South African Competition Law's approach to Dual Distribution Arrangements

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SUMMARY

Dual distribution arrangements are arrangements that, for the purposes of competition law, can simultaneously be classified as vertical and horizontal. In terms of the Competition Act No, 89 of 1998 ("the Act"), the actions that can be taken, and the legal consequences of those actions, are vastly different depending on the type of relationship between the parties. Unlike in a conventional horizontal relationship, in a dual distribution arrangement the manufacturer creates competition with itself. This type of hybrid relationship has confused competition authorities, as it is difficult to decide whether the horizontal or vertical aspect should prevail in order to characterise the agreement. In some instances, competition authorities have elected to disregard the other elements of the relationship and prosecute parties for contraventions of the Act based purely on one dimension of the relationship.

Manufacturers are often placed in difficult positions when concluding these types of arrangements as it is unclear how the competition authorities will characterise such agreements. The purposes of the Act, imply that the focus should not solely be on the letter of the Act but also on *inter alia* detecting and addressing conditions in the market that tend to impede, restrict or distort competition in connection with the supply or acquisition of goods and services. It is submitted that the pro-competitive benefits of these arrangements must also be considered. Although the Competition Appeal Court in *Competition Commission v South African Breweries and others* 2015(3) SA 329 (CAC) provided some clarity on the legality of such agreements by requiring that the agreements be characterised as different, it failed to provide absolute certainty on the treatment of all such agreements.

This dissertation will consider how other jurisdictions, which have had competition laws for much longer than South Africa, treat such arrangements in order to gain insight from their experience. Further, it will look at the development of the South African competition authorities approach to such arrangements, and will make proposals regarding their treatment going forward.

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1 CHAPTER ONE: BACKGROUND TO THE STUDY

1.1 Introduction

South Africa's competition law is largely concerned with ensuring free and fair competition amongst businesses.[1] The first comprehensive piece of legislation regulating competition law in South Africa was the Regulation of Monopolistic Conditions Act 24 of 1955 ("the 1955 Act"). The 1955 Act was considered ineffective, as it did not contain provisions that adequately discouraged firms from engaging in anti-competitive practices.[2] As a result, a review of the South African competition policy was conducted by the Commission of Inquiry into the Regulation of Monopolistic Conditions Act ("the Mouton Commission"). The Mouton Commission found that the 1955 Act's main weakness was its inability to deal effectively with the impact of economic concentration and its effect on competition.[3] The Mouton Commission consequently recommended the rectification of a number of deficiencies identified in the 1955 Act and ultimately a new piece of legislation was introduced, being the Maintenance and Promotion of Competition Act 96 of 1979 ("the 1979 Act"). The 1979 Act included provisions that allowed for investigations into suspected monopolistic conditions and mergers, and the establishment of an autonomous body being, the Competition Board.[4] Unfortunately, the 1979 Act also proved to be ineffective in that it failed to address anti-competitive conduct and there was also an overall lack of competition law expertise in the country at the time to adequately address anti-competitive conduct.[5]

Finally in 1997 the Department of Trade and Industry published its *Proposed Guidelines for Competition Policy*[6] which stipulated fundamental principles that set out the government's competition policy. These guidelines formed the basis of the

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[1]Van Heerden-Neethling *Unlawful Competition* (2008) Lexis Nexis: Durban (herein after referred to as Van Heerden-Neethling) at 10.
[2]Prins and Koornhof "Assessing the nature of competition law enforcement in South Africa" 2014 18 *Law Democracy and Development* 136 (herein after referred to as Prins and Koornhof) at 138.
[3]Report of the Commission of Inquiry into the Regulation of Monopolistic Conditions Act 24 of 1955 at 66.
[4]Van Heerden-Neethling at 24.
[5]For example as set out by Prins D and Koornhof P, the 1979 Act "specifically provided that certain violations were to be treated as criminal offences. However this was unsuccessful in addressing anti-competitive conduct due to high rates of more serious crime dominating investigative resources, and a lack of expertise in competition matters on the part of investigating and prosecuting officers."
[6]Department of Trade and Industry, Proposed Guidelines for Competition Policy: A Framework for Competition, Competitiveness and Development (1997). Competition Law and Policy in South Africa An OECD Peer Review https://www.oecd.org/daf/competition/prosecutionandlawenforcement/2958714.pdf at page 16 (accessed 21 October 2019).

Competition Act 89 of 1998 (the "Act").[7] The Act repealed the 1979 Act and provided for the establishment of the Competition Commission ("Commission") and the Competition Tribunal ("Tribunal").[8] Amongst other prohibitions, the Act prohibits a number of restrictive horizontal practices and restrictive vertical practices and introduces a mechanism for the control of mergers.[9] It also confers on the Commission and the Tribunal extensive powers designed to prevent anti-competitive conduct.[10]

As set out above, the Competition Act prohibits a number of restrictive horizontal and vertical practices which present unique problems in so far as dual distribution arrangements are concerned. Dual distribution arrangements are arrangements that, for the purposes of competition law, can simultaneously be classified as horizontal and vertical.[11] Horizontal and vertical relationships are defined in section 1 of the Act. A "horizontal relationship" is defined as being one between competitors. As such in order to be in a horizontal relationship, parties must be in the same line of business.[12] A "vertical relationship" refers to the relationship between a firm and its suppliers and/or customers.[13]

In order to understand the complexities that are presented by dual distribution arrangements, it is important to consider the practices prohibited by the Act in more detail. Section 4 of the Act outlines a number of restricted horizontal practices. In terms of section 4(1)(a) of the Act agreements between parties in a horizontal relationship, which have the effect of substantially preventing or lessening competition in a market, are prohibited.[14] Section 4(1)(a) of the Act, unlike section

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[7]The Competition Act was promulgated under Proclamation no 121 of 1998. Sections 1-3, 6,11,19-43,78,79 and 84 came into effect on 30 November 1998. The remaining sections of the Act came into effect on 1 September 1999.
[8]Chapter 4 of the Act establishes the Competition Commission and the Competition Tribunal and sets out their functions
[9]Restrictive horizontal practices are regulated by section 4 of the Act and restrictive vertical agreements are regulated by section 5 of the Act.
[10](refer to note 3 above).
[11]Simon W "Dual distribution" 1967 Antitrust Law Journal 37(1) 168.
[12]Section 1 of the Act defines horizontal relationship. Further, as set out in Sutherland and Kemp Competition Law of South Africa 2017 (hereinafter referred to as Sutherland and Kemp) at 5.3, the relationship between firms will be classified as a horizontal relationship if the firms operate in the same business line. Although the Act provides no definition for the term "competitor" firms will be regarded as competitors if they compete in the same market in respect of the same or substitutable goods or services. Although section 4 of the Act only makes reference to competitors, section 4 also applies to potential competitors. Potential competitors are said to include firms which have the ability to be compete with one another.
[13]Section 1 of the Act defines vertical relationship. Further, Sutherland and Kemp at 6.6.1 explain that in section 1 of the Act, the term customer should be interpreted widely and should not be equated to ultimate consumer. Both ultimate consumers and intermediate purchasers ought to be included within the ambit of the definition in section 1 of the Act.
[14]The test for a substantial prevention or lessening of competition is that set out by *the Competition Appeal Court in the Netstar (Pty) Ltd and others v Competition Commission South Africa and another 2011 JOL 27325 (CAC)* at 30 "*The references to preventing and lessening competition are qualified by the adverb 'substantially'. Whether any particular prevention or lessening of competition is substantial will be a question of fact in every case. However, the existence of this qualification demonstrates*

4(1)(b), is a rule of reason-prohibition that provides suspected violators of the provision with an opportunity to justify their behaviour, if they can prove that the pro-competitive benefits outweigh the negative impact on competition.[15] The sub-section that proves to be the most problematic for parties involved in dual distribution arrangements is however section 4(1)(b), which sets out specific outright (per se) prohibited horizontal practices.[16] These outright prohibited horizontal practices are referred to as *per se* prohibitions, meaning that no reasons can be advanced by an offending party to justify a contravention of such a prohibited horizontal practice.[17]

It is important to note that the restrictive practices set out in section 4(1)(b) of the Act find no application to parties in a vertical relationship, which then creates difficulties when parties are simultaneously in both horizontal and vertical relationships. An example of this would be a manufacturer who distributes products to end customers but also makes use of distributors for the same purpose. However it is submitted that it is important to understand the general objectives of South African competition law and the Act in order to consider how parties that operate in the realm of both horizontal and vertical agreements should be approached.

