

SOUTH AFRICA / JUDGMENT

Wispeco (Pty) Ltd v The Sheerline Business of AGI Solutions (Pty) Ltd (69/LM/Oct09) [2010] ZACT 35 (20 May 2010)

[2010] ZACT 35

COURT

Competition Tribunal

BEFORE

N Manoim, Y Carrim, M Holden

CASE / FILE NUMBER

69/LM/Oct09

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COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 69/LM/Oct09

In the matter between:

Wispeco (Pty) Ltd Acquiring Firm

And

The Sheerline Business of AGI Solutions (Pty) Ltd Target Firms

Panel : Norman Manoim (Presiding Member)

Yasmin Carrim (Tribunal Member)

Merle Holden (Tribunal Member)

Heard on : 01/02/2010

Order issued on : 03/02/2010

Reasons issued on : 20/05/2010

Reasons for Decision

Approval

On 3 February 2010 the Competition Tribunal (“Tribunal”) approved with conditions the merger between Wispeco (Pty) Ltd (“Wispeco”) and the Sheerline business of AGI Solutions (Pty) Ltd (“Sheerline”). The reasons follow below.

The transaction

This is an acquisition by Wispeco, a wholly owned subsidiary of Wispeco Holdings Limited, which in turn is controlled by Remgro Limited, of the Sheerline business, a division of AGI's aluminium business.

Wispeco consists of four divisions; remelt (billet) production, extrusion production, finishing and stockist division in which it operates a number of stockist outlets under the Conways, Almex and RF Metals' brands. AGI's aluminium business has three divisions; Sheerline, its stockist or distribution business in which it operates a network of stockist outlets across the country, Profal its manufacturing business which produces aluminium extrusions, and its manufacturing business (finished goods plant) which assembles doors, windows, etc., using glass and aluminium extrusions.

In terms of the transaction, Wispeco intends to acquire the business of Sheerline comprising the stocking, wholesale and distribution of aluminium products, as well as the design and development of these aluminium products. The proposed transaction does not involve

Wispeco purchasing the entire aluminium operations of AGI. AGI will continue to operate its Profal extrusion operations as well as its manufacturing operations (finished goods plant), and the proposed transaction will only result in the acquisition by Wispeco of the Sheerline division of AGI.

Principally this transaction results in the combination at the stockist level, where post merger Wispeco and Sheerline will be under common management where they were competing entities pre-merger.

Rationale for the transaction

Wispeco views Sheerline as a reputable brand which will also add an additional distribution network to its business. AGI was forced to sell the Sheerline business because of its present financial predicament.

The Relevant Market

The aluminium supply chain comprises several levels. Figure 1 below helps to understand the relevant market at its various levels as well as the overlaps relevant to this merger.

Figure 1: South African (country specific) aluminium supply chain from alumina up to finished extruded products

Refineries

Import

Mass manufacturers

Extruders (Semi-fabricators)

Stockists

Smelters

BHP Billiton (Bayside smelter-billet production stopped), foreign and secondary (remelt) producers

Alumina

Billets

Lafarge

Imports

Star

Hulamin

Wispeco

Profal

Extrusions

Wispeco / Sheerline

Others

Fabricators

Installers

Finished products

products

Bespoke Contractors

From Figure 1 we can identify the market interfaces in the supply chain of aluminium, leading to the supply of finished extruded products which includes; (i) the supply of alumina feedstock to smelters; (ii) the supply of billets to semi-fabricators; (iii) the supply of semi-fabricated products to stockists/distributors by firms known as extruders; (iv) the supply of semi-fabricated products by stockists to fabricators; and (v) the supply of fabricated products (finished products) to the installer or end user. This transaction is concerned with market interfaces (iii) and (iv) of which stockists and fabricators are an important market.

Although the Commission in its analysis distinguishes between the roles of fabricators and stockists, thus suggesting that they operated at different levels of the supply chain, this classification became less certain during oral testimony in the course of the hearing. The Tribunal had called as a witness, Mr Paul Howard from a firm called Xline. Howard was the former chief executive of Sheerline. At the time the firm was facing the prospect of being sold by its parent company he left with some of his colleagues to form a rival stockist firm called Xline.

