**INTERNATIONAL BAR ASSOCIATION**

**ANTITRUST SECTION MERGERS WORKING GROUP**

**SUBMISSION TO THE COMPETITION COMMISSION OF SOUTH AFRICA**

**REGARDING THE AMENDMENT OF THE SMALL MERGER GUIDELINES**

25 June 2021

## 1. INTRODUCTION

1.1 This submission is made to the Competition Commission of South Africa (the **Commission**) on behalf of the Mergers Working Group (**Working Group**) of the Antitrust Section of the International Bar Association (**IBA**). The IBA Antitrust Section welcomes the opportunity to comment on the Amendment of the Small Merger Guidelines (the **Guidelines**).

1.2 The IBA is the world's leading organization of international legal practitioners, bar associations and law societies. The IBA takes a keen interest in the development of international law reform and helps shape the future of the legal profession across the world.

1.3 The IBA's 50,000-strong membership of individual lawyers from across the world, including the East African Community, places it in a unique position to provide an international and comparative analysis in the development of commercial laws. Further information on the IBA is available at http://www.ibanet.org/.

1.4 The Antitrust Section includes antitrust/competition law practitioners and experts with a wide range of jurisdictional backgrounds and professional experience. The Working Group's comments draw on the vast experience of the Section's members in merger control law and practice in jurisdictions worldwide. Further information on the Antitrust Section and its Working Groups is available at: https://www.ibanet.org/LPD/Antitrust-Section/Antitrust/Default.aspx.

## 2. EXECUTIVE SUMMARY

2.1 Aside from the jurisdictional validity of the proposed requirement to notify smaller mergers in *'digital markets'* in the Guidelines, the Working Group has made submissions relating to the criteria and procedure relating to the proposed informal notification of transactions in *'digital markets'*.

2.2 The Working Group respectfully submits that the Guidelines would benefit from greater certainty around concepts referred to in the proposed amendments such as *'digital markets'*, *'operates'* and *'activities'* so that it is completely clear to parties when the Guidelines may apply to them and their transactions.

2.3 While the Working Group understands the concerns raised by the Commission regarding transactions in *'digital markets'* escaping regulatory scrutiny on the basis that thresholds are not met, it is respectfully submitted that caution should be exercised when employing a criterion based on transaction value. Only transactions with a material local nexus and effect should be considered by competition authorities to reduce both transaction costs, and resources expended by competition authorities. In addition, due consideration should be given to the commercial realities surrounding transaction values, including that they are not always determinable at the outset of a transaction and may only be known at closing. In addition, if a transaction value criterion is to be applied, the level at which the transaction value level is set should be based on historic transactional information as opposed to existing financial merger notification thresholds, as consideration and turnover/asset value are very different metrics.

2.4 The Working Group also recommends against including criteria based on market share or post-implementation effects as this is not objectively determinable, and may be particularly complex in *'digital markets'* where market definitions are not always clear.

2.5 Finally, for certainty, it would be useful to include a time period in which the Commission will indicate whether or not a small merger notification is required in order not to delay the closing of the transaction.

## 3. BEST PRACTICE PRINCIPLES

3.1 The Working Group encourages convergence towards best practices by all jurisdictions in the application of merger control laws and rules. The International Competition Network (**ICN**) plays an important role in the development of international best practices. The ICN has over 100 members, including the competition authorities in South Africa.

3.2 The Working Group considers that the Guiding Principles for Merger Notification and Review (**ICN Guiding Principles**) issued by the ICN play an important role in promoting legal certainty.[1] In addition, the Recommended Practices for Merger Notification and Review Procedures (**ICN Recommended Practices**) issued by the ICN provide detailed guidance regarding best practices for the design of merger control processes.[2] Where relevant, the ICN Guiding Principles and ICN Recommended Practices are referenced in this submission.

## 4. JURISDICTION

4.1 The Working Group notes that the Competition Act No. 89 of 1998, as amended (the **Act**), provides that a party to a small merger is not required to notify the Commission of that merger unless the Commission requires it to do so in terms of subsection 13(3); and may implement the merger without approval, unless required to notify the Commission in terms of subsection (3).

