

SOUTH AFRICA / JUDGMENT

# Freeworld Coatings Ltd v Competition Commission and Another

## (62/X/Oct10) [2010] ZACT 88; [2010] 2 CPLR 409 (CT) (14 December 2010)

[2010] ZACT 88

## COURT

Competition Tribunal

## BEFORE

N Manoim, Y Carrim, A Wessels

## CASE / FILE NUMBER

62/X/Oct10

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## COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 62/X/Oct10

In the matter between:

Freeworld Coatings Limited .....Applicant

And

Competition Commission .....1st Respondent

Kansai Paint Company Limited .....2nd Respondent

Panel: N Manoim (Presiding Member)

Y Carrim (Tribunal Member)

A Wessels (Tribunal Member)

Heard on: 9 November 2010

Order Issued on: 14 December 2010

Reasons Issued on: 14 December 2010

Order and Reasons

## Introduction

On 4 October 2010 Freeworld Coatings Ltd (“Freeworld”) applied to the Tribunal to review and set aside the Commission’s decision not to accept Freeworld’s application to file a separate Merger Notification. The application concerns an indicative non-binding proposal by Kansai Paint Company Ltd (“Kansai”) to acquire all the shares in Freeworld.

The review is brought in terms of sec 27(1)(c) of the Competition Act (‘the Act’)<sup>1</sup> read with sec 6(2)(c) and (d), 6(2)(e)(iii), 6(2)(f)(i) and (ii) and 6(2)(h) of the Promotion of Administrative Justice Act (‘PAJA’)<sup>2</sup>. Kansai opposed the application while the Commission indicated in its answering affidavit that it would abide by the Tribunal’s decision.

## Background

Freeworld is a South African listed company that produces automotive coatings for original equipment manufacturers (“OEMs”), automotive coatings for refinishing, decorative paints and various other related products. Freeworld sells its automotive coatings to OEMs through a joint venture with DuPont.<sup>3</sup>

Kansai is a Japanese listed paint company which is also involved in the production and marketing of automotive coatings and decorative paints. It currently supplies automotive coatings in South Africa through Duco.

Kansai first approached Freeworld in a letter on 30 April 2010 in which it expressed an interest in a potential combination of Freeworld and Kansai. This happened on the same day that Freeworld posted a circular in relation to another potential bid to its shareholders initiated by a consortium led by Brait S.A., through Sapphirefield Investments (Pty) Ltd.<sup>4</sup> Since then Kansai and Freeworld, through their senior management and legal advisors, had been in constant contact via letters and various meetings. According to Kansai, Freeworld was obstructive in their discussions, raising competition concerns in order to block Kansai’s access to information.<sup>5</sup> In order to allay the competition problems, Kansai undertook to dispose of Freeworld’s interest in the joint venture with Du Pont, if the merger occurred, since Kansai and DuPont are competitors. This did not satisfy Freeworld which continued to resist Kansai’s efforts to access the due

diligence information. For this reason Kansai withdrew its offer on 20 May 2010. On 14 June 2010 Freeworld shareholders voted down the Sapphirefield offer.

On 23 August Kansai acquired a 25.03% shareholding in Freeworld from Brait S.A.<sup>6</sup> Subsequent to acquiring these shares Kansai reconsidered its offer and on 24 August 2010, at the instance of Kansai, a further meeting was held between representatives of Kansai and Freeworld. At that meeting Kansai delivered a letter to Freeworld which contained a second indicative non-binding proposal to acquire a majority shareholding in Freeworld.<sup>7</sup> This offer was subject to certain pre-conditions which included a due diligence, engagement on competition issues, an approach to Freeworld’s joint venture partner DuPont, financing, the approval of Kansai’s Board to the making of a formal offer, an intention to seek shareholder support from Freeworld’s shareholders and a

board recommendation from Freeworld's Board.

Following this Freeworld, on 3 September 2010, filed an application with the Commission to submit a separate merger filing in terms of Competition Commission Rule 28. Typically merging parties file a merger jointly. Freeworld listed the following reasons in support of its application for a separate filing:

Kansai had already acquired 25.03% of Freeworld's shares,

The unsolicited indicative proposal made by Kansai indicated a serious intention to acquire control,

The transaction raised serious competition concerns,

Freeworld and Kansai did not agree on whether the proposed sale of the Freeworld's interest in the Du Pont joint venture could remedy those competition concerns.

