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COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: IM175Dec14 (020461)

In the matter between:

CLOVER SA (PTY) LTD — Primary Acquiring Firm

And

NKUNZI MILKWAY (PTY) LTD — Primary Target Firm

In re: Request for Consideration of Intermediate Merger

NKUNZI MILKWAY (PTY) LTD — First Applicant

CLOVER SA (PTY) LTD — Second Applicant

And

The Competition Commission of South Africa — Respondent

Panel	: N Manoim (Presiding Member)
	: Y Carrim (Tribunal Member)
	: M Mazwai (Tribunal Member)
Heard on	: 23 April 2015
Order Issued on	: 23 April 2015
Confidential Reasons Issued on	: 25 May 2015
Public version Reasons Issued on	: 27 May 2015

Reasons for Decision – Public Version

Conditional Approval

[1] 23 April 2015, the Competition Tribunal ("Tribunal") in terms of section 16(2)(b) of the Competition Act, 1998 (Act No. 89 of 1998, as amended) ("**the Act**") conditionally approved the acquisition by Clover SA (Pty) Ltd ("**Clover**") of Nkunzi Milkyway (Pty) Ltd ("**Nkunzi**").

[2] The reasons for the conditional approval of the proposed transaction follow below.

The Parties and their activities

[3] The primary acquiring firm is Clover, a wholly-owned subsidiary of Clover Industries Limited ("**Clover Industries**"). Clover Industries is a public company listed on the Johannesburg Securities Exchange and is not controlled by any one firm. Shareholders with more than 3% include; Clover Milk Producers Trust, Government Employees Pension Fund, Coronation Fund Managers, Investec Limited, Vorster JH and Sanlam Limited.

[4] Clover is a branded consumer goods company in the food and beverage industry in SA and some parts of Africa. Clover's products comprise of a range of dairy and non-dairy products such as; cheese, milk, milk powder, butter, cream, amasi and non-alcoholic beverages. Clover produces products for its own brand and third parties such as Pick n Pay and Woolworths. Clover only manufacturers butter for Woolworths.

[5] The primary target firm is Nkunzi, a company not controlled by one firm and its largest shareholders include Nkunzi Investment Holdings (Pty) Ltd, Hariva Bank Limited, Investec Bank Limited, Jaba Trust and the Jancar Trust.

[6] Nkunzi primarily manufactures fresh dairy products such as Ayrshire, organic, lactose free product ranges, short life juices and non-dairy substitutes.

The Transaction

[7] In terms of the Draft Sale of Business Agreement, Clover is acquiring the business of Nkunzi comprising the manufacturing, packaging, marketing, distribution and sale of dairy products (including but not limited to fresh Ayrshire, organic and regular milk), utilising the fixed assets, the stock, the contracts, the intellectual property and goodwill. Post-merger, Clover will have sole control over Nkunzi.

[8] The proposed transaction thus constitutes a merger in terms of section 12(1) of the Act. The merging parties further meet the merger thresholds prescribed in terms of the Act.

Nkunzi's relationship with Woolworths

[9] What is relevant for this transaction is the fact that Nkunzi is one of six suppliers of Ayrshire products to Woolworths. Woolworths intends increasing its sales volumes by [15 -35%][1] in the short to medium term. Nkunzi claimed that it was unable to make the necessary investments to meet Woolworths' future growth strategy. Clover has committed to making the necessary investments in capital and production in Nkunzi post-merger to ensure it has sufficient manufacturing capacity to meet Woolworths' requirements in this regard.

Rationale

[10] Clover submits that the proposed transaction provides a good opportunity for Clover to serve Woolworths as a customer and in doing so build on and expand their relationship.

Areas of overlap

[11] There is a horizontal overlap in the activities of the merging parties with respect to the manufacture and sale of dairy products and procurement of raw milk. More specifically, the merging parties activities overlap in respect of the following dairy products; fresh cream, full cream, short life juice, amasi, and yoghurt products.

Background

[12] On 18 September 2014, the applicants gave notice of the proposed transaction in terms of section 13 of the Act.

[13] On 12 December 2014, the Commission prohibited the proposed transaction on the basis that, taken as a whole, the proposed transaction raised both competition and public interest concerns. The competition and public interest concerns included the impact of the transaction on small farmers and employment. The Commission found that the proposed transaction is likely to result in a substantial prevention of lessening of competition in two markets, namely,

[1] Actual amount claimed as confidential

(i) the market for the manufacture and sale of dairy products and (ii) the market for procurement of raw milk.

