**COMPETITION TRIBUNAL OF SOUTH AFRICA**

**Case No: IM232Feb16**

In the matter between:

| | |
|---|---|
| **CTP LIMITED AND** | |
| **COMPACT DISC TECHNOLOGIES** | |
| **(A DIVISION OF TIMES MEDIA (PTY) LTD)** | Applicants |
| and | |
| **THE COMPETITION COMMISSION** | Respondent |

---

| | |
|---|---|
| Panel | : Norman Manoim (Presiding Member) |
| | : Andreas Wessels (Tribunal Member) |
| | : Anton Roskam (Tribunal Member) |
| Heard on | : 15 March 2016 |
| Order Issued on | : 16 March 2016 |
| Reasons Issued on | : 11 May 2016 |

---

**Reasons for Decision**

---

**Introduction**

[1] This is an application for the reconsideration of an intermediate merger decision made by the Competition Commission ("Commission") to prohibit a merger between by CTP Limited ("CTP") and Compact Disc Technologies (a division of Times Media (Pty) Limited) ("CDT"). This application is brought in terms of section 16(1)(a) of the Competition Act, 89 of 1998, ("the Act").

[2] The merger was notified to the Commission on 15 November 2015 and the Commission issued its decision to prohibit the merger on 2 February 2016. We heard the merger on 15 March 2016 and approved it conditionally on 16 March 2016. Our reasons for that decision follow.

**Background**

[3] The Commission received notice of the intermediate merger on 15 November 2015. In terms of the transaction CTP was to acquire the Digital Disc Manufacturing and Replicating Business of CDT from the Times Media Group. Post-merger CTP would control CDT.

[4] CTP and CDT are both involved in the manufacture and replication of optical discs (CDs and DVDs) for the entertainment industry in South Africa. Therefore, the activities of the merging parties overlap horizontally with respect to the manufacture and replication of CDs and DVDs. In essence the merger involves the sale of CDT's assets to CTP, the most valuable being its replication machines.

[5] The Commission defined the relevant market as:

a. The national market for the manufacture and replication for CDs with some imports; and
b. The national market for the manufacture and replication for DVDs with some imports.

[6] The Commission concluded that the merging parties were the only effective competitors in the relevant markets pre-merger. The only other replicator in the market is Jetline. However, Jetline is not a specialist music replicator and does not have the capacity to service the large recording firms such as Universal Music, Warner Music, and Sony Music. It further found that imports were not substantial in these markets and are mainly limited to old music titles and niche products.

[7] Despite the fact that the Commission found the barriers to entry into this market to be low, it concluded that entry into this market was unlikely as it is common cause that the market

is in decline. CD's and DVD's represent outdated technology as customers, particularly younger ones, make use of online offerings as their source for music and movies.

[8] The customers of the merging parties are large recording companies, many of which were international. Prior to the merger, these customers had some countervailing power over pricing as they could credibly threaten to switch their business from the one replicator to the other. Post-merger this option would be eliminated.

[9] The merging parties did not seriously dispute these facts. However, they raised as the central plank of their defence that CDT was a failing firm in a dying market. The merger would thus preserve assets that would otherwise exit the market and because some jobs would be saved, the merger would have a positive public interest outcome.

[10] The Commission rejected the merging parties failing firm defence as it concluded that they had not met the necessary requirements of that defence, in particular proof that there was no other buyer for the target firm. Nor was it satisfied that CDT had taken sufficient steps to rationalise its business.

[11] Given its findings that the merged entity would be a near monopoly and that the failing firm defence did not avail the merging parties on these facts, the Commission pursued a unilateral effects theory of harm. In its reasons it identified three anticompetitive effects:

a. Post-merger supra-competitive price increases;

b. The merged entity would have the ability and incentive to increase minimum order sizes for CDs and DVDs thus raising customers' costs; and

c. The merged entity would be able to bundle the manufacture and replication of CDs and DVDs with the distribution of CDs and DVDs.

[12] Furthermore, with respect to the public interest considerations, the Commission found that no rational process was followed to identify the potential impact of the merger on employment.

