

**COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA**

Case No: 87/LM/Sep05

In the large merger between:

Momentum Group Limited

and

African Life Health (Pty) Ltd

Reasons for Decision

APPROVAL

On 9 December 2005 the Competition Tribunal issued a Merger Clearance Certificate approving the merger between Momentum Group Limited and African Life Health (Pty) Ltd in terms of section 16(2)(b) of the Act subject to conditions. The reasons appear below.

The Parties

1. The acquiring firm is Momentum Group Limited ("Momentum"), a wholly-owned subsidiary of FirstRand Limited ("FirstRand"). Momentum controls Momentum Healthcare (Pty) Ltd; Momentum Interactive (Pty) Ltd and Sovereign Health (Pty) Ltd.
2. FirstRand Limited ("FirstRand") is a large group of companies in the financial services sector. It has many subsidiaries in the South African context. The only ones that need concern us are Discovery Holdings Limited, which controls Discovery Health (Pty) Ltd. FirstRand holds approximately 65,6% of the issued shares in Discovery Holdings.
3. Rand Merchant Bank ("RMB") is a subsidiary of FirstRand. It is a private equity/investment banking business and holds a 10% minority interest in Life Healthcare (Pty) Ltd ("Life").¹

¹ Life Healthcare is a leading hospital group, previously known as Afrox Healthcare (Pty) Ltd.

4. The primary target firm is African Life Health (Pty) Ltd (“ALH”). It is controlled by its holding company, African Life Assurance Company Ltd (“African Life”). African Life is held as to 20.5% by Sanlam Limited and as to 33.4% by Momentum.

The Merger Transaction and Rationale

5. Momentum is acquiring the entire share capital of ALH from African Life.² Post-merger, ALH will be a wholly-owned subsidiary of Momentum. Momentum seeks to expand into new market segments including the emerging market and other African countries. African Life sees the merger as facilitating access to Momentum’s presence and expertise in distribution and marketing.

The relevant product and geographic markets

6. Momentum is a provider of health funding, life insurance, investment and multi-management activities. Momentum markets and distributes a medical aid scheme called “Pulz” for which Sovereign is the administrator. Therefore, through its subsidiary Sovereign Health, Momentum provides medical administration services.³
7. Discovery Holdings is a specialist insurance company that finances and manages healthcare and other related risks. Discovery Holdings itself operates four main businesses, viz. Discovery Health, a South African medical aid scheme administrator; Discovery Life (South African life insurance products); Destiny Health (US based healthcare products); and PruHealth, which is UK based healthcare products.
8. ALH is a medical aid scheme administrator which provides certain administration services to various medical aid schemes through various entities, including Ingwe Med (Pty) Ltd, Ingwe Med Risk Managers (Pty) Ltd.⁴
9. The overlap therefore occurs in respect of the market for medical scheme administration. The activities comprising this market include the provision of health plans, administration, risk management services such as claims processing and payment, monitoring spend of healthcare funds, integrating information and providing management information to the trustees of schemes.

² In a previous transaction, the Competition Tribunal approved Sanlam’s takeover of Momentum’s stake in African Life under case no. 81/LM/Aug05

³ Sovereign Health provides medical administration services also for Topmed, Meridian Health and Medshield, all open medical schemes. It also provides these services for several closed schemes, including Anglo American Corporation Medical Scheme, Midmed, Nampak Group Medical Society, amongst others. See commission’s report page 6

⁴ These administration services comprise health plan administration and risk management services. Ingwe Risk provides management services to Ingwe Health Plan.

10. We have previously found that the market for medical aid administration services is national, and we see no reason to depart from that finding in this decision.⁵

Impact on Competition

11. It is common cause that FirstRand controls both Momentum and Discovery Health. In previous mergers, we have raised the concern that since Discovery Health and Momentum are administrators of two of the largest medical aid schemes, any inkling of the possibility of co-ordination must be carefully evaluated.⁶ There are common structural links in that FirstRand owns both Discovery Health and Momentum as well as common directorships. The Commission assessed the case on the basis that Momentum and Discovery Health belong to a single economic entity.
12. In computing market shares between the relevant entities, the Commission postulated the worst case scenario, whereby the combined entity, including Discovery would command 34.62% of the medical scheme administration market based on gross contribution income.

