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COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: LM017May15

In the matter between:

Pioneer Foods (Pty) Ltd

Primary Acquiring Firm

and

Future Life Health Products (Pty) Ltd

Primary Target Firm

Panel	:	Norman Manoim (Presiding Member) Yasmin Carrim (Tribunal Member) Andiswa Ndoni (Tribunal Member)
Heard on	:	08 July 2015, 01, 02, 04, 10 September 2015 & 26 October 2015
Order issued on	:	09 November 2015
Reasons issued on	:	22 December 2015

REASONS FOR DECISION

INTRODUCTION

1. This is a merger in which a large integrated food manufacturer Pioneer Foods (Pty) Ltd ("Pioneer") seeks to purchase a 50% interest in a smaller food manufacturer, Future Life Health Products (Pty) Ltd ("Future Life").¹

¹ We will use the term Future Life from now on to refer to both the company and its brands which bear the same name.

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2. Pioneer makes many products and is the largest manufacturer of breakfast cereals in the domestic market. Included in its cereal portfolio is Pro Nutro, one of the most prominent and enduring of the local brands, described in the industry as an instant porridge.
3. Future Life is a recent start up and entrant into the market. It makes a variety of food products apart from its standard porridge offering and is diversifying into snacks, other cereal segments such as oats and has ambitions to go into many other food types with an emphasis on a health offering. Its eponymous primary and pioneering product can be consumed either as a porridge or a food supplement drunk as a shake. The issue in this case is whether this product is competitive with the Pro Nutro product made by Pioneer, and if it is, what market they compete in. Over the course of this case that question has received inconsistent answers, with the candidate markets ranging from one extreme position – they do not compete at all as they are in separate markets, to the other – they are the closest competitors in a narrow market for ready to eat porridges.
4. The approach to market definition and the history of this case are inextricably linked. When the merger was notified to the Commission the parties argued that the parties' products were not substitutes. Pioneer's products, including Pro Nutro were breakfast cereals. Future Life, although similar to a breakfast cereal in texture and appearance was not one, but rather what is termed a "functional food" and hence not considered a substitute for a breakfast cereal. If the two products were not substitutes they argued, the merger did not lead to any increase in concentration of Pioneer's share of the cereal market and hence posed no competition concerns.
5. The Competition Commission ("the Commission") investigated the merger and concluded that the merging parties were correct. Future Life's products it concluded were functional foods and hence not substitutes for the breakfast cereals of Pioneer. However during the course of the investigation, Kellogg, a significant competitor of Pioneer, disputed this market definition and suggested that the merger would harm competition.
6. When the matter first came before this panel on 08 July 2015 we were of the view that the Commission's conclusions that the products were not in the same market,

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appeared to be inconsistent with the documents it had accumulated in the record. Further, Kellogg was not alone among the third parties interviewed by the Commission to suggest that Future Life and Pioneers' products, in particular Pro Nutro, competed, some going further and suggesting, like Kellogg, that they were each other's closest competitor.

7. For this reason we felt the matter required further probing and exercising our inquisitorial powers we requested further information from the Commission, the merging parties and Kellogg.
8. This information was subsequently provided. We also permitted Kellogg to intervene in the matter, although there was no formal intervention application, because the merging parties, to their credit, raised no objection. Kellogg thus performed the role of challenging the merging parties' version, a role normally taken by the Commission. We have found that participation of Kellogg's legal team in this matter was useful and appreciate the efforts made by their attorneys and expert, even though ultimately we have not followed their suggested remedy.²

Issues raised by the merger

9. This merger has raised two issues; first the market definition on which turns an assessment as to whether the merger will lead to unilateral or co-ordinated anticompetitive effects; the second relates to the control of the post-merger company. As we go on to discuss we see an interrelationship between these issues.
10. On 09 November 2015 we gave our order to approve the merger subject to the conditions which are attached to these reasons. These conditions in our view mitigate the anticompetitive effects which we have found the merger brings about as, for the reasons we go on to discuss later, these effects are likely to be transient and will be mitigated by the timely, likely and sufficient entry of an incumbent competitor.

² Kellogg had proposed the divestiture of the Pro Nutro brand.

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The transaction description

11. The transaction entails Pioneer buying 50% equity in Future Life Pty Ltd. The remaining shares will be owned by Mr. Paul Anthony Saad ("Saad") the founder and who wholly owns the company prior to the merger.
12. Pioneer and Saad have entered into a shareholders agreement which provides, *inter alia*, for Saad to continue managing the company for at least 5 years. The agreement also purports to regulate the rights of the shareholders *vis a vis* one another. During the course of the hearing in response to questions from both Tribunal members and Kellogg's representative it became apparent that the agreement was far from clear as to whether Saad enjoyed full autonomy to manage the company or whether this autonomy was constrained by Pioneer's right to veto or require approval of certain strategic decisions.³
13. During their oral testimony both Saad and Mr. Phildon Martin Roux ("Roux"), the Chief Executive Officer of Pioneer Food Group Ltd ("Pioneer Group"), conceded this point but stated that the intention of the parties, regardless of how the agreement had been drafted, was to give Saad the autonomy to run the company subject to Pioneer's rights to know how the business was being run hence their presence on the board.⁴ But this was contrary to what had been uncompromisingly stated in the merging parties competitiveness report where on the issue of post-merger control the position was explained in this way:

"The merging parties wish to state explicitly at the outset that they seek approval of the Competition Commission in respect of this transaction on the basis that Pioneer will have an unfettered discretion from a legal point of view insofar as the manner and form of control that it is able to exercise in respect of the target firm because this is germane to the rationale for the transaction from Pioneer, Future life's and Mr Saad's perspectives".⁵

14. At the end of the hearing however the merging parties had abandoned this position and retreated to asserting that Roux's and Saad's understanding was the correct

³ Compare paragraphs 9.6 and 9.4 for example.