[14] Arising from its investigation of the transaction, the Commission identified 4 main concerns, which can be summarised as follows:

- Concerns over milk producers;
- Concerns over customers of Nkunzi;
- Concerns surrounding the restraint of trade which applies to the owners of Nkunzi; and
- Concerns over employment.

[15] We shall discuss these concerns as well as the proposed behavioural remedies in regard to each below.

Grounds for Consideration

[16] On the 22 December 2012, the merging parties filed a request for consideration of an intermediate merger in terms of which they sought to have the merger approved by the Tribunal without conditions.

[17] The basis for the merging parties' request, in short, was that the Commission in its analysis erred in concluding that the proposed transaction is (i) likely to result in a substantial prevention of lessening of competition and (ii) raises public interest issues. However, they ultimately agreed a set of conditions with the Commission to address the Commission's competition concerns.

Competition assessment

[18] Two main theories of harm emanate from the aforementioned concerns and the Commission's findings, namely post-merger (i) pricing of Ayrshire raw milk purchased from the milk producers (farmers); and (ii) price increases imposed upon customers who purchase milk from Nkunzi.

[19] Subsequent to the notice being filed, the Commission and the merging parties met on 12 February 2015 to discuss a possible settlement. On 4 March 2015 the merging parties

proposed certain remedies to address the concerns of the Commission. The merging parties made it clear during the hearing that they do not necessarily agree with the concerns raised by the Commission but have agreed to the Conditions nonetheless.

[20] We shall discuss each of these theories in turn, as well as the other concerns raised above, and the remedies in regard to each.

Concerns over milk producers

[21] The Commission received concerns from farmers and members representing the Milk Producers' Organisation of South Africa, that Clover may not pay farmers the correct value for Ayrshire milk at the premium milk price that makes it sustainable and profitable for producers to continue to breed Ayrshire cows.[2] Farmers are concerned that Clover will offer lower prices and not pay the required premium for Ayrshire raw milk which is above the average price of regular milk.

[22] In order to address the producers' concern that Clover may not pay the premium that Nkunzi has been paying to them for Ayshire and organic milk post-merger, Clover has agreed to:

22.1 take over Nkunzi's existing supply agreements with the producers on the same terms and conditions; alternatively

22.2 offer the producers new supply agreements with Clover subject to the pricing conditions as further agreed by the parties set out in Clause 3.4.5 – 3.4.9 and in Annexure A to the Conditions, it being recorded that these supply agreements will be negotiated individually by Clover with each producer; and

22.3 honour the current transport agreements that exist between certain producers and Nkunzi or alternatively transport milk on behalf of these producers, and

22.4 take over the existing loan agreements entered into between Nkunzi and certain of its producers, on the same terms and conditions, and it further undertakes to enter into discussions with the producers on an individual basis for further funding in line with Woolworths' future growth strategy.

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[2] Ayrshire milk commands a price premium in the market due to its higher quality but lower quantity yields. The cows also have to be registered and accredited by the Ayrshire Breeders Society of South Africa which cost is further carried by the farmers.

[23] Mr Danie Schutte ("Schutte") a farmer and chairman of the Milk Producers Organisation,[3] confirmed that Clover has indicated to them that it will honour the current agreements. He further added that the merger will result in improvements in the farming community as it has introduced "in-principle guidelines" (hereinafter referred to as the "**Pricing Guidelines**") governing the way the future price of raw milk is calculated. These Pricing Guidelines have further established a link between the price for raw milk produced by the farmer and the retail price of milk in Woolworths. In principle then, any major increases in the retail price will result in a benefit also being passed on to the upstream farmer, which was not the case before.

Concerns over customers of Nkunzi

[24] The Commission also received concerns from small customers, namely **[CONFIDENTIAL]** who purchased regular milk from Nkunzi.[4] These customers were concerned that Nkunzi would increase its prices of this regular milk post-merger to bring it in line with that of Clover, whose prices tend to be higher than those of Nkunzi. Further, that Nkunzi offers a better price, payment terms and packaging sizes in comparison to other suppliers. These customers submitted that changes to the above would negatively impact on the efficiency and profitability of their businesses.