This is made up as follows:

Market Shares aggregated to include Discovery Health

Administrator	Market share based on gross contribution income	Market share based on number of beneficiaries
Discovery Health	26.29%	23.98%
Momentum (via Sovereign Health)	5.03%	4.39%
African Life Health (including Multimed and Amanzi)	3.3%	3.25%
TOTAL	34.62%	31.62%

Source: Council for Medical Scheme Annual Report 2004-5⁷

13. However the Commission contends that although the parties combined post merger market shares are high this is unlikely to lead to market power because Discovery generates 95% of its revenue from its own medical aid scheme and hence these beneficiaries should be excluded from the contestable market for third party medical aid schemes. On this view, if Discovery Medical schemes beneficiaries are excluded, the combined market share is only 12.77%. We consider this approach by the

⁵ See Momentum Group Ltd and Bonheur 94 General Trading (Pty) Ltd – 84/LM/Oct04

⁶ See Momentum Group Limited and Bonheur 94 General Trading (Pty) Ltd – 84/LM/Oct04 decision at paragraph 4.

⁷ Record page 352

Commission to be erroneous and we deal with our reasons for this more fully below.

14. There are more than 25 medical scheme administrators registered with the Registrar of Medical Schemes. The commission found that 17 administrators compete with the merging firms.
15. Absent the link via FirstRand to Discovery the acquisition of ALH does not raise concern. This is because:
 - a. We have previously found barriers to entry into this market to be low, and we have no basis to find otherwise in respect of the market in this transaction;⁸
 - b. There is evidence of a high degree of switching activity from medical schemes to alternative medical scheme administrators in recent years.; and
 - c. Medical scheme administrators do not have carte blanche to set prices, since the Registrar for Medical Schemes monitors fees and regulates the relationships between the schemes and the administrators.
16. However the relationship with Discovery does raise concerns and it is to this that we now turn our attention. The merging parties focussed their argument on the contention that Momentum and Discovery are vigorous competitors. They framed their competition analysis around this and presented strong arguments on this basis. In their Competitiveness Report they state that:-

“Although Discovery Health and Momentum both fall within the FirstRand group of companies, they are managed and operate separately and independently of each other. These businesses compete fiercely with each other in the market and operate at arms’ length. This also applies to the marketing and distribution of the various open medical aid schemes administered by each of them...We therefore submit that even though Discovery Holdings and Momentum fall within FirstRand’s stable of companies the transaction must be assessed on the basis that the market shares of the two firms should not be aggregated”⁹ (Our emphasis)

17. Their expert’s report also follows the same line of contention:-

“It is my opinion that Momentum Health and Discovery Health operate independently in the medical scheme market.... In my dealings with both groups I have found there to be no co-operation

⁸ Momentum decision at paragraph 19

⁹ Competitiveness Report, pages 22-26

between them on benefit design, pricing, tariff negotiation or any other aspect of their business.”¹⁰

18. Similarly, Mr Dippenaar, FirstRand’s chief executive officer, also attests to this vigorously competitive relationship as well as to the “owner/manager” ethos adopted within the FirstRand group which allows companies within the group to pursue their own cultures and freedoms:-

“This difference in cultures is a major contributor to the two groups being fiercely competitive, also against one another. Concerns have been expressed internally about the competition being internally destructive. At this stage this has not manifested although he competitive relationship between the two groups is such that there is no prospect of them combining forces or colluding in any way. The short history of the two long-term insurers competing head-on as set out above clearly demonstrates this.”¹¹

19. Furthermore, in a follow up letter addressed to the Commission after the filing of the merger, the parties’ legal representatives also went to great pains to stress the intensity of the competitive relationship between Momentum and Discovery and why an aggregation of market shares was an incorrect approach:-

“Please note that the totalling of the market shares of Momentum, African Life Health and Discovery Health above does not constitute a concession that those market shares should in fact be aggregated. In this regard we refer to the submission in the Competitive Report to the effect that Momentum and Discovery Health are separate and independently run businesses. We once again repeat that the merging parties are willing to negotiate conditions should it be necessary to ensure that this independence is demonstrated.”¹²

20. While we accept that there is evidence to suggest that there is, at present, vigorous competitive rivalry between the Discovery and Momentum businesses, our concern is whether the overall governance structure and corporate governance issues will allow this to continue into the future. We deal with this further later on.