⁴ Transcript, pages 88, 90, 94, 313, 368 and 369.

⁵ See competitiveness report record page 463, paragraph 1.7. See also paragraphs 1.4 and 1.6.

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one, notwithstanding that this was far from clear in the shareholders' agreement. For this reason we imposed as a condition for the approval of the merger a recordal confirming Saad's status as having management control. There are two reasons why post-merger, the issue of control should be clear. In the first place as a juristic fact in all mergers the post-merger control position needs to be clear. Merger notification is after all premised on a change in control - one asks the question from whom to whom? In the second place in the context of this merger the issue of who controls the company post-merger is important to the substantive competition analysis that we go on to discuss.

Who the merging firms are

15. The primary acquiring firm in this merger is Pioneer. It is a subsidiary of Pioneer Group, a large food service company that operates in several markets, *inter alia*, of relevance to this merger, in the upstream production of inputs to the cereal market, the downstream cereal market and products considered adjacent to these markets such as snack bars.
16. Over the past few years Pioneer has been an aggressive acquirer of breakfast cereal brands in mergers that have been notified to the competition authorities. One such acquisition in 1999 was the acquisition of the Pro Nutro brand from Anglo Vaal Industries.
17. Pioneer Foods is now the number one firm in cereals and owns four of the top ten brands. These brands are Weetbix, Pro Nutro, Bokomo Cornflakes and Alpen Nutrifix.
18. Recently in April 2013 Roux, formerly with Tiger Brands, the leading rival to Pioneer, took over as Pioneer Group Chief Executive Officer. In the hearing Roux was frank about what he saw as the faults of his new company and what steps he was taking to rectify them. Of relevance to this transaction was an ambition to own winning brands and hence his decision to acquire the stake in Future Life, which as we explain below, is perceived in the industry to be a winning brand.
19. Future Life was founded in 2007 by its sole shareholder, i.e. Saad in Kwa-Zulu Natal. At that time Saad was involved in the South African feeding scheme program, which was aimed at giving basic food and other essentials to impoverished and

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malnourished communities throughout the country. This work inspired him to develop a health product that could be successfully and affordably commercialised. Future Life took 2 years to fully research and develop. By 2009 the product was ready and the first sales of the brand started coming through from retailers and pharmacies.⁶

20. Initially intended to be a health food, it has evolved rapidly into a brand which defies easy categorisation; is it a cereal or the enigmatic new concept of functional food. According to Kellogg, for whom there is no mystery about the categorisation, this product is a breakfast cereal and on its estimate, Future Life is now the third or fourth largest cereal player produced in the country and has the number 5 cereal brand nationally.
21. Given that Saad had no prior experience in this market, his product is novel and his firm is start-up, this is no small achievement in a market dominated by large firms, including global players, with years of experience in brand management and a superior access to retail particularly the large chains where the success or failure of a brand is determined.
22. But the porridge-like avatar of Pro Nutro, whilst the standard product of Future Life is not the only one it makes.⁷ It also makes crunch (a muesli-like cereal), smart drinks and snack bars.
23. Saad's vision is largely, if not wholly, what Future Life is about. During his testimony what became clear was that he was an entrepreneur, a maverick with a huge passion for what he does. But nor is he some starry eyed idealist. He is underneath a smart businessman who would not be doing this deal if he did not recognise the advantage it would have for his company in expanding its footprint into other products and other markets.
24. This accounts for a key reason for why Saad wanted this merger. Saad wants to use the Future Life brand to expand into other product categories. Several of these don't require the merger and hence need not be discussed now. However one of these

⁶ Record, page 2368.

⁷ RCL a rival of both firms, refers to Pro Nutro as an old fashioned version of Future Life. Record, page 1512.

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does. [CONFIDENTIAL]. Having carefully thought through this option and seeing its limitations, he explored merger options with other firms. None were appropriate as he explained in his evidence.⁸ They either wanted control of his brand or were not interested in a deal.

25. Pioneer proved the ideal partner. As we explain later this was not a first time romance. The deal was initially explored but not consummated a few years ago.⁹ According to Saad he had rejected Pioneer's offer because he was still developing his brand.¹⁰ We do know that only after Roux came to Pioneer was the deal possibility resuscitated in 2014 and hence the present merger.

RELEVANT MARKET

26. When the merging parties notified this merger their position was that the two firms made complementary not competing products. Future Life was a functional food and not a breakfast cereal. Pioneer on the other hand was a manufacturer of breakfast cereals. The Commission in its recommendation accepted this thesis. However in the course of the merger hearing the merging parties, but not the Commission, changed their position. This was largely it appears because their expert witness, economist Mr. James Hodge ("Hodge"), did not advocate this thesis. Rather his position was that Future Life was a cereal competitor of Pro Nutro but in a wider cereal market and not necessarily the closest competitor of Future Life.

