcare further controls a range of medical related businesses such as Netcare 911, Ampath, and Pharmacies to name but a few. Netcare has recently extended its international business interests by acquiring a controlling interest in the leading private hospital group in the United Kingdom, GHG.

#### Netpartner

- [6] Netpartner is an investment holding company, which holds two assets namely, a 20% shareholding in Medicross and an 18.7% interest in Netcare. Currently Netpartner does not undertake any business activities.

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<sup>1</sup> Community Healthcare has an 8.2% shareholding in Netpartner, while SAMDP has 8.6% and individual shareholders hold 36.9% of the issued share capital in Netpartner. See page 16 of the record for details.

<sup>2</sup> On pages 29-30 of the record, the parties submitted that Netpartner’s wholly owned subsidiary, Netdirect, was incorporated on 23 June 2003. Its activities closed down at the end of February 2006. The company is dormant and Netpartner derives no income from Netdirect. Netpartner had participated in the managed care industry through Netdirect.

[7] Netpartner controls Netdirect, which contracted with a variety of doctors, dentists and other medical specialists in order to provide a national network of healthcare providers. The parties advised that the activities of Netdirect were closed down at the end of February 2006 and that currently, Netdirect is dormant.

### **Rationale for the transaction**

[8] The proposed transaction is viewed by the merging parties as an opportunity to simplify their ownership structure.<sup>3</sup> The parties submitted that there were several reasons as to why they were eliminating the cross shareholdings between them.<sup>4</sup>

### **The Merger Transaction**

[9] In this transaction Netcare will acquire all the issued shares in Netpartner which it does not already own.<sup>5</sup> The purchase price payable to the Netpartner shareholders will be discharged by issuing one ordinary Netcare share for every four Netpartner shares. Netcare will acquire the Netpartner assets and liabilities, which include the Netcare shareholding and its Medicross shareholding as well as Netpartner's debt of R470 million loan from a third party.