On 17 September 2010 Maarten van Hoven, the Head of the Commission's Merger division, informed Freeworld's legal representative during a telephonic discussion that the Commission was considering whether or not the application was premature owing to the fact that the indicative bid was not an unconditional bid, but a non-binding indicative bid. Subsequent to the call and two further letters from Freeworld to the Commission, the Commission on 22 September 2010 responded to Freeworld's application informing it that it had rejected Freeworld's application.

Freeworld then launched these review proceedings in which it submitted that the Commission's approach was fundamentally flawed and that the Commission had committed a number of reviewable errors in coming to its decision. Freeworld sought an order that the Tribunal set aside the Commission's determination and replace it with its own 1) declaring that the Kansai offer was a proposed merger and 2) permitting Freeworld to file the merger in terms of Rule 28.

Was the decision of the Commission reviewable

The Commission concluded in its letter of 22 September 2010 that on the facts provided:

*".....the indicative proposal by Kansai does not constitute a merger or proposed merger as defined in the Competition Act and therefore in the Commission's view the application in terms of Rule 28 is premature in nature."*<sup>8</sup>

Freeworld argues that the Commission's decision was informed by a material error of law. It also argued that the Commission had not given Freeworld an opportunity to consider Kansai's submissions and to respond to them. The decision was thus also procedurally unfair. On both these separate and self-standing grounds the Commission's decision was reviewable.

It seems that the Commission based its decision on the fact that intent to acquire control was an insufficient condition to constitute a proposed merger. This is evident from a passage to this effect from a Tribunal decision in *Goldfields v Harmony and Others*, which it quotes in the letter, where the Tribunal stated:<sup>9</sup>

*“Whilst intention may have some evidential value in deciding whether a transaction is a merger it is by no means decisive of the issue. A good many buyers have ambitions to control a firm one day and if all purchases were to be notified as mergers once they have assumed this intent, any number of people would be jamming the highways to Pretoria to notify mergers to the Commission. Intent in the ‘air’ does not suffice.”*

Whilst Gold Fields’ case is perhaps stronger on the mechanics of the transaction inasmuch as the offer documentation purports to facilitate a smooth passage from the early settlement offer to the final offer, we nevertheless find that the chain between the transaction is broken for several reasons and that, accordingly, control is not effected at this, the first stage. Even if Harmony receives all of its acceptances at the first stage it does not follow that the second stage is inevitable. Whilst the second offer is automatic, acceptance of it is not, and many things may happen between now and then, including the possibility of movement in both share prices which might lead to arbitrage selling by holders or opportunistic squeezes for a better offer.”

This conclusion was the subject of criticism in the Competition Appeal Court (‘CAC’) decision in the same matter where the CAC noted:<sup>10</sup>

*“But this conclusion is exactly the opposite of what it claims; it has elevated form over substance. The cumulative weight of the documents cited is a crystal clear indication of the value of the transaction – to effect a merger. This is not about day dreams to control a company, - the prospect and substance of first respondent’s is publicly announced.”*

The Commission in its letter quotes the first paragraph from the Tribunal decision quoted above, but not the second which is the subject of the CAC criticism. Freeworld argues that this indicates that the Commission was unaware of the correct legal test. In our view this goes too far. A careful reading of the CACs’ critique of the Tribunal approach is not so much a disagreement on the location of intention in the analysis, but the application of that principle to the analysis of the facts. Hence its reference to the “conclusion” of the Tribunal and placing “form over substance”. Note that the CAC’s reference to “...not about day dreams to control a company”, too suggests the insufficiency of intention on its own as condition to determine whether a merger has come about. Rather what we read from this decision is that what is crucial is the accumulation of facts and their interpretation in the context of

that intention. It is criticising a too mechanistic approach to the facts, not the principle. Thus the take home message from the CAC decision is - do not be too mechanistic about the facts when intention is accompanied by events subject to some contingency.