Howard explained that the extruder is the original supplier who extrudes the aluminium product and adds finishing to it; i.e. powder coating, surface treatment and painting. The product is then delivered to stockists who are direct purchasers of extrusions, and who stock a range of aluminium profiles at a variety of outlets and sell those products to fabricators.

Stockists, he testified come in different sizes, from large national players to smaller local players. The same can be said of fabricators – they too range from large to small. What blurs the dividing line is the range of services they provide be they classified as fabricator or stockist. Some provide designer services and technical know-how, others are little more than transporters of the product. Some stockists operate as well as quality controllers – inspecting the work of fabricators on site. Products themselves vary in complexity – the more complex the more value added by the expertise of the particular stockist or fabricator. On the record we have before us it is clear that segmenting the market between fabricators and stockists is not a useful way of understanding the competitive dynamics of those firms who are downstream from the extrusion market, but upstream from the final users.

What seems finally to distinguish stockists from fabricators is the quantities that they order from extruders. Stockists order in bulk and then on sell to fabricators in smaller quantities. Yet even this distinction it seems is not consistent industry practice. For this reason it would be better to consider the market as one in which firms operate to supply extrusions to the building industry but in which a range of services is offered which differentiate firms from one another.

It is clear that in this market the four firms most closely related and hence likely to operate as a competitive restraint on one another are the two merging firms, and Hulamin and Lafarge. All these firms apart from their size have another thing in common, they are vertically integrated.

Market Definition

Horizontal

Analysis

Unilateral effects

The Commission struggled to obtain reliable market share figures from the market participants in the relevant stockist market. Estimates of the merging parties' combined post merger market shares in this market varied widely ranging from between 47% to 67%, although undoubtedly Wispeco has the largest market share, followed by Sheerline pre-merger.¹ However there are a number of reasons for concluding that the merging parties would post merger still be subject to competitor

restraints from Hulamin and Lafarge, albeit by firms more differentiated from them and also the need to recognise that Sheerline would, absent the merger, not be the competitive force it had been in the past.

In the first place the market shares are historic and for reasons that we explain are not likely to be an indication of what they might have been in the future if the merger was prohibited. For a variety of reasons which we do not need to go into, it seems common cause that Sheerline is not the strong competitor it used to be until quite recently. Sheerline was purchased and became part of the AGI group in 2002. It, as Howard testified did not have a happy history as part of the broader AGI group for amongst other reasons that vertical integration between the businesses was notional only and they operated quite independently of one another. The troubles of AGI led to its bankers forcing the present sale as a solution. This had two consequences. Management and a large chunk of the staff left with Howard to form a new rival firm called Xline.

Secondly, the performance of the firm declined rapidly and up to date figures supplied to us at the time of the hearing confirmed this. Thus the true counterfactual is not the Sheerline of recent years which was a strong competitor, and at times the industry maverick, but the rather more depleted business that is sold to Wispeco.

There are two other features that would also serve to diminish competition concerns. The more important feature that we alluded to earlier is that although the market is differentiated between players downstream from the extruders there is a level of constraint coming from so called fabricators who it appears are a diverse and numerous population of business and would be in a position to compete more fiercely with the merging parties in the event of sustained supra-competitive price rises.

According to evidence at the hearing AGI will remain in the market at the stockist level even though it has sold Sheerline. Whilst this may not be an enormous source of comfort until the group sorts out its problems, it could emerge as another source of competition. The merging firms also relied on the existence of import competition as a huge constraint. Figures based on customs documentation evidenced this with imports sometimes spiking and then declining over short time periods - although curiously they seemed not to correlate with pricing responses from figures produced in another document by the merging parties. Despite this anomaly, imports do seem to pose at least some upper limit to the domestic suppliers, albeit subject to the usual caveats about relying on imports for comfort from domestic concentrations viz, currency vagaries, logistical problems at ports and the reliability of local distribution networks.