[13] Despite these adverse findings the Commission still sought to resurrect the merger by proposing certain conditions which it considered would address the competition and public interest concerns mentioned above. The one condition that remains relevant to the current decision, as we go on to explain, was a price cap, requiring the merging parties to price at current levels plus inflation for the next five years. The merging parties rejected these proposals. Given this stance by the merging parties the Commission concluded that its only option was to prohibit the merger. This it did on 2 February 2016.

[14] On 11 February 2016, the merging parties filed their request for reconsideration. They sought an order that the merger be unconditionally approved. The essence of their argument was that the Commission had erred in rejecting their failing firm defence. In particular they focused on the Commission's conclusion that the target firm had not taken any steps to address its decline and second that it had made no attempt to find an alternative buyer which would have represented less of a loss to competition. They submitted that:

a. Contrary to the Commission's findings, CDT had taken steps to arrest its decline such as:

    i. expanding into other geographic areas;

    ii. reducing its workforce from 149 to 58 employees;

    iii. CDT sought to renew contracts with existing customers and sought to regain the business of Sony;

    iv. CDT closed its loss making distribution business and debt collection business;

    v. CDT also retrenched its managing director and consolidated the senior managerial roles in CDT with those of other parts of TMG.

b. They should not be required to prove that they had attempted to find an alternative buyer. They argued that on the facts no alternative buyer was likely as:

i. CDT was loss making;

ii. the industry was in decline;

iii. CTP was the only entity which was able to purchase CDT and reduce the per unit costs of production; and

iv. no other purchaser would have the track record to deal with the "majors".

c. CDT would almost certainly exit the market in the short term, which meant there would likely be only one long run replicator in South Africa.

d. The Commission did not take into account the established jurisprudence which relates to the acquisition of a firm failing or likely to exit the market. Had the Commission applied the correct counterfactual, it would be found there is no likelihood of merger specific unilateral effects.

[15] With regards to the Commission's proposed conditions the merging parties submitted the following:

a. The Commission proposed a condition prohibiting the merged firm from increasing its prices above inflation for a period of 5 years from the Implementation Date and reserved the right to conduct a review to assess whether there is a need to extend the application of this condition for an additional period. The merging parties argued that much of their production costs relied on imported material and these costs increased at levels above inflation.

b. The Commission required the merged firm to not require minimum orders of more than 100 for a period of 5 years. The merging parties argued that the Commission did not take into account that the standard minimum order quantities of the parties pre-merger is 300 units. These are set as such as it is prohibitively expensive to produce CDs and DVDs on a smaller scale. The Commission's condition is therefore not merger specific, and in any event, absent the proposed merger, CDT will exit the market, meaning any change in this regard is not merger specific.

c. CTP did indicate it had no objection to the condition that it may not compel its customers for its replication services to use its distribution services.

d. The Commission did not apply the correct counterfactual in considering the public interest considerations. Retrenchments were inevitable absent the merger and as such the Commission ought to have concluded the reduction in employment was not merger specific. The criticism that a rational process in establishing the impact on employment was not followed, was incorrect. Absent the transaction CDT would close and therefore the entire workforce of CDT (58 employees) would be retrenched. Therefore this condition was not warranted given that the proposed transaction was employment enhancing.

[16] Based on the above submissions, the merging parties submitted the proposed transaction should be approved without conditions. Alternatively if any conditions were imposed these should only relate to the confirmation that CTP will not compel replication customers to use its distribution services.

[17] At a pre-hearing on 18 February 2016, the Tribunal ordered that the merging parties tender revised conditions to the Commission. On 25 February 2016, the merging parties submitted revised merger conditions to the Commission. The merging parties proposed conditions which dealt with all the concerns of the Commission other than the pricing concern.

[18] Accordingly, at the hearing there was only one issue in dispute for the Tribunal to determine and that is whether the Commission's proposal for a pricing cap condition was justified. A key issue to determine whether a pricing condition was warranted was whether CDT was a failing firm. If it was, then a post-merger price rise could be justified as a consequence of saving the firm from exiting the market; or alternatively the counter factual was that if it exited, because no other buyer for the assets existed, then the market outcome would be the same - there would still only be CTP left in the relevant market. However if it was not a failing firm, the merger was clearly anticompetitive – a move from a two firm market to a single firm one – and then imposing a pricing remedy or prohibiting

the merger would be justified. For this reason we first consider whether the failing firm defence applied in this case.

