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**A CONSIDERATION OF HORIZONTAL PRACTICES REGULATION IN
RESPECT OF FRANCHISE AGREEMENTS**

By

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DECLARATION

I declare that the Master's script, which I hereby submit for the degree LLM Mercantile Law at the University of Pretoria, is my own work and has not previously been submitted by me for a degree at another university.

Signed by **Carmel Jessica Buckham** on 28.10.2014

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ABSTRACT

A cornerstone of Anti-trust (Competition) regulation is a Prohibition on Abuse of Dominance; however, the question must be asked: what recourse does a multinational Dominant Firm have when a franchisee with an exclusive manufacturing agreement, conducts itself in such a way that the Dominant Firm is being commercially constrained and consumers are being disadvantaged, through the forced market exit of a large firm providing lower prices?

The dissertation looks at South African Competition Law provisions and international developments; and provides comment based on a hypothetical market scenario, aimed at assessing whether the current South African law provides adequate relief for Dominant Firms, should a franchisee become so powerful that it begins to constrain the Dominant Firm's market growth.

The hypothetical scenario touches on the relationship between the franchisees that is created by the Dominant Firms' vertical agreements, and considers if the franchisees conduct on the one hand lessened intra-brand competition for the Dominant Firms products, and on the other hand, if the arrangement created by the vertical agreements in fact amounted to collusion by dividing and controlling markets.

The value in this research lies in the fact that there are conflicting commercial interests that exist in the marketplace; and Competition policies could interfere with a firm's rights to freedom to contract. It is envisioned that the South African legislature will in time, be put under pressure to step up regulation in this space, should South Africa want to position itself as an attractive market for investors to expand their businesses.

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CHAPTER ONE: ORIENTATION AND GENERAL BACKGROUND

1.1 INTRODUCTION

A fundamental cornerstone of Anti-trust (Competition) regulation in any jurisdiction is a Prohibition of Abuse of Dominance, which results in harm to consumer welfare¹. Whilst Competition Legislation is there to protect the franchisee and consumer against a Dominant Firm; the question must be asked: what recourse does a Dominant Firm have, when the conduct of such a franchisee is resulting in the market being foreclosed, and simultaneously constraining the Dominant Firm's commercial growth.

The purpose of the Competition Act² is listed in Section 2, which is necessary precursor to this dissertation, as it is important to appreciate the South African government's motivation in assenting to the Competition Act³. It is submitted that the South African legislature enacted the Competition Act for political reasons but also to realise economic reform and the growth of a pro-competitive business culture.

Section 3(1) of the Competition Act⁴ states that:

the Act applies to all economic activity within or having an effect within South Africa.

Section 3 (1A)(a) of the Competition Act states that:

¹ See D Lewis "*Building new competition law regimes: selected essays*" Edward Elgar Publishing Limited UK (2013) 81 where Janice Bleazard states that South African competition authorities have enjoyed considerable political backing, as the [African National Congress]- led government recognised competition law and policy as instruments for remedying the oppressive distortions of the apartheid economy. Competition law and policy were introduced not simply to pursue the traditional functions of promoting market efficiency and consumer welfare [but also] viewed as a means of remedying the excessive concentration of economic power in the hands of the state and white-only elite; promoting participation in the economy of small and medium-sized enterprises, especially if owned by historically-disadvantaged persons; promoting employment; and dissolving state owned monopolies and market oligopolies.

² The Competition Act 89 of 1998.

³ Section 2 of the Competition Act sets out the objectives of the Act; See further on the background to the Competition Act at D. Lewis "*South African competition law: origins, content, and impact*" in V.Dhall (ed.), "*Competition law today: concepts, issues and the law in practice* Oxford University Press Oxford (2007) 340.

⁴ The Competition Act 89 of 1998.

in so far as this Act applies to an industry, or sector of an industry, that is subject to the jurisdiction of another regulatory authority, which authority has jurisdiction in respect of conduct regulated in terms of Chapter 2 or 3 of this Act, this Act must be construed as establishing concurrent jurisdiction in respect of that conduct.

To put it differently and create the causal link between Competition Law, Common Law, Law of Contract and Law of Delict, it is submitted that should a contractual dispute arise with a franchisee over territory and product supply, one would expect the parties to confine such dispute to adjudication under the laws of Contract and Delict. However, when a franchisee (cunningly) elects to launch a complaint with the Competition Regulator as a tactic to handcuff the Dominant Firm, one must consider whether parameters must be established by the competition regulator to distinguish instances when concerns across several legal regimes should be separated and addressed respectively⁵. It suggested that academics and the legal fraternity at large should emphasise that a firms commercial conduct does not *prima facie* constitute violations, that in turn results in anticompetitive harms; and further, that a firm should not be constrained unnecessarily from fulfilling its commercial agenda.

1.2 HYPOTHETICAL SCENARIO

This dissertation is based on a consideration of the following hypothetical scenario:

“A particular market has two third party franchisees (A and B) that are appointed by way of written commercial agreement, by a Dominant Firm, to manufacture finished products owned by the Dominant Firm. Due to several business considerations, i.e., research and development, non-performance in manufacturing the necessary volumes, unsatisfactory product quality results, non-compliance with applicable labour laws and the Dominant Firms supplier guiding principles; the Dominant Firm elects to enter into discussions with franchisee A and franchisee B with the intention to alter the current Geographical Product Model⁶ and migrate to a SKU Product Model⁷. The Dominant Firm believes that this will

⁵ Harvard Law Review “*Deception as an antitrust violation*” Vol 125 1235 see http://cdn.harvardlawreview.org/wp-content/uploads/pdfs/vol125_deception_as_an_antitrust_violation.pdf.

⁶ This dictates that each respective franchisee has exclusive territorial distribution restrictions.

⁷ This envisions that each respective franchisee distributes an exclusive product range of the Dominant Firm, throughout the territory of South Africa. In other words, franchisee A manufactures sparkling juice beverage products and franchisee B manufactures the still juice beverage products.

serve to increase efficiency and reduce operating expenditure of the franchisees; and ultimately these benefits would positively impact the entire value chain. The devil is in the detail with this scenario, as the Dominant Firm and the non-performing franchisee (franchisee B) entered into discussions and it was agreed between the parties in writing that as an alternative to the Dominant Firm exercising its termination rights in the agreement (it may be assumed that the termination is lawful and will withstand court scrutiny), the manufacturing model would be altered (it may be assumed that franchisee A is satisfied with the shift in model) and franchisee A would now manufacture all sparkling juice beverage products and Franchisee B would now manufacture all still juice beverage products. Once the written agreements are finalised and signed by the parties, Franchisee B elects in bad faith to approach the Local South African Competition Authority (“Competition Commission”) and lodge a complaint of in terms of Section 5 of the Act, claiming abuse of dominance, inducement and general exclusionary conduct. The Competition Commission decides to investigate the matter further, subsequently elects to extend the scope of the investigation beyond the initial complaint, wherein it will look into the entire business model of the Dominant Firm, in respect of the Dominant Firm’s historic conduct as well as consider the implications of this new business franchise model.”

1.3 PROBLEM STATEMENT

The development and enforcement of South African Anti-Trust (Competition) regulation by means of the Competition Act of 1998⁸ and subsequent Consumer Legislation⁹ was as a result of a need to protect the constitutional and other rights of consumers. Due to the nature and sequence of legislative developments in South Africa, there will inevitably be circumstances in which several legal regimes, namely the laws of contract and competition, whilst all being applicable; may conflict with each other, resulting in ineffectiveness, inequality and uncertainty. The result of which is an unforeseen situation where the same legislation enacted to protect the consumer, is flipped and the very principles that are aimed at protecting the

⁸ Act 89 of 1998.

⁹ The Consumer Protection Act 68 of 2008.

economy and consumer, result in the opposite happening, when such competition law is applied too literally.

1.4 RESEARCH OBJECTIVES

A critical analysis of existing Consumer and Competition relief mechanisms and law reform initiatives is especially relevant in the current economic climate. The research problem to be investigated therefore deals with the compatibility of Competition Law, Consumer Law, Common Law and Law of Contract principles, to effectively address a complex scenario where the conduct of Franchisee B results in commercial market squeeze¹⁰.

It is suggested that whilst the notion of anti-trust (Competition) has been around for decades, regulation needs to be somewhat sensitised to the macroeconomic elements at play in a complex market such as South Africa, where parts of the economy are developed and other parts remain severely underdeveloped. Furthermore, the South African political climate, economic meltdown, weakening currency, and overreaching global macroeconomic influences, have left a substantial percentage of consumers in financial dire straits which highlights the need for further and current insight and development of the interplay between consumer protection and commercial profitability.

A summary of the objectives of this proposed study and dissertation are therefore:

¹⁰ See the case of *The Competition Commission v Senwes Limited* 110/CR/Dec06, where the competition tribunal recognized the notion of a 'margin squeeze' as a distinct abuse in terms of s 8(c) of the Competition Act 89 of 1998; In L Kelly & T van der Vijver "*Less is more: Senwes and the concept of margin squeeze in South African competition law*" South African Mercantile Law Journal (2009) 246-255 it is submitted that market squeeze is a gradual commercial strangulation of a downstream competitor by a dominant, vertically integrated undertaking, which controls access to an essential input and uses its upstream dominance to extinguish competition at the downstream level. Notwithstanding the above, margin squeeze is a controversial concept. A system of competition law that forces dominant companies to deal favorably with downstream rivals runs the risk of subsidizing inefficient competitors to the detriment of consumer welfare. The doctrine could thus have a chilling effect on competition. Firms may well think twice about investing in a costly input if they may be forced to share it with others on advantageous terms; The counter argument that is discussed by R J van den Bergh and P D Camesaca "*European competition law and economics: a comparative perspective*" Intersentia Belgium (2001) 277 is that 'margin squeeze sceptics' are of the view that in considering margin squeeze, inefficient entry does not need to occur as long as competition law authorities only consider margin squeeze complaints by downstream competitors that are at least 'as efficient' as the dominant firm's downstream business.