4.2 Subsection (3) provides that within six months after a small merger is implemented, the Commission may require the parties to that merger to notify the Commission of that merger in the prescribed manner and form *if*, in the opinion of the Commission, having regard to the provisions of section 12A, the merger (a) may substantially prevent or lessen competition; or (b) cannot be justified on public interest grounds.

4.3 We understand that a primary objective of the issuing of guidelines is to provide notice to the public of the Commission's policy on certain matters.

4.4 The current Guidelines, which are not binding on any party, indicate that the Commission will require the notification of all small mergers which meet any of the following criteria: (i) at the time of entering into the transaction any of the firms, or firms within their group, are subject to an investigation by the Commission in terms of Chapter 2 of the Act; or (ii) at the time of entering into the transaction any of the firms, or firms within their group, are respondents to pending proceedings referred by the Commission to the Competition Tribunal in terms of Chapter 2 of the Act. The Working Group understands that the jurisdictional grounds set out in section 13(3) must still be shown to exist before the Commission requires the notification of small mergers in these circumstances, i.e. the Commission must be of the opinion that the merger may substantially prevent or lessen competition or cannot be justified on public interest grounds.

1 https://www.internationalcompetitionnetwork.org/wp-content/uploads/2018/05/MWG_GuidingPrinciples.pdf.
2 https://www.internationalcompetitionnetwork.org/wp-content/uploads/2018/09/MWG_NPRecPractices2018.pdf.

4.5 The proposed amendments to the Guidelines indicate that '*the Commission will require that it be informed of all small mergers and acquisitions where either the acquiring firm, the target firm, or both operate in one or more digital market(s)'* provided that certain criteria are met (which we discuss below).

4.6 The Working Group respectfully submits that the proposed amendments seem to go beyond notifying the public of the Commission's policy with respect to small mergers which it will require be notified under section 13(3). The proposed amendments instead attempt to impose a blanket obligation on parties to inform the Commission of all small mergers that meet certain criteria, regardless of whether there is any basis for an opinion that the merger would negatively affect competition or the public interest. The Working Group understands that there is no ex ante basis to assume that any or all mergers in a *'digital market'* would have such an effect. It is respectfully submitted that the prevailing *'theory of harm'* with '*killer acquisitions'* or *'copy, kill, acquire'* strategies typically apply only to tremendously powerful platforms and not every acquisition in a digital market.

4.6.1 As mentioned above, the Working Group understands that, in terms of the Act, the Commission may only require small mergers to be notified if the section 13(3) jurisdictional grounds have been shown to exist i.e. in the opinion of the Commission, the merger may substantially prevent or lessen competition or cannot be justified on public interest grounds.

4.6.2 It is respectfully submitted that the Commission is not empowered to impose this as a standing obligation on parties, however, it may of course request the notification of mergers relating to digital markets within six months of implementation if the jurisdictional grounds set out in section 13(3) are present;

4.6.3 The Commission's wording in 4.5 above refers to *'small mergers and acquisitions'*. It is not clear why a reference to *'acquisitions'* is necessary. The Guidelines only deal with small mergers as defined in the Act not with other types of acquisitions. The reference to *'and acquisitions'* should accordingly be deleted.

4.7 The Working Group nevertheless provides comments on the criteria set out in the Guidelines below.

## 5. INEFFECTIVENESS OF TRANSACTION VALUE THRESHOLDS

5.1 The Working Group respectfully submits that, on the basis of experiences in other jurisdictions, the introduction of transaction value thresholds is not recommended.

5.2 There is limited evidence that the transaction value thresholds have achieved their desired effect in jurisdictions which have introduced this threshold, such as Germany and Austria. The German Federal Cartel Office (**FCO**) has published an evaluation report assessing its transaction value threshold where it concluded that the threshold only caught a very small number of tech transactions, with none of these transactions raising any anti-competitive or *'killer acquisition'* concerns. None of the notified transactions was the subject of a phase II investigation. At the same time, the transaction value threshold has caused significant legal uncertainty for businesses, particularly (but not exclusively) due to uncertainties regarding the necessary local nexus. It is respectfully submitted that this experience supports the notion that an economy-wide transaction value threshold is not necessary or proportionate.