27. Hodge was correct to change the argument here. The merging parties contention of separate markets was wholly unsustainable and at variance with their own internal documents. The Commission however did not change its view and remained steadfastly adamant about the correctness of its recommendation. This is how it put in the final paragraph of the heads of argument that it presented at the end of the hearing: *"For these reasons the Commission has not changed its view and recommends an approval without conditions."*

28. It is a matter of regret that the Commission adopted so inflexible and blinkered approach to the facts of this case. Fortunately the efforts of Kellogg ensured that the

⁸ Transcript, pages 77 – 78.

⁹ Saad said this happened 3 or 4 years ago - Transcript page 228.

¹⁰ Transcript p.228.

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issues of the case were debated exhaustively and thus enabling us to assess the evidence with the benefit of a proper consideration of the key issues.

29. Whilst the debate moved on in the course of the hearing from functional foods to a broader cereal market it is necessary to briefly consider what the contentions were.
30. The term functional food is not a recent invention of Future Life nor is the term its own and it has some food industry pedigree. According to a definition we were provided with a functional food is a food that beneficially affects one or more target functions in the body beyond adequate nutritional effects in a way that is relevant to either an improved state of health and well-being and/or reduction of risk of disease. It is consumed as part of a normal food pattern. It is not a pill, a capsule or any form of dietary supplement.¹¹
31. The question for us at the beginning of the case – before the merging parties changed their position on this – was whether this industry categorisation translated itself into one whose distinctiveness was appreciated by consumers and hence to put into our language, constituted it into a relevant antitrust market.
32. The functional food characterisation had two aspects to it. The first was the idea of a food that was not culturally defined by a traditional meal time. Not a cereal associated with breakfast as the first meal of the day although appropriate then too, but also a hunger buster capable of being consumed at any time of the day. The second characteristic was a health one. The consumer of the product wanted it for some health attribute it possessed which the consumer apparently found lacking in a traditional breakfast meal.
33. In the continuum between a cereal and a health supplement, at least as one marketing document the merging parties sought to rely on suggested, Future Life lay closer to the supplement end than the cornflakes end.
34. However Future Life fell short of convincing us on this issue and it seems the merging parties' economist.

¹¹ Record, page 2369.

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35. The standard Future Life product which is its smart sub-brand is priced close to those of cereals like Pro Nutro and considerably cheaper than the products located in the supplements markets which it had tried to convince us it competed with. Nor admittedly with one or two exceptions did the latter supposed rivalry, evidence itself in the parties marketing materials. Rather the most consistent theme through both firms marketing materials was a recognition of a close rivalry between Pro Nutro and Future Life.
36. Finally, and most tellingly, bar one retail outlet, Future Life found itself placed in the most significant outlets in the cereal category most often from photos we saw of the displays right next to Pro Nutro. Saad himself conceded that he had not wanted his product in the supplements shelves because of their low footfall.¹²
37. We thus find that Pro Nutro and Future Life do not fall into separate markets. However the more difficult question is that even if they fall into the same market what are its boundaries. This was the main issue that pre-occupied the hearing.

Parties' contention on the relevant market

38. **Commission:** The Commission, as we have seen, argued that the merger did not result in an overlap as the two firm's key products, i.e. Pro Nutro and Future Life competed in separate markets.
39. **Kellogg:** Kellogg oscillated between two theories of the relevant market. The one contended for most strongly was that the two products formed part of a narrow Ready to Eat ("RTE") porridge category. The consequence of this market definition was that the merging parties would have in excess of [CONFIDENTIAL] of the market.¹³ However Kellogg also conceded that the market might be as wide as all RTE cereals, in which case the combined market shares would be approximately [CONFIDENTIAL], comprising of Pioneer at [CONFIDENTIAL], and Future Life at about [CONFIDENTIAL]. However its central contention was that this was a market in which products were differentiated but that the two products Pro Nutro and Future Life were each other's closest competitor. The merger would thus lead to significant

¹² Transcript, pages 57-58.

¹³ See Kellogg's heads of argument paragraph 2 and reference to record, pages 3260 and 3331.

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unilateral effects and the possibility of Pioneer as the leading manufacturer of breakfast cereals acquiring portfolio power *vis a vis* retailers.¹⁴ It would also, Kellogg argued, lead to the removal of a maverick firm whose behaviour had changed the structure of the market.¹⁵

40. **Merging parties:** The merging parties in their final argument, whilst still contending for Future Life as a functional food, argued that the relevant market was a broad cereal market, which included hot cereals such as oats and in the case of Future Life, should include supplements. Expressed differently, having once contended for separate markets, the merging parties now viewed Future Life as a product on the boundaries of two markets – one for cereals more broadly and one for supplements. More specifically the merging parties averred “...*Pro Nutro and Future Life are not particularly and uniquely close competitors*”.¹⁶

Analysis

41. Two conceptual problems arise in this merger. First the products that serve as possible candidates for the relevant market are differentiated from one another. Second that this differentiation makes assessing the boundaries of the market the approach antitrust traditionally takes more difficult.

42. We will analyse this case by performing two exercises. First we ask of Pro Nutro and Future Life whether they are each other's closest substitute, and then we ask, if they are, what the extent of the market in which they operate in is.

1) Closest substitutes

43. One of the factors that the Act expressly recognises in assessing the competitive effects of a merger is “... *whether the merger will result in the removal of an effective*

¹⁴ Ibid paragraph 3.

