

COMPETITION TRIBUNAL OF SOUTH AFRICA

Case NO: 107/LM/Oct 08

In the matter between

Mobile Telephone Networks Holdings (Pty) Ltd

Primary acquiring firm

And

iTalk Cellular (Pty) Ltd

Primary target firm

Panel : D Lewis (Tribunal Member); U Bhoola (Tribunal Member) and N
Manoim (Tribunal Member)

Heard on : 06 January 2009

Decided on : 06 January 2009

Reasons Issued : 20 February 2009

Reasons for Decision

Approval

[1] On 06 January 2009 the Competition Tribunal issued a Merger Clearance Certificate unconditionally approving the merger between Mobile Telephone Networks Holdings (Pty) Ltd and iTalk Cellular (Pty) Ltd. The reasons appear below.

Parties

[2] The primary acquiring firm is Mobile Telephone Networks Holdings (Pty) Ltd ("MTN Holdings"), a wholly owned subsidiary of MTN Group Ltd ("MTN Group").

[3] MTN Group is listed on the JSE and does not have a controlling shareholder. The shareholders holding in excess of 5% of MTN Group's issued share capital are: The Public Investment Corporation ("PIC"), which holds a 13.27% interest; Newshelf 684 (Pty) Ltd, which holds a 13.06% interest; and Lomard Odier Darier Hentsch & Cie (M1 Limited), which holds a 9.82% interest.

[4] MTN Group controls a number of subsidiaries, including but not limited to MTN Holdings, and MTN Management Services (Pty) Ltd. MTN Holdings in turn controls a number of subsidiaries three of which are relevant for the purposes of the current transaction namely Mobile Telephone Networks (Pty) Ltd; MTN Service Provider (Pty) Ltd ("MTN SP") and MTN Network Solutions (Pty) Ltd ("MTN NS"). MTN Holdings has a 41% interest in iTalk, the primary target firm.

[5] The primary target firm is iTalk Cellular (Pty) Ltd (“iTalk”), a cellular service provider owned and controlled by the Bebinchand Seevnarayan Trust (“the S Trust”)¹ and MTN Holdings.² The S Trust and MTN Holdings hold 59% and 41% of the shares in iTalk respectively.

[6] MTN and iTalk are both active in the telecommunications sector. The MTN Group is a multinational telecommunications provider and offers services in the Information Communication and Technology (“ICT”) sector. In South Africa MTN is a mobile network operator that provides mobile voice and data services. iTalk is a cellular service provider that contracts with consumers and corporate customers directly for the provision of MTN airtime, handsets and related products. iTalk entered into a service provider agreement³ with MTN on 11 May 1999 for the provision of these services. This agreement effectively enables iTalk to distribute MTN’s products at a significant discount. MTN also owns its own service provider MTN SP, which is a dedicated provider of its products and competes with iTalk. MTN is thus in the curious position of being a supplier, competitor of, and shareholder in, iTalk.

Transaction

[7] In terms of the proposed transaction, MTN Holdings intends to acquire the remainder of the shares (59%) in iTalk by exercising its pre-emptive right according the shareholders agreement. Post-merger, the S Trust will exit as a shareholder in iTalk. MTN Holdings will hold 100% of the total issued share capital in iTalk and will therefore exercise sole control over iTalk. The significance of the transaction is that MTN, presently a joint controller of iTalk, becomes its sole controller.

Rationale for the Transaction

[8] In recent years there have been a series of mergers involving acquisitions by mobile network operators of their service providers. The mergers are Vodacom GSM⁴, Vodacom

1 The S Trust holds shares in Budget Properties (Pty) Ltd;Two Two Four Chamberlain Road Properties (Pty) Ltd;Lyl-Properties (Pty) Ltd;Windermere Road Properties (Pty) Ltd;Seevbrook Road Properties (Pty) Ltd;Serta Bedding (Pty) Ltd;Lyl Bedding Spring Manufacturers (Pty) Ltd;Kiran Sales (Pty) Ltd; and iTalk. None of these entities are involved in the telecommunications industry.

