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Impact of Covid-19 on merger conditions

19 May 2021 *11 min read*

Merger conditions

There is no doubt that the Covid-19 pandemic has had, and is continuing to have, a severe impact on all aspects of our lives. Informed sources say that the consequences are likely to continue for many months, if not years, to come. In particular, the pandemic has directly affected the South African and global economy in ways that no one could have predicted. It is therefore hardly surprising that competition enforcement has come into sharp focus since the commencement of the pandemic.

On the one hand, the Competition Commission and Competition Tribunal ("**Competition Authorities**") have, as reported previously[1], dealt expeditiously and severely with businesses that exploited the emergency to charge excessive prices for medical and other essential products, while Government has granted exemptions to allow competing firms in certain industries to cooperate to meet the pandemic's challenges. On the other hand, many companies experiencing financial difficulties became the subject of mergers or takeovers that required approval from the Competition Authorities.

More recently, merged companies that are subject to merger conditions imposed prior to the advent of the pandemic, have approached the Competition Authorities to alleviate conditions that are, in the new crippled economic climate, impossible or difficult to comply with. Two such cases, the Coca-Cola[2] and PepsiCo[3] mergers cases, are discussed below.

Regulatory power to vary merger conditions

Merger conditions are imposed when the Competition Authorities find, on a forward looking assessment, that a proposed merger or acquisition transaction may have adverse effects on competition or the public interest. On most occasions, the merging parties agree to the conditions, even if they are onerous, as they wish to ensure that the Competition Authorities approve the transaction as soon as possible. A typical condition is a two year moratorium on merger related retrenchment of employees. However, it is impossible to predict future economic conditions with perfect accuracy and merging parties often find that it is impossible to meet the conditions fully or within the stipulated time period.

Many merger conditions therefore include a so-called "variation" clause that allows for an amendment, waiver or extension thereof by the Competition Authorities under certain circumstances. Absent such a clause, the power to vary merger conditions is less certain, as the Competition Authorities are administrative bodies that are *functus officio* once they have made a decision.

If the conditions are imposed by the Competition Tribunal ("**the Tribunal**"), the Tribunal is able, on application of the merged parties, to vary the conditions in terms of section 66(1)(c) read with section 27(1)(d) of the Competition Act 89 of 1998 ("**the Act**") if, *inter alia*, if it is made or granted as a result of a mistake common to all of the parties to the proceeding[4]. It could possibly be argued that it was a common mistake not to include a variation clause in the merger conditions. However, it is clear that these grounds are very narrow.

If the conditions are imposed by the Competition Commission ("**the Commission**"), there is no statutory basis to apply for a variation. In the case of *AMEC Foster Wheeler SA (Pty) Ltd v Competition Commission*, the Tribunal stated that since the Commission has the power to impose a condition it should logically have the power to subsequently amend the condition. However, no authority is cited for this proposition.

A possible basis for varying the condition may be the inherent power of an administrative functionary to correct an obvious error in its decision or if it is in the interest of justice[5]. However, this is not free from contention — it is not clear whether a failure to predict the particular economic circumstances correctly would indeed qualify as an obvious error.[6] The arguable lack of jurisdiction to effect a variation in these circumstances appears to be an omission in the Act that should be corrected by the legislature.

Basis for variation of merger conditions

Once it has been determined that the Competition Authority in question has the jurisdiction required to vary merger conditions, the criteria to be met for variation must be considered. This typically depends on the variation clauses themselves. They usually refer to the fact that changes in circumstances or good cause for variation must be shown.

In the case of *Zimco Metals (Pty) Ltd and Another v Competition Commission*[7] the variation clause referred to "good cause, including "changes in economic conditions" as the factors to be satisfied in supporting a variation of merger conditions. In that case, the basis for the variation was a decline in commodity prices that led to a decline in demand for the relevant commodities. This ultimately led to the merging parties being excused from complying from a retrenchment moratorium.

In the case of *Ferro South Africa (Pty) Ltd and Others v Atland Chemicals CC t/a Atlin Chemicals*[8] ("**Ferro**") good cause was considered in conjunction with 'exceptional circumstances' as the factors to be satisfied for variation. The Tribunal held that whether there were "exceptional circumstances" was to be established on the facts of each case. It was decided that "good cause" and 'exceptional circumstances' would not need to be separately addressed as the evidence was the same for both purposes. Good cause is therefore a consideration of causality, foreseeability as well as the purpose of the conditions themselves, in light of the factual matrix of the matter at hand.

Coca-Cola Beverages

On 10 May 2016, the Tribunal conditionally approved a large merger between Coca-Cola Beverages Africa ("**CCBA**") and various Coca-Cola and Related Bottling Operations ("**the first merger**")[9]. The rationale supporting the merger was increased access to investment resources and generation of benefits, as well as enhancing the ability to distribute products of The Coca-Cola Company ("**TCCC**") effectively. Three independent bottlers would be consolidated under a single entity, CCBA, and the owners would hold shares in CCBA. The condition of primary relevance to the variation case was an undertaking by the merging parties that a follow-on empowerment transaction would be implemented that would increase the B-BBEE ownership percentage of CCBA (at the time 9%) to 20% within 5 years of the approval date.