¹⁵ Ibid paragraph 4-5. Kellogg says that Future Life is one of the few mavericks to enter the market in the last two decades. It relies on Roux for the contention that Future Life had “...*changed the structure of the market.*” (See Transcript 337).

¹⁶ See merging parties' heads of argument, paragraphs 1.3.2 – 1.3.4.

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competitor".¹⁷ Expressed differently what this is saying is, the closer two products are to one another as substitutes the more a merger between them may mean the removal of an effective competitor.

44. European competition law recognises this approach as well. As one leading text on the subject puts it: "*The closer the competition between parties before the merger, the greater the loss of competition, as a result of the merger*".¹⁸

45. The reason for this is clear. If the merging parties' products are the closest substitutes of one another then it makes a post-merger price increase more likely. Assume the acquiring firm owns product A, which has as its closest substitute, pre-merger, product B which it acquires as a result of the merger. The acquiring firm is likely to consider that a post-merger price increase for product A, may still be profitable, because even though it may lose some customers of A, as long as it can recapture a sufficient number of those lost customers if they are likely to switch to product B.

46. Bishop and Walker point out that when dealing with differentiated products the traditional relevant market approach fails to take into account that the strength of competitive constraints can vary.¹⁹ Thus they argue that in a broadly defined market, a merger between two firms whose products together have a high market share may despite this, be less problematic if the products are strongly differentiated, than one where the market shares of the respective firms are lower, but the products of the firm are less differentiated. In other words what matters is the strength of competition between the two firms' products in relation to that with other products of non-merging firms in the candidate relevant market.

47. The central contention of Kellogg in this case is that Pro Nutro and Future Life are the closest competitors of one another. The merging parties whilst belatedly acknowledging the existence of a competitive dynamic between them, deny that they are the closest competitors.

¹⁷ Section 12A(2)(h).

¹⁸ *European Merger Control: Rosenthal and Thomas*, Paragraph C 150.

¹⁹ Bishop and Walker, *Economics of European Competition Law*, page 126 paragraph 4.87

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48. Economists typically regard cross-price elasticity evidence as the most robust test of whether two products are close competitors. Cross-price elasticity tests whether a price rise for product A will lead to an increase in demand for product B.
49. This would have been an ideal case for such a test because supermarket data which are available to firms, would have been well suited to such a test. However both economists in this matter, Hodge for the merging parties and Mr. Patrick Smith ("Smith") for Kellogg, stated they could not perform such a test due to the lack of time given to them in this case.
50. This means that we have had to look at other sources of evidence to come to a conclusion on the closeness of competition between the products.
51. In the well-known United States Supreme Court decision in *Brown Shoe*, the court dealt with the problem of whether markets for products could be segmented into smaller ones for the purpose of considering the competitive interaction between differentiated products. The court suggested a list of what it termed indicia to use to examine the evidence. We followed this approach in our decision the *JD Ellerines merger*.²⁰ In *Brown Shoe* the court held, "[t]he boundaries of [a product market] may be determined by examining such practical indicia as industry or public recognition ..., the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors."²¹
52. Although the *Brown Shoe* indicia had become unfashionable, with economists considering that more recently acquired economic tools could do a better job of testing for differentiation, it is still followed by courts. For instance in the recent case of *FTC v Sysco Corporation et al* the U.S. District Court for Columbia took the approach of applying the indicia despite being aware of this criticism and having economic evidence available to it from both sides of the dispute.²² The reason for this we would suggest is that despite the existence of economic tests, in most cases we find that that they either are not used, perhaps because of time or data

²⁰ *JD Group Ltd and Ellerine Holdings Ltd*, case number: 78/LM/Jul00.

²¹ *Brown Shoe*, 370 U.S. at 325.

²² Case 1:15-cv-00256-APM Document 192 Filed 06/29/15

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constraints, or when they are, remain the subject of contention between experts and hence prove inconclusive.²³

53. We have decided to take the approach suggested in *Brown* and apply some of the indicia to the facts of this case.

(i) *Views of industry participants*

a. *Competitors*

54. The views of Kellogg on this issue have already been mentioned. The views of the other rivals whilst less strident than those of Kellogg tend to confirm this view in respect of those who opined. For instance RCL a competitor had indicated to the Commission that it had done its own research comparing the two as RCL wants to introduce its own sorghum based brand into this category called Monati instant. Similarly Nestle, Alphen Foods and Tiger were of the view that the two products were substitutes.

b. *Customers*

55. One customer, Mohamed Casoojee of the Independent Buyer Consortium stated that the functional food distinction was not as big a difference as merging parties alleged. He was more equivocal when asked by the Commission pursuant to a request from the Tribunal to provide greater specificity. This reticence however may have been the instinct of someone not wanting to get further involved. His initial submission was strong on the point of closeness of competition. Given that unlike Kellogg, he is a customer, not a competitor of the merging parties whose views need to be taken with the caution, we can accept his evidence on this point is not opportunistic.

²³ In *Sysco* the court noted the criticism of *Brown Shoe* as being 'old school', but nevertheless noted that: "Courts have relied on the *Brown Shoe* factors in a number of cases to define the relevant product market. See, e.g., *Staples*, 970 F. Supp. at 1075-80; *Cardinal Health*, 12 F. Supp. 2d at 46-48; *Swedish Match*, 131 F. Supp. 2d at 159-64; *CCC Holdings*, 605 F. Supp. 2d at 39-44; *H&R Block*, 833 F. Supp. 2d at 51-60.