- to extract the current legislative regulation of horizontal commercial dealings, and vertical relationships, using case law ;
- to address the question as to whether current procedures provide adequate relief for Dominant Firms should a downstream firm become so powerful that it can begin to constrain the Dominant Firm's market growth (hypothetical scenario above);
- to do a comparative study on South African competition relief for constrained Dominant Firms against international developments, principles and guidelines; and
- to put across viewpoints and to suggest recommendations for the South African Competition regulators with regard to the need for franchise disputes to be resolved in a manner that enhances and protects the franchise model.

1.5 HYPOTHESIS

A downstream firm's conduct in a vertical franchisee relationship can change the market dynamic, therefore constraining market growth.

1.6 CONCEPTUAL FRAMEWORK

The proposed research and subsequent dissertation, involves a literature study of historical and comparative competition law schools of thought, enacted legislation, books, journal articles, academic opinions and case law. The study is primarily an opportunity to forecast and comparatively discuss the potential gaps created by the rigid implementation of first world legislation, into a South African market¹¹.

A comparative study will be undertaken by focusing on investigations into certain aspects of the anti-trust system of the United States of America

1.7 DEFINITION OF TERMS

¹¹ It is submitted that the South African market is conflicted with being developed at certain levels but at the same time being an emerging market.

- The meaning of **Arms-Length**¹² for purposes of this dissertation is a transaction in which the buyers and sellers of a product act independently and have no relationship to each other. The concept of an arm's length transaction is to ensure that both parties in the deal are acting in their own self-interest and are not subject to any pressure or duress from the other party.
- **Category Management** refers to decisions on product placement, promotion and pricing; executed by a “category captain” from the ranks of the largest manufacturers.
- **Concerted Practice**¹³ means co-operative or co-ordinated conduct between firms, achieved through direct or indirect contact, that replaces their independent action, but which does not amount to an agreement. A possible example might be the type of cartel arrangement where a market leader signals a price increase by way of public announcement and, in accordance with long-standing practice in the industry, the other participants follow its lead. However care must be taken not to confuse independent conduct with interdependent conduct.¹⁴ It suffices for present purposes to say that the emphasis is on the conduct of the parties, which could be a written contract, or an arrangement or understanding that is not, but which the parties regard as binding upon them. Its essence is that the parties have reached some kind of consensus.¹⁵
- The **Dominant Firm** has a complementary food and technology portfolio of products that are available around the world, and includes eight brands that each generates in excess of \$1 billion in estimated annual retail sales¹⁶.
- A **Horizontal relationship** means a relationship between competitors.¹⁷
- **Intra-Brand competition** refers to competition by firms that compete to perform some function e.g. distribution in respect to the same brand hence intra-brand.¹⁸

¹² Available at <http://www.investopedia.com/terms/a/armslength.asp> accessed on 28 October 2014.

¹³ See *Netstar (Pty) Ltd and Others v Competition Commission South Africa and Another* (99/CAC/MAY10, 98/CAC/MAY10, 97/CAC/MAY10) [2011] ZACAC 1; 2011 (3) SA 171 (CAC) (15 February 2011) par 25; see P Sutherland and K Kemp “Competition Law of South Africa” LexisNexis Durban (2013) 5-17 that ‘there is no need to draw a clear line between arrangements and concerted practices’ as such a line is drawn by the language of the definitions. Nor are concerted practices merely diluted agreements (5-25).

¹⁴ Sutherland and Kemp *supra* 5-9 to 5-11.

¹⁵ Sutherland and Kemp *supra* 5-14 to 5-15 where they deal with the approach of the European Commission and the European Court of First Instance to the topic of agreement.

¹⁶ See Section 7 of the Competition Act 89 of 1998 where an explanation is given regarding when a firm is considered to be dominant in a market as well as where the definition of market power is provided.

¹⁷ Section 1 of The Competition Act 89 of 1998.

- **Inter-Brand** refers to competition between brands.¹⁹
- **Monopoly**²⁰ is defined as a situation where, due to lack of competition or the availability of a substitute product/service, a single enterprise can determine the terms, such as price and availability, under which others can have access to the service or product it is offering.²¹
- **Oligopolies:** Taking its name from the Greek word 'oligo' meaning 'few', an oligopoly is a small number of sellers, referred to as oligopolists, dominating an industry or market.²² It is commonplace in oligopolistic markets, to see the competitors being influenced and responding commercially to the decisions of another company. Because of this close interaction, an oligopolistic market is considered high risk when it comes to collusion – the setting of prices, limiting of production and division of market share.²³
- **SKU** for purposes of this dissertation, is an acronym that refers to a stock keeping unit. In other words, a unique packaging for each distinct product.
- A **vertical relationship** means the relationship between a firm and its suppliers, its customers or both.

1.8 DELINEATION OF STUDY AND LIMITATIONS

The market that forms the basis of the hypothetical scenario makes the dissertation one that requires the reader to think in an abstract manner, and to critically evaluate a scenario that is based on the very stark reality that stalemates between legal regimes exist in today's commercial market.

¹⁸ <http://en.wikipedia.org/wiki/Competition>.

¹⁹ <http://en.wikipedia.org/wiki/Competition>.

²⁰ <http://www.compcom.co.za/assets/Uploads/events/Fourth-Competition-Law-Conference/Session-4B/Boshoff-Market-Definition.pdf> accessed on 28 October 2014; See the article by W H Boshoff "Antitrust market definition: rationale, challenges and opportunities in South African competition policy" available at <http://www.compcom.co.za/assets/Uploads/events/Fourth-Competition-Law-Conference/Session-4B/Boshoff-Market-Definition.pdf> accessed on 27 Oct 2014.

²¹ See the meaning of Monopolies at <http://www.stockmarkets.com/blog/monopoly-oligopoly-duopoly> accessed on 28 October 2014.

²² See the discussion on Oligopolies at <http://www.stockmarkets.com/blog/monopoly-oligopoly-duopoly> accessed on 28 October 2014.

²³ See the further discussion at <http://www.stockmarkets.com/blog/monopoly-oligopoly-duopoly> accessed on 28 October 2014.

1.9 DEMARCATION OF STUDY

The study is centred on South African Fast Moving Consumer Goods Market; and in particular, the broader juice beverage product market.

CHAPTER TWO: THE POWER STRUGGLE IN BUILDING A HEALTHY MARKET

2.1 INTRODUCTION

First, an outline of the relevant background information in relation to the relevant market(s) in which the Dominant Firm and both these Franchisee's operate²⁴. *Second*, an outline of the approach that is generally adopted by local South African competition authorities when analysing the agreement that governs the vertical relationship between the Dominant Firm and franchisees. *Third*, and with reference to the principles applicable to this franchise agreement, the written commercial agreement, between the Dominant Firm and the franchisees will be discussed. *Fourth*, some insights will be provided into the horizontal relationship between Franchisee A and Franchisee B, and a brief consideration into whether these two franchisees would be considered competitors given the separate geographical territories in which they supply and sell products, as authorised by the Dominant Firm. *Fifth*, and the crux of this dissertation, will entail a look into the unusual scenario when a player in the downstream market is able through its conduct, to constrain the Dominant Firm and thereby causing a reversal of power in the vertical relationship.

2.2 HYPOTHETICAL RELEVANT FACTS

The Dominant Firm has a strong consumer base across South Africa and since launching its brands in South Africa twenty years ago, these products market share has been growing exponentially. The Dominant Firm's business model in South Africa is one that is fairly commonplace worldwide, and is based on the outsourcing of its products manufacture to independent third party franchisees.

²⁴ See W H Boshoff *supra* 1-2 where he submits that Competition policy is arguably rationalist in nature, but practitioners seem nevertheless quite aware of the uncertainties involved in judging business strategy and practices and its effects. Market definition is one area of competition policy investigations that is frequently contentious and one that may take up some time of authorities in sometimes unnecessary arguments over including or excluding a particular substitute from the relevant market.

The benefits to these two franchisees are immense. Above all, they are able to manufacture widely known products, they have exclusive rights within a particular area and they are able to benefit from technical advice and support from the Dominant Firm or the Franchisor, as well as an established and successful marketing distribution system in South Africa. Moreover, the franchisee is able to benefit from the sheer scale of the Dominant Firm's organisation, enabling them to purchase manufacturing equipment which is based on state-of-the-art technology at a lower price. By the franchisees participating in the franchise arrangement with the Dominant Firm, they are able to bottle and sell many well-known and popular brands of fast moving consumer goods, more specifically juice beverage products, to retailers in both the developed and traditional trade. Several years ago one can appreciate that the Dominant firm had very few competitors of its products, however the current market segment in which the Dominant firm's products exist, is growing, and now is being characterised by a high-degree of competition.

The reader can appreciate that the juice beverage segment is a broad market with many products, however, consumers and competition regulators alike only serve to differentiate this juice segment into two markets,²⁵ namely still juices and sparkling juices. Significantly, however, consumers are prepared to pay prices of between 15% more for the Dominant Firm's products in the overall juice segment, than for other similar competitor offerings, and research shows that this is significantly driven by South African consumers brand awareness.

For several years the Dominant Firm had allocated five year manufacturing agreements ("Agreement") to the respective franchisees, with rights to make, move and sell both still juice products and sparkling juice products in exclusive geographical provinces. The Agreement prohibits manufacture of competitor products, however it allows the respective franchisees to source and purchase all raw materials themselves, with the exception of the unique and secret beverage bases which are only bought from Dominant Firm.

²⁵ See W H Boshoff *supra* 2 where he considers the rationale for market definition and highlights a number of challenges and opportunities in conducting market definition. He argues that market definition is not a mere first step for the sake of formalism, but an important component of a sound competition investigation.

It is therefore submitted that the franchisees were in a ‘vertical’ relationship with the Dominant Firm, for purposes of a competition law assessment.