South African competition law is enforced by the Commission, the Tribunal and the CAC, collectively referred to herein as the competition authorities. The functions and powers of the competition authorities are set out in the Act and the purpose of the Act is set out in section 2, namely to promote and maintain competition in South Africa in order –

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that what is required is something that is neither speculative nor trivial. It may be notional or hypothetical in the sense that there is no actual instance of a person being prevented by the agreement or concerted practice from entering the industry concerned. Nonetheless, if the evidence is strong enough to show that, but for that agreement or concerted practice, persons would probably have entered the industry and engaged in competition, the requirements of a substantial prevention of competition will almost certainly be satisfied."

[15]As set out in Sutherland and Kemp at 5.6, the Act distinguishes between two types of considerations. Those that are prohibited without determining whether they have produced or may produce anti-competitive consequences in particular and those that will only be condemned once it has been established on the facts of the case that they affect competition negatively. Section 4(1)(a) of the Act is a codification of the latter being the rule of reason.

[16]Section 4(1) of the Act.

(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) ...

(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.

[17]*American Natural Soda Ash Corporation and Another v Competition Commission of South Africa 2005 (6)* SA (herein after referred to as Ansac) at paragraph 37.

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 recognise the role of foreign competition in South Africa;
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 black South Africans.

It follows then that when assessing the impact of conduct alleged to be anti-competitive one must ultimately return to the purpose of the Act as the foundational prism through which its provisions must be interpreted. Not only does section 2 of the Act set out the traditional competition law efficiency objects, it also sets out certain innovative public interest objectives which have been specifically tailor-made in to order address the requirements of the South African market given the historical context of the country.[18]

1.2 Dual Distribution Arrangements

Dual distribution arrangements refer to arrangements where a manufacturer simultaneously sells to third parties or independent dealers and operates at the dealer level by supplying customers directly.[19] Dual distribution arrangements take different forms: the manufacturer may operate its own distribution network in competition with other retailers; or establish a distribution arrangement and preserve

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[18]Saggers "Vertical mergers - the European guidelines on non-horizontal mergers and their relevance for South Africa" 2008 South African Journal of Economic And Management Sciences 249 at 255. The competition authorities have the additional duty of addressing the country's small markets, history of economic isolation and state intervention which have contributed to an economy in which many markets remain concentrated and insulated by entry barriers.

[19]Lianos I "The Vertical/Horizontal Dichotomy In Competition Law: Some Reflections With Regard To Dual Distribution And Private Labels" (2009) Private Labels, Brands and Competition Policy, A Ezrachi and U Bernitz (eds),pp and Private Labels 168 – 186, Oxford University Press, Oxford 2009. https://poseidon01.ssrn.com/delivery.php?ID=982097066117089105096013113121120066099037085046045000109119090099091106102103002090025030031007112048112098067110071102030081006085002001036069000122093091109011010060086099078091107069092067117074011011009065028069068094069124089012019012094030020&EXT=pdf (hereinafter referred to as Lianos) at 161.

certain territories for its own distribution.[20] In addition a manufacturer may elect to sell directly to large end customers, such as large chain retail stores or as even sell directly to end consumers over the internet.[21]

Unlike in a conventional horizontal relationship, a manufacturer who is party to a dual distribution agreement creates competition with itself by supplying a dealer in a vertical relationship.[22] It is clear why this type of hybrid relationship would confuse competition law authorities as it makes it rather difficult to decide whether the horizontal or the vertical dimension of the relationship should prevail in order to categorise the agreement. The South African competition authorities have in some instances held that dual distribution arrangements are merely vertical agreements used as a mechanism for effecting horizontal agreements.[23]

There are a number of pro-competitive justifications for dual distribution arrangements. Dual distribution arrangements can expand a manufacturer's output and reduce distribution costs, which will result in pro-competitive benefits that would not otherwise have been realised. Lianos provides a few examples of such pro-competitive benefits.[24] Firstly, by being present at the distribution level the manufacturer will be able to collect information on the level and quality of distribution services and take this information into account, and adequately tailor any decision to impose vertical restrictions that will provide competitive incentives at the retail level.[25] Secondly, dual distribution may increase the opportunities to serve different types of customers, in particular those that the manufacturer's regular distributors do not serve due to limitations that the manufacturer may be aware of and lastly the manufacturer will be able to encourage the provision of presale services and avoid opportunistic behaviour by the distributors.[26] All of these may ultimately result in the end customer receiving a cheaper and better quality product. The manufacturer will

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[20]Lianos at 172. In such an instance, Considering that a component of the relationship then becomes horizontal, the manufacturer be found guilty of violating section 4(1)(b)(ii) of the Act as the manufacturer would essentially be dividing the market.
[21]Carlton and Chevalier "Free Riding and Sales Strategies for the Internet" *Journal of Industrial Economics* (2001), 441 at 443
[22] Lianos at 172.
[23]*Natal Wholesale Chemists v Astra Pharmaceuticals and Others* (2001) ZACT 7 at paragraph 8.
[24] Lianos at 173 – 174.
[25]Lianos at 173 – 174.
[26]Lianos at 173 – 174.

have an intimate understanding of the entire distribution chain, the challenges faced by its distributors and the needs of consumers.[27]

It would be ill-informed to ignore the potential anti-competitive effects of the horizontal dimension of the dual distribution agreements. The manufacturer may of course still use the agreements as a platform for collusion.[28] Manufacturers could still construct complex structures to create fictitious vertical relationships. However, in respect of true dual distribution agreements, collusion at the retail level would not be in the interest of the manufacturer, as it would limit any possibility of increasing its profits. The manufacture's aim is ultimately to make as many sales as possible and increase its profits. A cartel at a retail level may however have the opposite effect. In fact, as pointed out by Lianos, in some instances manufacturers enter the distribution level in order to combat collusion at the retail level.[29] Although the restriction of intra-brand competition[30] downstream may affect the distribution of profits between the supplier and the retailers, it will not affect output to consumers as both the manufacturers and the distributors will have a considerable interest in maximizing their profits.[31]

It cannot be denied that manufacturers involved in dual distribution agreements have the ability to impose restrictions which may have the effect of reducing competition. In the same breath, manufacturers also have the ability to promote competition "*by attracting highly aggressive distributors and retailers, to induce its distributors to engage in and contribute to promotional activities, and to exercise control over the service and safety of its products in order to attract and keep its customers*".[32]

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[27] Lianos at 173.
[28] Lianos at 173.
[29] Lianos at 173 – 174.
[30] As set out by Carlton, intra-brand competition refers to competition among different distributors of the same product brand, the manufacturer will often impose restrictions on the area in which its independent distributors may market the product. These territorial restrictions take the form of exclusive and non-exclusive "areas of primary responsibility" whereby the distributor agrees to concentrate his best efforts on marketing the product in that area. An area of primary responsibility clause does not prevent the distributor from making sales in other territories. If, however, he fails to concentrate his best efforts in his assigned area, the distributorship is subject to termination.
[31] Zwirb "Dual Distribution and Antitrust Law" (1988) *Loyola of Los Angeles Law Review* 1273 at 1289. (accessed on 24 October 2019).
[32] Lianos at 173 -174.

1.3 Nature and Scope of Dissertation

Carlton argues that dual distribution arrangements actually promote competition.[33] Unfortunately the manner in which the Act is currently drafted does not provide an opportunity for parties who are guilty of a contravention of the *per se* prohibited section 4(1)(b) of the Act to justify their actions. This opportunity is denied irrespective any possible pro-competitive benefits that their actions may yield.