We also explored the issue of the value of brand names in this market. As a result of the merger Wispeco will control two of the four strongest brands in the market. Although counsel for the merging parties in opening address suggested brands were not important given the nature of the product, the evidence of Mr Herman Rolfes, the Managing Director of Wispeco was more circumspect on this point. Asked pointedly if the merger was subject to a condition that the Sheerline brand be divested of, he stated plaintively that "it would be nasty".² Howard's view was that brands had some value, but that given the intimacy of industry contacts, the reputations of managements

were equally important. Hence a new firm with an unknown brand might compete strongly with branded firms if the management enjoyed

industry recognition. This seems a plausible explanation given that the product is sold to industry players as opposed to a mass market customer base.

The final theory of harm in relation to unilateral effects is to consider whether Wispeco is using the merger to protect it from import competition. In a motivation to the board concerning the merger, a document described as an AGI opportunity was presented in which the rationale for the acquisition of Sheerline was stated as follows:

“The acquisition of Sheerline will add an additional distribution network and reputed brand to Wispeco and fits in with Wispeco’s

*strategy of increasing its market footprint and becoming the dominant player in architectural aluminium. In addition it will prevent the possible entry of a new or foreign competitor backed by another or foreign extruder”.*³

When asked about this at the hearing Rolfes explained that he had used this motivation to help gain board support for the merger. In other words this should be considered as a sales pitch and not a real consideration that Sheerline might have constituted a competitive threat to the Wispeco business.

Although this explanation is not entirely satisfactory and the merger may well have been driven by a defensive strategy on behalf of Wispeco to protect its market position in the extruder market, that fact taken on its own, is insufficient to condemn the merger. Barriers to entry in the stockist market are not so compelling that a committed new entrant would not be able to buy another stockist or create a new business should it be so inclined.

On a balance of all these considerations, although the merger will lead to an increase in concentration there is not enough to conclude that the merger will raise unilateral effects concerns that would not be present in the market even absent the merger given the demise of the Sheerline business.

Co-ordinated effects

During the course of its investigation into the merger, the Commission uncovered correspondence between the extruders and their customers concerning price increases during March 2005.⁴ The correspondence indicated that extruders advised their customers of similar increases in prices at similar times of the

year. The Commission considered whether this was evidence of a co-ordinated relationship between firms at an extruder level and

whether the merger at the downstream stockist level might enhance this co-ordination potential.

The Commission concluded it did not. This, it argued was because AGI's Profal is post merger, likely to have the incentive to supply independent stockists since it will no longer be vertically integrated into the stockist level, and would rather exert some competitive pressure against the vertically integrated stockists. On the other hand, Wispeco is likely with its increased stockists facilities to want to increase its market share, rather than act in concert with rivals.⁵

The merging parties denied that any co-ordination existed in the past and argued that common cost increases that all firms faced because of increased input costs, accounted for the pricing similarities.

We do not need to take a view on this for the purpose of this merger. Assuming that co-ordination had taken place at the extruder level, the question for us would be whether the merger at the downstream level would help strengthen this co-ordination upstream in some way? Typically downstream mergers would facilitate an upstream co-ordination if pre-merger there were problems in the exchange of information or monitoring that the merger would resolve. It seems from the record that firms at the upstream level were able to exchange information and monitor one another absent the merger. Thus if the conditions for co-ordination already exist in the market upstream the merger does not facilitate this.

AGI, as the Commission points out, is free to perform its own distribution function and does not need to distribute through Sheerline. Nor does Sheerline bring to Wispeco pricing information of other extruders that it does not already have access to. This information appears to get known in the market from letters to customers. Thus in our view the merger would have no impact on any collusion should it exist at the extruder level. There is no suggestion of any co-ordination existing at the stockist /fabricator level of the market.

Vertical

Analysis

The transaction results in vertical integration in relation to the markets for the production and supply of extrusions on the one hand, and stockists on the other. However, the Commission's investigation showed that Wispeco is unlikely to have the ability to engage in input foreclosure since independent stockists can switch to AGI, which post merger is no longer vertically integrated, and to Hulamin which is not operating at full capacity.

In addition there are a range of alternative domestic suppliers of extrusions such as Lafarge, Profal, Star Aluminium, as well as imports which are viable. These alternatives render any likely strategy of input foreclosure, unlikely or unviable as Wispeco would not gain any significant market power over the downstream stockists market if it engaged in such strategy.