[25] In order to address these concerns Clover has undertaken not to **[CONFIDENTIAL]**.

Concerns surrounding the restraint of trade which applies to the owners of Nkunzi

[26] A three year restraint of trade has been identified in the Sale of Business Agreement between Nkunzi and Clover. This restraint applied to the manufacturing, distribution, marketing and/or sale of any dairy products (including but not limited to cheese, fresh and long life milk, yogurt, butter and ghee). Note that the reason for the restraint is that although Clover is purchasing the business of Nkunzi, it is not purchasing the company. Whilst in our view re-entry by the firm is unlikely it is not impossible hence the need presumably for the restraint. The Commission is of the view that the restraint is overly broad and exceeds what is reasonably necessary in order for Clover to protect its investment in Nkunzi. In order to address this concern, Clover agreed to limit the restraint to the manufacturing, distribution, marketing of

[3] Mr Schutte indicated however, that he was not present in his capacity as chairman of the Milk Producers Organisation but was instead representing the 8 farmers that will be affected by the merger.
[4] Note Nkunzi markets and sells regular milk in small quantities under its own label.

any product containing dairy raw materials to Woolworths Holdings Limited (our emphasis added).

Concerns over employment (Public Interest)

[27] The Commission had public interest concerns that related to employment. During the course of its investigation the Commission was informed that Clover may relocate the Nkunzi facility from its current facility to its (Clover's) facility in Clayville. The merging parties had provided the Commission with an undertaking in that should this relocation occur within one year from the date of the approval of the transaction, that they (the merging parties) would not retrench any employees and they would further compensate the affected employees for travelling expenses. The Commission was however not satisfied with the duration of the proposed condition, being within one year of the approval date, and felt it left the employees exposed to possible retrenchments which may occur should the relocation take place outside of the first year post-merger.

[28] In order to address this concern Clover undertook to not retrench any employee as a result of the merger subject to the caveat that such retrenchments do not include (i) voluntary separation arrangements; (ii) voluntary early retirement packages; and (iii) unreasonable refusals to be redeployed in accordance with the Labour Relations Act, 1995, as amended.

Conclusion

[29] Although it had initially prohibited this merger, and flowing from negotiations that followed the filing of the consideration application, undertakings were offered by Clover which the Commission was satisfied addressed the competition and public interest concerns it had previously.

[30] We have approached this consideration on the basis that the Commission's concerns were correct. On that assumption we have considered whether the undertakings given, which will be made conditions for the approval of this merger, are sufficient to address those concerns.

[31] This merger entails what in competition economics are referred to as a 'two-sided market'. In this regard the merged firm operates as buyer of raw milk from farmers and a supplier of processed milk to retailers. In the present case, concerns that the buying power of the merged firm would be enhanced post-merger if Clover becomes the owner have been addressed by the conditions. The merged entity however is unlikely to have gained market

power as a seller post-merger as its sole customer for this milk is Woolworths. Since we were advised that Woolworths is the only retailer selling Ayrshire milk, which it has successively marketed as a niche product, its buyer power over the processor remains unchanged post-merger, since Clover has no other outlet for this product, whilst Woolworths could increase supply from other processors in the event of a dispute. Indeed the merger is likely to have a pro-competitive aspect as well as it is likely to lead to an increased supply of Ayrshire milk to Woolworths. Although Woolworths executives did not attend the hearing we were advised by the Commission that they are in favour of the transaction.

[32] We consider that given the Commission's reasoning for accepting these undertakings has been well motivated, as well as the fact that affected parties are satisfied that the undertakings will take care of their concerns, we conclude that the proposed transaction is unlikely to substantially prevent or lessen competition in the relevant markets and further alleviates any public interest concerns. Accordingly we approved the proposed transaction subject to the conditions attached hereto marked "**Annexure A**".

Mr. N Manoim	27 May 2015 DATE

Ms. Y Carrim and Ms. M Mazwai concurring

Tribunal Researcher:	Derrick Bowles assisted by Moleboheng Moleko
For the merging parties:	Adv. Jerome Wilson instructed by Bowman Gilfillan
For the Commission:	Anisa Kessery, Jabulani Ngobeni, Portia Bele, Melissa Naidoo and Sunel Grimbeek.