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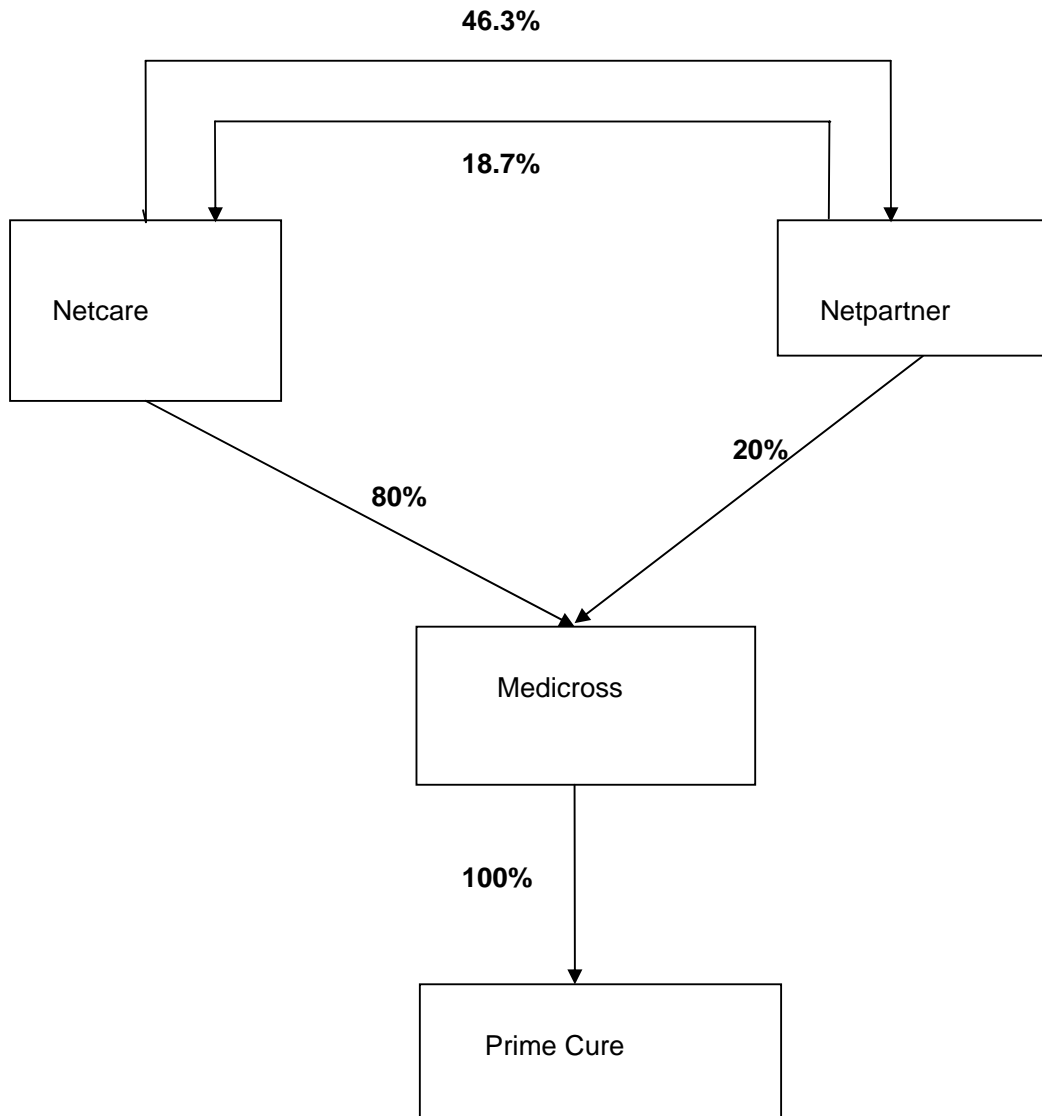
<sup>3</sup> Initially Netpartner viewed the transaction as an opportunity for it to generate an operational income as opposed to a dividend income. However, Netpartner will no longer have any shareholding in Medscheme and/or Rowan Angel, but will consequently be a wholly owned subsidiary of Netcare. Dr Friedland testified that the change in strategy was as a result of him assuming the position of CEO of Netcare and after undertaking a strategic review of business with external consultants, IBM.

<sup>4</sup> In Exhibit 2, Netcare outlines some of the reasons why it has undertaken to unwind its cross-shareholding with Netpartner. Netcare states that the unwinding process began with the appointment of Dr. Richard Friedland as the CEO on 1 September 2005. After his appointment Netcare undertook a strategic review of business using external consultants. Netcare's relationship with Netpartner was reviewed as a result of, inter alia, Government concerns, stakeholder reactions and regulatory frameworks. There was recurring pressure from institutional investors and analysts for Netcare to eliminate the cross shareholding which was viewed as a 'value trap'. Moreover, the relationship between Netcare and Netpartner had failed to bring new lives and there was a need to simplify the accounting and avoid confusion arising from the cross-shareholding. The decision to unwind was precipitated by an independent decision of the board and management of Netpartner to make an offer for Medscheme and Rowan Angel. Netcare wanted to remain funder-neutral in light of that transaction. (Transcript pp51-54, 62; Exhibit 2 pp1-5).