In 2017, subsequent to the first merger, the Tribunal conditionally approved a second merger between TCCC and CCBA, whereby TCCC acquired SABMiller's shares in CCBA ("**the second merger**")[10]. Prior to the Commission finalising its recommendation, the merging parties and the Minister of Economic Development entered into an agreement which addressed certain public interest issues including that the minimum B-BBEE shareholding in CCBA be increased to at least 30% by 11 May 2021 ("**the B-BEE Condition**"). It was also agreed that an Employee Share Ownership Programme ("**ESOP**") of a "meaningful stake" be implemented by May 2020.

With the onset of the Covid-19 pandemic, it became clear that the time periods for implementation of the ESOP as part of the B-BBEE Condition would not be achievable by May 2020. Therefore, on 8 May 2020, the Competition Tribunal granted an extension for compliance with the ESOP condition to 24 July 2020[11]. The reason for this extension was the "limited availability of government and administrative services (essential for registering Trust documents) as a result of the Covid-19 pandemic."

The most recent order, granted on 4 February 2021, was pursuant to an urgent application for variation of the B-BBEE Condition, alternatively a further extension of the time period. In terms of the variation, CCBA's B-BBEE ownership percentage would be required to increase to only 20%, as opposed to 30% imposed in the second merger. Further, additional commitments were made by CCBA in respect of a substantial investment to localisation initiatives and to collaborate with its sugar suppliers to increase the volume of sugar procured from black farmers to a specified percentage of its total sugar procurement.

In determining whether to grant the order for variation the Tribunal considered whether there was good cause to do so, as required by the variation clause in the merger conditions. It was decided that good cause "will be shown where the circumstances giving rise to the merging parties' request for a variation could not have been reasonably foreseen by them at the time of the Tribunal's approval of the merger and which cannot be reasonably mitigated". In line with the *Ferro* judgment it was confirmed that "exceptional circumstances are "unusual and unexpected circumstances", which must be determined on the facts of each case".

The Tribunal discussed the measures taken by the parties to comply with the conditions, and paid particular attention to the reasons why the transactions previously envisioned to achieve compliance with the conditions, did not come to fruition. Ultimately the Tribunal held as follows –

> *"Nobody could have anticipated the Covid-19 pandemic and the havoc it has wreaked on the global economy and human species. This would certainly constitute "unusual and exceptional" circumstances that cannot be reasonably mitigated. The Covid-19 pandemic has also caused great economic uncertainty for businesses such as CCBSA in South Africa. Apart from the drastic economic decline caused by restrictions imposed on the movement of people, businesses and the sale of certain goods and services, the projections for economic recovery also remain uncertain for as long as the pandemic prevails".*

The Tribunal considered whether a mere extension of the time period for compliance may be sufficient to mitigate against the unexpected circumstance. However, it decided that it would not be adequate due to the uncertainty surrounding the duration and impact of the pandemic. On this basis, a variation of the B-BBEE Condition, on the basis set out above, was granted.

PepsiCo

Not long after the Coca-Cola variation was granted, the Tribunal on 19 March 2021 extended the compliance period for one of the conditions that was imposed in a March 2020 merger in which approval was given for PepsiCo to acquire control over Pioneer Foods Limited. The condition sought to be varied, in this case by means of an extension and the addition of further obligation, was also with regard to a B-BBEE ownership plan in PepsiCo. The delays in compliance, according to media reports, was as a result of Covid-19 and the associated lockdown. The variation granted was a further 6 months to the implementation period of the B-BBEE ownership plan and the contribution of an additional amount of R55 million as compensation for any potential economic prejudice to the Workers of the Merged Firm during the period 23 March 2021 and 22 September 2021 (when South Africa was in lockdown due to the pandemic).

Conclusion

It is evident from these cases that the Covid-19 pandemic falls within the established criteria for the granting of a variation of a merger condition, on the basis that it is a valid exceptional and unforeseeable circumstance. Accordingly, should the pandemic be the reason why merging parties are unable to comply with merger conditions imposed by the Competition Authorities prior to the pandemic, that will constitute "good cause" to apply to the relevant Competition Authority for an amendment, waiver or extension of the condition in question.

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[1] See Excessive pricing in State procurement of PPE available at https://werksmans.com/legal-updates-and-opinions/excessive-pricing-in-state-procurement-of-ppe/; Ten things you need to know about price gouging: The state of play in South Africa available at https://werksmans.com/legal-updates-and-opinions/ten-things-you-need-to-know-about-price-gouging-the-state-of-play-in-south-africa/; Some more exemptions from Competition Law during the pandemic is available here.

[2] LM021Apr17/VAR010Apr20 and LM021Apr17/VAR178Jan21

[3] LM108Sep19/EXT199Feb21

[4] This occurred in the case of DCD Dorbyl/Elgin Brown and Hammer IM022May12/VAR008Apr14

[5] *Zondi v MEC, Traditional and Local Government Affairs and Others* 2006 (3) SA 1 (CC)

[6] Note that the Tribunal would not, in our view, have the jurisdiction to grant such a variation on review; arguably the Competition Appeal Court does. The only other possible remedy for a merging party seems to be to wait until the Commission claims that it is in breach of the condition and then to argue that its non-compliance should be excused on the basis of the common law concept of *vis major*. At that point a "remedial plan" could be agreed with the Commission in terms of Competition Commission Rule 39.

[7] Case No: AME160Oct15.

[8] Case No: LM179Jan14/VAR152Nov16.

[9] Case No: LM243Mar15

[10] Case No: LM021Apr17

[11] Case No: LM021Apr17/VAR010Apr20



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