Determining how dual distribution arrangements should be categorised is a contentious issue in various jurisdictions around the world. Having regard to South Africa's relatively new competition law legislation, this issue was only properly ventilated relatively recently in Competition *Commission v South African Breweries and others* (the "*SAB-case*").[34] In the *SAB-case*, the Competition Appeal Court (the "CAC"), recognised that dual distribution agreements present some complexities and as such, the *per se* prohibitions set out in the Act, when interpreted in relation to these agreements, may be characterised as "different" if it can be shown that they do not fall within the scope of section 4(1)(b), once the characterisation principle has been applied.[35]

The Supreme Court of Appeal ("SCA") introduced the concept of characterisation into South African law, in *American Natural Soda Ash Corporation and Another v Competition Commission* ("the *Ansac-case*").[36] In the *Ansac-case* the SCA dealt with the concept of "characterisation" of conduct by a firm and confirmed that the purpose of "characterisation" is to establish whether the conduct complained of coincides with the character of the prohibited conduct. This process embodies two elements, "*...one is the scope of the prohibition. The other is the nature of the conduct complained of.*"[37]

Although the CAC in the *SAB-case* applied characterisation, it did so within a limited scope. It is submitted that the CAC did not go far enough. The CAC conceded that a rigid application of the Act and a failure to recognise dual distribution arrangements

[33] Carlton M "Dual distribution and the horizontal-vertical dichotomy of non-price restrictions" 2013 Tulsa Law Review 306.
[34] Competition Commission v South African Breweries and others 2015 (3) SA 329 (CAC) (herein after referred to as SAB case).
[35] SAB case at paragraph 46.
[36] *Ansac* at paragraph 158.
[37] *Ansac* at paragraph 47.

as different could result in consequences which the legislator may not have intended and yet no clear guidelines were provided on when parties can characterise their behaviour as "different" without approaching the Tribunal.[38]

In light of the historical context of South Africa and the concentration in many industries, it is submitted that participation in the economy may be compromised by the uncertainty related to how competition authorities deal with dual distribution arrangements. Firms may consequently stay away from such arrangements out of fear of contravening the *per se* prohibitions.[39]

It is accepted by several other jurisdictions that the objective of competition legislation is to address the issues surrounding market failure[40] as a result of anti-competitive behaviour.[41] Ultimately competition law is concerned with ensuring free and fair competition amongst businesses.[42] In South Africa, the legislators specifically sought to set out the development of the economy as one the purposes of the Act. It is submitted that dual distribution arrangements often promote competition and offer a multitude of pro-competitive benefits which include lower prices. Why is it then that the Act fails to specifically recognise these types of arrangements as different, especially if this failure results in consequences that are in direct conflict with the purpose of the Act?

As alluded to above manufacturers may choose to opt out of engaging in dual distribution arrangements out of fear of contravening a provision of the Act. In fact, there have been a number of mergers that have resulted in vertical integration, increasing the control of dominant firms through vertically integrated production chains.[43] Although vertical integration can result in efficiency gains, it can also increase barriers to entry, makes collusion easier to maintain, and leading to

[38] SAB at paragraphs 45 – 47.
[39] Chabane, Goldstein and Roberts "The changing face and strategies of big business in South Africa: more than a decade of political democracy" 2006 Industrial and Corporate Change 15(3) 549 at 557 – 558.
[40] Market failure is the economic situation defined by an inefficient distribution of goods and services in the free market. Furthermore, the individual incentives for rational behavior do not lead to rational outcomes for the group.
[41] Smit "The rationale for competition policy: a South African perspective" 2005 Paper read at the biennial ESSA Conference, 7-9 September 2005, Elangeni Holiday Inn, Durban, Kwazulu- Natal, South Africa https://econex.co.za/wp-content/uploads/2015/04/econex_researcharticle_10.pdf (accessed on 20 October 2019) at 3.
[42] Van Heerden-Neethling at 10.
[43] Chabane, Goldstein and Roberts "The changing face and strategies of big business in South Africa: more than a decade of political democracy" (2006) 15 *Industrial and Corporate Change* at (herein after referred to as Chabane) at 557 – 558.

foreclosure of competitors.[44] It is submitted that if dominant firms do not enter into dual distribution arrangements it could easily result in a situation where small and medium-sized enterprises are denied an opportunity to participate in the economy, because dominant firms may elect to control the entire supply chain and negate any risk of contravening section 4(1)(b) of the Act.[45]

It is further submitted that, as a matter of policy, *per se* prohibitions should not apply to true dual distribution agreements. The catch all provision set out in section 4(1)(a) of the Act should be the only provision utilised in assessing whether or not conduct complained of in the context of dual distribution arrangements is anti-competitive. It is submitted that the focus should not solely be on the categorisation of the relationship between the parties.

In this dissertation I will explore why the legislators have not considered drafting a provision that specifically addresses these types of arrangements or alternatively creating an exception that ensures that *per se* prohibitions do not apply to them. The characterisation proposed in the *SAB-case* in my view only partially clarifies the legality of dual distribution arrangements, and in circumstances where the facts do not neatly fall within those set out in the *SAB-case*, they will need to be scrutinised on a case-by-case basis.

1.4 Research Methodology

The research methodology applied in this dissertation, will involve a review of local and international academic literature, case law and legislation. This dissertation will contain both a theoretical and a practical analysis. For the practical analysis I will focus on the cases reported by the Tribunal, SCA and the CAC. In addition I will also look at the media releases in order to understand the approach to dual distribution arrangements over the years. Lastly I will review the approaches adopted by other jurisdictions in dealing with these arrangements, specifically the approaches adopted by the European Union and the United States.

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[44] Chabane at 557 – 558.
[45] Chabane at 557 – 558.

1.5 Chapter Layout

The first chapter is the roadmap to the study and provides background on the topic, the research statement and objectives, research methodology, selection of comparative jurisdictions and chapter lay-out.

In the second chapter I will look at how dual distribution arrangements are dealt with in different jurisdictions and whether it would be practical to adopt any of these approaches in South Africa. As previously stated, South Africa's competition law framework captured in the Competition Act 89 of 1998 is relatively new and as such our competition authorities often borrow from foreign law when interpreting complex competition law concepts t. In fact, the Act itself encourages international comparison.[46] There will be a focus on the treatment of dual distribution arrangements by the European Commission and a particular focus on the evolution of American competition authorities' treatment of these arrangements.

In the third chapter I will discuss the evolution of South Africa's approach to "characterisation" specifically in relation to dual distribution arrangements. Particular focus will be paid to the *SAB-case* and the impact of the CAC's decision on how parties in dual distribution arrangements are permitted to interact with one another.

In the fourth chapter I will put forward for consideration alternative ways in which the competition authorities could deal with dual distribution arrangements in order to avoid uncertainty and ultimately encourage competition.

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[46] Section 1(3) of the Act states that any person interpreting or applying the Act one must consider appropriate foreign law.

2 CHAPTER 2: DUAL DISTRIBUTION ARRANGEMENTS IN OTHER JURISDICTIONS

2.1 The American Approach to Dual Distribution Arrangements

American competition law is predominantly governed by three pieces of legislation, namely the Sherman Antitrust Act of 1890 ("Sherman Act"); the Federal Trade Commission Act of 1914, which created the Federal Trade Commission; and the Clayton Act of 1914. The Clayton Act addresses specific practices that the Sherman Act does not clearly prohibit, such as mergers and interlocking directorates.[47] For the purposes of this paper, my focus will be on the Sherman Act.

Similar to South Africa, one of the greatest difficulties faced by American courts when dealing with dual distribution arrangements is the classification of the particular relationship between the parties. The imposition of restrictions, on one another, by parties in a horizontal relationship is *per se* prohibited and illegal under section 1 of the Sherman Act.[48] Yet, when parties are in a vertical relationship and elect to impose restrictions on one another, the relationship is subject to a rule of reason analysis.[49]

The rule of reason analysis requires that the party, who alleges that an agreement or behaviour contravenes competition law, prove that such agreement or behaviour is anti-competitive.[50] This approach has had an interesting evolution: despite the *per se* prohibition in section 1 of the Sherman Act, the American Supreme Court

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[47]Interlocking directorates refers to instances where that is, the same person (such as director of a company) makes business decisions for companies that compete with each other. https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/antitrust-laws (accessed on 07 October 2019).

[48]*Section 1 of the Sherman Act Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred* thousand *dollars or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.*

[49]Zwirb at 1340.