2 iTalk does not own or control any subsidiaries.

3 iTalk used to be an exclusive service provider to MTN but the exclusivity in the iTalk/MTN Service Provision Agreement expired on 13 March 2003. Therefore while currently iTalk only sells MTN services, it is a non-exclusive independent service provider and it is entitled to provide services in respect of both Vodacom and Cell C airtime products should it choose to do so.

4 Case NO: 10/LM/Nov99

Teljoy Holdings⁵, Vodacom Smartcall⁶, Vodacom Tiscali⁷ and Vodacom Africell⁸, Vodacom Glocell/Global Telematics⁹. We have also adjudicated a transaction of this nature in which the service provider owned by MTN, Vodacom's largest competitor in the provision of network services, acquired Cell Place.¹⁰ We approved all of these mergers unconditionally.

[9] MTN submits that the proposed transaction must be seen against this background. It is part of MTN's strategy to increase its distribution footprint through ownership and increased control of the distribution channel. MTN has developed a branded channel distribution strategy with the aim of providing its customers with a common customer experience. Through this strategy, MTN claims that it can: control the quality of service; ensure that customers have a homogenous brand experience; ensure that staff training and motivation and incentives of staff are consistent and provide the customer with an overall seamless experience.

[10] MTN also claims that it is shortening the distribution chain through increased vertical integration with substantial expected efficiency gains.

Background

[11] Despite the strategy of MTN set out above, the transaction came about because the S Trust took a decision to sell its interest in iTalk. However MTN was not its first choice of buyer. On 28 January 2008, a sale of share agreement was signed between the Huge Group (Huge) and the Trust in terms of which Huge agreed to purchase the Trust's 59% shareholding in iTalk.¹¹ According to Huge the purpose of the acquisition was to enable Huge to acquire and distribute MTN's products at a significant discount afforded to iTalk in terms of the Service Provider Agreement. Huge submitted that such an acquisition would have enabled it to aggressively compete with MTN SP and other independent service providers, in providing MTN's products to individual customers and in particular to Huge's significant corporate customer base.¹² This transaction was notified to the Competition Commission (the Commission") as an intermediate merger and approval was granted. After

5 Case NO:13/LM/Nov99

6 Case NO: 68/LM/Dec03

7Case NO: 87/LM/Oct04

8 Case NO: 48/LM/06

9 Case NO:12/LM/Jan08

10 Case NO: 83/LM/Sep05

11 Huge is a company listed on the Johannesburg Stock Exchange. It provides value added, cost controlling telecommunications services to corporate customers in South Africa, including cellular least cost routing ("CLCR") services, bulk SMS solutions and call cost management services. Huge Telecom (Pty) Ltd ("HugeTel") is a wholly owned subsidiary of Huge Group. HugeTel provides cellular airtime ("SIM cards") to its corporate customers as part of CLCR services. HugeTel is a customer of iTalk and according to Huge Group; HugeTel currently competes with MTN SP and the other two independent MTN cellular service providers being Autopage Cellular (Pty) Ltd ("Autopage") and Nashua Mobile (Pty) Ltd ("Nashua"). See Huge Group submission, record page 3 paragraph 2.2.

12 See para 5 page 17 of Mr. James Herbst's founding affidavit in the intervention application.

the conclusion of the Huga transaction agreements, MTN exercised its pre-emptive rights in terms of the iTalk shareholders agreement so as to purchase the Trust's shares itself. The proposed transaction between MTN and iTalk was then notified to the Commission and the Huga transaction was never implemented.