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(ii) *Internal marketing documents*

56. Both firms have third party consultancies undertaking marketing and brand surveys for them from time to time. What is striking about this merger is that each party had separately acquired research, from different consultants who independently came to the same conclusion viz. that Pro Nutro and Future Life are each other's closest competitors. Granted, some surveys also mention other products in the cereal category that compete with these two products but none are as consistently and as significantly signalled to the respective firms as the rivalry between the two products. The advice given is on how to further differentiate the two products and assess strengths and weaknesses. However the fact that the firms tried to differentiate their products respectively and target different customer groups, does not detract from the fact that they may still be each other's closest substitute. It is precisely to avoid head on competition that rival firms seek to differentiate their products; it's another matter if they succeed.
57. The record shows for instance the extent to which Pro Nutro was trying to model itself on Future Life by changing the look of its product's box, using sports stars to market it (each had their own swimming star and soccer stars endorsing them).
58. The strongest evidence of the closeness of competition comes from a strategy document prepared for Pioneer by a company called Carnelly Rangelcraft entitled the "Pro Nutro reality". This document prepared in 2014 compares the respective market shares of Pro Nutro and Future Life over a two year period between 2011 and 2013. It must have rung alarm bells at Pioneer Foods because it contains a graph that shows that Pro Nutro's market share (it assumes a two firm market) had dropped from 63% to 38%. In a separate graphic Future Life was shown to have grown in three years from 26% to 43%. Other points on the page headed "*Current Pro Nutro vs Future Life*", *Category Drivers?*, *PN Innovation – concept, taste?*
59. From its side Future Life had marketing material prepared for it that compares the two products respective sales at the four largest retail outlets. ProNutro is the only other product compared in this particular survey with Future Life.

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60. These documents support the Kellogg's view that there is a separate porridge market with only these two firms as significant players. Strengthening the suggestion is that both firms had independently, before the merger, instructed consultants to prepare these comparisons.
61. Neither firm gave a convincing account of why this should not be evidence that they are each other's closest competitors. Roux to be fair was not the one who commissioned the Pioneer survey so he could not comment on it, but he did concede under cross examination that this constituted "... *a battle plan to counter Future Life*".²⁴ Saad explained that the surveys were done because Future Life is located on shelves next to Pro Nutro in all these outlets and hence they competed for them for shelf space or in retail market jargon facings. To win more facings in the store and thus be more visible to consumers and sell more, a brand has to win more facings by outselling competitor products; in this sense Future Life competes head on with Pro Nutro for shelf space. Put differently, Saad sees a difference between being close competitors and competing for shelf space because of what he regarded as a retailer imposed shelving regime as opposed to his choice of close rival.
62. However Saad may feel personally about what retailers dictate, the fact is that the two products are placed next to each other in stores because the retailers perceive that they are nearest competitors and hence Future Life is forced to compare its performance with that of Pro Nutro. This is entirely consistent with the case of Kellogg. That Saad may not want this to happen is beside the point.
63. There are however other indicators in the marketing material suggestive of a market wider than RTE porridges. Although Kellogg has discounted these as not meaningful, they appear in snippets in both firm's marketing materials. Whilst certainly less compelling than the rivalry suggested between Pro Nutro and Future Life, they are referred to nevertheless and it is a factor that we have had regard to when we discuss some of the economic evidence later.

(iii) *Company minutes (natural experiment)*

²⁴ Transcript, page 346.

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64. There are no minutes for Future Life in the record however we have a few for Pioneer Foods and they are illuminating on the subject of how Pioneer saw competition from Future Life.
65. A 2011 minute records that the Pioneer legal department was attending to a complaint against Future Life regarding claims made on its packaging. Although the fact of this complaint does not indicate which brand Pioneer saw as most threatened by Future Life, it later becomes clear, as the same minute goes on to state: *"Pro Nutro volumes are still a concern with Future Life (Moducare) the major competitor. B-Fast volumes are declining all the time".*²⁵
66. Another extract from the Pioneer minutes indicates that Future Life's (and Kellogg's) "aggressive" pricing was considered a threat to Pioneer breakfast products which had lost volume.²⁶
67. But the most important fact that emanates from the minutes is an indication of Pioneer's strategy toward Future Life. In a minute dated 30 May 2013 the following is stated: *"Future Life growth as a functional cereal remains a major threat. The strategy of acquiring Future Life was not successful. The alternative strategy to develop functional cereals now needs to be fast tracked."*²⁷
68. Thereafter followed a discussion of what the strategy was. According to the minute, and as confirmed by Roux in his testimony, the alternative to buying out Saad, which as the minute noted had failed, was to launch a product to compete with Future Life for which testing of a new ingredient was apparently taking place at a laboratory. It is not clear from this extract as to whether the product was going to be a revamped ProNutro or a new brand. As it happened the new product was not developed because when Roux joined Pioneer discussions with Saad were resumed and resulted in an agreement for the present transaction. Roux's evidence is he had realised that Pro Nutro could not compete with Saad and hence the strategy of taking him on was never going to happen. That of course presupposes that the deal would happen. It seems highly probable that if the deal did not happen that Pioneer would

²⁵ Record, page 1864.

²⁶ Record, page 1856.

²⁷ Record, page 3480.

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not meekly yield the field to Future Life. Rather they would have taken counter measures and Pro Nutro was best placed to do this.