2.3 A BRIEF OVERVIEW OF THE APPLICABLE COMPETITION REGULATIONS

From the above analysis it is evident that two relationships that in this tri-party scenario, with the *first* being the vertical relationship between the Dominant Firm and each of the respective franchisees, and the *second* being the horizontal relationship between the two respective franchisees.²⁶ The local South African competition regulators will when considering a vertical relationship, look to Section 5 of the Competition Act²⁷ which reads as follows:

An agreement between parties in a vertical relationship is prohibited if it has the effect of substantially preventing or lessening competition in a market, unless a party to the agreement can prove that any technological, efficiency or other pro-competitive, gain resulting from that agreement outweighs that effect.

An analysis of when a vertical relationship becomes anti-competitive, and an exploration into the franchise relationship, will be canvassed further on, in Chapter 3.

2.4 THE VERTICAL AGREEMENT

The issue that needs to be determined is whether there is a risk that the Dominant Firms practice of concluding these manufacturing agreements with franchisees could contravene Sections 5(1), 8(1)(c) or possibly Section 8(1)(d)(i) of the Competition Act²⁸. These aforementioned sections need to be considered having reference to the most relevant terms of the manufacturing agreement, which are indicated below:

2.4.1 The manufacturing agreement endures for an initial period of five years. Should the franchisee want to continue the relationship it should indicate this in writing and the

²⁶ See Sections 5 and Section 4 of the Competition Act 89 of 1998 respectively.

²⁷ Act 89 of 1998.

²⁸ Act 89 of 1998.

agreement can be extended by the Dominant Firm at its voluntary election, for a further period of five years.

2.4.2 The franchisee manufactures, processes, packages and sells certain specified sparkling juice products and still juice products on Dominant Firm's behalf and in accordance with strict specifications supplied to it by the Dominant Firm.

2.4.3 The Dominant Firm may support the franchisees in assessing which are the best suppliers, and at the best prices; and possibly leaning into negotiations with these suppliers of raw materials from an arm's length perspective, and guiding the franchisee about what prices are fair and reasonable. However the franchisee itself is responsible for controlling all aspects of the production process, including having the final say on the sourcing of raw materials used to produce the products, with the exception of the unique beverage base, which is sourced only from the Dominant Firm itself.

2.4.4 The franchisee is required to reach certain volumes of sales and to achieve its highest potential efficiency.²⁹

2.4.5 The franchisee undertakes to ensure maximum outputs and efficiencies in its production process and unless the Dominant Firm specifically agrees in writing to the contrary, the franchisee may not use any excess capacity to produce any competitor products.

2.4.6 Market research shows that when these two franchisees were appointed several years ago, the juice beverage market was an oligopoly³⁰ however today this market has several competitors.

2.4.8 There are a number of viable franchisee alternatives with capability to manufacture juice beverage products, accordingly one can easily be compelled to accept that the barriers to entry into this market are in fact low.

2.4.9 The Dominant Firm's position in justification of its non-compete clauses included in these franchisee manufacturing agreements, is based in the *first part*, on the notion that

²⁹ E Elhange "Defining better monopolization standards" Stanford Law Review (2003) 253.

³⁰ See definition of the term in paragraph 1.7 above.

the beverage base used in the manufacture of these juice products, is unique and thus proprietary to the Dominant Firm as brand owner. In the *second part*, the restraint obligations are restricted to a limited phase of one year only.

The notion of dominance and market power will be considered further in the next Chapter.

2.5 RELATIONSHIP BETWEEN FRANCHISEE A AND FRANCHISEE B

It is submitted that South African competition regulators will look at Section 4 of the Competition Act³¹, in considering *firstly* whether these two franchisees are competitors in a horizontal relationship and *secondly* when considering if any conduct by the franchisees amount to any of the prohibited practices of price-fixing, be it either direct or indirect, and which may relate to a purchase or selling price or any other trading condition, dividing markets by allocating customers, suppliers, territories, or specific types of goods or services; and collusive tendering.

It is important to have a good understanding of the market in question as an enabler to assess the extent of the competitive harm, if any. Critics argue that market definition is not required under an effects-based approach: these opponents argue that market definition is superfluous if one moves away from “dominance-plus-form” questions towards case-by-case analysis of actual or predicted effects of a particular conduct or merger.³²

The South African competition authorities, the European commission and other competition authorities have retained market definition as a first step in competition analysis.³³

It is submitted that in the current scenario, defining the relevant market is a crucial unlock to facilitate a fair analysis of the alleged anti-competitive behaviour of the Dominant Firm. In so doing it is suggested that as a matter of course, the study will highlight any market effects of

³¹ Act 89 of 1998.

³² W H Boshoff *supra* 2-3; Boshoff discusses the views of certain critics who consider market definition as simply a tool to assess dominance, and who contend that markets must be exactly delineated in order to calculate market shares and concentration indices.

³³ W H Boshoff *supra* 3

the Dominant Firms franchise model, as well as highlight exactly what alternative players exist in this market. The market definition exercise therefore helps us to assess the feasibility and possible effect of anti-competitive strategies – the heart of an antitrust inquiry.³⁴

In line with the hypothetical scenario referenced in part one, the Dominant Firm has altered the respective exclusive manufacturing agreements; meaning that there was a shift from the previous position where franchisee A and franchisee B manufactured the same products but had exclusivity over different geographical markets in South Africa (“Geographical Product Model”), to the current position where franchisee A manufactures sparkling juice beverage products and franchisee B manufacturer still juice beverage products in the entire country of South Africa (“SKU Product Model”).

Franchisee B’s failure to meet the required efficiencies has resulted in a decline in market share for the Dominant Firm’s products. It is suggested that should a dominant brand be excessively constrained commercially, the market segment growth will slow down; as such dominant players will either be unable to invest in innovation, or become despondent and pull out of the market altogether. It is submitted that it is possible that incorrect application of the Competition Act can in fact harm consumer welfare and weaken a Dominant Firm to such an extent that such Dominant Firm is squeezed out of the market.³⁵

As the competition regulator has elected to investigate both the Dominant Firm’s current operating model and previous model, it is imperative to touch on the day to day operating model of the tri-party relationship, where the franchisees participate in a quarterly system alignment forum; hosted by the Dominant Firm (“Alignment Forum”). The franchisees sit around a table in one room with each other during the Alignment Forum, and discuss category management and national account promotional initiatives.

³⁴ See W H Boshoff *supra* 2-3.

³⁵ Put differently, see the discussion in D Lewis “Building new competition law regimes: selected essays” Edward Elgar Publishing Limited UK (2013) 81-109.

Category management has the potential to provide significant benefits to suppliers, retailers and consumers³⁶; the process also has the potential to result in anti-competitive conduct. It is important for any of the players in this tri-party relationship to appreciate the risks from a competition law perspective, and ensure that there are guidelines implemented for all parties to follow, in relation to category management and during the Alignment Forum meetings; to avoid excessive information sharing and potential collusion.³⁷ Section 4(1) of the Competition Act³⁸ is relevant in considering if category management may facilitate collusion among retailers or manufacturers; Section 5(1)³⁹ of the Competition Act is relevant in considering if category management may be construed as a restrictive vertical agreement that lessens inter-brand and intra-brand competition; Section 8(c)⁴⁰ of the Competition Act and Section 8(d)(i)⁴¹ of the Competition Act are relevant in so far as considering if category management could result in a supplier abusing a dominant position, which could be considered as an “exclusionary act” or conduct that unfairly “requires a supplier or customer to not deal with a competitor”.

³⁶ T Woker ‘*Understanding the relationship between franchising and the law of competition*’ South African Mercantile Law Journal (2006) 107-120, comments at 110 that ‘because [franchisees] have tied into the franchisor’s most important asset, his trademark with its attached goodwill, the franchisor needs to exert considerable control over his franchisees. [The franchisor] must ensure that his trademarks are protected and that a national goodwill is developed that will enhance the investments made by the franchisor as well as other franchisees. A successful network depends on considerable co-operation and co-ordination between the parties and so restraints are imposed on the way in which these supposedly independent businesses function; See SE Wachstock & EL Amarante “*Antitrust and franchising: conspiracies between franchisors and franchisees under Section 1*” Franchise Law Journal 7 (2003) 12.

³⁷ T Woker (2006) *supra* 110 comments that ‘the extent of franchisor control has been the subject of extensive litigation in other jurisdictions, particularly in America, with one of the primary issues being whether franchising restricts competition in violation of competition regulations’.

³⁸ Section 4 (1) An *agreement* between, or *concerted practice* by, *firms*, or a decision by an association of *firms*, is prohibited if it is between parties in a *horizontal relationship* and if –

(a) it has the effect of substantially preventing, or lessening, competition in a market, unless a party to the *agreement, concerted practice*, or decision can prove that any technological, efficiency or other procompetitive gain resulting from it outweighs that effect; or

(b) it involves any of the following *restrictive horizontal practices*: (i) directly or indirectly fixing a purchase or selling price or any other trading condition; (ii) dividing markets by allocating customers, suppliers, territories, or specific types of *goods or services*; or (iii) collusive tendering.

³⁹ Section 5(1) an agreement between parties in a vertical relationship is prohibited if it has the effect of substantially preventing or lessening competition in a market, unless a party to the agreement can prove that any technological, efficiency or other pro-competitive, gain resulting from that agreement outweighs that effect.

⁴⁰ Section 8 provides that it is prohibited for a dominant firm to –

(c) engage in an exclusionary act, other than an act listed in paragraph

(d) if the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive gain.

⁴¹ Section 8 provides that it is prohibited for a dominant firm to –

(d) engage in any of the following exclusionary acts, unless the firm concerned can show technological, efficiency or other pro-competitive gains which outweigh the anti-competitive effect of its act –

(i) requiring or inducing a supplier or customer to not deal with a competitor.