**The Failing Firm**

[19] Section 12A(2) of the Act recognises that the question of whether the business or part of the business of a party to the merger or proposed merger has failed or is likely to fail is one of the factors to which regard will be had in considering a merger.

[20] The Tribunal in *Iscor/Saldahna Steel*[1] made the following observation about the failing firm:

> *"In our Act, the failing firm doctrine is not used as a 'defence' to a merger that has been found on an initial market analysis to be anticompetitive. Rather it is recognised as one of list of 'factors' that one takes into account before one can determine whether a merger is anticompetitive."*[2]

However, the Tribunal made plain that in certain circumstances a finding that a firm was failing could be decisive:

> *"A merger would not be regarded as lessening competition if the conditions laid out in the more stringent EU test [for a failing firm] can be satisfied."*[3]

The stipulations for the EU test were recorded by the Tribunal in *Iscor* as follows:

*"a) the acquired firm would have withdrawn from the market if not taken over by the other firm;*

---

[1] *ISCOR Limited and Saldanha Steel (Pty) Ltd* 67/LM/Dec01 [2002] ZACT 17.

[2] *ISCOR Limited and Saldanha Steel (Pty) Ltd* 67/LM/Dec01 [2002] ZACT 17 at [101].

[3] *ISCOR Limited and Saldanha Steel (Pty) Ltd* 67/LM/Dec01 [2002] ZACT 17 at [110].

*b) the acquirer would gain the market share of the acquired firm if the latter were to exit the market; and*

*c) no alternatives were available that were less anticompetitive."*[4]

[21] The Tribunal further made clear that even where the EU test conditions were not met, the fact that a party to the merger was failing in the broad sense may still be sufficient to justify the approval of an otherwise anti-competitive merger, "*depending on the degree of the anti-competitive sting*"[5] of the merger.

[22] At the hearing we heard the testimony of two witnesses: Mr Andrew Gill ("Gill"), an Executive of Times Media Group ("TMG"), who was called by the merging parties and Mr Paul Jenkins ("Jenkins"), the Executive Chairman of CTP who was called at the request of the Tribunal.

[23] According to Gill in his witness statement:

a. TMG resolved that CDT should be disposed of and if no purchaser was found CDT would be closed with effect from June 2016. CDT made significant losses in the previous financial year and it was forecast to do so again this year. Times Media Home Entertainment is CDT's largest single customer and made a substantial loss in TMG's latest financial year, and thus TMG has decided to *wind down* this business.

b. CDT's financial position had worsened considerably as Coleske had moved their business from CDT to CTP, and Universal (which accounts to more than 50% of CDT's turnover) has indicated it will do the same once its current contract with CDT ended. Universal had also cancelled its contract in respect of new releases and now places its orders on an *ad hoc* basis. CDT had also lost the UNISA tender for replication of DVD's.

[4] *ISCOR Limited and Saldanha Steel (Pty) Ltd* 67/LM/Dec01 [2002] ZACT 17 at [82].

[5] *ISCOR Limited and Saldanha Steel (Pty) Ltd* 67/LM/Dec01 [2002] ZACT 17 at [110].

[24] In his oral submissions before the Tribunal at the hearing on 15 March 2016, Gill submitted that TMG had taken a strategic decision to dispose of its non-core businesses and that included CDT. Gill also submitted that CDT had incurred significant losses during the previous financial year, which were exacerbated by the loss of the major clients mentioned.

[25] Gill testified that this was a unique market in its final phase of use, and that there are only two significant players left (being CTP and CDT), and that several customers that have left CDT have moved over to CTP. It then follows that the market share of CDT would be gained by CTP anyway if CDT was to exit the market. This, argued the merging parties, satisfies the second requirement of the EU test for failing firms.