This leads us to what we consider to be the legal error of the Commission on the present facts of this case. The Commission states in the letter that Kansai must notify the transaction once the offer becomes binding. It thus appears that the Commission in applying the case law to the facts of this case considered a non-binding offer not to constitute a proposed merger. Freeworld argues that this is an error of law. We would agree.<sup>11</sup>

A proposed merger can have taken place before an offer becomes binding. In this sense the Commission's application of the law may have been too mechanistic. This is what the reading of the Goldfields case law is about. We say more about this below when we discuss how the Commission should approach the matter. We do not therefore need to decide the second part of the review which goes to whether the Commission's procedures were fair.

Freeworld suggests, based on previous merger decisions of the Tribunal and the CAC, the test should amount to:<sup>12</sup>

Is there indicated a sufficiently serious intent, not a certainty, not a final decision by a controlling board, but a sufficiently serious intent?

Is there indicated a capability of carrying through the contemplated transaction, which is to eliminate the idea of some investor just buying up shares as he or she goes?

What is the conduct of the parties which is consistent or inconsistent with the intent to acquire control?

Although we have found that the Commission has applied the wrong legal test that is not to say that the merging parties' legal test is the correct one or that the Commission's ultimate conclusion was wrong. We do not express any view on this.

Although both parties argued that if we found a reviewable error, we should be at large to substitute our own decision for that of the Commission, we have decided not to. There are two reasons for this. In the first place Freeworld complains that the Commission did not have before it information placed before us relating to Kansai's written submission to the Securities Regulation Panel (SRP) which Freeworld contends would manifest the seriousness of its acquisitive intent. Kansai for its part in a supplementary affidavit filed after Freeworld's reply submitted another draft but unsent letter from Freeworld to the SRP. This too had not been before the Commission. Then, subsequent to the conclusion of our hearing on 9 November, Freeworld, submitted further new information regarding Kansai's conduct, which it deemed necessary to bring to our attention, despite the fact that the hearing into the matter had been concluded. This information was submitted on 22 and 29 November. On 23 November 2010 Kansai wrote to us and objected to this approach and requested to be given an opportunity to file a response if we were to consider this new evidence.

The new information consisted of further interactions between Kansai and some Freeworld shareholders which, according to Freeworld, indicate its intent to buy further shares in the company, and then a press statement which purports to quote Kansai's intentions to assume control. If Freeworld considers all these facts that the Commission did not have before it

material, it should place them before the Commission again, as events in this saga appear to be a moving target. The Commission is given the primary discretion to determine whether a particular set of circumstances give rise to a merger or proposed merger. Whilst we might substitute our decision for the Commission's where the record is largely the one they had before them, it is not appropriate for us to decide on a record that is increasingly ceasing to resemble the one they had before them.

Secondly, and more importantly, because the Commission considered the merger notification request premature it did not consider the provisions of its Rule 28 which provide:

A primary firm may apply to the Commission for permission to file separate notification of a merger and, on considering an application under this sub-rule, the Commission –

may allow separate filing if it is reasonable and just to do so in the circumstances;

may give appropriate directions to give effect to the requirements of the Act and in particular, specifying which primary firm must satisfy which of the requirements set out in Rule 27; and

in an appropriate case, may further permit the applicant to file any document on behalf of the other primary firm.

Rule 28 gives the Commission the discretion not only to determine whether it is reasonable and just to allow the separate filing, but also to give the directions contemplated in sub rules (b) and (c). Since the Commission is tasked with investigating mergers, not the Tribunal, it should make these determinations, should it come to that, as they have a material bearing on its investigation. It would not be appropriate for the Tribunal to give these directions itself.

We have therefore decided to refer the matter back to the Commission to consider:

Whether on the correct legal test and the new facts and any further response to the new issues from Kansai a proposed merger has come into existence ; and if it has

Whether it would be reasonable and just in the circumstances to have Freeworld notify the merger in terms of Rule 28.

In determining the first part of the enquiry it should be noted that we are not pre-judging the Commission's final conclusion on the facts. We simply find that it adopted a too strict and mechanistic legal test. It was however common cause in the argument before us that no bright lines exist to determine when a proposed merger comes into being.

For this reason Freeworld, as we noted earlier, suggested its own test for when a proposed merger has come about.<sup>13</sup> If it considered that the case law was clear on this point it would not need to have done so. It seems the best one can read from the case law is that intention to control is a necessary, but insufficient condition, but that the additional factors which would prove decisive are not capable of prior definition as mergers can take so many varieties of forms. It is the cumulative weight of the 'intention plus' factors that tilts towards the conclusion that the transaction is a proposed merger.