In June 2009, the South African Commission initiated an investigation into the supermarket industry; wherein it probed into the conduct⁴² of supermarket chains Pick ‘n Pay, Shoprite Checkers, Woolworths and Spar, together with two wholesaler-retailers Massmart and Metcash (“Supermarket Probe”). The Commission identified several possible competition concerns one of which is the category management piece, wherein the Commission commented that:

category captains may gain access to sensitive information such as the sales volume data of all brands. This could potentially minimise inter-brand competition. Moreover, competitive exclusion may take place and the conduct could facilitate collusion. This has been the focus of extensive anti-trust concern in the US.⁴³

On 27 January 2011, the Commission announced that it had concluded its inquiry and declared that there were no contraventions that it had found during this probe into the food and agro-processing sector.⁴⁴ It is worthwhile however to note that the Commission noted that:

the dissemination of highly disaggregated information to suppliers [through third parties such as AC Nielsen and Synovate] may chill competition between suppliers.⁴⁵

For purposes of the hypothetical scenario and the ongoing material shared at the Alignment Forum, this comment is noteworthy since the information upon which the franchisees together with the Dominant Firm base their strategic business decisions, is could be informed by data from the same third parties, namely AC Nielsen and Synovate.

⁴² See Sutherland and Kemp *supra* 5-17; 5-25.

⁴³ Competition Commission, Press Statement, 29 June 2009 at <http://www.compcom.co.za/assets/Uploads/AttachedFiles/MyDocuments/29-June-09-Competition-Commission-to-probe-the-supermarket-industry.pdf> accessed on 14 September 2014.

⁴⁴ Competition Commission media release “*Competition commission findings of the supermarket industry probe*” (27 January 2011) accessed at <http://www.compcom.co.za/wp-content/uploads/2014/09/Supermarket-Investigation-Release.pdf>.

⁴⁵ Competition Commission media release (27 January 2011) *supra* 1-2.

2.6 THE EFFECT OF THE VERTICAL AGREEMENT ON COMPETITION

In context of the vertical relationship between the franchisees and the Dominant Firms, consideration should be given to the Dominant Firms conduct serves to lessen intra-brand of products, as well as if the vertical agreements in fact amounted to collusion by dividing and controlling markets.

The consideration for the Commission to review after receiving a complaint from Franchisee B is whether the Dominant Firm is abusing its buyer power. The abuse of buyer power was considered by the Commission in the Supermarket Probe, wherein:

concerns were raised that Supermarket chains may be abusing their buyer-power by placing onerous demands on suppliers, especially small suppliers. This includes practices such as exclusive supply arrangement, listing fees, slotting allowances, payment policies, return policies, promotional discounts and other rebates.⁴⁶

In the Supermarket Probe, the Commission found no contraventions of the Competition Act, however the scenario wherein the Dominant Firm elected to shift the franchisees from the Geographical Product Model to the current SKU Product Model, may yield a different finding, should one consider whether in the long run this conduct undermines the competitive process at this level of the supply chain.

It is suggested that should the Dominant Firm be in a position to do so, it would be justified in its contention that the franchisees are not competitors in either of Product Model's, given that the Dominant Firm determines the price of the products, among other elements of control. Should this assertion be accepted, one can further defend the notion that the participation of the franchisees in the Alignment Forums, does not amount to collusion.

⁴⁶ Competition Commission, Press Statement, 27 January 2011 available at <http://www.compcom.co.za/assets/Uploads/AttachedFiles/MyDocuments/Supermarket-Investigation-Release.pdf> accessed on 14 September 2014.

In then considering the SKU Product Model, the Dominant Firm could contend that the franchisees are now manufacturing and selling products from different markets, namely the sparkling juice beverage market and the stills juice beverage market; hence cannot be considered competitors. Further discussion will be deferred to Chapter 3 below.

It is however submitted that the above contention alone may be insufficient substantiation as the possibility that the franchisees may be competitors, cannot be rejected altogether. In the case of *Cancun Trading*⁴⁷, the Competition Tribunal found that each franchisee is an independent entity and that franchisors and franchisees are to be treated as competitors in the marketplace. In particular, the Tribunal found that the nature of franchising is inconsistent with traditional concepts of agency, because the franchisee invests his own capital in his own business, pays and is liable for operating expenses, absorbs his own losses and enjoys net profits⁴⁸

The aforementioned considered one may still take the view that the relationship between Dominant Firm and the franchisees is "essentially vertical". This means that Dominant Firm cannot 'do as it freely wishes'⁴⁹ in the forums but rather that the Dominant Firm needs to make sure that the vertical character of the relationship is maintained with its franchisees. It is also recommended that the parties consider implementing a competition law compliance policy.

Based on the above view on the "essentially vertical" relationship, and in considering the vertical restraints, it is submitted that the Dominant Firm's franchise model and overall business operations, as canvassed above, should withstand scrutiny by the Competition Commission following an investigation.

⁴⁷ *Cancun Trading & Others v Seven-Eleven Corporation SA (Pty) Ltd* (1999-2000) CPLR 173 (CT).

⁴⁸ *Cancun Trading supra* in par 31 at 181; T Woker "The franchise relationship and the problem of encroachment: *Silent Pond Investments CC v Woolworths (Pty) Ltd*" South African Mercantile Law Journal (2008) 402-413.

⁴⁹ T Woker (2008) *supra* 405 comments that nevertheless, although these are independent entities, franchisees are not free to develop their businesses as they see fit. Because they are buying into the franchisors' business model, franchisors exercise a great deal of control over the way in which their franchisees do business. This is a very unusual business relationship because although franchisees tend to own the assets of their businesses, someone else is entitled to tell them how to function. This leads to a relationship that is highly intimate and interdependent; see also G K Hadfield "Problematic relations: franchising and the law of incomplete contracts" Stanford Law Reports (1990) 42 877; 963.

2.7 THE POWER SHIFT

It is common cause that consumers in this juice beverage market shop according to price, therefore it is of utmost importance that competitors remain efficient in their value chain and efficiencies i.e. product innovation, successful promotional campaigns, positioning products as aspiration brands, punctual and reliable logistics or route to market, good prices, high product quality, stock availability especially during peak summer season. Consumers in the still juice beverage market are not necessarily brand loyal as there are not many incentives to stay with one particular juice brand, therefore will base their decision on which product brands to buy according to the factors mentioned above. As mentioned earlier, there are numerous players in the still juice beverage segment.

It is a primary role of franchisors to protect the interest of their networks and to develop their brands. Franchisors therefore have the right to ensure that they are able to protect those interests through the terms of their agreements with franchisees.⁵⁰ It can be accepted that prior to the shift in the Dominant Firms model to this new SKU Product Model, it was apparent that franchisee B was insufficiently investing into its manufacturing business and the result being that the Dominant Firm's market power in the broader juice beverage segment within franchisee B's territory was gradually declining, and several new brands were entering the market within this geography. A significant motivator behind the Dominant Firm's shift to the new SKU Product Model was in response to its products declining market share in the wider juice beverage market, as the Dominant Firm aims by reorganising its operations that it will recover some of the lost market share, or at the very minimum be well placed to counter any further loss in market share.

It goes without saying that the entry of these new still juice brands into the narrow still juice beverage market is positive for the market as it is indicative of the positive market health through the enhanced competitiveness in the wider juice beverage market. The entry of the

⁵⁰ T Woker *supra* 405.

several new juice brands has resulted in effective price competitiveness in that consumers now have more choice at better prices.

It is submitted that the mere decline in franchisee B's manufacturing performance and sales, is sufficient commercial grounds for the Dominant Firm to terminate the franchise agreement. It can be said that despite the vertical agreement under both the Geographical Product Model and SKU Product Model, the franchisees are able through their conduct, or lack thereof, to constrain the Dominant Firm from growing under the Geographical Product Model, within the designated territory; and under the SKU Product Model, within the still juice beverage market.

It is further recommended that the conduct of franchisee B; who is a player in the downstream market, also needs to be considered by the Commission, as such conduct indirectly serves to constrain juice beverage market growth, thereby causing a reversal of power in the vertical relationship between the parties.

CHAPTER THREE: EXTRACTION AND DISCUSSION OF THE APPLICABLE PORTIONS OF SOUTH AFRICAN LAW

3.1 INTRODUCTION

Section 3 of the Competition Act applies to all economic activity within or having an effect within South Africa. In light of the facts at hand and the current legislation, the Commission will have jurisdiction to investigate the alleged anti-competitive conduct of the Dominant Firm as raised by franchisee B.

As discussed in greater detail below, it would appear that the provisions of the Competition Act which may be relevant to an analysis of the potential competition law implications arising from the exclusivity provisions in the vertical agreement between the franchisees and the Dominant Firm; the arrangement in the horizontal relationship between the franchisees; and a general comment on the Dominant Firms manufacturing agreements; would be Sections 4(1), Section 5(1), Section 7 and Section 8(c) of the Competition Act⁵¹.

3.2 AN ASSESSMENT OF THE FACTS AT HAND UNDER SECTION 2 OF THE COMPETITION ACT

It is common cause that the purpose of the Act, as listed in Section 2, is to: promote and maintain competition in the republic in order –

- (a) to promote the efficiency, adaptability and development of the economy;
- (b) to provide consumers with competitive prices and product choices;
- (c) to promote employment and advance the social and economic welfare of South Africans;
- (d) to expand opportunities for South African participation in world markets and recognize the role of foreign competition in the Republic;
- (e) to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and
- (f) to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.

⁵¹ Act 89 of 1998.

3.3 ALLOCATING EXCLUSIVE TERRITORIES

From the discussions above, it should be accepted that the relationship between the franchisees and Dominant Firm under both the Geographical Product Model and SKU Product Model is a vertical relationship as the respective franchisees and the Dominant Firm are at different levels of the supply chain. The Competition Act recognizes that certain vertical agreements may have anti-competitive effects when it restricts the freedom of either party to the agreement to trade. “Agreement” is defined widely in Section 1 of the Act that states:

when used in relation to a prohibited practice, includes a contract, arrangement or understanding, whether or not legally enforceable.

The vertical restraints in the franchise model must be conducted through the lens of Sections 4(1) and Section 5 of the Competition Act⁵², respectively.