In addition, despite the likely change in the orientation of the Sheerline business, the proposed transaction is not likely to raise customer foreclosure concerns.

Although the Commission initially wanted to advance the argument that the upstream market for the production of extrusions was susceptible to interdependent conduct, particularly in so far as pricing strategy is concerned, it found that this merger is unlikely to facilitate or strengthen co-ordination.

The transaction is therefore unlikely to substantially prevent or lessen competition neither in the horizontal nor the vertically related relevant markets.

Public Interest

This transaction raises the public interest matter of employment. According to their submissions to the Commission, the merging

parties estimated that the proposed transaction, in the worst-case scenario, would result in the reduction of employment of approximately 40-50 employees of Sheerline. However, the parties insisted that these retrenchments are not merger specific as

Sheerline would have in any event, engaged in wide-scale restructuring in order to ensure viability of the business which is

said to be currently loss making. In addition the parties stated that the number of employees who have resigned from Sheerline and moved to Xline, will result in far less smaller impact on employment within the business.

At the hearing Mr Eugene Mutileni from NUMSA⁶ appeared before the Tribunal and raised the concern that the merging parties had not properly consulted with NUMSA. It is common cause that the merger documents were served on the representative trade unions of both merging parties. Mutileni confirmed that NUMSA had received the merger notification, however it sought clarification of the possible employment impact both from the Commission and the directors of the merging parties, and that after various attempts to interact on this issue, there was no further engagements

forthcoming, nor was any feedback obtained.

According to the Commission's assessment, the employment issues are not merger specific, given Sheerline's dire financial

circumstances, which accordingly would have necessitated such retrenchments whether the merger was going to take place or not.

The Commission's assessment ended on that point and did not address the issue of whether the unions had been properly consulted.

A dispute of fact arose over the adequacy of the consultation process. Mutileni alleges that he had contacted the merging parties' attorneys to discuss the matter and was referred by them to Wispeco management who never returned his calls. This was not denied by Wispeco but it argued that consultation had taken place in discussions with NUMSA's local organiser for the East Rand. Mutileni countered this by stating that NUMSA handles merger related issues at head office level and that it was not adequate to have discussions with local branch organisers.

We have previously held that proper consultation is an essential part of the public interest consideration particularly where job losses are contemplated post merger. Where a union has indicated that it wishes to have further consultation and through which office it wants consultation to take place, provided it does so timeously, this request should be respected by merging parties. We do not consider that in this merger the acquiring firm met its obligations. However we are not inclined to postpone the hearing further to allow these deliberations to take place, as NUMSA requested, given the parlous state of the target business.

For this reason we have imposed the conditions that:

"1. For a period of one year after the date of this order, the merged entity may not make any merger-related retrenchments at the target firm, provided that this will not prevent the merged firm making operationally related retrenchments at the target firm during this period.

2. During the one year period, the merged entity must notify the Competition Commission of any retrenchments taking place at the target firm within 20 days of the retrenchment being notified to the employee/s concerned. The notification to the Commission must include the number of employees retrenched and the reasons for the retrenchment."

CONCLUSION

We have found that there is insufficient evidence to suggest the merger is likely to have an anti-competitive effect. The merger might have an adverse effect on the public interest in respect of employment, but this concern is adequately addressed by the condition we have imposed on the merger which is annexed hereto marked A.

20/05/2010

N Manoim Date

A Wessels and Y Carrim concurring

Tribunal Researcher: Londiwe Senona

For the merging parties: Adv. D Unterhalter S.C. instructed by Nortons Inc.

For the Commission: Mfundo Ngobese and Jabulani Ngobeni

1 Pgs. 43-46 of the Commission's recommendations.

2 At pg. 186 of the transcript.

3 At pg. 851 of the merger record.

4 At pgs. 671-673 of the merger record.

5 At pg. 92 of the Commission's recommendation.

6 NUMSA represents some of Wispeco's employees, as well as all of Sheerline's employees. United Association of South Africa (UASA) and Solidarity, which are unions representing some of Wispeco's employees, both provided the Commission with letters of non-participation.

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