[50]Zwirb "Dual distribution and antitrust law" 1988 Loyola of Los Angeles Law Review 1273 at 1276 – 1277. In *Midwestern Waffles Inc. v .Waffle House, Inc. 734 F.2d 705, 720 (11th Cir. 1984)* Justice Brandeis submits that "The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and *to predict consequences*".

developed the "rule of reason" approach which sought to limit the application of section 1 in certain circumstances.[51] The result of this restriction was that when courts were instructed to examine the competitive impact of agreements to determine their reasonableness, antitrust litigation became prolonged.[52] To reduce the complexities that arose from this approach, American courts adopted and applied the doctrine of *per se* illegality. As a result, defendants who had violated section 1 of the Sherman Act would automatically be found guilty of a contravention of the Sherman Act without an inquiry into the reasonableness of their act.[53] Comanor submits that the *per se* concept should be considered a refinement rather than a departure from the rule of reason approach and remarks that "*[A]ttachment of the per se label to a type of agreement expresses the judgment that the adverse competitive effects of the arrangement outweigh its purported justifications, or, at least, that the benefits accruing from the restriction can be achieved by a less restrictive alternative.*"[54] It follows that when an agreement can simultaneously be classified as both horizontal and vertical, the analysis becomes that much more complicated. The American Supreme Court sought to address the issues surrounding dual distribution arrangements through three main decisions, *White Motor,*[55] *Schwinn,*[56] and *Sylvania*.[57]

In *White Motor,* the Justice Department challenged the territorial and customer restrictions imposed by White Motor, a truck manufacturer, which prohibited its dealers from reselling to certain large customers reserved for itself. For the first time, the Supreme Court used the term "vertical arrangement" to describe vertical territorial restrictions imposed by a manufacturer on retailers.[58] The lower court found that the term was broad enough to cover agreements that raised both horizontal and vertical issues.[59] The American Supreme Court however found that the vertical price restraints were equivalent to horizontal collusion between competitors and as such

[51] Standard Oil Co. v. United States 2 22l U.S. I (1911).
[52] (1968) Harvard Law Review, vol. 81, no. 7, 1419–1438 (hereinafter referred to as Comanor) at 14120.
[53] Comanor at 14120.
[54] Comanor at 14120.
[55] *White Motor Co. v. United States, 372 U.S. 253 (1963)* accessed on 10 October 2019 at https://supreme.justia.com/cases/federal/us/372/253/#254 (herein after referred to as White Motor case).
[56] *United States v. Arnold, Schwinn and Co., 388 U.S. 365 (1967)* accessed on 10 October 2019 at https://supreme.justia.com/cases/federal/us/388/365/ (hereinafter referred to as Schwinn and Co case).
[57] *Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).*
[58] Lianos at 162. White Motor case at 261 – 264.
[59] Lianos at 162. White Motor case at 261 – 264.

both were then prohibited *per se* under section 1 of the Sherman Act.[60] The American Supreme Court rejected any extension of the *per se* illegality rule to non-price vertical agreements, noting that it *"needed to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a pernicious effect on competition and lack of redeeming virtue"*.[61]

Carlton submits that two important points were drawn from the *White Motor* decision:[62] First, the Court declared the territorial restrictions to be vertical. In doing so, the American Supreme Court focused on the source of the restrictions for the purpose of distinguishing vertical and horizontal restrictions rather than the type of distribution arrangement employed by White Motor. Secondly, the Court indicated that depending on the evidence presented at trial, restrictions in dual distribution arrangements could: (i) be *per se* illegal; or (ii) may be protected under the rule of reason as allowable protections against aggressive competitors.[63]

The Supreme Court returned to the issue of categorisation of dual distribution arrangements in Schwinn. In *Schwinn,* the Court held that while a dual distributor's restraints were *vertical,* they were nevertheless *per se* illegal.[64] In Schwinn, the Supreme Court held that the view that *"[o]nce the manufacturer has parted with title and risk, he has parted with dominion over the product, and his effort thereafter to restrict territory or persons to whom the product may be transferred—whether by explicit agreement or by silent combination or understanding with his vendee—is a per se violation of s 1 of the Sherman Act"*.[65] The American Supreme Court further held that it was only where the supplier retained ownership that the restrictions could still be governed by the rule of reason standard.[66] In *Schwinn* the American Supreme Court once again failed to analyse the effect of the arrangement and for the most part focused its investigation of the passing of ownership.

Fortunately, the American Supreme Court revisited the issue of dual distribution

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[60]Lianos at 162 and White Motor case at 264.
[61]Lianos at 162 and White Motor case at 263.
[62]Carlton at 313 - 314 and and White Motor case at 263.
[63]Carlton at 314.
[64]Zwirb 1285 Schwinn and Co case at 382.
[65]Schwinn and Co case at 382.
[65]Schwinn and Co case at 382.
[66]Schwinn and Co case at 381.

arrangements in *Sylvania*.[67] In *Sylvania*, a franchised retailer challenged a restriction imposed by the manufacturer on the location from where products could be sold. As in *Schwinn*, the American Supreme Court categorised the restrictions as vertical; however, the Supreme Court acknowledged that there was a need for clarification of the law. The American Supreme Court in *Schwinn* noted that *"the pivotal factor was the passage of title: All restrictions were held to be per se illegal where title had passed, and all were evaluated and sustained under the rule of reason where it had not."*[68] Deviating from the *Schwinn* rationale, the Supreme Court in *Sylvania* held that there was no basis for the distinction between sale and non-sale transactions.[69] As a result, the American Supreme Court in *Sylvania* concluded that there was no justification for the application of a *per se* rule in one instance and a rule of reason in the other. Consequently, the rule of reason was reinstated as the proper mode of analysis for vertical restrictions and the *per se* rule stated in *Schwinn* was overruled.[70]

Under *Sylvania* horizontal restraints are illegal while non-price vertical restraints are governed by the rule of reason standard.[71] *Sylvania,* in effect, requires courts in dual distribution cases to "characterise" the restrictions as either vertical or horizontal.[72] The Supreme Court in *Sylvania* emphasised that the determination of legality of distributional restraints "*must be based upon demonstrable economic effect rather than upon formalistic line drawing.*"[73] Zwirb submits that while *Sylvania* requires courts to rely on economic analysis in deciding distribution issues, its distinction between vertical and horizontal restraints forces courts to engage in very formalistic line drawing. [74]

Currently, American courts analyse cases involving dual distribution arrangements by first focusing whether the arrangement is horizontal or vertical rather than focusing

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[67]*Continental T. V., Inc. V. GTE Sylvania Inc 433 U.S. 36* https://supreme.justia.com/cases/federal/us/433/36/ (accessed on 20 October 2019 (1977) (herein after referred to as the Sylvania case).
[68]United States. Supreme Court *United States Reports: Cases Adjudged in the Supreme Court, Volume 433* 1976 (U.S. Government Printing Office) at 52.

[69]Sylvania 47 – 59.
[70]Sylvania 47 – 59.
[71]Zwirb at 1284 – 1285.
[72]Zwirb at 1284 – 1285.
[73]Sylvania 59 – 60.
[74]Zwirb at 1284 – 1285.

on an economic analysis of the arrangement.[75] The main difference between the positions held by the American Supreme Court in respect of dual distribution arrangements after the *Sylvania* case is that restrictions are viewed as vertical and are now analysed under the rule of reason. American courts have shown a clear tendency to interpret dual distribution arrangements in *post-Sylvania* cases as vertical, whereas before they were seen as horizontal.[76]

Zwirb observes that following *Schwinn,* most courts viewed distribution restraints imposed by dual distributors as horizontal. However, their categorisation had little practical significance since most vertical restraints were also *per se* illegal. After *Sylvania,* the courts then decided that restrictions associated with dual distribution arrangements were vertical and thus governed by the rule of reason.[77] Altschuler, summarized the change in the classification as follows "*before Schwinn, when no-price vertical restraints were subject to the rule of reason, courts refused (or neglected) to view dual distribution as triggering the per se rule applicable to horizontal restraints. Following Schwinn, courts consistently took precisely that position. Now, however, with Sylvania's reinstatement of the rule of reason, courts are again refusing (or neglecting) to apply the horizontal approach, with a few notable exceptions. The majority of cases decided after Sylvania treat dual distribution restraints exclusively under the rule of reason.*"[78]

Lianos points out that three trends have progressively appeared in American case law, namely: (i) some courts have continued to characterise dual distribution as a horizontal practice and refused to apply the rule of reason approach as set out in *Sylvania*; that said however, the majority of the courts classified restraints in dual distribution arrangements as forms of vertical restraint; (ii) some decisions focused on a formalistic examination of the type of the relationship that linked the supplier and the retailers, the only difference with the previous approach being the presumption that the vertical dimension was predominant; and (iii) other decisions adopted a more economic test that focuses on the source of the particular restraint within the dual

[75] Zwirb at 1285.
[76] Zwirb at 1285.
[77] Zwirb at 1285.
[78] Altschuler, "Sylvania vertical restraints, and dual distribution" 1980 Antitrust Bulletin 25(1) 1 at 84.

distribution agreement.[79] In essence American courts have elected not to create a third category for hybrid arrangements. The starting point for the adjudication of any dual distribution arrangements still begins with a process that requires that the dual distribution arrangements be categorised as either vertical or horizontal.