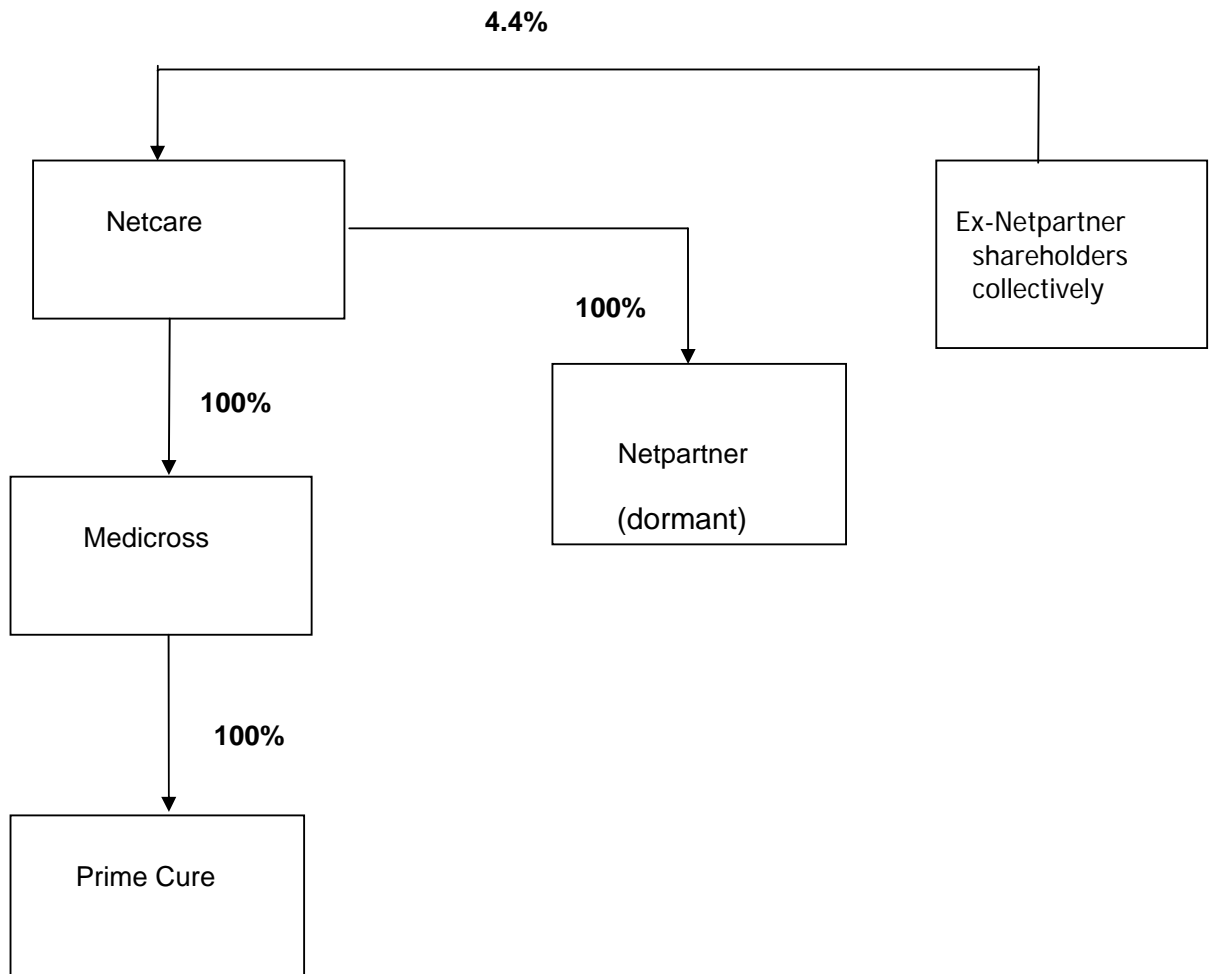
<sup>5</sup> This acquisition will be in the form of a scheme of arrangement. Should the scheme of arrangement fail, there will be a substitute offer in terms of section 440 of the Companies Act, 1973.

[10] The net result of this transaction is that the current Netpartner shareholders will obtain a total of 4.4% interest in Netcare after the scheme of arrangement and Netcare will control all the issued share capital in Netpartner and all the issued share capital in Medicross. The diagram below shows the pre and post merger structures in this transaction.

**Pre Merger:**



**Post merger**



[11] The Competition Commission (“the Commission”) submitted that there is no product overlap between the activities of Netcare and Netpartner. The Commission stated that no market definition is necessary, as the transaction constitutes a restructuring of ownership of the same assets

**Background**

[12] The current merger transaction is part of a complex series of steps, which achieve a number of outcomes for the merging parties. It is unnecessary to repeat those steps in this decision. For a complete description of the series of these steps refer to Annexure “D” hereto. Of significance to us are three specific transactions described below.