69. The respective decisions made by Pioneer; to re-enter into negotiations with Saad and to discontinue the strategy to compete head to head with Future Life, whilst not simultaneous, were so close in time as to suggest that they were interdependent. It is probable that the likelihood of a deal with Saad was what led Pioneer to abandon going head to head with Future Life. But absent the deal the probability is that they still would. As the minutes indicate they had too much to lose if they didn't.

(iv) Survey evidence

70. The bulk of the time during the hearing was devoted to hearing and critiquing survey evidence introduced by the merging parties through two witnesses a Mr. Martin Neethling ("Neethling"), the newly appointed Chief Marketing Officer of Pioneer, and their economic expert i.e. Hodge.

71. This evidence did not form part of the Commission's record and was introduced by the merging parties for the purpose of the hearing. It emerged that of the surveys, two had been conducted for the purpose of the hearing at the request of the merging parties.

72. We will not spend as much time as the parties on this evidence. This is for several reasons. The reliability of the surveys was seriously open to question with even the merging parties expert conceding that in some respects one of the surveys contained calculation errors. Secondly, the data was peripheral to the main question as to whether Pro Nutro and Future Life were the closest competitors. Third, the fact that data was prepared as survey evidence for the sole purpose of this litigation as opposed to survey evidence conducted by firms in the ordinary course of business, such as the marketing material referred to earlier, meant that its independence as research was less reliable. Finally, the conclusions sought to be reached from the data was unusual and unorthodox for the purpose of a competition analysis.

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73. Bar one survey, which did not suffer from the same defects, and which we go on to discuss, we have decided to reject any reliance on this evidence. To the extent that this evidence, at best, says something about a concept known as repertoire shopping, we go on to discuss this more fully below.

(v) *Functionality*

74. In examining the issue of substitutability or whether products are the closest competitors of one another competition authorities will also consider the functional characteristics of respective products. With differentiated products the strength of competition between products may be assessed by the degree to which they differ or are similar functionally. The merging parties made much of what they alleged were important product differences between Pro Nutro and Future Life. They argued that Future Life had far more health ingredients than Pro Nutro. Future Life appears to have used this in marketing particularly with dieticians in order to make its product distinctive from others. Yet Pro Nutro also promotes the health attributes of its product. Dieticians aside, whether consumers would detect a profound difference between the products or know whether claimed ingredients (such as Moducare an input into Future Life) make the products distinctive has not been established. Rather, it appears from the packaging and internal marketing materials that both firms used health as a marketing strategy and it is unlikely that consumers perceive the differences or perceive them so as to diminish the strength of competition between them.

75. Kellogg relied on functionality to make the opposite argument. The physical characteristics of the products, (both a porridge like substance, which came in a standard version and then different flavours which themselves were similar) their preparation (both were ready to eat and did not require cooking time as might other porridges) made the products functionally similar.²⁸ Kellogg also relied on the fact

²⁸ Alphen Foods told the Commission the same thing about the similarities between textures of the two products. Record, page 1507

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the two products had closely resembling packaging (Pro Nutro having recently modified its packaging making it look more alike to that of Future Life) with the standard product coming in the same size.

(vi) *Pricing*

76. The pricing of two standard products whilst not identical is in a similar range with Pro Nutro at the time selling for R33.99 and Future Life for R35.95. In most cases Future Life's standard product was pricing at a slight premium to the standard Pro Nutro product but an internal Pioneer document from a 2104 strategy session noted that in KZN Future Life was cheaper than Pro Nutro.²⁹

77. Future Life was also planning a 300 gram pack (the standard pack is 450 grams) to target, as the company put it, the lower end of the market.³⁰

78. Future Life also has higher value increased protein product priced at a substantial premium to the standard product and the Commission appeared to see this difference as creating a distinction suggesting the products did not compete with one another. However as Kellogg's expert Smith pointed out, the relevant competitive dynamic is with the standard products and thus the Commission erred, particularly in a table it produced for this hearing, in failing to make this distinction.³¹

79. In contrast the price differences between the so called health products as evidenced from Future Life's own internal materials shows that they price at a substantial premium to the Future Life product suggesting that they are not in the same segment of the market as the standard Future Life product and hence competition between

²⁹ Record, page 1160: 2014 Pro Nutro strategy session.

³⁰ Record, page 2967.

³¹ Transcript, pages 393 -394.

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these products and Future Life would be much weaker than the more closely priced Pro Nutro. For instance one internal document from Future Life notes that the supplements are priced at three times that of the standard product.³²

(vii) *Presence on retailer shelves*

80. Whether manufacturers approve or not retailer decisions have substantial impact on consumer perceptions of substitutability. The evidence in this case was that all major grocery retailers placed the two products Future Life and Pro Nutro next to one another on their shelves. The only exception to this practice is the pharmacy group Dischem with whom Future Life has an arrangement to give it a dedicated shelf to all its products. Since the majority of sales are through retail grocery outlets this exception does not significantly alter the fact that retailers present the two products to consumers in a manner that suggests they are each other's closest substitute.

Conclusion

81. The evidence suggests that on a balance of probabilities, pre-merger, Pro Nutro and Future Life were the closest substitutes in a ready to eat breakfast market. This evidence comes from the internal marketing material of both merging parties which is consistent on this fact, views of a representative number of industry participants, the concessions made in cross examination by merging party witnesses and most strongly from the board minutes of Pioneer and its actions pursuant to this in the market place. However it is also bolstered by their functional and pricing similarities and the manner in which they are marketed at retail level to consumers.