Section 5(1) of the Competition Act envisions what is termed the ‘rule of reason’ approach, which is sometimes referred to as the ‘effects based’ approach⁵³ to determining the anti-competitive and therefore unlawful nature of a vertical agreement such as the Agreement at hand. The discussion in the American case of *Federal Trade Commission v Indianan Federation of Dentists*⁵⁴ correlates to Section 5(1) of the Competition Act wherein the US adjudicators stated that parties to the Agreement may be able to exercise market power through the vertical Agreement as a:
surrogate for the proof of actual detrimental effects.⁵⁵

Section 5(1) of the Competition Act reads as follows:

An agreement between parties in a vertical relationship is prohibited if it has the effect of substantially preventing or lessening competition in a market, unless a party to the agreement can

⁵² Act 89 of 1998.

⁵³ L Kelly & T van der Vijver *supra* 251 where it is submitted that European dominance cases are increasingly effects-based.

⁵⁴ *Federal Trade Commission v Indiana Federation of Dentists* 476 US 447 (1986).

⁵⁵ *Federal Trade Commission supra* at par 461.

prove that any technological, efficiency or other pro-competitive, gain resulting from that agreement outweighs that effect.

The Commission is therefore left to discharge the burden of proof that the Agreement ‘has the effect of substantially preventing or lessening competition in a market’. Any legislative framework must not act in such a way that it protects franchisees that are simply not up to the task.⁵⁶

As concluded earlier, it is important from the outset when assessing any anti-trust conduct, to first determine the relevant market.⁵⁷ In this case one can accept that there are two separate and defined markets in question, namely the still juice beverage market and the sparkling juice beverage market.

It must then be considered if a) competition in the still juice beverage market is prevented or lessened to a substantial degree or b) the Agreement is the *de facto* cause of the anti-competitive results. It is submitted that there is a duo-effect that a vertical Agreement can take, which is the *de facto* or actual direct anti-trust effects (i.e. reduction in franchisee B’s output resultant from the migration to the SKU Product Model), or that the parties to the Agreement are able to exercise market power through the vertical franchise Agreement.⁵⁸ This notion will be discussed in further detail in Chapter four below.

The aforementioned approach is referred to as the ‘rule of reason’ or ‘effects based approach’ approach, and was considered in the case of *Netstar (Pty) Ltd v Competition Commission*⁵⁹. wherein the adjudicator held that to determine if the Agreement itself was the cause of the anti-trust result, the franchisee B or Commission must prove that the Agreement is the ‘necessary cause’ of a prevention or restriction of competition; and then must also go one step further and show that the Agreement is the ‘primary cause’ of the anti-competitive result. In order to have a material impact under Section 5(1) one of the parties must be dominant.

⁵⁶ T Woker “*Franchising – the need for legislation*” South African Mercantile Law Journal 55.

⁵⁷ See the discussion on how the relevant market should be defined in W H Boshoff *supra* 1-18.

⁵⁸ T Woker (2006) *supra* 111-112 considers the nature of the franchisor-franchisee relationship and the relationship between respective franchisees, she does so in light of the *Cancun Trading* case, see note 29.

⁵⁹ 17/CR/Mar05 at pars 231 - 235; this should be considered in the context of Section 4(1)(a) of the Competition Act, but its useful for the discussion at hand, in particular because Section 4(1) will be considered later on in this dissertation.

It can be accepted in the hypothetical scenario that if considered in light of the Geographical Product Model, the Dominant Firm would certainly be considered dominant insofar as the narrow market definition of sparkling juice beverage products; however the converse is submitted in the still juice beverage product market.

3.4 ABUSE OF DOMINANCE AND GENERAL EXCLUSIONARY CONDUCT

The Competition Act prohibits the abuse of a dominant position. Section 8 of the Competition Act prohibits a ‘dominant’ firm from engaging in certain conduct; however a prerequisite is that the firm in question (Dominant Firm) must be in fact established as dominant. Section 7 of the Competition Act in fact provides that:

A firm is considered to be dominant in a market if

- (a) it has at least 45% of that market;
- (b) if it has less than 35% of that market, but less than 45% of that market, unless it can show that it does not have market power; or
- (c) it has at least 35% of that market, but has market power.

Accordingly “Market power” is defined in Section 1 as:

the power of a firm to control prices, or to exclude competition or to behave to an applicable extent independently of competitors, customers or suppliers.

Establishing whether a firm is dominant, therefore, involves a calculation of the firm’s market share within the relevant market, as well as an assessment of its market power. Again this can, only be done once the market is defined⁶⁰

If the definition of the ‘relevant market’ is considered in the context of the aforementioned wider definition, one must use the ‘small but significant non transitory increase in the price’ test (“SSNIP test”).⁶¹ The SSNIP test involves an assessment of whether the franchisees

⁶⁰ W H Boshoff *supra* 1-18.

⁶¹ W H Boshoff *supra* 3; and See Kaushal Sharma ‘SSNIP test: A useful tool, not a panacea’ <http://cci.gov.in/images/media/presentations/SSNIPTestKKSharma260711.pdf> accessed on 30 October 2014.

customers would switch to readily available juice product substitutes, or to suppliers located elsewhere, in response to a “small but significant non transitory increase in the price” of the Dominant Firms juice beverage products. It is the writer’s view that in light of the trend of many new competitor products being launched in the still juice beverage category, one can accept that in a highly competitive market such as this, that price is a huge factor that consumers consider. That being said, if products are readily substitutable for each other, then those products belong in the same market, hence it is the writer’s view that the narrow approach to defining this market is the correct approach for the Commission to take in this matter. There is a growing consensus amongst economists and competition lawyers that market definition is very much fact-specific and that the market parameters that are relevant for a merger, may not necessarily be the same boundaries that would be relevant for an abuse of dominance case or a restrictive practice case.⁶²

The Dominant Firm in the hypothetical scenario’s ‘relative’ dominance in the wide market definition raises the question whether the conclusion of the franchises manufacturing agreements could be sailing too close to the wind and effectively carry the risk of the Dominant Firm abusing its position of dominance in both the market sparkling juice and still juice beverage markets; as well as in its vertical relationships with the respective franchisees.

In assessing the possible contravention of Section 5(1) of the Competition Act, there are two possible anti-competitive effects, namely the softening of both inter-brand⁶³ competition and intra-brand competition⁶⁴, that the Commission will need to make a finding and decision to refer to the Competition Tribunal or not. Section 8 of the Competition Act has two important provisions when considering the conduct of an upstream Dominant Firm which is Section 8(c) that prohibits the Dominant Firm in this case from engaging in ‘exclusionary acts’ which is where franchisee B would likely base his complaint of the new SKU Product Model, in terms of which it is now only entitled to manufacture and sell still juice beverage products, and in terms of which there are several competitor brands in the narrowly defined market.

⁶² Baker and Wu "*Applying the market definition guidelines of the european commission*" *ECLR* (1998) 19, 277.

⁶³ See the definition in clause 1.7 above.

⁶⁴ Again see the definition in clause 1.7 above.

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It is submitted that whether or not the Dominant Firm fails under Section 8 of the Competition Act, will be dependent on it demonstrating to the Commission that its conduct of implementing the new SKU Product Model gives rise to certain measurable pro-competitive efficiency benefits that outweigh any alleged anti-competitive effects.

The Competition authorities will consider the Dominant Firm's Agreement and accompanying conduct under the 'rule of reason' exploration. In other words, if the Dominant Firm can prove that the SKU Product Model will result in:

- a large number of previously disadvantaged individuals gaining critical employment and gaining a skill;
- a financial benefit for the South African government in the form of increased taxes directly resultant of the volume growth and profitability of a small to medium sized South African enterprise;
- improved product logistics with the result that consumers in remote outlying areas will now have access to sparkling juice beverage products;
- growth of the narrowly defined sparkling juice beverage market segment by increased investment into product innovation;
- bulk purchases will drive a significant reduction in costs of raw materials used in the product manufacture, which cost savings will be passed directly onto the consumer;
- a dedicated and improved route to market strategy which will drive improved product quality;

It is noteworthy to consider that the Commission could contend that the Dominant Firm's conduct by allocating territories under the Geographical Product Model and/or conduct of separating sparkling and still juice beverage portfolios to the respective franchisees in terms of the SKU Product Model, amounted to an abuse of dominance by a dominant firm in terms of Section 8(c) of the Competition Act which states that:

It is prohibited for a dominant firm to engage in an exclusionary act, other than an act listed in paragraph (d), if the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive gain.

An "exclusionary act" is defined as follows in in Section 1(1)(x) of the Competition Act:

an exclusionary act means an act that impedes or prevents a firm entering into, or expanding within a market.

3.5 RESTRICTIVE HORIZONTAL PRACTICES

The general concern with the Alignment Forums hosted by the Dominant Firm is for this forum to be used as a conduit to convey pricing information between franchisees, which raises concerns of price fixing between potential competitors in contravention of Section 4(1)(b) of the Competition Act, or alternatively give rise to the risk of anti-competitive information exchanges between competitors in contravention of Section 4(1)(b) of the Competition Act⁶⁵.

For purposes of a thorough consideration of restrictive horizontal practices under the hypothetical scenario, it may be assumed for the current purpose that the franchisees are in fact competitors. Section 4 of the Competition Act proscribes certain arrangements between entities which are ‘in a horizontal relationship’ with one another. Section 4(1) of the Competition Act provides:

an agreement between, or a concerted practice by, firms, or a decision by an association of firms, is prohibited if it is between parties and in a horizontal relationship and if –

- (a) It has the effect of substantially preventing or lessening the competition in the market, unless a party to the agreement, concerted practice, or decision can prove that any technological, efficiency or other pro-competitive gain resulting from it outweighs that effect; or
- (b) It involves any of the following restrictive horizontal practices:
 - (i) Directly or indirectly fixing purchase or selling price or any other trading condition;
 - (ii) Dividing markets by allocating customers, suppliers, territories, or specific types of goods or services; or
 - (iii) Conclusive tendering.

⁶⁵ The reader will recall the discussion in Chapter two around the consideration about whether or not the third party franchisees A and B are in fact competitors.