2.2 **The European Approach to Dual Distribution Arrangements**

The regulation of competition law in the European Union ("EU") is laid down in Articles 101 and 102 in the Treaty on the Functioning of the European Union ("TFEU")[80] and detailed guidance on implementation of these principles is given in numerous council regulations of the European Union.[81] Of particular importance to this discussion on dual distribution arrangements is Article 101(1) of the TFEU, which prohibits agreements, decisions of associations and concerted practices that may affect trade and which have as their object the prevention, restriction or distortion of competition. A consideration of whether dual distribution agreements are actually prohibited under this article is pivotal.

Article 101 includes an indicative list of the types of agreement that will prevent, restrict or distort competition, *albeit* not an exhaustive list.[82] The European Commission and EU courts have given the term "prevent, restrict or distort competition" a wide interpretation.[83] In fact, Rodger and MacCulloch observe that the prohibition contained in Article 101(1) is wide enough to include restrictions contained in both horizontal and vertical agreements.[84] As such, an agreement will only contravene Article 101(1) if it has the objective or the effect of preventing, restricting

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[79] Lianos at 180.
[80] Treaty on the Functioning of the European Union OJ C 202, 7.6 (2016) http://data.europa.eu/eli/treaty/tfeu_2016/oj (accessed on 02 October 2019).
[81] The detailed guidance on implementation of council regulations of the European Union https://ec.europa.eu/competition/antitrust/overview_en.html (accessed on 09 September 2019).
[82] Article 101(1) of the TFEU.
"The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:
(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
(b) limit or control production, markets, technical development, or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."
[83] Rodger and MacCulloch (2015) Competition law and policy in the eu and UK. 5th edn. London: Routledge. https://ebookcentral-proquest-com.uplib.idm.oclc.org/lib/pretoria-ebooks/detail.action?docID=1791302(Accessed 10 September 2019) (hereinafter referred to as Rodger and MacCulloch.) at 168.
[84] Rodger and MacCulloch at 170.

or distorting competition. The difficulty with this assessment is however determining when exactly when an agreement has this effect.[85]

Article 101 makes a distinction between agreements which have the *object* of restricting competition and those which have the *effect* of doing so. In *STM v Maschinenbau*[86] the court held that consideration should be given to whether an agreement has the *object* of restricting competition and if it is established that it does not, only then does it become necessary to consider, in detail, the *effects* of the agreement.[87] To assist in clarifying this position, the European Commission's Guidelines on Horizontal Cooperation Agreements ("Horizontal Guidelines")[88] sets out the approach to be adopted in relation to *object* restrictions as follows, "*Restrictions of competition by object are those that by their very nature have the potential to restrict competition within the meaning of Article 101(1). It is not necessary to examine the actual or potential effects of an agreement on the market once its anti- competitive object has been established.*"[89] Thus, restrictions of competition by object are actually *per se* prohibitions.

Similar to the American competition laws, in the EU certain types of agreements are deemed *per se* infringements of Article 101(1), whereas other possible infringements require a fuller examination of the economic context in which the possible infringements take place - thus meaning that a rule of reason approach is followed. It is my submission that this approach is fair largely because the legislators actually look at that specific market when deciding whether a rule of reason approach must be utilised. The approach to *per se* prohibitions was clearly expressed by the European Court of Justice in *Competition Authority v Beef Industry Development Society Ltd.*[90] In that case, the court confirmed that "*where the object of an agreement, taking into account its wording and objectives, was to restrict, limit or distort competition, it was prohibited by Article 101(1) irrespective of any anti-*

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[85]Rodger and MacCulloch at 167.
[86]Case 56/65 *STM v Maschinenbau Ulm* (1966) ECR 235 (hereinafter referred to as Maschinenbau case).
[87]Rodger and MacCulloch at 169 and Maschinenbau case at 250.
[88]Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52011XC0114(04) (accessed on 24 October 2019 (Hereinafter referred to as the Horizontal Guidelines).
[89]Horizontal Guidelines (Note 36 above) at paragraph 24
[90]*Competition Authority v Beef Industry Development Society Ltd* Case C-209/07, (2008) ECR I-8637.

competitive effects produced by the agreement."[91] The types of agreements which have been considered to have the object of restricting competition are horizontal cartel activities, such as price fixing or market sharing.[92] If an agreement is caught by the prohibition in Article 101(1) it will be null and void, and unenforceable unless it falls within the scope of the exception to the prohibition in Article 101(3)[93] or is covered by one of the block exemptions, as explained in more detail below.

Article 101(3) of TFEU allows for the prohibition in Article 101(1) of TFEU to be declared inapplicable if certain criterion is met.[94] The importance of Article 101(3) stemmed from the wide interpretation adopted under Article 101(1). Article 101(3) gives the European Commission discretion to the grant exemptions under Article 101(3). Block exemptions similarly also exempt certain decisions; in fact the block exemptions exempt a class of agreements automatically without the formal intervention by and approval from the European Commission.[95]

One such exemption is the *Vertical Agreement Block Exemption Regulation* ("*Vertical Agreements Exemption*").[96] In 2010, the EU adopted the exemption relating to vertical agreements along with the *Guidelines on Vertical Restraints.*[97] As a general rule the *Vertical Agreements Exemption* do not explicitly cover agreements entered into between competitors who also happen to be in a vertical relationship - this would obviously include parties in a dual distribution arrangement.[98]

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[91]Rodger and MacCulloch at 169.
[92]Rodger and MacCulloch at 169.
[93]Article 101(3) of the TFEU.
"*The provisions of paragraph 1 may, however, be declared inapplicable in the case of:*
- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices,
which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

94 For example as set out by Arina Gorbatyuk "*Article 101(3) suggests that the prohibition specified in Article 101(1) may be declared inapplicable when agreements between undertakings contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit.*" https://www.law.kuleuven.be/citip/blog/rd-agreements-and-eu-competition-law-when-can-companies-be-safe/ (accessed on 25 October 2019)

95 Rodger and MacCulloch at 177.
[96]Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices. http://data.europa.eu/eli/reg/2010/330/oj (accessed 01 September 2019).
[97]European Commission Notice — Guidelines on Vertical Restraints (2010) https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010SC0411&qid=1568125446042&from=EN (accessed 01 September 2019).
[98]Peeperkorn "Revised EU Competition Rules For Supply And Distribution Agreements" 2010 Competition Law Yearbook https://ec.europa.eu/competition/speeches/text/sp2011_10_en.pdf (accessed on 05 September 2019) (herein after referred to as Peeperkorn) at 208.

Agreements between competitors are first and foremost assessed as horizontal agreements.[99] That said however, the application of the *Vertical Agreements Exemption* to agreements between parties in a vertical and horizontal relationship is limited to situations of dual distribution. This is clearly set out in the Guidelines on Vertical Restraints. Article 2(4) of the Block Exemption Regulation contains two exceptions to the overall exclusion of vertical agreements between competitors. These exceptions concern non-reciprocal agreements. *As set out in paragraph* 28 of the Guidelines on Vertical Restraints *"Non-reciprocal agreements between competitors are covered by the Block Exemption Regulation where (a) the supplier is a manufacturer and distributor of goods, while the buyer is only a distributor and not also a competing undertaking at the manufacturing level, or (b) the supplier is a provider of services operating at several levels of trade, while the buyer operates at the retail level and is not a competing undertaking at the level of trade where it purchases the contract services. The first exception covers situations of dual distribution, that is, the manufacturer of particular goods also acts as a distributor of the goods in competition with independent distributors of its goods. In case of dual distribution it is considered that in general any potential impact on the competitive relationship between the manufacturer and retailer at the retail level is of lesser importance than the potential impact of the vertical supply agreement on competition in general at the manufacturing or retail level. The second exception covers similar situations of dual distribution, but in this case for services, when the supplier is also a provider of products at the retail level where the buyer operates."*[100]

In addition to the above, the European Commission in its *Guidelines to Technology Transfers Agreements* provides that in order to establish whether parties are competitors, one must first determine whether the parties would have been competitors without the agreement.[101] If parties would not be competitors without the existence of the agreement, then they are deemed to be non-competitors.[102] These guidelines make it clear that an agreement is not enough to create a competitor relationship. This is particularly important in respect of dual distribution

[99] Peeperkorn at 208.
[100] Paragraph 28 of the Guidelines on Vertical Restraints.
[101] The Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements 2014/C 89/03 (hereinafter referred to as The Guide Lines) https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014XC0328%2801%29 (accessed on 05 September 2019).
[102] The Guidelines at paragraph 28.

arrangements. In many instances, the parties in the vertical relationship would not become competitors without an agreement creating this relationship.