- [13] On 16 May 2006, the merging parties filed three seemingly interrelated mergers with the Commission. The first two mergers were filed as intermediate mergers and the third was filed as a large merger. The two intermediate mergers were the merger between Lethimvula Investments Limited (“Lethimvula”) and Rowan Angel (Pty) Ltd (“Rowan Angel”),<sup>6</sup> and the merger between Lethimvula and Medscheme Limited (“Medscheme”)<sup>7</sup> (collectively “the preceding two transactions”). The large merger is the current transaction under consideration in terms of which Network Healthcare Holdings Limited (“Netcare”), which currently own 46.3% of the shares in Netpartner Investments Limited (“Netpartner”), will acquire the remaining shares in Netpartner that it does not already own.
- [14] According to the merging parties, the complex series of steps was designed to, *inter alia*, enable Lethimvula (which ultimately consisted of the erstwhile shareholders of Netpartner but excluding Netcare) to acquire the two medical schemes, to facilitate the removal of any Netcare shareholding from Lethimvula and a simplification of the shareholding between Netcare and Netpartner, ostensibly a preferred structure for the Netcare Group. The complex series of steps was seemingly designed to confer the best commercial and tax advantages to all the parties involved. While the transactions were interrelated in that they were all conditional upon each other, the merging parties contended that the three transactions were discrete stand-alone transactions and were accordingly filed as such with the Commission.
- [15] The only competition evaluation of these transactions was done by the Commission at the level of the two preceding transactions filed with the Commission as intermediate mergers. This current transaction, referred to the Tribunal as a large merger, raised no competition concerns. Hence, by the time the large merger was referred to the Tribunal, the Commission had assumed and already exercised its jurisdiction over the two preceding transactions.
- [16] On 8 August 2006 the Commission conditionally approved the two intermediate mergers thereby effectively approving the acquisition of Medscheme and

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<sup>6</sup> *Lethimvula Investments Limited and Rowan Angel (Pty) Ltd Competition Commission case number 2006MAY2286.*

<sup>7</sup> *Lethimvula Investments Limited and Medscheme Limited Competition Commission case number 2006MAY2287.*

Rowan Angel by Lethimvula. During its investigation of these two transactions the Commission received submissions from Medi-Clinic which raised a number of concerns<sup>8</sup> namely –

[16.1] *Large mergers*

Medi Clinic was concerned that the preceding two transactions may have been incorrectly filed as intermediate mergers. It argued that if Netcare held 46.3% in Lethimvula at the time Lethimvula acquired Rowan Angel and Medscheme,<sup>9</sup> then the preceding two transactions would constitute large mergers and would accordingly have been incorrectly filed as intermediate mergers.

[16.2] *Control or influence by Netcare over Medscheme and Rowan Angel*

Medi-Clinic argued further that these transactions would constitute large mergers in the event that Netcare is found to exercise any other form of control over Medscheme and Rowan Angel as contemplated in terms of section 12 of the Act. Medi-Clinic submitted that although it appeared that neither Netcare nor Netpartner will ultimately hold any shares in Lethimvula, Medscheme or Rowan Angel, Netcare could have acquired direct or indirect control or influence over these firms other than through shareholding. In this regard Medi-Clinic highlighted the following aspects of the transactions:

[16.2.1] Netcare will provide funding to Lethimvula for the purchase of Medscheme and Rowan Angel. This raises two separate immediate concerns. Firstly, the extent to which Netcare, as creditor, could influence the debtor entities. Secondly, Medi-Clinic was concerned that the acquisition of Medscheme and Rowan Angel was being funded by a hospital group that at the same time disavows acquiring any interest at all in the acquisition;

[16.2.2] There appeared to be cross-shareholdings and cross-relationships between the Netcare group (including Netcare, its shareholders and the firm controlled by them) and the Lethimvula group (Lethimvula and its shareholders);

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<sup>8</sup> These concerns are fully articulated on page(s) 5-11 of Medi-Clinic's letter to the Commission. See Bundle of additional documents.