[26] With regards to the final requirement of the EU test for failing firms, Gill testified that CDT considered that trying to find an alternative buyer, and thus a less anticompetitive outcome, would have been fruitless because it would make no sense for any other firm besides CTP to buy the business given that no other firm had the expertise and this was a dying market. CTP would be in a unique position as it could post-merger, lower production costs. This was not something any other buyer could do.

[27] Although the Commission cross examined Gill to test the reasons why no attempt had been made to find another buyer it did not lead any of its own witnesses on this point. Moreover the Commission had during its investigation approached Jetline which indicated it would not be interested in buying the firm, nor was Universal, one of the major customers. This would vindicate the testimony of Gill i.e. that the effort of finding a buyer, although not embarked on, would have proved fruitless.

[28] There was also no serious challenge to Gill's testimony that CDT's market share would, on exit, have all gone to CTP. The evidence was that this was already taking place pre-merger with some customers moving across already.

[29] We find that on a balance of probabilities despite CDTs' lack of effort to find another buyer the argument why another was unlikely given the nature and characteristics of this market was persuasive. Nor had the Commission identified a likely candidate either although it had made the effort to identify one. Further the facts show that if CDT had exited all its market share would have gone to CTP. Nor were we persuaded that CDT was not a failing

firm. Its recent performance in the market and steady loss of customers to CTP suggest it was. Therefore, based on the facts before the Tribunal, we find CDT meets the requirements of the EU test for failing firms.

[30] The next aspect to be decided by the Tribunal was whether or not the imposition of a pricing condition on the failing firm was warranted.

## Pricing Condition

[31] Jenkins testimony was relevant to the pricing condition, which recall, CTP had rejected. Essentially he made two main points:

a. The industry might not even last another two years let alone five years so a five year cap was excessive.

b. That basing a pricing cap subject to an annual inflationary increase would be uncommercial as the firm's costs were largely dependent on imports whose prices increase at a supra-inflationary level.

[32] The Commission cross examined Jenkins to see whether he would agree to a pricing cap that was not based on inflation as the index. Jenkins however rejected any pricing cap. His reasons were that the acquisition was highly risky and that the prospects for returns, given that the CD industry was dying, were short term. Any form of pricing cap would remove any justification for doing the merger.

[33] We have no reason not to accept Jenkins's evidence on these two aspects.

[34] As a result we have concluded that the imposition of a pricing cap condition either in the form proposed by the Commission or a more modified form, is not justified. We make this finding for two reasons:

a. As noted earlier, applying the approach in *Iscor,* where the merger meets the stringent EU standard then it would not be regarded as anticompetitive. This is because on the counterfactual the market share would have gone to the acquiring firm if the target firm had exited. We have found on the facts this to be the case here.

b. Even if we are wrong about all the elements of the European test being met in this case, we have to have regard to the most significant common cause fact in this case - this is a fast declining and potentially dying market. Whilst undoubtedly post-merger the prices for the products will increase, the market power enjoyed post-merger will be relatively brief. In the words used in *Iscor,* the anticompetitive "*sting*" whatever its intensity will of necessity be brief. Nor will the merging parties have carte blanche to charge what they like. The higher their prices the quicker they will speed up the demise of their ailing product. This fact alone should disincentivise any short term price gouging.

c. Further the non-pricing concerns have been met by the concessions the merging parties made at the hearing including, at the request of the Tribunal, an undertaking not to require exclusivity in in its contracts with customers.

[35] Further, the merger does have some positive outcomes. By purchasing the assets, according to Jenkins, some efficiencies will be achieved as with increased capacity the merged firm can meet demand quickly at times such as Christmas where demand spikes. Increased volumes will also drive down unit costs of production.

[36] Further, on public interest grounds the merger will save some jobs at least for some time. The moratorium on retrenchments whilst not protecting all jobs mitigates the effects on some.

**Conclusion**

[37] For these reasons we decided on 16 March 2016 to approve the merger subject to conditions that address the non-price competition concerns and the public interest concern. For ease of reference these conditions are attached again to these reasons as Annexure A.