21. The Commission contended that since Discovery generates 95% of its revenue from its own medical aid, this membership is thereby excluded from the contestable market for third party medical aid schemes. We don’t agree with this latter view. Just as Discovery competes for customers to join its medical aid scheme, so other medical aid administrators compete to get customers away from schemes administered by their rivals, to join their

¹⁰ Report for Momentum Health for the Competition Commission filing by Roseanne da Silva, Independent Consulting Actuary, at record page 71

¹¹ Affidavit by Dippenaar, record page 120 at 120.3

¹² Letter from Brink, Cohen Le Roux to the commission, record page 365

own. Administrators assist medical schemes to win customers, and Discovery has in fact been able to win customer to its own schemes in this way. In fact, its own expert's report indicates this:-

*"Discovery Health has more than doubled its market share over the period mainly through the increase in the number of members on the Open Medical Scheme and also by acquiring some administration contracts."*¹³

*"Discovery Health and Momentum Health offer a comprehensive range of services to medical schemes including administration, managed care and marketing services."*¹⁴

22. The more fundamental error is that the Commission fails to appreciate that medical administrators compete for beneficiaries. They do so whether these beneficiaries are their clients via a closed medical scheme, an open scheme or the administrator's own scheme.¹⁵ Nothing in the documents that accompany the filings, or in the reports of the CMS which analyses market shares by number of beneficiaries, would suggest that the Commission's delineation is correct. Since individual beneficiaries, or the collective in a closed scheme, are free to change administrators, and the quality of an administrator is what makes a scheme an attractive one in the case of an open scheme, Discovery Medical Aid's members are part of a contestable market. The Commission may be correct that the scheme itself as a legal entity may not be about to defect to another administrator, but the same cannot be said of the individual members and hence, they do form part of the contestable market.
23. Though the parties argued that they are vigorous competitors, there might nevertheless be problems if there is an aggregation of market shares, and if they begin to participate in the same markets in some sort of co-operative manner. The parties have not dealt with these potential concerns, although there is evidence in the record that Discovery and Momentum's spheres of influence are set to overlap with the advent of new markets and the fact that they exert a potential or actual competitive pressure on each other would be endangered, should this "competitive" relationship be rendered more tenuous by a future strategic collaboration.

¹³ Report for Momentum Health for the Competition Commission filing by Roseanne da Silva, Independent Consulting Actuary, at record page 65

¹⁴ Da Silva report at page 72 of record

¹⁵ Open medical schemes accept any member able to pay contributions whilst restricted medical schemes restrict entry to schemes based on employment with a specific employer which contracts with the medical scheme. Da Silva Record page 54. The Council for Medical Schemes states that the open scheme market has shown a significant swing from self-administration to the large third party administrators, which restricted schemes have not seen the same movement from self administered towards the large third party administrators. Annual Report, record page 315

24. In a due diligence report prepared for the Momentum Board on the acquisition, the authors of the report allude to the fact that Discovery is the only other effective competitor in the market.¹⁶

“An acquisition of ALH will immediately give Momentum access to all essential building blocks, not only to be a dominant (and unique) health care player, but also to have access to health data in all market segments as described above. It will furthermore almost eliminate the ability of other insurers (except Discovery) to compete on an equal footing.” [Our underlining]