<sup>9</sup> This might be case even if Netcare held 46.3% in Lethimvula for a brief moment in time.

[16.3] *Incentives or obligations for cross-referral between parties to the proposed merger*

Medi-Clinic was concerned that the tangled web of cross-holdings upstream and downstream in the supply of medical services and funding was being effected by Netcare with a view to influence referral patterns to the benefit of the Netcare group. This might come in the form of Netcare obtaining better tariffs from the medical schemes administered by Medscheme and Rowan Angel or the members of such schemes might be obliged or be given incentives to exclusively make use of the Netcare facilities. Even in the absence of any binding preferences or exclusivities, the mere fact that such a degree of entangled cross-holding exists along the supply chain of medical services causes severe distortions in the market.

[16.4] *Deviation by Netcare from its well established strategy of vertical integration*

Medi-Clinic submitted that in the case of *Medicross Healthcare Group (Pty) Ltd and Prime Cure Holdings (Pty) Ltd*,<sup>10</sup> the Tribunal had noted that vertical integration lay at the heart of Netcare's strategy. Medi-Clinic argued that this might be a vertical integration in disguise, which will be used to Netcare's benefit.

[17] In an attempt to address the concerns raised by Medi-Clinic the Commission approved the preceding two transactions subject to the conditions contained in annexure B.

[18] The Tribunal noted these concerns, which concerns were exacerbated by the manner in which the merging parties had filed these transactions. Often in merger filings, when a particular transaction has consisted of more than one leg, which may be conditional upon the occurrence of some future event or the fulfilment of another transaction which could lead to a further change in control, merging parties have filed such transactions as one indivisible whole and have sought the approval of this Tribunal for the entire series of transactions. The reasons for this are obvious. Merging parties would like to save on the costs of

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<sup>10</sup> Tribunal Case Number 11/LM/Mar05.



additional filing fees and the time or inconvenience of filing further and subsequent steps in their commercial arrangement. It was surprising to see that the merging parties in this matter had gone through the expense and trouble of filing three separate mergers, two of which, by virtue of being categorised as intermediate mergers, were not subjected to the scrutiny of this Tribunal.<sup>11</sup>

[19] At the pre-hearing in this matter, held on 16 August 2006, Medi-Clinic advised us that their concerns had been adequately addressed by the conditions imposed by the Commission on the merging parties, and that once they had received certain undertakings from Netcare, they would have no opposition to the merger. The hearing of the matter was set down for 24-25 August 2006.

### **The hearing**

[20] The Tribunal requested the parties and Medi-Clinic to address it on a number of issues at the hearing of this matter, namely –

- a. whether it could have regard to the preceding transactions in its evaluation of the current transactions and if so to what extent;
- b. the question of jurisdiction particularly on whether or not the Tribunal is entitled to review the Commission's assumption of jurisdiction over the preceding two transactions;
- c. should the Tribunal determine that the Commission wrongly assumed jurisdiction over those transactions, whether it could substitute its decision with that of the Commission;
- d. whether or not Netcare directly or indirectly controls or jointly controls Medscheme or Rowan Angel subsequent to the implementation of the transactions. If it does the competition implications of this vertical integration and the competition implications of any horizontal effects arising from the transactions;

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<sup>11</sup> Also surprising was that these separate filings did not raise any jurisdictional flags for the Commission.

- e. whether or not the preference shares in Netcare have already been issued, who the purchasers are, and whether or not the issuing of the preference shares will result in a change in the control of Netcare;
- f. for the merging parties to provide the Tribunal with implementation dates for all the steps involved in the preceding two transactions and the preceding current transaction.