Importantly, in order for Section 4(1) to apply, it would have to be shown by the Competition Commission that there is a concerted practice⁶⁶ by the franchisees through the Dominant Firm. Should the Alignment Forums be carefully structured by the Dominant Firm who is conscious of the prevailing competition laws, and accordingly ensured that the franchisees only dealt with each other at an arm's length basis, it is submitted that the Competition Commission would fall short in discharging the onus of proof of the existence of a concerted anti-competitive practice or agreement.

It is submitted that further considerations are the duration of the exclusivity Agreements, a consideration of the Agreement termination provisions, penalties for termination or breach thereof, and whether the alleged abuse is believed to still be continuing. If the agreement is for ten years for example, the Commission's case gets stronger. The shorter these exclusivity Agreements are, the weaker the Commission's case, as any threatened damage to competition in the market can be justified through the proposition that the potentially unfair effects are contained and somewhat limited⁶⁷. In the case at hand however, the converse occurs in that these exclusivity Agreements with the respective franchisees have been longstanding.

To succeed with a case under the restrictive horizontal practices umbrella, it would also serve as imperative that the Commission show that as a direct result of the migration to the new SKU Product Model, its business has suffered significantly, thus proving that the old exclusivity agreement where it *firstly* was limited to a predetermined geographical territory and *secondly*, participated in manufacturing the broader juice beverage products (which included sparkling products), was so important to franchisee B's success, that it now cannot successfully compete in the market.⁶⁸ It is the writer's view that the Commission would struggle to present a convincing case in this regard. The case of *York Timbers*⁶⁹ becomes of

⁶⁶ See definition of terms in clause 1.7.

⁶⁷ See a discussion on the duration of the exclusivity arrangements in Slaughter and May "*The EU competition rules on vertical agreements*" (May 2012) 43 at <http://www.slaughterandmay.com/media/64575/the-eu-competition-rules-on-vertical-agreements.pdf>.

⁶⁸ See generally HJO van Heerden & J Neethling "*Unlawful Competition*" (1995) op cit note 22 at 12 wherein it is discussed that 'it is generally recognised that free competition carries within itself the seeds of its own destruction by creating the possibility of the formation of cartels and monopolies'.

⁶⁹ See *York Timbers Ltd v South African Forestry Company Ltd* 15/IR/Feb01 wherein York Timbers complained that SAFCOL had abused its dominance by terminating York Timbers' guaranteed level of supply of raw logs under the contract between the parties.

relevance as it was the first of the Tribunal cases to consider monopoly leveraging.⁷⁰ Insofar as monopoly leveraging was concerned, the Competition Tribunal first recognised that the effect of a dominant firm's abuse may be in a related market where the firm is not dominant.⁷¹ But the Competition Tribunal qualified this by stating that, in such a case, the complainant must establish that the dominant firm is, "by drawing on its power in the market in which the dominant, attempting to create or to exercise market power in this related market".⁷² Later in the judgement the Tribunal proceeded to apply a quote from Areeda and Hovenkamp⁷³ by stating:

Following Areeda and Hovenkamp, what is rather at issue is whether the dominant firm, SAFCOL⁷⁴, has attempted to use – or 'abuse' – its dominance to extend or preserve its dominant position, what US antitrust jurisprudence refers to 'monopolization'.⁷⁵

In discussing the effects of the Dominant Firms conduct on the downstream market, the Competition Tribunal in *York Timbers* commented that:

We do not believe that the applicant has established an abuse of dominance, that is we do not believe that the respondent has, by its alleged refusal to supply York extended, preserved, created or threatened or threatened to create power in the downstream market.⁷⁶

In essence Sections 4, 5 and 8 of the Competition Act consider whether or not it could be shown that the franchisees manufacturing agreements under the respective or collective Geographical and/or SKU Product Models have a foreclosing effect on franchisee B or third party competitors or aspiring competitors who wish to enter the market.

⁷⁰ P Sutherland & K Kemp "Competition Law of South Africa" Lexis Nexis (2013) 6-7.

⁷¹ *York Timbers supra* at par 71.

⁷² *York Timbers supra* at par 71.

⁷³ Areeda and Hovenkamp "Antitrust law" IIA North America Hart Publishing (2009) 94.

⁷⁴ South African Forestry Company.

⁷⁵ See *York Timbers supra* at par 95.

⁷⁶ *York Timbers supra* at par 97.

CHAPTER FOUR: VIEWPOINTS AND DISCUSSION ON EXISTING SOUTH AFRICAN LAWS AND INTERNATIONAL PRINCIPLES, TO THE HYPOTHETICAL SCENARIO

4.1 DEFINING THE RELEVANT MARKET

The relevant market in each case must be identified with reference mainly to two factors: a particular product or service and a geographical area. Substitutability is the key concept to be applied when identifying and analysing the dimensions of the market. The European commission has defined a relevant product market in its notice on the definition of the relevant markets⁷⁷ as comprising:

all those products and/or services which are interchangeable or substitutable by the consumer, by reason of the products' characteristics, and their intended use.

It is submitted that if upon a change in their relative prices, products are readily and speedily substitutable for each other, either by consumer or suppliers, then those products belong in the same market.

The Dominant Firm contends that by signing up the franchisees as manufacturers of its products, the Dominant Firm is able to utilise the franchisees available manufacturing capacity at its plants, thereby improving the franchisees respective assets and leveraging the franchisees overhead expenses.⁷⁸ The franchisees that are appointed by the Dominant Firm are preferably majority black owned enterprises or are controlled by previously disadvantaged individuals.

⁷⁷ Official Journal OJ C 372 of 9 December 1997.

⁷⁸ See Sutherland and Kemp *supra* 1-31 and the references made to the way in which the goals of competition law are utilized by Harvard scholars; see C Kaysen & D F Turner "*Antitrust policy: an economic and legal analysis*" Harvard University Press (1959) wherein it is submitted that, Firstly, competition law should ensure that competition achieves desirable economic results for firms and the economy as a whole. Emphasis is placed on two particular aspects. Initially competition law should promote competition for the purpose of ensuring "the achievement of the largest number of outputs from the available bundle of resources", in other words the productive and allocative efficiency. Secondly considerable emphasis is placed on dynamic efficiency and the promotion, or the development, of new and cheaper production methods and new products; Sutherland & Kemp *supra* 1-31 comment definitively that the promotion of efficiency is the most important, desirable, economic result of competition.

4.2 SOUTH AFRICAN CASE LAW

The recent decision of *Woolworths*⁷⁹ deals with the common franchisee complaint of encroachment. This problem has plagued franchise relationships in other jurisdictions such as the United States of America, among others, for many years, and as franchising becomes more popular in South Africa, this issue will probably become the focus of further litigation. The Franchise Association of South Africa (“FASA”) states that South Africa has one of the fastest-growing franchise markets in the world.⁸⁰ Encroachment is a problem because expansion and consumer demand may eventually mean that an outlet is established within the jurisdiction of an existing franchisee, which now has to compete with that new outlet. The judgement of the court in the *Woolworths case* centred on the concept of good faith and its application in the law of contract. Morley AJ stated that:

[a duty was imposed] upon the parties to exercise good faith in the implementation of the contract as a whole.⁸¹

Morley AJ in *Woolworths* referred to various decisions in South Africa⁸², in which this concept has been comprehensively examined. The court further pointed out that the duty of good faith was a mutual duty. The court further held that the relationship between the franchisor and the franchisee was an arm’s length, commercial relationship where both parties were promoting and protecting their own interests. It is relevant to consider the constitutional court decision in *Barkhuizen v Napier*⁸³ wherein Ngcobo J confirmed that good faith gives substance to the concept of public policy; however he declined to investigate how extensive a role of good faith should play in the law of contract.⁸⁴

⁷⁹ *Silent Pond Investments CC v Woolworths (Pty) Ltd & Another* ([2007] JOL 20088 (D); 2007 JDR 0547 (D)).

⁸⁰ See FASA Newsletter 15 January 2005.

⁸¹ *Woolworths supra* in pars 52-66.

⁸² *Mutual and Federal Insurance Co Ltd v Outshoorn Municipality* 1985 (1) SA 419 (A); *Bank of Lisbon and South Africa v De Ornelas & Another* 1988 (3) SA 580 (A); *Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman NO* 1997 (4) SA 302 (SCA); *Brisley v Drotosky* 2002 (4) SA 1 (SCA); *Afrox Healthcare Bpk v Strydom* 2002 (6) SA 21 (SCA); *South African Forestry Co Ltd v York Timbers Ltd* 2005 (3) SA 323 (SCA).

⁸³ 2007 (5) SA 323 (CC).

⁸⁴ T Woker *supra* at 404.

The adjudicator in *Woolworths* also found that the parties intended their franchise relationship to be a fiduciary⁸⁵ one. Although the notion that the franchisor owes the franchisee a fiduciary duty is an attractive one, this approach has now been rejected in other jurisdictions because franchising does not accord with the true principles of a fiduciary relationship.

In *Natal Wholesale Chemists and Astra Pharmaceuticals*⁸⁶ the Competition Tribunal confirmed that concrete evidence would be required in support of a claim that purports to identify anti-competitive consequences flowing from a vertical agreement in terms of Section 5(1) of the Competition Act, wherein it was held that:

Anti-trust scholarship and jurisprudence conventionally adopts a sceptical attitude to claims of anti-trust harm rising from all species of vertical agreement. In particular it is widely recognised that the diminution of intra-brand competition consequent upon exclusive distribution arrangements is frequently compensated for by pro-competitive benefits that enhance the ability of the producer to compete against its competitors, that is, by the strengthening of inter-brand competition (writer's emphasis). This general approach, which we follow, is recognised by the claimants in the present matter. We stress that this does not mean that we propose following the influential scholarship that argues for treating vertical agreements as legal per se. It simply serves to underline the requirement, even under the less vigorous evidentiary burden that attaches to an application for interim relief under the amended [Competition] Act, to provide concrete evidence in support of a claim that purports to identify anti-competitive consequences flowing from a vertical agreement. When examining the exclusive vertical agreements, rather than attempting to define the relevant market in the abstract, we will ask ourselves whether the exclusionary right will give one or both parties to the arrangement the power to raise prices in the market. "Competition will be harmed only if, as a result, prices can be raised above the competitive level. In other words, claims of anti-trust harm resulting from vertical arrangements should generally be treated with scepticism and any perceived decline in intra-brand competition resultant from the exclusive distribution was frequently compensated for by other pro-competitive benefits.⁸⁷ The Tribunal also explained that commercial harm to a party due to a vertical restraint is not sufficient to prove a vertical prohibited practice – antitrust harm has to be shown⁸⁸ or proven.