5.3 As discussed in more detail below, the European Commission (**EC**) and the French Competition Authority (**FCA**), considered the introduction of a transaction value threshold but ultimately decided against it, including because of the difficulty in setting an appropriate threshold to capture potentially problematic mergers without over-burdening the authorities and parties.

5.4 The introduction of a transaction value threshold could have a number of unintended adverse consequences.

5.4.1 There is a risk that the introduction of a transaction value threshold may dampen innovation by disincentivising both founders and investors alike as a result of increased regulatory burdens, costs, delays and legal uncertainty for small merger transactions.

5.4.2 It may also result in the capture of a significant proportion of transactions that do not raise substantive concerns, particularly given that start-ups often have limited or no current market presence and uncertain futures, thereby unnecessarily burdening the Commission's resources and imposing unnecessary additional regulatory burdens, costs and delays on parties to small merger transactions.

6. **CRITERIA**

***Parties to the small merger and key definitions***

6.1 The Working Group understands that the Commission is concerned that (i) there is an increasing risk that the growth of digital players through the rising number of acquisitions of new, innovative companies may have a detrimental impact on innovation, particularly where these digital companies act as gatekeepers in multiple markets; and (ii) certain mergers in the digital market may escape regulatory scrutiny due to acquisitions taking place at an early stage in the life of the target before they have generated sufficient turnover that would trigger a merger notification.

6.2 The proposed amendment to the Guidelines intends to capture small mergers and acquisitions where either the acquiring firm or the target firm or both operate in one or more digital market(s) provided certain criteria are met.

6.3 Having regard to 6.1 and 6.2 above, it is unclear why the Guidelines should apply to small mergers where only the acquiring firm operates in a digital market and the target firm does not. It is difficult to see how such a merger would give rise to the concerns raised by the Commission. The Working Group submits that only small mergers where the target firm operates in a digital market may be of interest in the context of the concerns raised by the Commission.

6.4 The Working Group considers that a definition for *'digital markets'* would be helpful and should be included in the Guidelines so that parties understand when the Guidelines may apply to them. The Working Group is concerned that the term *'digital market'* is far too broad on the face of it, and could encompass a great many businesses with an online or *'ICT'* (i.e. information communication technology) presence. For example, would a traditional brick and mortar store with an online store fall into a *'digital market'*? Would all software developers, vendors or consultants be captured by the Guidelines? The Working Group expects this type of business is unlikely to be the focus of the Commission's concerns. If this understanding is correct, the Commission might consider narrowing the scope of the Guidelines to *'digital transactions markets'*, *'digital platform markets'* or other specific and genuine digital markets. Furthermore, it is respectfully submitted that what is of relevance to the Commission are digital markets *in South Africa* and this should be made clear. The experience in Germany with the transaction value threshold has shown that the local nexus requirements should be stipulated as precisely as possible in order to avoid unnecessary legal uncertainty in particular for foreign-to-foreign transactions.[3]

6.5 It may also be helpful to include a definition for *'operates'*. In doing so, the Commission should consider the ICN's Recommended Practices which recommend incorporating a material local nexus to the reviewing jurisdiction in any merger thresholds (or in this case criteria requiring informal notification to the Commission).[4] This is consistent with section 3 of the Act which provides that the Act applies to all economic activity within, or having an effect within, South Africa. The definition of *'merger'* in section 12 of the Act also expressly refers to the acquisition or establishment of control over the *<u>'business'</u>* of the target and any definition of the term *'operates'* should be consistent with section 12 and not cover *'operations'* unrelated to a business.

6.6 The Working Group suggests that it may, however, be clearer if a turnover or asset value threshold were included as a separate criterion in the Guidelines. This is discussed in more detail in paragraphs 6.16 and 6.17 below.

***Consideration or transaction value criterion***

6.7 It appears that the threshold level for the consideration criterion is simply set at the same level as the higher target financial (turnover and asset) threshold for a notifiable merger (ZAR 190 million). As an initial observation, it is worth highlighting that a threshold based on transaction value is uncommon. Only a small number of jurisdictions currently use this type of notification threshold (e.g. Nigeria, the United States, and Austria and Germany in Europe). Also, it is telling that while others have considered introducing one, they have ultimately not proceeded. For example, as mentioned briefly above, the EC and the FCA have each consulted on the introduction of such a threshold and subsequently decided against it. The FCA, in particular, had concerns as to how effective such a threshold would be in capturing problematic mergers while imposing a significant burden on parties to transactions.