25. When this extract was put to the merging parties for comment during the hearing Mr Kruger, the CEO of Momentum’s Group Business – stated that the due diligence was expressed in this way to sell the deal to the board. This post hoc explanation of a difficult piece of evidence is not credible given the fact that the board of Momentum is not new to the industry and could not that easily be sold on some hype which was not true. Mr Kruger also argued that since the due diligence report, the market has changed and that Metropolitan Health and Medscheme are far more formidable competitors due their winning of tenders in respect of the administration of the GEMS (Government Employees Medical Scheme) This evidence has not been dealt with in the filings of the merging parties nor even if it had, does it detract from the importance of the rivalry between Discovery and Momentum, especially post merger.
26. Moreover, the evidence shows that Momentum’s sales of Pulz, its new health offering have shown marked growth, and is described in the FirstRand annual report as the *“fastest growing open medical scheme within the first year of operation.”* Further, the amalgamation provides Pulz with the *“critical mass to enable it to compete with larger schemes”*.¹⁷ Its expert confirms that the Pulz scheme enabled Momentum to compete with established players like Discovery.¹⁸
27. ALH has, through its own various schemes, attained approximately 50% of the local government market.¹⁹ Momentum clearly intends, with the acquisition of ALH, to expand into the low income market:

*“With the acquisition of African Life Health, Momentum Health will be moving towards supporting benefit options structured on a more traditional basis and targeted at the lower income market where the greatest levels of membership growth are expected... This will also put Momentum Health in a position to compete for GEMS business.”*²⁰

¹⁶ See Due Diligence Report and Proposal, Project Emerald, dated 4 April 2005, on page 199 of record at paragraph 6.5

¹⁷ FirstRand annual report, record page 47

¹⁸ Da Silva report at page 71

¹⁹ Memo from Momentum Exco dated 8 June 2005, updating on African Life Health. Record page 214

²⁰ Da Silva report, record page 72. GEMS refers to the “Government Employees Medical Scheme”.

28. What is also significant is that Discovery seems also to have entered this low-income market, in that LAMAF (the “local authorities’ medical aid fund”), a local government scheme, has, since 2005, been moved to the Discovery portfolio of in-house schemes and is known as the LA Health Medical Scheme. Discovery accesses local government and municipal worker employees through its KeyCare Plan, or low-income, offering.²¹
29. Although ALH does not have a large market share in relation to that of Discovery, its strategic importance to Momentum is emphasized in the due diligence report where great concern is shown about Sanlam’s possible entry into the market, should they have acquired this business when they bought the rest of the African Life business.

“The one component of AfLife that will cause concern if sold to a competitor like Sanlam is its Health operations”

and later on:

“Its is clear that an acquisition of AfLife will greatly assist Momentum’s strategic initiative to enter the Growth Market segment.”²²

30. The consolidation of Discovery and other larger players in the market is also a point worth noting. Momentum’s expert states the largest four administrators covered some 53% of the beneficiaries in the market at the end of 2003.²³ She points to the increasing consolidation of medical schemes, attributable to regulatory requirements around minimum membership and reserve levels to stabilise risk pools, as entailing an associate consolidation at the level of medical scheme administrators, which are ‘for-profit’ entities. Part of this consolidation has involved Momentum. It acquired Sovereign Health from Medscheme earlier this year, and as a result of the present merger, will benefit from ALH’s acquisition of Amanzi Health Administrators in 2004.
31. This reinforces the fact that the administration market is one in which large, well-resourced firms and institutions compete, but in an ever-consolidating environment. The fact that both Discovery and Momentum are seeking to enter this lucrative lower income market, coupled with the increasing consolidation at the administration level, does not bode well for future competition in light of the fact that they share a common parent. Their size and market power under one umbrella could remove the competitive pressure from the market and thereby enable them to behave strategically and submit bids and tenders for large government projects. It is therefore imperative to maintain the rivalry between these entities and the concern

²¹ Da Silva report, record page 72 and Discovery Health Annual Report, record page 390

²² Due diligence report , record page 200- 201

²³ Da Silva report page 52.

raised by this merger would be that post merger there would be an enhanced incentive to co-ordination, rather than rivalry.

32. At the present moment Discovery Holdings and the Momentum Group have two common non-executive directors Mr Laurie Dippenaar and Mr Burger, respectively the chief executive and financial director of FirstRand. We find cause for concern with respect to the level of cross-holdings and common directorships between Discovery and Momentum, even at non-executive director level. The possibility of exchange of sensitive information at board level becomes even more of a concern where conceivably a market division strategy could easily be entertained between Discovery and Momentum.
33. For this reason our condition requires the elimination of cross-directorships between the Momentum and Discovery Groups. This was not an issue of concern for the Commission as given the approach it had taken to the size of Discovery's share, it obviously felt no need to address this issue. It was however of concern to the industry regulator the Council for Medical Schemes, who in a submission to the Commission on the merger remarked:

“ The issues pertaining to the First Rand Limited’s joint shareholding in both Momentum Group and Discovery Holdings Limited are dealt with in sufficient detail in the parties’ filings.