[21] This transaction considered on its own without reference to the series of preceding transactions, does not raise any competition concerns since it is merely a restructuring of shareholding between the merging parties. However, the evaluation of this transaction could lead to a totally different conclusion if it and the preceding two transactions were treated as one indivisible transaction.

[22] The parties and Medi-Clinic argued the matter extensively at the hearing. However it became unnecessary for Tribunal to decide any of these issues or for the Tribunal to explore the potential competition concerns of considering the preceding two transactions and the current transaction as one indivisible transaction. This is because, as discussed below, the parties to this transaction offered to be bound by the conditions imposed by the Commission in the preceding two transactions and those contained in paragraph 31 below.

[23] We turn to consider the conditions imposed by the Commission.

### **Conditions**

[24] The manner in which the three transactions were notified undoubtedly raises a considerable amount of suspicion. While the conditions imposed on the parties and Netcare by the Commission clearly seek to address the concern that Netcare would, directly or indirectly, control Lethimvula, the conditions were imposed on Lethimvula, who did not appear before the Tribunal at this stage of the series of transactions, and on Netcare who did not appear before the Commission. Since Netcare was not a party to the preceding two transactions, the conditions imposed in those two transactions would be unenforceable against it. This was clearly also the concern of Medi-Clinic who in order to ensure that Netcare would be bound by these conditions *qua* conditions, sought a written undertaking from Netcare.

- [25] Netcare, however, submitted that it was willing, in this transaction, to be bound by the conditions imposed by the Commission in the preceding two transactions. The conditions clearly seek to restrict direct or indirect control of Lethinvula by Netcare, require a separation of the financial and shareholding relationship between Netcare and the Lethinvula group and its shareholders, and restrict Netcare from funding the Lethinvula group and its shareholders for the purchase of Rowan Angel and Medscheme.
- [26] Mr Unterhalter, on behalf of Netcare, assured the Tribunal, as is evident from the following exchange, that his client would not have difficulty with the Tribunal imposing the Commission's conditions on Netcare in this transaction -

*“CHAIRPERSON: That’s another point, but manifestly the Commission have imposed a series of conditions that apprehend the prospect that Netcare may control Lethinvula. That’s the basis of their conditions, like it or not, scorn it or not, that’s the basis of their conditions. And they didn’t have Netcare before them and so they couldn’t impose it upon Netcare. And hence Medi-Clinic have had to seek undertakings, which were reputation maybe, but beyond that not worth terribly much and certainly I think, by agreement without any statutory backing at all. And that’s a cause for concern.*

*ADV UNTERHALTER: We understand that, but if I could just make 2 submissions? The first is that as I say, it’s not a matter that this is designed to avoid, because it hasn’t avoided anything, I mean Netcare has freely given those undertakings, because it’s entirely consistent with what it says, but let me come to the question ... there may be another route to enforceability. I don’t think that there is any problem that you, now having Netcare before you, impose conditions. Because this merger is about undoing the relationship between Netcare and Netpartner, i.e. undoing the relationship between Netcare and Lethinvula, which is what Netpartner was.*

*So you can quite legitimately take the position here. We are going to stitch this up, good and proper because we want to make it abundantly clear, enforceable by statutory sanction that no form of influence can seep out of the unwinding in some fashion that would give rise to...*

*MR MANOIM: Because that’s where I may have misunderstood you. You’re now ... because what I understand you to say now if we feel*

*that there is some slippage ... let me put one possible suggestion to you. Assuming we thought there's nothing wrong with the Commission's conditions and undertakings that they've got. They seem to address the problem, but we're worried about the Netcare situation, the difficulty the Commission had. So we would say as a condition to this merger, Netcare must comply with these undertakings in terms of one and two. Do you see a problem with us doing those provisions? ADV UNTERHALTER: No at all and it may be the neat solution to the entire problem."<sup>12</sup>*