Boundaries of the market

82. Although we have determined that Pro Nutro and Future Life's standard products are the closest substitutes for one another in the market we have not yet determined the boundaries of that market, a far more difficult question.

³² Record, page 2219.

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83. Both Kellogg and the merging parties have through these proceedings changed their positions on this. The merging parties recall had originally contended that the products operated in separate markets in their notification, but abandoned that position for a broader breakfast market that included not just RTE products, but hot porridges such as oats. However in their original filing they had referred to Pro Nutro as belonging to an RTE market that excluded hot products.³³

84. Kellogg had argued for a narrow RTE porridge product in which the merging parties would have had [CONFIDENTIAL] of the market with an increment of [CONFIDENTIAL]. However in final argument this contention was softened by the suggestion that the market may include some RTE products but they rejected the idea that it could include hot products.

85. As Justice Wood remarked in *Kraft Foods* a United States decision in a cereal market merger:

*"In a differentiated product market such as the RTE cereal market, the decision whether to include a product in the market is inevitably somewhat arbitrary, because not all products in a relevant market compete equally with all the other products".*³⁴

86. We cannot conclude with definity on the boundaries of the market as we lack sufficient data on this aspect. It seems that the market is likely to be broader than that of RTE porridges. Kellogg appears latterly to concede this. The only economic evidence we have on this point that is of probative value, is data from the survey firm Nielsen and confirmed over a longer period by another firm Aztec which suggested that Future Life's gains and Pro Nutro's losses were not wholly explicable by a shift from one to another and that brands such as Kelloggs cornflakes, not classified as a porridge, also seem to have been harmed by the entry of Future Life.

87. If this data was unreliable Kellogg would have been in a very good position to refute it; at least in respect of its own products. Given that Kellogg's legal team produced no evidence at all from their client, we draw the inference that they could not, and

³³ Record, page 498.

³⁴ *New York v Kraft Gen. Foods Inc.*, 926 F. Supp. 321 (S.D.N.Y. 1995) at 334.

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hence we can assume, that at least in this respect, the data showing switching away from other non-porridge brands to Future Life is reliable even though the extent of the effect is not known.

88. Hence we conclude that the two products compete in a broader RTE market which includes further non-porridge RTE cereal products that are competitive with those of the merging parties. However the latter are likely to impose a weaker competitive constraint on Future Life and Pro Nutro than they impose on each other. Nor is it likely that all RTE products can be considered substitutes but precisely where that boundary is to be drawn is difficult to establish on the present evidence.

Repertoire shopping

89. An argument raised by the merging parties during the hearing was that consumers of cereals engage in what is known as repertoire shopping. As explained by their expert (Hodge), repertoire shopping involves a consumer choice to favour buying not one type of cereal but several at the same time. Thus a person who does the household shopping may choose to buy a muesli cereal, a cornflake and a porridge, at the same time, as part of a repertoire of breakfast products.
90. The relevance of the repertoire, on this argument of the merging parties, is that consumers will substitute from one product in the repertoire to another in response to a price increase. Whilst at best for the merging parties there was some evidence of substitution on some surveys it is by no means clear why this was happening nor whether this was connected to a price increase in another product.
91. Nor is it clear that because consumers have a repertoire – which may exist simply to provide consumers with variety to avoid the monotony of facing the same packet at the breakfast table each morning – tells us anything of consumer behaviour in the face of a price increase of one product in the repertoire and if there is, whether it will be replaced by another existing product in the repertoire or another not in the repertoire but a closer substitute, i.e. from one brand of muesli to another as opposed to from muesli to more cornflakes.

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92. We thus do not find that the repertoire shopping thesis tells us anything meaningful about the likely future competition between the two products.

93. The merging parties have attempted to introduce a theory of consumer behaviour posited as a finding of fact in one case (*Kraft*) and to rely on it to support a general theory of substitution in the present case. But in this case the supporting data shows at best shifts in buying patterns, but does not explain why they came about. It cannot be relied on to establish that other brands in a repertoire act as a constraint on either Pro Nutro or Future Life.

Conclusion on substantial lessening or prevention of competition

94. On balance the evidence shows that although the relevant market in which the merging parties products operates is probably wider than the RTE porridge market and would include certain other RTE products, the exact boundary is uncertain. We can however conclude that on a balance of probabilities Pro Nutro and Future Life are less differentiated from one another, than other candidate RTE products in this market, and hence a merger between the two will weaken the competitive constraint between them in two respects; price and non-price competition in the form of innovation and improved products.

Efficiency

95. Although Saad in his evidence raised what may be considered an efficiency defence by alleging that the joint venture will allow him to expand his brand into new products in the cereal market that he would not have been able to do timeously without the production facility afforded him by the merger, the merging parties in final argument did not seek to rely on this to justify the merger and accordingly we do not need to consider this aspect further.³⁵

Remedies

96. Analysing the effects of this merger is complicated by the fact that this is only a partial merger. Pioneer is only buying half of Future Life, whilst Saad, the other joint

³⁵ Note Kellogg challenged the submission that Saad required the merger as opposed to an agreement to access this manufacturing facility.

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venture partner, has stated that he has no financial interest in Pioneer Foods or its brands. Thus, post-merger, absent co-ordination, Saad's incentives do not change.