**Mr Norman Manoim** 11 May 2016
DATE

**Mr Andreas Wessels and Mr Anton Roskam concurring**

| | |
|---|---|
| Tribunal Researchers: | Derrick Bowles and Kameel Pancham |
| For the merging parties: | G. Marriot instructed by Nortons Inc. |
| For the Commission: | Anisa Kessery and Gilberto Biacuana |

# CONFIDENTIAL

**"Annexure A"**

**CTP LIMITED / COMPACT DISC TECHNOLOGIES, A DIVISION OF TIMES MEDIA (PTY) LTD**

**CT CASE NUMBER: IM232Feb16**

---

**CONDITIONS**

## 1. Definitions

The following expressions shall bear the meanings assigned to them below and cognate expressions bear corresponding meanings –

1.1. **"Approval Date"** means the date referred to in the Competition Tribunal's Merger Clearance Certificate (Form CT10);

1.2. "**CDT**" means Compact Disc Technologies, a division of Times Media (Pty) Ltd;

1.3. "**Commission**" means the Competition Commission of South Africa;

1.4. **"Commission Rules"** means the Rules for the Conduct of Proceedings in the Commission;

1.5. "**Competition Act**" means the Competition Act, 89 of 1998, as amended;

1.6. "**Conditions**" means these conditions;

1.7. "**CTP**" means CTP Limited, the acquiring firm;

1.8. "**Effective Date**" means the date, occurring after the Approval Date, on which the Proposed Transaction is implemented by the Merging Parties;

1.9. "**Merging Parties**" means CTP (the Acquiring Firm) and CDT (the Target Firm);

1.10. "**Proposed Transaction**" mean the acquisition by CTP of the fixed assets and stock less certain liabilities of the business in CDT;

1.11. **"Tribunal Rules"** mean the Rules for the Conduct of Proceedings in the Tribunal.

**2. Conditions to the approval of the Proposed Transaction**

2.1. CTP will not compel any customer (or potential customer) which wishes to use its services to replicate CDs and/or DVDs to use the distribution services which it offers through RNA. Put differently, it will not make the use of its services as a replicator of DVDs or CDs conditional on the use of its services as a distributor of CDs or DVDs.

2.2. CTP will allow customers to place minimum orders of between 100 and 300 CDs.

2.3. CTP will not require any customer to commit to exclusivity in its contract with CTP in respect of replication.

2.4. CTP will not, after the Effective Date, effect more than 23 merger specific retrenchments of employees employed by CDT or by CTP in its CD and DVD replication division.

2.5. This condition will not preclude CTP from:

2.5.1. implementing voluntary retrenchment or voluntary separation arrangements;

2.5.2. offering voluntary early retirement packages;

2.5.3. dismissing employees as a result of unreasonable refusals to be redeployed in accordance with the provisions of the Labour Relations Act;

2.5.4. accepting resignations in the ordinary course of business;

2.5.5. terminations in the ordinary course of business including dismissals as a result of the conduct or capacity of the employees in question (including misconduct, poor performance, ill-health or incapacity); and

2.5.6. not filling positions which become vacant as a result of any of the eventualities specified in this clause and including retirement.

2.6. The conditions contained in paragraph 2.4 read with paragraph 2.5 will apply for a 24 month period after the Approval Date.

3. **Monitoring of compliance with the Conditions and General Provisions**:

3.1. The Merging Parties shall notify the Commission of the Merger Implementation Date by way of an affidavit within 10 days of the Merger Implementation Date.

3.2. The Merging Parties shall circulate a copy of the conditions to the employees employed by CDT and those employed within the CD and DVD replication business of CTP within 7 days of the Tribunal Order.

3.3. CTP will for a period of 2 years after the Merger Implementation Date notify the Commission of any retrenchment that will take place. The notification must take place within 3 days of the issuing of a notice to employee(s) in terms of section 189 of the LRA.

3.4. In the event that the Commission determines that there has been an apparent breach by the Merging Parties of these Conditions, this will be dealt with in terms of Rule 39 of Commission Rules read together with Rule 37 of the Tribunal Rules.

3.5. The Merging Parties may at any time, on good cause shown, approach the Tribunal for the conditions to be lifted, revised or amended.

3.6. All correspondence in relation to these Conditions should be forwarded to mergerconditions@compcom.co.za.