[27] The CEO of Netcare, Dr Richard Friedland, assured the Tribunal that it did not seek to control the two medical schemes or Lethimvula since Netcare had changed its strategy away from its previous strategy of vertical integration.<sup>13</sup> In his view the regulatory obstacles and the market's dim view of the cross-shareholding between Netcare and Netpartner had led to this change in Netcare's strategy. Accordingly Netcare was willing to comply with the restrictions and the obligations imposed by the Commission, which would effectively see a separation between Netcare and its partners in Netpartner.<sup>14</sup> On August 23 2006, Netcare has also provided the Commission with undertakings (as requested by Medi-Clinic) in a letter signed by Dr Friedland and addressed to Mr HB Senekal of the Commission. In this letter, which is attached hereto as annexure C, Netcare seeks to assure the Commission that post-merger it will not, inter alia, exercise any form of control, directly or indirectly, over the Lethimvula Group and its subsidiaries, or provide any funding or financial assistance<sup>15</sup> to it for the acquisition of Medscheme and Rowan Angel.<sup>16</sup>

[28] Furthermore, in the course of the hearing, Netcare, in order to satisfy the Tribunal's concern that it might exercise *any other* form of control over Lethimvula and its subsidiaries, submitted a letter from Investec Bank indicating that it, and not Netcare, would provide Netpartner with the funding to ultimately acquire Medscheme and Rowan Angel. . The Investec funding was made

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<sup>12</sup> Transcript pp283-285. See also footnote 4.

<sup>13</sup> Transcript pp55-59, 90. See also footnote 4

<sup>14</sup> Which included Community Health. See also Transcript pp67, 71.

<sup>15</sup> Save with the financial assistance provided to the SAMCC. See annexure C and clause 3.5 thereof.

<sup>16</sup> The undertakings are contractually binding as between Netcare and Medi-Clinic. They serve to show Netcare's willingness to be bound by the conditions imposed in the preceding two transactions.

available to Netpartner to purchase shares in Lethimvula. The letter states that Investec was *“pleased to confirm that Investec has approved an 18-month facility to Netpartner Investments Limited of R470 million in order for Netpartner to acquire 46.3% of the ordinary shares of Lethimvula. We are currently in the process of preparing legal documents, which will record the terms and conditions, as agreed between us”*<sup>17</sup>. Dr Friedland confirmed this during cross-examination.<sup>18</sup>

[29] The Tribunal is satisfied that the Commission’s conditions (annexure A and B), together with the undertakings provided by Dr Friedland in his testimony and those contained in his letter addressed to the Commission (annexure C) adequately address any competition concerns that could arise from this transaction.

### **Public Interest**

[30] There are no public interest issues.

### **Conclusion**

[31] Accordingly this transaction is approved subject to the following conditions

[31.1] that Netcare complies with the conditions imposed by the Competition Commission (“the Commission”) in cases 2006MAY2286 and 2006MAY2287, annexed hereto as Annexure ‘A’ and Annexure ‘B’ respectively.

[31.2] that Netcare complies with its undertakings to Medi-Clinic Corporation Limited and to the Commission in a letter dated 23 August 2006, annexed hereto as Annexure ‘C’.

[31.3] that clause 3.5 of Annexure ‘C’ also applies-

[31.3.1] prior to the implementation of this merger and the mergers contemplated in clause 31.1 of this order; and

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<sup>17</sup> Exhibit 3.

<sup>18</sup> Transcript pp75-85.

[31.3.2] in respect of the shareholders of Lethimvula Investments Limited with the exception of the financial support given by Netcare to SAMCC to the extent disclosed at the hearing.

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Y Carrim  
Tribunal Member

15 November 2006

**Date**

**Concurring:** N Manoim and DH Lewis

Tribunal Researcher : R Kariga

For the merging parties : Adv. D Unterhalter SC and Adv J Wilson  
instructed by Webber Wentzel Bowens

For Medi-Clinic : Adv. F Snyckers SC instructed by Hofmyer  
Attorneys

For the Competition  
Commission : A Kalla (Mergers and Acquisitions)