To the extent that the proposed merger could increase the likelihood of collusive relationships between these entities, we are of the opinion that these concerns could be adequately dealt with by conditions attached to the approval of the transaction, perhaps formalizing some of the governance issues outlined in pages 9 to 12 of the parties’ competitiveness report.”²⁴

34. Moreover, the parties themselves, in their competitiveness report, offered a condition to this merger: ²⁵

“Nevertheless should the Commission or Tribunal consider that it needs further assurances that the existing independence will continue into the future or that it can intervene if FirstRand indeed changes its mind (the fear referred to in 7.7.2), the merging parties are prepared to offer and negotiate merger conditions to satisfy any concerns in this regard.” [Our underlining]

35. This tender is again repeated by the parties’ legal representatives in a letter addressed to the Commission after the filings had been made:

²⁴ Letter from CMS to Commission, dated 4 November 2005, page 482 of Record

²⁵ Parties’ Competitiveness Report, p 26 of Record

“We once again repeat that the merging parties are willing to negotiate conditions should it be necessary to ensure that this independence is demonstrated.”²⁶

36. The issue of what the condition should be was raised at the hearing with the parties who had not yet concretised their offer into a draft condition. At the hearing their legal representative Mr Coetzer indicated that whilst they had no objection to an elimination of cross-directorships at operating company level i.e. at the level of Discovery Health (Pty) Ltd and Momentum Healthcare (Pty) Ltd, they did object to this condition being extended to the boards of the respective holding companies i.e. at Discovery Holdings and Momentum Ltd level. We queried if this addressed the problem of information co-ordination as the extract from the transcript below indicates:²⁷

CHAIRPERSON: And are you saying that there’s no information that goes from the Momentum Health Board to its Holding Board.

MR COETZER: Well I think it would be unrealistic to expect that none of the financial information goes out obviously but the consolidated financial information does serve on the Momentum Holdings Board. I will have to confirm the exact facts with my client but I think it’s fair to suspect that some of the consolidated financial information will serve on that Board.

CHAIRPERSON: And strategic information?

MR COETZER: Yes I think it’s fair to expect that they will consider what happening in the health business of Momentum Holdings.”

37. What Mr Coetzer has said was not a spur of the moment response. The same emerges from the affidavit of Mr Dippenaar, which we have previously referred to, where he states:

“I am also aware of Momentum and Discovery Holdings’ policy and strategic decisions relating to its medical aid scheme administration businesses if and to the extent that these matters are discussed at the respective board meetings which I attended.”²⁸

38. After having been given an opportunity to consult with their legal representatives, the parties refused to offer a condition whereby there would be no common directorships at Momentum Group and Discovery Holdings levels. This exchange appears from the transcript which we quote below:

MR COETZER: Thank you Chair. Thank you Chair for the indulgence. Chair I have taken instruction from my client. In answering your direct question the merging parties cannot accept the

²⁶ Letter to the Commission dated 21 October 2005, page 365.

²⁷ See Transcript page 3

²⁸ Laurie Dippenaar Affidavit, page 120 of record.

situation where there are simply no common directorships on the Momentum Group board, which is the holding company on that side and the Discovery Holdings side. ...

MR COETZER: Ja. Mr Chair as I ... so unfortunately at this time I cannot offer such a condition. Like I say the two people on the Discovery Holdings board that are common to the Momentum Board is the none executive (should read non-executive) Chairperson of Discovery Holdings and the Financial Director of First Rand who has got the responsibility to look at all the finances in any event of these companies. So it's just I'm instructed that it's unrealistic to expect him not to sit on the boards of the companies from where the financial information is sourced and that seems to be a philosophy of the First Rand Group but again I stress that the fact that there are common directorship by no means mean that they control those boards. They are simply there as nominees of the First Rand Group and they are in a minority position control those boards. They are simply there as nominees of the First Rand Group and they are in a minority position. Mr Chair sorry I just want to mention one more thing. We can potentially contemplate that the existing directorships on the Discovery Health Board, i.e. not Discovery Holdings, who are also Directors of Momentum Holdings that potentially they can be removed. So where on the operating company on a day-to-day basis there are no common directorships in the two health businesses. That is certainly something that can be taken on board but at the Holdings level there these companies certainly Discovery Holdings is a JSE listed company. The First Rand feeling is that there should be representatives there and also people of reputation and position of Mr Dippenaar and the Financial Director Mr Burger."