[12] During its investigations of the proposed MTN transaction, the Commission received a number of objections from the merging parties' competitors. Huga, the erstwhile purchaser, submitted that it was concerned that MTN would use its control of iTalk as a tool to diminish competition in the service provider market, and thereby restrict the ability of service providers to spark competition in the upstream market for voice telephony products and services. Huga argued that MTN would use its control of iTalk to eliminate the discounting arrangement that is currently secured through the Service Provision Agreement between MTN and iTalk and thereby restrict competition amongst service providers.

[13] According to Huga, iTalk is one of the only three non exclusive service providers left in the market and if MTN acquires iTalk, there is no prospect that iTalk would become a tri-service provider. Huga therefore submitted that the merger effectively results in the reduction of competition because the number of independent non-exclusive service providers will be reduced from three to two. By tri-service provider, Huga means a service provider that sells the products of all three networks, Cell C., MTN and Vodacom. At present we are advised only two firms are tri-service providers, Autopage and Nashua. Because iTalk which was once contracted exclusively to MTN up until 13 March 2003 is now free to contract with the two other networks it is, in Huga's view, the only firm placed to become a number three tri-service provider. If MTN becomes sole controller this potential will not be realised because MTN has not through MTN SP ever distributed the products of its two rival networks.

[14] Huga's also argued that there should be a real concern about the diminution of competition between iTalk and MTN. According to Huga currently MTN offers genuine intra brand competition on price, distribution and pre-sales and after sales service with MTN SP, Autopage and Nashua Mobile. Huga argues that such intra-brand in turn drives inter brand competition.

[15] On 1 December 2008, Huga brought an application before this Tribunal for leave to intervene and participate in the merger proceedings in terms of section 53(1) (c) (v) of the Competition Act 89 of 1998 ('the Act') read with rule 46 of the Competition Tribunal Rules. We were notified by the other competitors who raised concerns during the Commission's investigations of the proposed merger that they did not intend to participate further in the merger proceedings. The application to intervene was opposed by the merging parties. The intervention application was heard on 9 December 2008. After hearing the intervention application we dismissed it on the same day.¹³ The merger hearing was set down for 6 January 2009. We did however permit Huga to make submissions at the hearing; one

¹³ The burden of Huges' submissions were directed at why it would be a more competitive buyer of iTalk than MTN. The role of merger adjudication is not decide whether one firms is better buyer than another but to decide whether the notified transaction will substantially prevent or lessen competition.

submission was to come from its chief executive and the other from its economist Geoff Parr who had prepared a report on the potential anti-competitive effects of the merger. In this report, Parr had prepared a table in which he compared the prices for MTN post paid packages offered by iTalk with those of other sellers of MTN packages, which suggested that overall, iTalk provided the cheapest contracts.

[16] Mr Parr did not take up the invitation to testify – in fairness to him we do not know if this decision was his own or that of his client and so he did not have an opportunity to defend his thesis. Nevertheless Mr James Herbst the Group Financial Director of Hugel made an oral submission on the firms' behalf at the hearing on 6 January. When he did testify Mr Herbst submissions were completely different from those signalled in the intervention application. His submissions were largely about how with Hugel, if it bought iTalk, would utilise the SPA to sell contracts to new entrants to the post paid market by allying itself with micro finance firms.

Competition Analysis

Relevant Market

[17] As can be seen above in paragraph 7, both MTN and iTalk are involved in the telecommunications sector. Whilst MTN provides a number of services, iTalk is a cellular service provider that contracts with consumers and corporate customers directly for the provision of MTN airtime, handsets and related products. The merging parties submit that there are at least two types of relevant product markets to consider in the telecommunications sector, the upstream market for the provision of mobile network access and the downstream service provider market.

[18] The upstream market is the market for network access, provided by cellular companies. The market consists of the three cellular networks, namely Vodacom, Cell C and MTN and these companies provide access to their individual networks. All three networks are active in the upstream and the downstream markets. In the downstream market service providers are the links between the consumer and the networks.

