

SOUTH AFRICA / JUDGMENT

Stefanutti Stocks (Pty) Ltd v Ax.sys Projects (Pty) Ltd and Another (LM069Jun17) [2018] ZACT 75; [2018] 1 CPLR 334 (CT) (22 March 2018) [2018] ZACT 75

COURT

Competition Tribunal

BEFORE

Yasmin Carrim, AW Wessels, Medi Mokuena

CASE / FILE NUMBER

LM069Jun17

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COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: LM069Jun17

In the matter between:

Stefanutti Stocks (Pty) Ltd

Primary Acquiring Firm

and

Ax.sys Projects (Pty) Ltd

TN Molefe Construction (Pty) Ltd

Primary Target Firms

Panel

: Yasmin Carrim (Presiding Member)

: AW Wessels (Tribunal Member)

: Medi Mokuena (Tribunal Member)

Heard on

: 14 February 2018

Last Submission Received : 19 February 2018

Order Issued on :

21 February 2018 Reasons Issued on : 22 March 2018

Reasons

for Decision

Approval

[1] On 21 February 2018, the Competition Tribunal ("Tribunal") conditionally approved the proposed transaction between Stefanutti

Stocks (Pty) Ltd and Axsys Projects (Pty) Ltd and, TN Molefe Construction (Pty) Ltd.

[2] The reasons for approving the proposed transaction follow.

Parties to proposed transaction

Primary acquiring firm

[3] The primary acquiring firm is Stefanutti Stocks (Pty) Ltd ("Stefanutti"), a company incorporated in accordance with the laws of the Republic of South Africa. Stefanutti is controlled by Stefanutti Stocks Holdings Limited ("Stefanutti Holdings"), which is a public company listed on the Johannesburg Stock Exchange. Stefanutti Holdings' shares are widely held and it is not directly or indirectly controlled by any single entity.

[4] Stefanutti operates through the following divisions:

- a. Roads, pipelines and mining services - this unit deals with the construction of all levels of transport infrastructure.
- b. Building - this unit provides infrastructure such as healthcare facilities, transport nodes, warehousing, retail and parkade developments, residential, commercial buildings and unit operates throughout South Africa and Southern Africa (including Namibia and Mozambique).
- c. Mechanical and Electrical - this unit undertakes structural, mechanical, electrical, instrumentation and piping engineering construction works.
- d. Structure - this unit offers foundation, concrete and marine construction capabilities spanning the full spectrum of public and industrial infrastructure delivery.
- e. Stefanutti also operates in the United Arab Emirates, where its associate undertakes interior fit-out, refurbishment and general construction projects.

Primary target firm

[5] The primary target firms are TN Molefe Construction (Pty) Ltd ("TN Molefe") and Axsys Projects (Pty) Ltd ("Axsys") - collectively referred to as the Emerging Contractors. The Emerging Contractors are all smaller construction companies that are more than 51% owned and controlled by historically disadvantaged persons ("HDPs").

[6] TN Molefe is a wholly-owned subsidiary of the MC Share Trust, which is ultimately controlled by an HDP.[1]

[7] TN Molefe specialises in civil engineering works, including the construction and regravelling of roads, bulk earthworks, pavement

rehabilitation and upgrading, storm water infrastructure and maintenance, construction management and refurbishment of waste water

treatment plants. TN Molefe also specialises in Turnkey projects where it designs the projects in-house.

[8] Axsys is a newly incorporated company established for purposes of the proposed transaction and is controlled by Spanseem Projects (Pty) Ltd, which in turn is a wholly owned subsidiary of the APC Trust. The APC trust's sole beneficiary is an HDP.

[9] Axsys undertakes structural, civils, roads, earthworks and building construction projects across South Africa and its services extend to the petrochemical, mining water and heavy industry sectors.

Proposed transaction and rationale

[10] The proposed transaction entails the formation of economic alliances between Stefanutti and the respective Emerging Contractors.