⁸⁵ T Woker *supra* at 406 defines a fiduciary as someone who must act primarily for the other's benefit and not for his own benefit. The principal is entitled to receive a 'single-minded loyalty' from his fiduciary; see D M Walker "*The oxford companion to law*" Oxford Clarendon Press (1980) 468.

⁸⁶ 98/IR/Dec00 pars 39-40, 60.

⁸⁷ *Natal Wholesale Chemists supra* at par 40.

⁸⁸ *Natal Wholesale Chemist supra* at par 40.

In interpreting Section 8(c), the Competition Tribunal held in the case of *York Timbers*⁸⁹ that Section 8(c) places an onus on the applicant, and that:

even if the practice complained of were to be established as an impediment to the applicant's expansion in the market, it still remains for the applicant to establish the 'anti-competitive effect' of the practice, to show, in other words, that market power has been created or extended in consequence of the alleged act. [Even] if anti-competitive effects had been established, the applicant would have to show that these outweighed any pro-competitive gains.

Once it has been established in line with Section 8(c) that a Dominant Firm has engaged in an "exclusionary act" the question to be considered is whether this "exclusionary act" has an anti-competitive effect. In the *SAA*⁹⁰ case, the Tribunal found that this question will be answered favourably where there is *firstly*, evidence of actual harm to consumer welfare; or *secondly*, the exclusionary act is substantial in terms of its effects in foreclosing the market to rivals. This latter conclusion is partly factual and partly based on reasonable inferences drawn from proven facts.

In the *York Timbers* case, the approach was whether the conduct would create, increase or maintain the market power of the Dominant Firm. The Competition Appeal Court affirmed the earlier view of the Tribunal that:

It is not enough to show that a given practice is a product of market power. It must also be shown that the act complained of actually extends that power or creates new sites of power.⁹¹

This being considered, it remains common cause that if it is demonstrated that there is anti-competitive behaviour, the Dominant Firm must then show that there are efficiencies which outweigh the anticompetitive effect of its conduct. The Tribunal has recently in its decision in the *Senwes*⁹² court case elaborated on the evidential onus which this places on a respondent and stated that:

even if the respondent firm raises what purports to be an objective justification, unless that justification, objective considered, and before balancing takes place, is a rational justification, the

⁸⁹ *York Timbers supra* at par 100.

⁹⁰ *SAA v Comair Limited case 92/CAC/MAR10 (CAC)* at par 132.

⁹¹ *York Timbers supra* at par 99.

⁹² *The Competition Commission v Senwes Limited 110/CR/Dec06* at par 173.

balancing exercise need not be embarked upon, because a defence will not have been properly held to have been raised. One can only balance considerations of anti-competitive effects versus pro-competitive gain once one has two weights to place on either side of the scale. If there is no objective justification, there is no weight to be placed as a counterbalance on the scale.

In order to justify the anti-competitive behaviour, the Dominant Firm must then show that there are efficiencies which outweigh the anticompetitive effect of its conduct. These efficiencies have been discussed in Chapter three above, so the Dominant Firm in the hypothetical scenario should successfully clear this requirement.

In the recent edition in a case involving two rival tobacco manufacturers *JTI v BATSA*⁹³, the Tribunal provided useful guidance as to how to consider allegations that a Dominant Firm has contravened Section 8 (c). The Competition Tribunal stated that:

In order to sustain an allegation of abuse of dominance anti-trust harm must be demonstrated. We have also held that such harm may be inferred from a direct loss of consumer welfare or from a significant degree of foreclosure. However, not only must foreclosure be shown; the foreclosure must also be shown to have derived from the alleged anti-competitive conduct. In other words where elements of the foreclosure may reasonably be inferred to have occurred in consequence of conduct beyond the reach of competition law, then we cannot necessarily conclude that the foreclosure amounts to anti-trust harm.

In respect of the subsequent allegation that BATSA's conduct contravenes Section 8(c) the court commented that:

in the absence of evidence of significant foreclosure, the impugned conduct cannot be said to be exclusionary, that is, it cannot be shown that the conduct impedes or prevents a firm entering into, or expanding within a market.⁹⁴

From the above an inference can be drawn that South African anti-trust (competition) regulators lean towards an "effects based" approach to abuse of dominance cases and therefore, any challenge to the exclusivity provision contained in the Agreement between the Dominant Firm and its franchisees, would have to be supported by a detailed analysis of the likely effect that the territorial and product exclusivity provisions would have on the relevant markets; and it is submitted that analysis has sufficiently been canvassed at length earlier. The crux therefore

⁹³ *JT International South Africa (Pty) Ltd v British American Tobacco South Africa* 55/CR/Jun05 at par 110.

⁹⁴ *JTI v BATSA supra* at par 300.

lies with whether or not the Commission and franchisee B can show that the exclusivity has a foreclosing effect, in line with Section 8(c).

4.3 AMERICAN CASE LAW

The principle of good faith has featured in numerous franchising matters in the United States of America because Section 1-203 of the Uniform Commercial Code provides that ‘every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement’. In addition some American states have introduced franchise-specific legislation that is quite diverse. A common thread, though, is the requirement that franchisors act in good faith in their dealings with franchisees. This duty requires that each party perform under the contract in such a way as to ensure that the purpose of the contract is achieved, and that the parties may not act to undermine the other party’s rights to enjoy the contract benefits⁹⁵. In *Sherman v Master Protection Corporation*⁹⁶. The California Appeals Court held that a franchisor had breached the implied covenant of good faith and fair dealing by the way in which it phased out its franchise operation in order to replace it with an employee-based business⁹⁷.

Relying on the duty of good faith that underlies all contracts is unproblematic in circumstances where the contract is silent on a particular issue⁹⁸, as was the case in *Sherman* (and the court awarded the franchisees damages). It is noteworthy that the hypothetical scenario differs to *Sherman* as the Agreement with franchisee B does provide that the parties act in good faith at all times, and it is arguable in favour of the Dominant Firm that franchisee B has indeed through its conduct over several years, been in breach of this provision.

It is submitted that the question whether this implied duty will trump an express provision is far more problematic, and generally the courts will not imply a duty of good faith if this would be inconsistent with the express language of the franchise agreement.

⁹⁵ See discussion by Matthew Moloshok “*Constraints against termination of dealers and franchisees*” The American Bar Association (2005).

⁹⁶ Cal Ct App Dec 18, 2002.

⁹⁷ *Sherman* case *supra* at 318.

⁹⁸ T Woker *supra* 409.

The United States Supreme Court judgement in *Pacific Bell v LinkLine Communications Ins*⁹⁹ (“LinkLine”) unanimously rejected the idea that a margin squeeze is an abuse of a dominant position.¹⁰⁰

⁹⁹ *Pacific Bell v LinkLine Communications Ins* US Supreme Court No 07-512 [2009].

¹⁰⁰ L Kelly & T van der Vijver “*Less is more: Senwes and the concept of margin squeeze in South African competition law*” *South African Mercantile Law Journal* (2009) 246.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

The complaint by franchisee B involves allegations of anticompetitive agreements that are a combination of vertical and horizontal restrictions prohibited in terms of Sections 4 and 5 of the Competition Act. There are three major possible restrictive practices introduced by the hypothetical scenario within the Dominant Firm's value supply chain. The *first* practice relates to a horizontal agreement by franchisee A and franchisee B to fix the selling price of the Dominant Firm's products that fall within the wider juice beverage products market, which is a possible contravention of Section 4(1)(b)(i) of the Competition Act. The *second* practice relates to a vertical agreement between the Dominant Firm and the respective franchisees in a vertical relationship, which is governed by respective vertical exclusivity agreements, wherein the Dominant Firm allocates exclusive territories to each of the respective franchisee manufacturers, a possible contravention of Section 4(1)(b)(ii) and 5(1) of the Competition Act. The *third* practice relates to minimum resale price maintenance by the Dominant Firm and the franchisees, which is viewed in light of the possible dampening of intra-brand competition under both the Geographical Product Model and SKU Product Model, and inter-brand competition, which is a possible contravention of Section 5(1) and 5(2) of the Competition Act. It would be my recommendation to the Dominant Firm that should the Commission investigate the complaint based on the evidence available in the hypothetical scenario and in light of the discussions and considerations raised throughout this dissertation. The Commission would have insufficient grounds (as things stand) to refer the matter to the Competition Tribunal for determination. The basis of this view is discussed below with reference to the aforementioned respective alleged restrictive practices.

5.2 CONCLUSIONS

It is submitted that although concerns around the design of the Dominant Firm's business operating model in South Africa cannot be ignored; in particular as far as this model promotes and facilitates a potential tri-party horizontal relationship that could result in collusion and price

fixing, the nature, purpose and effect of the arrangement between the Dominant Firm and the franchisees remains essentially vertical, and would as things stand, pass scrutiny under the microscope of a possible contravention of Section 4(1)(b)(i) of the Competition Act. Regarding the possible contravention of Section 5(1) of the Competition Act, two-anticompetitive effects can possibly arise from the exclusivity clauses in the Agreements between the Dominant Firm and its product manufacturing franchisees, namely vertical softening of inter-brand competition which could result in foreclosure of third party competitor brands, and the stifling result of competition within the Dominant Firm's own juice beverage product brands. It is noteworthy to appreciate that the latter challenge relating to intra-brand competition, could be resultant under both of the Dominant Firms Geographical and SKU Product Models.