[19] There are two classes of customer in the downstream market, pre-paid customers who buy airtime to get service each time they need it and customers with contracts, referred to in the industry as post paid. Post paid customers are considered more credit worthy and hence pay after the fact, hence post paid. Service provider firms are primarily concerned with this customer segment because they assume the risk of non-payment not the network itself. Hence they receive discounts from the networks to sell the product, give some of the margin to the customer, and keep the rest for themselves. The pre-paid business model works differently, as the customer buys upfront, and the distributor assumes no risk. Hence many outlets offer pre-paid products, typically retailers, and the role of service providers in serving this customer segment is limited.

[20] Service providers have the responsibility for marketing and selling different mobile network operators' services; billing customers; setting credit limits; collecting debts and

offering after sales service and technical support. The Commission's view was that the downstream product market comprised service providers who sell post paid services. It did not come to a definitive conclusion as to whether the market might be even narrower than this and confined to service providers who sell packages for a particular network, in this case MTN. The Commission noted that certain post paid customers could not easily substitute between networks and hence the adoption of a narrow market definition might be appropriate. It did not have to come to this conclusion as it assumed the narrowest market as a possibility and still found no reason for concern.

[21] The Commission did not examine the prepaid market because prepaid customers are a small percentage of iTalk's business.¹⁴

[22] Another service offered by iTalk is that of cellular least cost routing or CLCR.¹⁵ Whether this constitutes a separate market is not something the Commission again concerned itself with, as iTalk's exposure to this service was too limited to raise concerns.

[23] The Commission also did not come to any conclusion on a geographic market definition. However in its assessment of the impact on competition the Commission focussed on iTalk's presence in KwaZulu-Natal ("KZN") as iTalk's presence in other provinces is significantly smaller.¹⁶

[24] We agree with the Commission's approach overall as it has assumed the narrowest view of the market to assess the potential competition concerns and hence, the one least favourable to the merging parties.

Effect on Competition

[25] As we noted above it is common cause that there is an increasing trend amongst network providers to vertically integrate downstream, by buying up their service providers and provide the services themselves. This is also in line with international trends.¹⁷ This transaction has both a horizontal and a vertical dimension.

[26] The Commission's report reveals that although firms in the downstream market sell a range of products they are predominantly distributors of post paid products as the fact that only 3% of iTalk's business is on pre-paid reveals. There does not seem to have been any dispute that post paid contracts are insufficiently constrained by pre-paid, the latter being more expensive for the consumer, so the issue is whether the relevant market is one for post paid in a particular networks contracts, for example, MTN only or that of post paid for all there networks. This is not something we need to decide on for the purpose of this merger. On the market shares if the market shares are those of post paid on all three networks then

¹⁴ According to the Commission iTalk's prepaid base constitutes 0.02% of MTN's prepaid customer base and is less than 3% of iTalk's total customer base. Please see page 23 of the Commission's report.

¹⁵ Least Cost Routing takes advantage of the fact that calls from "cell-to cell" are cheaper than "landline-to-cell" calls. The "cell-to cell" calls are cheaper than "landline-to-cell" phone calls because of the cheaper rates and the per-second billing as compared to the per minute billing with Telkom. The saving is achieved by utilizing the Least Cost Routing, which converts the outgoing "landline-to-cell" calls to "cell-to cell" calls. See submissions by Du Pont Telecom (Pty) Ltd on page 266 of the record.

¹⁶ According to the Commission 88% of iTalk's sales are in KZN and 85% of its subscribers are in KZN. See the Commission's record page 16.

¹⁷ See Case No: 87/LM/Oct04 at paragraph 5.

MTN SP has a pre-merger market share of 22.7%, iTalk of 1.9% leading to a post merger market share of 24.6%. If the market is only MTN post paid then the market shares are MTN SP 62.5%, iTalk 4.9% and a post merger combined market share of 67.4%. Although MTN SP's market share is high post merger, it is also high pre-merger. At the level of market share it holds, even an additional 5% accretion is unlikely to materially alter the market power it already enjoys. But the effective accretion of market share is less than 5% and more in the region of 3% as MTN pre-merger owns 41% of iTalk.