[11] The merging parties submitted that it is intended that post-merger, the merging parties will operate as a single economic entity (i.e. the Stefanutti Alliance).

[12] These alliances are the result of a settlement agreement concluded between a number of Construction Companies[2] and the Government of the Republic of South Africa (as represented by the Ministers of Rural Development and Land Reform, Economic

Development, Public Works and Transport) on 11 October 2016 ("the Settlement Agreement").

[13] Stefanutti submitted that in order to achieve the objects of the Settlement Agreement, it was essential for them and their respective Emerging Contractors to establish an alliance pursuant to which Stefanutti will acquire material influence over the direction, operation and competitiveness of the business of the Emerging Contractor. The Stefanutti Alliance, therefore gives rise to a merger in terms of section 12(2)(g) of the Competition Act, no. 89 of 1998 ("the Act").

[14] The mentoring and development that Stefanutti has chosen to embark on, requires that the Emerging Contractors identified should acquire the necessary skill, quality and status as well as the quantity of work to generate and sustain a cumulative combined annual turnover equal to at least 25% of the annual construction works turnover of Stefanutti during the relevant period (7 years extendable to 10 years).

[15] It is worth noting that if Stefanutti does not meet that turnover obligation within the relevant period, Stefanutti would incur

substantial penalties in addition to the possibility of the Government instituting civil proceedings against Stefanutti for previously having colluded on certain Government projects. If Stefanutti fails to pay the penalty, it may even be blacklisted and disqualified from being awarded contracts from public enterprises for up to 12 months.

[16] The Settlement Agreement prescribes that the development of the Emerging Contractors will be undertaken in terms of a formalized development and mentorship program proposed by Stefanutti in consultation with the Black Business Council.

[17] As per the Settlement Agreement, the proposed transaction is due to terminate after a maximum period of 10 years from the date of its implementation. Following the termination, the alliance members are expected to return to their original positions where they will no longer operate as a single economic entity; they will be expected to be completely independent and vigorously compete with each other. The Commission acknowledged that the parties may by mutual agreement, choose to terminate the alliance prior to the lapse of the 10 year period.

[18] The Commission noted that Stefanutti had acquired 20% of the share capital in Axsys, which confer certain minority rights upon Stefanutti. These rights include the recruitment and appointment of executives and the determination of salaries for executives,

determination and payment of bonuses to employees as well as the approval of budgets and business plans. The merging parties submitted

that they have made the same offer to TN Molefe, who have declined, but the offer remains on the table for acceptance should TN Molefe wish to do so.

[19] TN Molefe indicated that it was concerned about the possibility of being treated unfairly because of the relationship between Stefanutti and Axsys. With this in mind the Commission resorted to imposing a condition relating to the fair and non-discriminatory allocation of work to the Emerging Contractors, this is elaborated on in the public interest section below.

[20] The primary acquiring firm's rationale for the transaction was that pursuant to the Settlement Agreement, Stefanutti had undertaken to the Government that it will increase investment, promote innovation and create entrepreneurial opportunities in the construction

industry, particularly for small-to-medium sized enterprises. In terms of those commitments, Stefanutti was required to identify

enterprises which it would mentor and develop and obtain such competition authority approval as is required to pursue those initiatives. The Emerging Contractors are the HOP firms identified by Stefanutti for this purpose.

[21] The primary target firm's rationale was that the program will (i) provide them with extensive support and access to skills and expertise to enable them to take on more projects of a large scale; and (ii) allow them to over time acquire a greater share of the construction

industry and compete more effectively.

Impact on competition

[22] The Commission identified horizontal overlaps in the following markets:

- a. The provision of services for civil engineering: road;
- b. The provision of services for civil engineering: other;
- c. The provision of services for general building: residential; and
- d. The provision of services for general building: non-residential.