Unlike their American counterparts, the EU's approach to dual distribution arrangements is not mainly focused on the categorisation of the relationship between the parties. It is submitted that the EU in fact tries to go one step further by actively choosing to understand the market in which the entities concerned operates. In fact as stated by Lake[103] the *Guidelines on Vertical Restraints* and the general approach of the European Commission appears to offer a highly impartial approach to understanding the needs of firms. The impact of the arrangement takes precedent over the structure of the arrangement.

2.3 **Conclusion**

From the above, it is clear that the challenges pertaining to the classification of dual distribution arrangements is not an issue that is unique to South Africa. In America the responsibility of determining how dual distribution arrangements should be characterised is left to the courts. The courts are given the responsibility of interrogating the substance of the relationships between the parties involved. This, despite the same courts highlighting certainty as one of the purposes of the *per se* prohibitions, in so far as the Sherman Act is concerned. It is my submission that if the courts are still required to interrogate some relationships then there is no certainty. The EU's approach seems a lot more sensible in that the EU sets out to regulate industries after gaining insight into the content of the relationship between the parties and not solely based on the structure of the relationship between them.

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[103] Lake at 190.

3 CHAPTER 3 CHARACTERISATION

3.1 Introduction

As previously submitted, because of the nature of the relationship between parties in dual distribution arrangements, the arrangement may be subject to a rule of reason analysis[104] and simultaneously be *per se* prohibited. In order to truly understand why these types of relationships must be characterised as different, there must be an interrogation into why the South African Act explicitly sets out different tests for analysing different relationships. This chapter will discuss the rationale for establishing different standards for assessing anti-competitive behaviour. Specifically, the rationale behind having the rule of reason test and *per se* prohibitions will be addressed. This will be followed by an exploration of why the rule of reason test differs from the concept of characterisation in the analysis of *per se* prohibited conduct. In order to do this, an analysis of the competition authorities' application of characterisation is necessary.

3.2 Per Se Prohibition vs Rule Of Reason

Section 4 of the Act currently sets out two distinct test sets in the consideration of prohibited conduct involving parties in a horizontal relationship. The first being the rule of reason consideration set out in section 4(1)(a) of the Act. The rule of reason consideration is twofold: First, anti-competitive effects must be established and proved. Once this had been done, the onus of proving that the technological, efficiency or other pro-competitive gains outweigh the anti-competitive effect, rests on the parties. In essence, the rule of reason consideration offers a defence to an offender of the Act. The rule of reason consideration is in line with the purpose of the Act in that it is ultimately concerned with the impact of the parties' behaviour on the market.

The second consideration is in respect of the *per se* prohibited conduct. Unlike with the rule of reason consideration, no defence or justification can be offered for

[104] The rule of reason analysis allows parties to submit evidence that to show that the pro-competitive benefits of their potentially anti-competitive behaviour outweigh the negative impact on competition. - see note 14 above.

conduct that is *per se* prohibited.[105] There are three types of restrictive horizontal practices which are prohibited outright these are (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 (referred to hereafter as the cartel provisions).[106] Although the Act does not use the terms "rule of reason" and "*per se* prohibition" competition authorities have given the meaning provided above to these terms.[107]

Declaring that conduct is automatically illegal without an interrogation into the factors leading up to it seems rather unfair at first glance. Especially in light of the fact that the Act seeks to uphold a level of market freedom in order to encourage economic growth.[108] Writers and competition authorities in other jurisdictions have however over the years provided notable justification for the presence of *per se* prohibitions in competition legislation.[109] As set out in the previous chapter, *per se* prohibitions are not unique to South Africa. In fact, Moodaliyar submits that agreements between competitors which are *per se* prohibited should not be tolerated because if they are allowed to exist they would negatively affect the benefits that consumers receive from free and fair competition.[110] The American Supreme Court has also provided a similar rationale for *per se* prohibitions in *Northern Pacific*,[111] where it held that "*certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of per se unreasonableness... avoids the necessity for an incredibly complicated and prolonged economic investigation...*" Neuhoff similarly submits that the adoption of *per se* prohibitions provide legal certainty and deters cartel activity.[112] In addition, the presence of these prohibitions ensures that competition authorities do not waste their

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[105] (refer to note 15 above).
[106] Moodaliyar "Characterising price fixing: a journey through the looking glass with Ansac" (2008) *SAJEMS* NS 11 at 337 (hereinafter referred to as Moodaliyar).
[107] *Venter v The Law Society of the Cape of Good Hope and others* (2013) 2 CPLR 477 (CT) at 25.
[108] Section 2 of the Act.
[109] Writers such as Robert Zwirb, an Attorney in the United Staes of America in Dual Distribution and Antitrust Law referred to note 30 above; Lianos a lecturer in European Union Law referred to at note 18 above.
[110] Moodaliyar at 340
[111] *Northern Pacific Railway v United States 356 US 1 (1958)* at 6.
[112] Neuhoff et al A Practical Guide to the South African Competition Act (2006) (hereinafter Neuhoff) at 16.

limited resources by engaging in a case-by-case evaluation of all conduct in respect of which complaints are received.[113]

It is submitted that the reasons put forward for the presence of *per se* prohibitions make commercial sense.[114] That said however, Moodaliyar further provides a view which I agree with. If the purpose of providing strict and distinct tests for the treatment of cartel activities is *inter alia* to provide certainty and minimise the use of competition authorities resources it follows that the competition authorities should not be presiding over any matters involving cartel activities.[115] Given the succinct wording of section 4 of the Act, one would naturally expect that the application of the *per se* rule would require no judicial interpretation.[116] This is not the case. The Act does not make provision for conduct that does *not* neatly fall into anyone of the categories created by it. As a result, we have seen our competition authorities increasingly being forced to engage in case-by-case evaluations of arrangements between competitors and looking at the substance of these arrangements.[117]

Considering that there is no provision in the Act that seeks to specifically regulate dual distribution arrangements our competition authorities have been forced to incorporate a third consideration for relationships that are partly horizontal and party vertical. In addition to the *per se* prohibitions and the cartel provisions, our competition authorities are now required to "characterise" behaviour to see if it will result in a contravention of section 4(1)(b) of the Act.

3.3 Characterisation of cartel activities

The competition authorities have increasingly had to investigate complaints in respect of arrangements that appear to contravene the cartel provisions but do not negatively affect free and fair competition. In such instances, we have increasingly seen our competition authorities elect to apply the characterisation principle when interrogating the substance of these arrangements. "Characterisation" involves an

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[113]Neuhoff at 16.
[114]Commercial sense in that the per se prohibitions, by giving us a clear indication of what behaviour will not be tolerated by the competition authorities allows parties to ensure that their business dealings are not compromised. In addition, there will in theory be no unnecessary wastage of the competition authorities' resources.
[115]Moodaliyar at 343.
[116]Moodaliyar at 343.
[117]This is shown in the SAB case referred to in note 33 and is discussed in more detail in paragraph 3.3 below.

investigation into whether the conduct complained of matches with the character of the prohibited conduct.[118] In this paragraph the focus will specifically be on the development of the South African competition authorities' approach to characterisation.

The concept of characterisation was officially incorporated into our law by the SCA in *American Natural Soda Ash Corporation and another v Competition Commission and others* ("*Ansac-case*").[119] Following the *Ansac-case*, the CAC in subsequent cases not only cemented the incorporation of the characterisation principle into our law, it also provided some guidance on the appropriate method for characterisation. What follows is a brief discussion on some of the notable decisions of the CAC and what specific aspects of the conduct has been characterised in determining that parties had not breached the cartel provisions.