6.8 Moreover, where such a threshold is used, it is often accompanied by a material nexus requirement (the importance of this is discussed above and further below), such as the

3 To reduce legal uncertainty resulting from the transaction value threshold the FCO, together with the Austrian competition authority, published a joint guidance paper in July 2018 focussing on *'consideration'* and *'domestic activity'*.

4 II Nexus to Review Jurisdiction, page 3.

United States which requires material local sales or assets[5] or Austria and Germany where *'substantial domestic operations'* are required. It is worth noting however that significant practical difficulties can arise even with such local nexus tests (e.g. see paragraph 6.16 onwards below).

6.9 It is respectfully submitted that the consideration criterion in the Guidelines is set at a very low level and could potentially be met by a large number of transactions, including many foreign transactions that would not have any material connection to or effect on South Africa. This may have a chilling effect on transaction activity in *'digital markets'* which could hamper innovation. The consequences of selecting the incorrect threshold was succinctly summarised by the European Commissioner, Margrethe Vestager, "*it's not easy to set a threshold like that at the right level. If it's too high, it doesn't really help – you still end up missing a lot of the cases that matter. On the other hand, if you set it low enough to make sure that you see all those mergers, you risk making companies file a lot of cases that simply aren't relevant*."[6]

6.10 Often the consideration paid for target businesses is unrelated to the target's turnover or asset value, but rather the market value of the business. As such, the consideration paid is often higher than the turnover or asset value of the target firm. It is therefore respectfully submitted that it is inappropriate to simply use the existing ZAR190 million turnover or asset value threshold for a criterion based on transaction value. Consideration ought to be given to the consideration paid in historic transactions in the *'digital market'* in order to determine an appropriate level.

6.10.1 For example, a threshold based on transaction value was also proposed in Germany where the threshold under consideration was EUR 350 million (approximately ZAR 5.82 billion at current exchange rates). It appears that this threshold was based on the analysis of potential acquisitions of German start-up businesses alone.

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5 16 C.F.R. §802.51. In addition, the Platform Competition and Opportunity Act being tabled in the United States sets thresholds far higher, and will relate only to certain designated platforms (USD 600 billion market capitalisation, 500,000 users and a *'critical trading partner'* for other businesses) which narrows the scope of *ex ante* limitations on mergers.

6 Speech by Margrethe Vestager at International Bar Association 24th Annual Competition Conference on 11 September 2020 accessible here: https://ec.europa.eu/commission/commissioners/2019-2024/vestager/announcements/future-eu-merger-control_en.

6.10.2 Pursuant to comments from stakeholders that this threshold was too low, including by the Working Group, the threshold ultimately applied was a transaction value of EUR 400 million (approximately ZAR 6.65 billion at current exchange rates).

6.11 In addition, the value set by the Guidelines does not appear to have any rational basis as to how or why the value is deemed to be meaningful in terms of significance overall or in competition terms. If the Commission has determined an economic or fact-based rationale for the value, the Working Group would urge the Commission to take stakeholders into its confidence to be able to consider this.

6.12 The proposed consideration criterion in the Guidelines may also create some difficulties as not all transactions have a fixed consideration. While transactions with a fixed purchase price should not be problematic, uncertainty will arise in transactions where it may be difficult to determine the transaction value precisely. For example, in some transactions the value of consideration may be subject to adjustment (for example based on the working capital, indebtedness, EBITDA and/or net asset value of the target as at closing, which amounts will only be determined after closing) or depend on certain conditions being met and is, therefore, determined partially at a later point in time or is in the form of options to receive the purchaser's shares in the future. Additionally, parties may decide the transaction value in the future after certain conditions occur, such as under earn-out arrangements or where there are provisions for material purchase price adjustments. In such circumstances, it will be difficult to assess a value of consideration for the proposed transaction. Clear rules or guidelines should be provided to reduce such uncertainties.