[27] It is therefore highly unlikely that the other networks will sell their products through a service provider that is partially owned and controlled by a rival network. Even if this transaction is prohibited MTN remains a joint controller of iTalk. There is thus no basis for assuming that this merger is potentially anti-competitive on these grounds.

[28] The one possible anticompetitive effect may be on intra-brand competition for MTN post paid customers. If iTalk is offering customers greater discounts than MTN SP then there may be something to this theory. However we have no evidence that this is the case and both MTN and the S Trust have denied this.¹⁸ Secondly, even if it is the market share of iTalk in post paid is so small as to not meet the test for substantiality. Thirdly, iTalk even if it is a greater discounter it is not going to enjoy its present service provider agreement with MTN much longer. The contract expires at the end of 2010. In the absence of the merger, if MTN does not want to continue the level of discount it offers to iTalk presently it does not have to offer a new contract. Thus if iTalk is a more aggressive discounter, it has notwithstanding this approach, failed thus far to improve its market share amongst MTN post paid subscribers, beyond a very modest market share. Nor, given the imminent lapsing of the contract with MTN, which is allegedly the source of its ability to discount aggressively, is this potential going to be long in the market, unless MTN wishes it to be.

[29] But we don't know if iTalk is such a discounter. Indeed its market share has been flat of late and since last year declined. This would suggest consumers are not aware that it is this aggressive discounter. Of course, as the merging parties frankly concede, consumers find it difficult to compare the packages of the respective networks and indeed even packages offered by the same network. Mr Parr who claimed to be able to do the latter did not testify in the end. But even if the product differentiation of the networks has led to ill informed consumer choices to date, it is hard to see how preventing the merger is going to rectify this.

[30] We are thus not in a position to conclude that there is a diminution of intra brand competition – iTalk may be offering no more discount to consumers than MTN SP. Nor, even if it did, that given its market share, and the near conclusion of its contract with MTN, this would be material.

[31] The merger also has a vertical dimension as MTN will be strengthening its position in the downstream service provider market. With regard to vertical effects the Commission analysed both input and customer foreclosure. According to the Commission in terms of customer foreclosure, the concern would be the ability of MTN to deprive its upstream rivals of access to iTalk as means of distribution. We are of the view that iTalk's ability to become a tri-service provider offering contracts of all three operators is not changed by this merger. Despite the fact that it is five and half years since iTalk's exclusivity with MTN ended, iTalk

¹⁸ See page 6 of iTalk's answering affidavit in the intervention application.

has not become a tri-service provider. We know from Vodacom's previous transactions before this Tribunal that they intend to vertically integrate and that they do not intend to issue any new service provider licences. Neither Vodacom nor Cell C had concerns about the merger. It seems highly unlikely that rival networks, who like MTN want to own their own distribution, would want to use as an outlet a small provider partially controlled by a rival. This would explain why since the period of exclusivity ended iTalk has never become tri-service provider.

[32] We now turn to the input foreclosure theory. This theory is premised on the fact that MTN has market power both upstream and downstream in the market for post-paid MTN contracts and could use this position to restrict supply of its post-paid contracts to its downstream service provider rivals namely Nashua, Orion and Autopage. We are of the view that MTN can engage in this type of foreclosure with or without the merger and we therefore agree with the Commission that MTN's ability to engage in input foreclosure is neither merger specific nor likely.

[33] There are no public interest issues. Accordingly the transaction is unconditionally approved.

N. Manoim
Tribunal Member

20 February 2009

Date

U Bhoola and D Lewis concurring

Tribunal Researcher : Jabulani Ngobeni

For the merging parties : Adv Arnold Subel SC instructed by Feinsteins Attorneys

For the Commission : Thabelo Masithulela and Kate Morris (Mergers and Acquisitions)