As pointed out, the concept of characterisation was officially incorporated into our law by the SCA in the *Ansac*-case. The *Ansac-case* involved the American National Soda Ash Corporation ("the corporation"), an export cartel made up of five American soda ash producers who exported soda ash.[120] Even though the establishment of the export cartel was illegal in America under the Sherman Act, the corporation was granted exemption from prosecution for contravening the Sherman Act and the exemption allowed companies to come together to fix prices when the products were to be exported.[121] In October 1999 Botswana Ash Proprietary Limited ("Botash") filed a complaint against the corporation and alleged that the corporation's operation within South Africa was in contravention of section 4(1)(b) of the Act. The complaint was referred by the Commission to the Tribunal.[122]

The *Ansac-case* involved litigation that spanned over a significant number of years before finally being heard by the SCA. Prior to being heard by the SCA, the *Ansac-*

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[118]American Natural Soda Ash Corporation and Another v Competition Commission of South Africa (2005) 3 All SA 1 (SCA) (hereinafter referred to as Ansac case) at 51.
[119]*Ansac* case.
[120]Soda ash is an ingredient essential to the manufacture of glass.
[121]As set out at paragraphs 1 to 2 of the Ansac case, within the United States, the creation of the corporation would have been illegal under the Sherman Antitrust Act, but a law as created that granted export-directed cartels exemption from the antitrust legislation.
[122]Any person may provide information concerning an allegation of a breach of a prohibited practice to the Commission. When a complaint is received, the Commission investigates the complaint and if it is of the opinion that there is merit to the compliant it, refers the matter for prosecution on behalf of the complainant.

case was heard by the Tribunal and CAC.[123] The Commission alleged that the corporation had engaged in price fixing and the allocation of markets. In response, the corporation sought to provide evidence to demonstrate that its presence in the South African market had pro-competitive gains which outweighed any anti-competitive effects. In effect, it appeared at first glance as though the corporation was attempting to raise a rule of reason defence which was not available to it when dealing with the cartel provisions as they are *per se* prohibited. As would be expected, the Tribunal held that no evidence could be lead to justify or defend the conduct of the corporation.[124] On appeal, the CAC held the same view and upheld the ruling of the Tribunal.

The SCA however held a different view on subsequent appeal. The SCA stated that the Tribunal had in fact misdirected its enquiry, in that the Tribunal decided that the corporation was trying to provide a defence for its contravention of section 4(1)(b) of the Act when this was not the case.[125] The SCA held that the corporation was not attempting to lead evidence to defend its conduct, but instead it was attempting to provide evidence that its conduct fell outside the object of section 4(1)(b) of the Act. In disagreeing with the Tribunal and the CAC, the SCA introduced the principle of characterisation into South African competition law jurisprudence. In doing this the SCA referred to principles borrowed from American competition law.[126] In essence the principle of characterisation requires an establishment of whether the character of the conduct complained of coincides with the character of the prohibited conduct. The SCA held that this process contains two elements: "One is the scope of the prohibition: a matter of statutory construction. The other is the nature of the conduct complained of: this is a factual enquiry."[127]

The SCA held that the characterisation process was flexible in that it could be conducted in reverse. The enquirer was permitted to first to identify the true character of the conduct that is the subject of the complaint, and only then turn to whether the conduct (so characterised) constitutes price-fixing as contemplated by

[123] American Natural Soda Ash Corporation v Competition Commission 2003 (5) SA 633 (CAC); American Natural Soda Ash Corporation v Competition Commission 2003 (5) SA 655 (SCA).
[124] *Ansac* case at paragraph 4 – 7.
[125] *Ansac* case at paragraph 40.
[126] *Ansac* case at paragraphs 46 to 47.
[127] *Ansac* case at paragraphs 46 to 47.

section 4(1)(b).[128] Ultimately after years of lengthy litigation, the SCA set aside the decisions of the Tribunal and the CAC. This decision allowed the corporation to submit evidence showing that its conduct fell outside the object of section 4(1)(b) of the Act. The matter was remitted to Commission, to enable it to determine what precise evidence was admissible to establish whether agreement fell within prohibition set out in section 4(1)(b) of the Act.[129]

In 2015 the CAC once again had an opportunity to interrogate the concept of characterisation first presented in the *Ansac-case* when it had to adjudicate in Competition *Commission v South African Breweries and others* (the "SAB-case").[130] The *SAB-case* stemmed from a complaint filed by distributors of beer who were appointed by South African Breweries ("SAB"). SAB distributed its beer through wholly owned depots as well as to appointed distributors ("ADs"). To facilitate this distribution, the ADs entered into agreements with SAB. The agreements amongst other things imposed territorial restrictions. In terms of the territorial restrictions, the ADs were only allowed to operate within certain defined geographical areas. Interestingly enough, there were no territorial restrictions on SAB and it was not prevented from selling within the territory allocated to the ADs. As such, in addition to supplying the ADs, SAB also competed with the ADs in their designated territorial areas. The Commission referred the complaint against SAB for prosecution. The Commission alleged that the exclusive territory agreements entered into between SAB and the ADs amounted to market allocation in contravention of section 4(1)(b)(ii) of the Act.[131]

In the *SAB-case* the CAC was forced to actually interrogate the characterisation process and decide what was admissible unlike in *Ansac* where this process was remitted to the Commission. As pointed out SAB the ADs were in a dual relationship with one another.[132] In assessing the complaint, the CAC referred to the *Ansac-case* and confirmed that the characterisation principle is part of the South African

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[128]*Ansac* case at paragraphs 46 to 47.
[129]Ansac case at paragraph 65.
[130]Competition Commission v South African Breweries and others 2015 (3) SA 329 (CAC) (herein after referred to as SAB case)
[131]*SAB* case at paragraph 15.
[132]SAB supplied the ADs with the beer and this amounted to a vertical relationship. SAB simultaneously competed with the ADs for the same customers, making their relationship horizontal.

competition law.[133] In his discussion on characterisation as it applied to the *SAB*-case Davis JP noted that *"the 'characterisation' that is required under our legislation is to determine (i) whether the parties are in a horizontal relationship, and if so (ii) whether the case involves direct or indirect fixing of a purchase or selling price, the division of markets or collusive tendering within the meaning of s 4(1)(b). However, since characterisation in this sense involves statutory interpretation, the bodies entrusted with interpreting and applying the Act (principally the Tribunal and this court) must inevitably shape the scope of the prohibition..."*[134] He further emphasised that the *per se* prohibitions contained in the cartel provisions were the most serious contraventions and as such the characterisation principle was in place to ensure that section 4(1)(b) of the Act only punished the behaviour it was intended to. In order to do this, Davis JP noted that the competition authorities would be required to draw on their legal and economic expertise and the experience and wisdom of legal systems within other jurisdictions.[135]

In respect of the hybrid relationship between SAB and the ADs, the CAC noted the key question in its assessment was how to classify an arrangement that could simultaneously be prohibited by virtue of being both vertical and horizontal.[136] The CAC ultimately found that the relationship between SAB and the ADs was vertical in nature and the horizontal component was purely incidental and flowed from, the vertical arrangement.[137] The CAC dismissed the Commission's complaint as it found that the restraints imposed by SAB did not fall within the scope of section 4(1)(b) of the Act, once the characterisation principle has been applied. The CAC thus characterised the relationship between SAB and the ADs as falling outside the scope section 4(1)(b) of the Act.

In 2018 the CAC had yet another opportunity to further ventilate its position on characterisation in *Dawn Consolidated Holdings and Others v the Competition Commission* ("the *Dawn Consolidated* case").[138] In the *Dawn Consolidated* case,

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[133] *SAB* case at paragraph 28.
[134] *SAB* case paragraph 37.
[135] *SAB* case paragraph 44.
[136] *SAB* case paragraph 38.
[137] SAB case at 45.
[138] *Dawn Consolidated Holdings (Pty) Ltd and Others v Competition Commission* (2018) CAC (hereinafter referred to as *Dawn Consolidated* case).

unlike in the *SAB-case*, the CAC characterised the actual conduct of the firms and not their relationship.