[23] The Commission found that the proposed transaction will result in a post-merger market share of less than 5% with minimal accretions in all markets. The Commission also identified a number of prominent rivals in the relevant markets such as Aveng, Group Five and Murray & Roberts among many other construction companies. The Commission concluded that the merged entity is unlikely to exercise market power given the presence of several viable alternatives who will be able to discipline the merged entity.

[24] The Commission concluded that there is no vertical overlap as Stefanutti produces various inputs for its own operations exclusively on a project specific basis. Accordingly the transaction does not give rise to any foreclosure concerns.

Public interest

Employment and public interest benefits

[25] The merging parties submitted that there will be no adverse effect on employment, as no duplications arose as result of the mergers. Rather the Construction Companies will ensure that the transactions provide the Emerging Contractors with the support, skills and guidance to grow into successful independent firms in the market. As a result employees will need to be sourced and the target firms will create quality jobs and entrepreneurial opportunities in the industry. The Commission found there to be no likelihood of duplications or rationalisations as a result of the proposed transactions.

[26] The merging parties submitted that in line with section 12A(3)(c) the proposed transactions result in public interest benefits as it enables the Emerging Contractors (BEE and Historically Disadvantaged firms) to become competitive. The merging parties outline the following benefits:

- a. It will improve the development of skills among HDPs in critical areas in the industry;
- b. It encourages participation and ownership of SMEs and enterprises managed and owned by HDPs; and
- c. It provides for demonstrable and measurable expansion opportunities in the construction industry which promotes competition, innovation and growth in the market.

[27] The Commission agreed with this and found that the proposed transaction raises strong public interest benefits in terms of the Act. The proposed transaction ensures that small black-owned construction companies are able to grow their businesses to hopefully one day be able to compete directly with firms such as Stefanutti. Regarding the current level of transformation in the construction industry, the Commission found that most black-owned construction companies operate in the lower levels of the market (smaller projects). The Stefanutti alliance therefore presents an opportunity for the black-owned businesses to be developed into large and more competitive firms in line with the objectives of section 12A(3)(c) of the Act.

[28] The Commission was of the view that it is necessary to monitor the performance of the alliances in their attainment of these public

interest benefits. The Commission therefore required the merging parties to provide a report to the Commission on all the projects the merging parties would have participated in as part of the Stefanutti Alliance.

[29] The Commission was also concerned about the possibility of unfair treatment of the Emerging Contractors within the Stefanutti Alliance,

given the disparity in size of the Emerging Contractors. The Commission was concerned that since the Settlement Agreement was silent on the apportionment of the 25% target and does not specify how the work is to be allocated, there may be a risk that Stefanutti

might focus all its resources and training on one of the Emerging Contractors and achieving the target through that one Emerging

Contractor rather than spreading the work across both.

[30] The Commission engaged the Emerging Contractors regarding this concern, who indicated that the value of the alliance is in the skills and development that is on offer, the Emerging Contractors plan to exploit the opportunity and learn from Stefanutti to the fullest.

- [31] Further, the Emerging Contractors provided that they are largely specialized in different areas of the construction sectors, which suggests that there will not be reason to trade-off working with one Emerging Contractor for another. The Commission concludes that there is more incentive for Stefanutti to work with both Emerging Contractors in a fair and equal manner as opposed to the converse.
- [32] The Tribunal addressed this concern by suggesting that the Commission's condition relating to this issue be reworded to say that the Emerging Contractors are to be treated equally, in order to prevent any bias to one or the other in the allocation of work.[3] The merging parties and the Commission had no objection to this amendment.

The Fund

- [33] The Settlement Agreement made provision for the establishment of a Fund, the objective of which will be the development and enhancement of the Construction Industry and in particular, transformation objectives.
- [34] The Trustees of the Fund will comprise of representatives of all of the Construction Companies who are party to the Settlement Agreement, as well as representatives of the Government, as appointed by the relevant government departments.
- [35] The Commission was of the view that further measures were required to ensure that the Fund is not used as an information sharing platform by the construction companies.
- [36] The Commission was of the view that all the economic alliances should put into place the necessary safeguards to ensure that competitively

sensitive information does not flow from one economic alliance to other construction companies through the Fund.