This leaves the Commission with an invidious task. If the law assumes that there comes a moment when a proposed merger comes into being, but cannot determine it with much precision, then it is difficult for the Commission to be expected to divine it, especially in circumstances when two putative merging parties contest the significance of their every act and utterance. For this reason the Commission may wish to place more emphasis on the second part of the enquiry in terms of Rule 28. In that event to assume that a merger exists where there is a body of cumulated facts to suggest this “intention plus”, albeit to some extent contested, and then consider if it should be notified i.e. move from the enquiry as to whether there exists a proposed merger, to an enquiry as to whether there exist grounds to apply Rule 28. Here it should consider not only the submissions made to date by Freeworld on the papers, but any from Kansai, as well as the implications for third parties who may be required to provide information to the Commission if the investigation

commences, as well as the implications for the resources of the Commission . Also relevant would be whether merger control will be effective; for instance if undertakings are to be sought from the acquirer in respect of competition or public interest issues and the acquiring firm is not a willing party to the filing.<sup>14</sup>

One issue of law must be drawn to the Commission’s intention. It was argued following a passage in the CAC Goldfields decision that, once a merger has occurred, it must be notified. As Kansai argued this is not correct. As long as a merger is not implemented, the Act does to state when it should be notified.

We would point out that prior to an amendment to the Act in September 2000 merging parties were required to notify a merger within 7 days after the earlier of (a) the conclusion of the merger agreement,

- (b) the public announcement of a proposed merger bid or
- (c) the acquisition of a controlling interest by any one of the parties to that merger in the other. This provision was deleted, signalling a clear legislative intent that there was no time period any longer by which a merger must be notified. Of course that does not preclude one party to the merger such as Freeworld from requesting notification. In this case it is common cause that no implementation has taken place – at least at date of this decision – so there was no legal obligation on the merging parties to notify.

## Conclusion

We have decided to set aside the Commission’s decision that the alleged proposed merger is not notifiable. We refer it back for the Commission to reconsider in the light of the correct legal test and the additional information provided since and the approach outlined above. If it concludes the transaction is a merger then to consider the application of rule 28 to the request for permission to file by Freeworld.

We make no order as to costs as the decision has been referred back to the Commission.

14 December 2010

N Manoim

Concurring: Y Carrim and A Wessels

Tribunal Researcher: R Badenhorst

For the Applicant: JJ Gauntlett SC assisted by J Wilson instructed by Nortons Inc

For the 1st Respondent: MM Le Roux instructed by the State Attorney

For the 2nd Respondent: J Blou SC assisted by K McLean instructed by Bowman Gilfillan Inc

1Act 89 of 1998

2Act 3 of 2000.

3The automotive refinishing products which make up a major part of Freeworld's automotive refinish business are produced under licence from DuPont.

4The Sapphirefield scheme of arrangement was rejected by the majority of Freeworld's shareholders on 14 June 2010.

5On 12 May 2010 Kansai approached the Securities Regulation Panel to compel Freeworld to make available the same information which had been provided to Sapphirefield Investments. Freeworld opposed the application raising competition concerns related to Kansai's bid.

6Its shareholding in Freeworld has since then increased to 27%.

7According to Kansai it already held a shareholding of 23.05% in Freeworld.

8Record page 88

9Gold Fields Ltd v Harmony Gold Mining Company and others, [2004] 2 CPLR 358 (CT) at par 62

10Gold Fields Ltd v Harmony Gold Mining Company Ltd and another [2005] 1 CPLR 74 (CAC) at 87

11In fairness to the Commission the non-binding offer comment can be read not as the basis for their decision, but a comment by when, in the circumstances of this case, the offer would, unambiguously, constitute a merger. Elsewhere in the letter the Commission

considers that the conditions attached to the offer had made the offer too premature to constitute a proposed merger. However the ambiguity on this point coupled with an uncritical approach to the case law, suggests that on balance a reviewable error of law has taken place.

12See Freeworld's Heads at p31 and Transcript p 21.

13See paragraph 17above.

14Freeworld also suggests that public interest issues in respect of employment will also be relevant if Kansai is the acquirer.

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