Should the Dominant Firm wish to successfully defend its position, it should consider demonstrating that the effects of the contracts exclusive dealing clauses will not have the effect of substantially lessening or preventing healthy competition in the market, irrespective of which market definition is considered, be it the narrow or wide market definition. In fact it should be put to the Commission that franchisee B's continuous non-performance in line with its deliverables under the Agreement, should in fact be the subject of an investigation¹⁰¹, as it has resulted in the Dominant Firm's continuous loss of market share, market power, and seen growth being significantly stifled in the still juice beverage category; to the ultimate detriment of the consumer. Ultimately it should be accepted that rigorous economic analysis lies at the heart of sound competition law policy¹⁰².

Whilst it may be accepted that Franchisors have the right to protect their business interests by driving a hard bargain, but they cannot overlap the mark by engaging in conduct that is unconscionable.¹⁰³ Then again, franchisees should not be able to rely on the legal system to sustain their business interests in circumstances where they are incapable of operating a business

¹⁰¹ See D. Lewis *supra* 99-100, wherein Janice Bleazard comments that 'The Competition Commission and the Competition Tribunal are tasked under the Competition Act with large and complex mandates and the success of their work has become a core tenet of South Africa's macro-economic policy. However the Commission and Tribunal are battling against firms that are accustomed to operating free of the strictures of competition law, according to their own rules of practice. These firms [such as franchisee B] readily resort to litigation over technical matters and vexatious litigation by well-sourced respondents, threatens to overwhelm the Commission and the Tribunal, and to undermine the pursuit of their mandates.

¹⁰² L Kelly & T van der Vijver *supra* 254.

¹⁰³ D. Lewis *supra* 99-100.

successfully.¹⁰⁴ The court in *LinkLine*¹⁰⁵ raised certain institutional concerns and the court appeared to suggest that the claimants should adequately assess which court is the most appropriate to approach when looking to assert their rights. Lastly, the courts believed that a rule mandating on ‘fair’ and ‘reasonable’ margins for competitors would be objectionable, since it left vertically integrated firms ‘no safe harbour for their pricing practices’.¹⁰⁶

With a major player being effectively squeezed out of the market¹⁰⁷, there is no leader in innovation which could grow the market segment by introducing new still juice beverage product innovations, which would then see the smaller competitors over time launching cheaper substitutes to the Dominant Firm’s product innovations. A key example of this would be that of The Coca-Cola Company’s launch of glacéau vitaminwater and Woolworths subsequent launch of its own variety of the product innovation. In fact it would be my recommendation to the Dominant Firm that it should aim to demonstrate to the Commission that the pro-competitive gains of the new SKU Product Model in fact outweigh any anti-competitive effects brought under Section 8(1)(c).

The Commission should demonstrate harm to the competitive process rather than to an individual competitor (franchisee B) and also the period over which this harm occurred. It’s not enough to show that franchisee B alone is now bankrupt resultant from the new SKU Product Model, but evidence of how other market players (if any) have been harmed must be evidenced by the Commission. What makes the case at hand more complicated for the Commission to prove anti-competitive effects is that this market is highly competitive and it appears from the recent influx of still juice beverage products, that the barriers to entry are relatively low. The Commission further needs to prove that franchisee B’s demise is a direct result of the Dominant Firm imposing these exclusive Agreements, and its removal from the market flowing from the Dominant Firm’s clear wish to terminate franchisee B’s Agreement, could mean the removal of an effective competitor and therefore harm to competition. One could go even further to say that

¹⁰⁴ T Woker (2005) *supra* 55.

¹⁰⁵ *LinkLine supra par* 13-14.

¹⁰⁶ L Kelly & T van der Vijver *supra* 252.

¹⁰⁷ See L Kelly & T van der Vijver *supra* 254 where they state that the recent “interpretation of a margin squeeze as a distinct abuse in terms of Section 8(c) of the [Competition] Act is a welcome development, [as] it enables challenges to behavior which may severely disrupt competition, and which would otherwise not be dealt with.

the Commission must show that the effect of the substantial lessening of competition; excluding franchisee B and migrating the entire sparkling and still juice beverage business to one franchisee A, would be detrimental to consumers. This will be a mammoth task for the Commission if one simply begins by considering the Dominant Firm's still juice beverage products continuous declining market share (resultant from franchisee B's poor performance) and secondly in light of the several pro-competitive gains referenced in Chapter three.

The Dominant Firm's competitors have access to alternate manufacturing capacity, as is evident from multiple players breaking into the juice beverage market. In particular the production and product distribution assets are not specialized. On the basis of the information that has been discussed and debated in this dissertation, and having regard to the competition law considerations set out above, the writer is satisfied that these franchisees manufacturing Agreements which the Dominant Firm is implementing, will not expose the Dominant Firm to competition law infringement risk following the investigation triggered by franchisee B's complaint. The Agreements when considered in light of the facts in the hypothetical scenario will not see the Dominant Firm fall foul of local anti-trust regulations in that it does not 'substantially prevent or lessen competition' in the relevant markets, as is required for a contravention to be established.

5.3 VIEWPOINTS AND RECOMMENDATIONS

The Commission's concern in relation to the franchisees manufacturing agreements, upon which franchisee B based its claim, should arise if the following situations are present, namely (i) the Dominant Firm holds a significant market position and there is a lack of productive capacity in the juice beverage product market; (ii) there are significant barriers to entry into the juice beverage product market; and (iii) companies that occupy a position of market power have concluded manufacturing agreements that effectively ties up the limited productive capacity available. It is evident in the hypothetical scenario at hand, that this is most certainly not the position. If one for a minute deviates from the reality of the current scenario, and assumes for purposes of closing the loop on this discussion, that the three factors above, are in fact present, then only in such instance would these factors potentially lead to a situation where there is a substantial lessening or preventing of completion in the market, meaning that competitors and/or

new entrants will not readily be able to increase output, which may lead to the exclusion of rivals by the Dominant Firm who would have successfully tied up the available capacity. Fortunately for the Dominant Firm and franchisee A in this case, the fictional position is unreal.

On the basis of the information in the hypothetical scenario, and having regard to the relevant competition law considerations set out above, one could comfortably take the view that the franchisees manufacturing agreements that the Dominant Firm has historically issued under the Geographical Product Model, as well as that which it currently has in place with the franchisees in terms of the SKU Product Model, would not expose the Dominant Firm to risk from a competition law perspective. Furthermore, as set out in more detail above, there are technological and other efficiency benefits arising from the franchisees manufacturing agreements model which would, if necessary, outweigh any perceived anti-competitive effects. In addition the Dominant Firm invests a significant amount of capital into each of the respective franchisees, whom are both small to medium size local enterprises, which is a significant pro-competitive benefit which would be favourably considered by the competition authorities. In order to minimize the potential risk associated with Section 4(1) of the Competition Act, the Dominant Firm must ensure that interactions at the Alignment Forum is limited to that which is strictly required between a principal and its customers on an “arms-length” basis. This will ensure that the Alignment Forum is not perceived to be a conduit to convey pricing information or any form of collusion, in contravention of Section 4(1) of the Competition Act.

On the assumption that a potential complainant, franchisee B, could demonstrate that the Dominant Firm is in fact dominant, the principal difficulty which it would then face is that it would have to demonstrate that the exclusive arrangement between the Dominant Firm and its respective franchisees, under either or both Models, in relation to its juice beverage products (in whichever the narrow or wide market) has the effect of foreclosing competitors from the juice beverage market, and, that this has an anti-competitive effect.

The Dominant Firm should carefully consider the provisions that relate to exclusivity relating to geography or products, with reference to the prevailing market conditions at the time of issue or renewal of these Agreements, each and every time, in order to assess any competition law risks. Lastly, in relation to its Alignment Forum, the Dominant Firm should implement a category management policy and a competition law policy with guidelines for all parties in this tri-party relationship to adhere to.

Franchising is a relatively new concept in South Africa and there are only a few decisions to provide guidance. Whilst it is useful to consider what is happening in foreign jurisdictions particularly the United States of America which is regarded as the home of franchising, it must always be borne in mind that franchising in South Africa is developing in a very different social and political climate.¹⁰⁸ Generally speaking, the goal of competition regulation is to ensure economic efficiency. However, in South Africa there are further goals, including economic upliftment and the development of small business. This is all the more reason why it is necessary for the competition authorities to develop a detailed policy for franchising and to reconcile the ideals of competition policy with the concept of franchising¹⁰⁹ which by inference is presupposed on the existence of an agreement, and therefore the law of contract. Certain franchise restraints do conflict with the competition laws and a lack of certainty regarding the authorities' approach may mean that successful entrepreneurs, especially foreign investors, decline to enter the South African market, choose not to adopt the franchise model¹¹⁰, or withdraw from the South African market altogether, in favour of an alternative Southern Africa neighbour.

If government is to succeed in its desire to promote small businesses, it is essential that a cost-effective and quick means of resolving disputes be developed to deal with franchise disputes. Such a dispute-resolving mechanism must also take into consideration the fact that the relationship between the franchisor and the franchisee is ongoing and so it is important that disputes be resolved in a manner that enhances and protects that relationship. The capacity of government, namely the Department of Trade and Industry, to play an effective role in resolving business disputes is a critical issue that needs to be considered¹¹¹ thoroughly, and as a matter of significant priority, by the state legislature.

In closing it is submitted that relationship issues between a franchisee and franchisor must continue to be primarily governed by the contract entered into by the parties; and only where there is a clear violation of the Competition laws, should the South African Competition authorities be burdened with such a dispute, and well-resourced parties should avoid vexatious-

¹⁰⁸ See also comments by Davis J in *Federal Mogul Aftermarket Southern Africa (Pty) Ltd & Others v Competition Commission* (unreported case 08/CR/Feb01).

¹⁰⁹ T Woker (2006) *supra* 120.

¹¹⁰ T Woker (2006) *supra* 120.

¹¹¹ T Woker (2005) *supra* 56.

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litigation that serves to overwhelm the Competition Commission and manipulate the purpose of the Competition Act.

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