6.13 Also, the timing of the determination of consideration value can affect the filing decision and cause costs, delays and uncertainty for small merger transactions. Accordingly, the Working Group respectfully submits that if, notwithstanding these submissions the final Guidelines retain consideration value as a criterion, the Guidelines should stipulate a fixed assessment date in advance of closing, such as the date of signing. Leaving the issue of determination of the consideration value to the date of closing would create significant uncertainty as parties would not be in a position to determine the applicability of the Guideline until the closing date with a host of potential adverse consequences on financing, tax planning, accounting and other factors that drive transaction timing.

6.14 Finally, the Working Group respectfully submits that, if a consideration value is set in the Guidelines, it needs to be frequently updated by the Commission. For example, the US Federal Trade Commission makes annual adjustments to the relevant thresholds based on changes in gross national product.

6.15 Similar issues arise in relation to the criterion in the Guidelines that requires notification to the Commission if the acquisition of a part of the target firm is less than ZAR 190 million but *'effectively values'* the target firm at ZAR 190 million (for example, the acquisition of a 25% stake at ZAR 47.5 million). This criterion (particularly the method of *'effectively valuing'* the target) should be clarified so that it is completely clear to parties when the Guidelines may apply to them and their transactions.

***Domestic activities***

6.16 The requirement that the target firm has *'activities'* in South Africa is unclear, for instance, what would constitute *'activities'* for the purposes of the Guidelines? This should be clarified so that it is completely clear to parties when the Guidelines may apply to them and their transactions. The definition of *'merger'* in section 12 of the Act expressly refers to the acquisition or establishment of control over the *'<u>business</u>'* of the target and any definition of the term *'activities'* should be consistent with section 12 and not cover *'activities'* unrelated to a business.

6.17 To require parties to inform the Commission of transactions based on such broad criteria, none of which on its face suggests any likelihood of an appreciable competitive or public interest effect within South Africa would impose commitments of the Commission's resources without a corresponding enforcement benefit. Thresholds for notification, even informal notification, should therefore capture only transactions that have a significant and direct economic connection to South Africa. The most common means of providing for a material nexus is by requiring significant local sales or local asset levels by at least two parties to the merger and at least by the business being acquired. While other thresholds or criteria may be used, such as transaction value and market share, these thresholds or criteria should not be applied without the application of the turnover/asset value criteria which establishes a material local nexus to and effect on the reviewing jurisdiction.[7]

6.18 The importance of a material quantitative local nexus and effect is imperative particularly for *'digital markets'* as undertakings operating on the internet usually offer their products

[7] II Nexus to Review Jurisdiction, page 3.

and services globally. Many of these undertakings can be expected to have at least some customers in South Africa, even where the main activities are based elsewhere. This could result in parties having to inform the Commission of a merger where it has *de minimis* sales in South Africa on the basis that these few sales could be considered as *'activities'* in South Africa. Accordingly, the Working Group respectfully submits that the introduction of a bright-line test, such as the percentage of the relevant digital users relative to the population, is necessary so as only to capture *significant* domestic activities in South Africa.

***Market shares and dominance***

6.19 The Commission is respectfully referred to the ICN Recommended Practices which recommend that thresholds (or in this case criteria) should be based on objectively quantifiable criteria, such as assets and sales/turnover. Market share and potential transaction-related effects, such as the gain or reinforcement of dominance, are not objectively quantifiable. While such criteria, which are inherently subjective and fact-intensive, may be appropriate for later stages of merger control processes, they are not appropriate for use in making the initial determination as to whether a transaction requires formal or informal notification and will result in unnecessary costs and delays for small merger transactions.[8]

6.20 The Working Group respectfully submits that the criteria based on market share and dominance, which potentially requires detailed economic self-assessment, is inappropriate, particularly in relation to 'digital markets' which are not easily defined.

## 7. PROCEDURE

7.1 The Working Group assumes that the Commission's confidentiality regime would apply to all letters informing the Commission of parties' intention to enter into transactions that meet the criteria set out in the Guidelines. It is, however, suggested that this is made explicit in the Guidelines.

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[8] II Nexus to Reviewing Jurisdiction, E, page 6.

7.2 The Guidelines provide that the Commission will reply to the parties' notification in writing and inform the parties whether or not they would require to notify the small merger to the Commission. The Working Group respectfully submits that, in order to promote transaction certainty, a time period in which the Commission will respond should be specified in the Guidelines.