- [37] In respect of the Fund, the Commission required that the alliance members ensure that all information submitted to the Fund be aggregated, and the members must ensure that the necessary measures are put in place to prevent the flow of competitively sensitive

information from one alliance to another through the Fund or any other medium.

- [38] The Commission further required that the people selected by the Construction Companies for the mentorship and development of the Emerging Contractors not be the same people appointed as Trustees on the Fund.

- [39] The merging parties submitted that such a condition was restrictive and prejudicial to the alliances as it:

- a. Precluded all key executives and personnel of Stefanutti from being trustees on the Fund. The merging parties submitted that although only one person may primarily be appointed with overall responsibility for the day to day and ongoing mentoring and development of the Emerging Contractors, various secondees will be involved in operational and other development and mentoring activities and Stefanutti executives are likely to participate in, and have oversight over the development and mentoring activities; and
- b. This would have precluded persons from being trustees of the Fund who, through their general enterprise development activities and their activities and their involvement with the Emerging Contractors, have the best knowledge and expertise of what development, transformation and other initiatives are required by the industry, being the principal objective of the Fund. The merging parties submitted that the restriction is therefore detrimental both to the objective so the Fund and to the Alliance Construction Company's interests at the Fund.

[40] The Commission remained of the view that having the same people responsible for the monitoring and development, while sitting as

Trustees increased the likelihood of coordination between the construction companies.

[41] The merging parties re-iterated before the Tribunal that this condition was extremely broad, restrictive and unnecessary.[4] The merging parties maintained that other conditions placed upon them were sufficient to address any information sharing concerns.[5]

[42] The Commission submitted that the objective of the proposed condition was not to exclude everyone affected by the mentorship activities but rather just particular individuals with intimate knowledge of the mentorship program as they felt that kind of engagement could create a platform for the sharing of competitively sensitive information.[6]

[43] The Tribunal shared the Commission's concern regarding the potential for the Trust Fund to be used as a platform for information sharing and ultimately approved this transaction subject to the reworded condition In this regard, so as to afford the merging parties more flexibility in who they could appoint but also protect the Commission's concern. In this regard the parties were asked to engage with each other so as to preclude operational people from being appointed as Trustees.[7]

[44] With regards to monitoring of the alliances, the merging parties must submit reports annually detailing the projects they have worked on during the joint venture. Further they must provide a report upon termination of the alliance.

Conclusion

[45] In light of the above, we concluded that the proposed transaction is unlikely to substantially prevent or lessen competition in any relevant market. Accordingly, we approved the proposed transaction subject to conditions. For convenience the set of conditions are attached, marked as "Annexure A".

Ms Yasmin Carrim

Mr AW Wessels and Mrs Medi Mokuena concurring

22 March 2018

DATE

Case Manager:

Kameel Pancham

For the Merging Parties: Paul Coetser and Paul Cleland from Werksmans Attorneys

For the Commission: Busisiwe Ntshingila and Ratshidaho Maphwanya

[1]

[2] Aveng (Africa) (Pty) Ltd ("Aveng"), Basil Read Holdings (Pty) Ltd ("Basil Read"), Group Five Construction Limited

("Group Five"), Murray and Roberts Limited ("Murray and Roberts"), Raubex (Pty) Ltd, Stefanutti Stocks (Pty) Ltd ("Stefanutti") and WBHO Construction ("WBHO").

[3] Transcript page 86, lines 1-3.

[4] Transcript page 59, lines 6-9.

[5] Transcript page 58, lines 13-14 & page 59, lines 1-9.

[6] Transcript page 66, lines 6-12.

[7] Transcript page 98, line 1-10.

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