²⁹

39. We find it incongruous that though the parties tendered the removal of certain key directors at the operational company levels, they were not prepared to tender the same in respect of directors at holding company level despite the fact that strategic issues of importance to the respectively competing companies are discussed there.

Conclusion

40. We have previously observed the importance to consumers in ensuring that markets within the health sector remain competitive.³⁰ We find that at present the medical administration businesses carried out by Discovery and Momentum compete in the market, irrespective of the fact that they are controlled by the same shareholder in the form of FirstRand. We find further that the FirstRand Group, if it was so inclined, is in a position to easily change its current strategy from a competitive to a co-operative one. Were

²⁹ See Transcript page 3-5

³⁰ Medicross Healthcare Group (Pty) Ltd and Prime Cure Holdings (Pty) Ltd – 11/LM/Mar05

this to occur, this would lead to a lessening of an important rivalry in the health care market between the largest present competitor in the form of Discovery, and the firm that itself asserts it is in a position, post merger, to be its most effective rival, Momentum.³¹

41. This change of strategy can be implemented at present without the need for a merger notification. The complete elimination of cross-directorships between the firms both at operating company and holding company level is necessary to preserve this rivalry, as whilst, post merger, the potential for greater competition between the firms exists, there is, conversely, also a greater temptation for the boards to collaborate as a means of overcoming the effects of competition.
42. The merging parties acknowledge what they euphemistically call the 'corporate governance issue' and tender to do something about it. Yet their tender to eliminate cross-directorships at operating company level, but not holding company level, is contradictory insofar as it does not resolve the problem, but merely shifts it to a different level in the corporate chain – a level where on their own version, strategic decisions in relation to these ostensibly competing groups are taken. For this reason, that is our point of departure with the parties and hence, despite their tender of eliminating cross-directorships at operating company level, we require that they be eliminated at holding company level as well. The condition will not prejudice the interests of the shareholder, as given the size of the First Rand group and its abundance of executive talent, it can presumably find other suitable directors to replace those to the board the present incumbents elect to resign from.
43. It is worth noting in passing that while the Competition Act does not outlaw the presence of cross-directorships between competing firms, the legislature's distaste for these arrangements is expressed in the creation of a presumption, designed no doubt to discourage such arrangements. This is to be found in section 4(2) which states that:

"An agreement to engage in a restrictive horizontal practice referred to in subsection 1(b) is presumed to exist between two or more firms if-

- a.) *any one of those firms owns a significant interest in the other, or they have at least one director or substantial shareholder in common; and*
- b.) *...."*

³¹It is worth noting that Discovery was previously a subsidiary of Momentum, until 30 June 2003, when Momentum's shareholding was transferred to FirstRand Limited. According to Dippenaar, there had been debate in the FirstRand group about having "two horses in the same race" but they had decided that there was merit in doing so as it was in his words, "possible to have two independent competing enterprises in one group, both creating value despite competing with one another". Dippenaar Affidavit, record page 120.1-120.2

Public Interest

There are no public interest concerns raised by this transaction.

Condition

The merger is therefore approved subject to the condition in the attached order. The condition addresses the cross-directorship problem that we have identified as a potential vehicle for collusion between two firms, whose existing rivalry we accept. The condition provides both for the resignations of the existing directors who serve on the boards of both groups and to prevent cross directorships in the future.

N. Manoim

3 January 2006
Date

Concurring: Y. Carrim, D.Lewis

For the merging parties:	P. Coetser, Brink Cohen Le Roux Attorneys
For the Commission:	M. Mohlala, Mergers and Acquisitions