97. Pioneer's might however. As only a 50% owner of the joint venture, it could have the incentive to facilitate a price rise increase for Future Life. If the lost sales in Future Life's product are diverted to Pro Nutro or to a lesser extent to other Pioneer brands, supporting such a price rise would remain profitable as it owns a 100% of the latter.
98. On the other hand Saad, not having any interest in the fortunes of Pioneer and in the absence of collusion, would have the same interest as he has had in pre-merger in ensuring the profitability of his brand only and thus might be more circumspect about a price rise if it is not profitable for Future Life even if it is profitable for Pioneer, by virtue of the diversion it might enjoy from its 100% owned brands.
99. For this reason the remedy offered by the parties address two key issues. It serves to remove the ambiguity around who controls the joint venture post- merger, making it quite clear that Saad does. This condition means that for as long as the condition is in place the incentives of Future Life or the acquired firm remain what they were pre-merger.
100. As Salop and O'Brien explain in an article on the competitive effects of partial ownership in mergers:

"A corporate control structure characterised by a silent financial interest is one in which the acquiring firm is entitled to a share of the acquired firm's profits but has no power to control or even influence the decisions of the acquired firm. Instead the acquired firm acts as if it were an entity independent of the acquired firm. Silent financial interest may arise from the issuance of non-voting stock, enumerated restraints on decision-making power of the acquired firm, or the acquisition of a financial interest too small to ever be decisive. Silent financial interest does not lead to any change in the incentives of the acquired firm".³⁶

101. Second, it reduces the possibility for a collusive outcome by inhibiting the information flow between the joint venture and Pioneer. The mechanism for doing

³⁶ Steven C. Salop and Daniel P. O'Brien "Competitive Effects of Partial Ownership: Financial Interest and Corporate Control. 67 Antitrust Law Journal 559 – 614(2000) at 577.

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so, whilst not perfect, ensures that the Pioneer appointees on the Future Life board are not operational people in the Pioneer cereal business. In short they sit on the board as representatives of an investor not a competitor.

102. The third mechanism introduced by the condition is to ensure that Pioneer does not reduce investment in Pro Nutro for the next two years thus ensuring that the brands retain their pre-merger competitive intensity in this respect.

103. The conditions are capable of easy monitoring and cannot be criticised in this respect.

104. Notable however is their brief duration. The conditions apply for a five year period and the investment condition in respect of Pro Nutro applies for a two year period. While their temporary nature may be the subject of criticism there is a reason for them not being much longer.

105. Barriers to entry in this market are high – the costs of developing a winning product and having the capital equipment to manufacture it to the requisite standard.³⁷ This is the difference between producing a product with a small distribution product to smaller retail outlets, of which there are many, and breaking into formal retail, which as Saad's own experience has shown, is not easy. Indeed, his success thus far is an exception not the norm in this market and his need to find a partner a recognition that even successful start-ups can plateau without a larger partner.

106. Further, a product capable of disciplining the pricing power of Pioneer and the joint venture post-merger must be capable of entering the retail market by having access to organised retail outlets.

107. The standard approach to the entry problem in mergers is to view entry from the vantage point of whether it will be timely, likely and sufficient.³⁸

108. What is notable in this market is the presence of strong competitors with access to the retail market. Among Pioneer's more significant rivals in the RTE cereal

³⁷ That barriers to entry are high is supported by a number of the industry participants interviewed by the Commission. See for instance the views of Nestle, Record page 499 and Alphen, record page 1507.

³⁸ See US Horizontal merger guidelines para 9, pages 27 – 29.

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category are a large domestic integrated food company, Tiger Brands and two international firms with a strong local presence in the form of Kellogg and Nestle.

109. We heard evidence already that Tiger has entered the market with its own RTE porridge brand although its success to date is not clear. However anyone of these firms is likely in the event of a sustained price rise by the merging parties to enter this market given the success of Future Life to date, a success which has not gone unnoticed by rivals. RCL had indicated that it is trialling a similar product. There are also a number of medium sized firms producing health products which might enter as well although the effectiveness of their entry would be open to greater doubt.³⁹

110. For this reason a post-merger price increase by the merging parties above a competitive level, will make entry of another RTE porridge-like brand into the market from a strong player likely, and given the strength of some of these firms, if it is one of them, then substantial. What is not clear is timeliness given that entry and trialling of a new brand may take time. Hence the time period of five years for the control condition and two years for the investment condition, is intended to deal with possible anticompetitive effects during the period when new entry is embryonic and not yet effective.

111. We are satisfied then that the undertaking made by the merging parties and which we have made a condition of the approval of the merger will remedy any short term anticompetitive effects and that entry of new products by existing rival firms is likely to make any longer term anticompetitive effect less likely.

Public interest

112. The merger it was common cause would be employment neutral and have no adverse effects on the public interest.

Conclusion

113. For these reasons the merger was approved on 09 November 2015 subject to the condition annexed hereto as "annexure A".

³⁹ These firms include Vitality Life, Healthy Life, Gluco-less, Smart Life and Nutri Start.

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Mr Norman Manoim

22 December 2015
Date

Ms Yasmin Carrim and Ms Andiswa Ndoni concurring

Tribunal Researcher : Ipeleng Selaledi

For the merging parties : Adv. Jerome Wilson and Adv. Michelle le Roux
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For Kellogg : Anthony Norton and Paul Russell of Nortons Inc.

For the Commission : Daniela Bove and Anisa Kessery