The facts in the *Dawn Consolidated* case were that the Commission had initiated a complaint in respect of a clause contained in a shareholders agreement between Dawn Consolidated Holdings ('Dawn') and Warplas Share Trust ('WST') in respect Sangio Pipes ('Sangio'). There had previously been a merger that was approved by the Commission wherein Dawn would become the sole shareholder of Sangio. In subsequent investigations, the Commission discovered a non-compete clause which in its view amounted to market allocation in terms of section 4(1)(b)(ii) of the Act, as Dawn and WST were, at the very least, potential competitors.[139]

The CAC in *Dawn Consolidated* pointed out that not all non-compete clauses in business agreements and joint venture agreements were objectionable. In fact, it noted that in circumstances where such agreements were commercially reasonable they were innocent. That said however, the CAC also noted that where the parties to the agreement were potential competitors, and the agreement amounted to a contravention of the cartel provisions in section 4(1)(b), the Tribunal did not have the power to approve them unless the principle of characterisation was applied. In effect, the only way an agreement containing a commercially reasonable clause (where the clause happens to breach the cartel provisions) would be acceptable would be if that commercially reasonable clause was characterised as not violating the cartel provisions.[140]

As previously set out in this chapter the characterisation principle as outlined in the *Ansac-case* requires an investigation into whether the character of the conduct complained of coincides with the character of the prohibited conduct.[141] In applying the principle to the facts presented, the CAC had to interrogate whether the restraint was reasonably required for the conclusion and implementation of the main agreement and proportionate to the requirement which the restraint served.[142]

[139]Dawn Consolidated at paragraph 22.
[140]*Dawn Consolidated* case at paragraph 28.
[141](refer to note 136 above).
[142]*Dawn Consolidated* case at paragraph 28.

In doing this, the CAC pointed out that the character of a non-compete clause could not be assessed as if it stood on its own. The non-compete clause needed to be assessed within the context of the transaction as a whole with a specific consideration of the circumstances in which the parties concluded the agreement.[143] The CAC proceeded to set out a three-step test in order to determine whether a restraint was reasonably required for the implementation of the transaction. The three–step inquiry requires that the parties (in their assessment of the restraint) question whether :

a) *"...the main agreement (ie disregarding the impugned restraint) is unobjectionable from a competition law perspective?*
b) *If so, is a restraint of the kind in question reasonably required for the conclusion and implementation of the main agreement?*
c) *If so, is the particular restraint reasonably proportionate to the requirement served"?*[144]

After following this three-step inquiry, the CAC ultimately held that this type of restraint was enforceable and reasonably required for the conclusion and implementation of the transaction between Dawn and WST. The reasons set out by the CAC were that Dawn would have access to Sangio's confidential information and know-how. As a result of this access, Dawn would be able to acquire insight into the successful conduct of a business in which it had no experience and expertise at the time the transaction was concluded. The CAC found that these reasons where reasonable given the legitimate concerns surrounding the potential abuse of Sangio's confidential information and know-how.[145] In respect of the proportionality of the restraint, the CAC held that the restraint was proportionate in so far as it related to the legitimate interests it served because it was only operational for as long as Dawn was a shareholder in Sangio.[146]

The CAC found that the restraint in the shareholders agreement between Dawn and WST was justified in the circumstances of the transaction. Applying the

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[143] *Dawn Consolidated* case at paragraph 32.
[144] *Dawn Consolidated* case at paragraph 32.
[145] *Dawn Consolidated* case at paragraph 42.
[146] *Dawn Consolidated* case at paragraph 43.

characterisation argument, the CAC held that this restraint would not fall foul of section 4(1)(b)(ii) of the Act and accordingly the CAC upheld the appeal of Dawn and WTS.

The last case that I will discuss, where the CAC once again interrogated the practical investigation involved when applying the characterisation principle, was *A'Africa Pest Prevention CC and Others v the Competition Commission ("A'Africa-case").*[147] Interestingly enough, unlike in previous cases where the CAC focused on the actual conduct of the firms and the economic relationship between the firms, the CAC in this case pierced the corporate veil. The CAC's enquiry looked into who managed and controlled the firms when characterising the conduct.[148]

In the *A'Africa-case*, the Commission initiated a complaint against two firms A'Africa Pest Prevention CC ("A'Africa CC") and Mosebetsi Mmoho Professional Services CC ('Mosebetsi CC'). A'Africa CC and Mosebetsi CC were close corporations conducting business in the pest control industry. A'Africa CC, at the time of the complaint, was owned by Aletta Labuschagne ("Labuschagne") who held 59% of the member's interest and Albertus Smith ("Smith") who held the balance. Labuschagne and Smith, in an aim to inter alia fulfil a growing demand for Black Economic Empowerment compliance, appointed Modise Mohelo ("Mohelo") as a member of Mosebetsi CC. Mosebetsi CC was initially incorporated by Labuschagne and Smith. Labuschagne and Smith subsequently decided to give Mohelo 52% of the member's interest in Mosebetsi CC and they held the balance. Even though Mosebetsi CC was a separate entity, it operated out of A'Africa CC's offices. In addition, A'Africa CC provided all the tools, equipment, the material that Mohelo required, and administrative services needed to operate the business.[149]

After some time Mohelo decided to resign from Mosebetsi CC but failed to submit his resignation letter to the Companies and Intellectual Property Commission in order to register Mosebetsi CC's change of membership. The problem arose when Labuschagne received two invitations from the Department of Public Works to submit

[147] *A'Africa Pest Prevention CC and Another v Competition Commission of South Africa* (2019) CAC (hereinafter referred to as *A'Africa* case).
[148] *A'Africa* case paragraphs 59 - 72.
[149] A'Africa case at paragraph 9.

a bid for the removal of bees ("the tender"). The one invitation was addressed to A'Africa CC and the other to Mosebetsi CC in respect of the same tender. Labuschagne proceeded to dutifully complete both sets of forms and file tender bids for both A'Africa CC and Mosebetsi CC. For the most part, the two tenders were exactly the same.[150] In the judgement, it is stated that the reason provided by Labuschagne for submitting the same tender was that she was of the view that since the pest control operators were providing the same service, the prices would be the same. The only difference between the two tenders was that VAT was not included in Mosebetsi CC's pricing, as it was not a registered VAT vendor.[151]

The Commission referred a complaint to the Tribunal on the basis that A'Africa CC and Mosebetsi CC who were in a horizontal relationship entered into an agreement to fix prices and tender collusively in contravention of sections 4(1)(b)(i) and (iii) of the Act. Prior to being heard by the CAC, the Tribunal held that that A'Africa CC and Mosebetsi CC had contravened sections 4 (1) (b) (i) and (iii) of the Act.[152] On appeal A'Africa CC and Mosebetsi CC challenged the Tribunal's interpretation of section 4(5) of the Act,[153]and its findings that the parties were in a horizontal relationship without applying the characterisation principles correctly. A'Africa CC and Mosebetsi argued that at the relevant period they formed part of a single economic entity, as envisaged in section 4(5) of the Act and that if the arrangement were properly characterised, their conduct did not coincide with the character of the prohibition contained in the cartel provisions as they were not in a horizontal relationship.[154] The Tribunal found that the threshold in section 4(5)(b) of the Act, requiring the concerned firms to be "*similar in structure*" to a parent and a wholly owned subsidiary, was not met. This was because the common membership that existed between A'Africa CC and Mosebetsi was capable of only exerting partial or joint control over one of the two firms.[155]

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[150]A'Africa case at paragraphs 15 to 16.
[151]A'Africa case at paragraph 16.
[152]A'Africa case at paragraph 5.
[153]In terms of section 4(5) of the Act, the provisions of section 4(1) of the Act do not apply to an agreement between, or concerted practice engaged in by a company, its wholly owned subsidiary as contemplated in section 1 (5) of the Companies Act, 1973, a wholly owned subsidiary of that subsidiary or any combination of them; or the constituent firms within a single economic entity.
[154]A'Africa case at paragraph 19.
[155]A'Africa case at paragraph 20 to 21.

The CAC ultimately held that "*Although on paper, by virtue of being separate entities, firms may be capable of colluding, ultimately, the actual role players behind those firms are natural persons. The question in this case, is whom was Labuschagne colluding with? Could she collude with herself, or engineer collusion between the two firms she completed the forms on behalf of, and what would the effect of that be?*"[156] The CAC held that in its view the Tribunal had not adequately addressed these questions even though there had been a submission on why the conduct ought to have been characterised. The fact that Labuschagne could not collude with herself meant that the hallmarks of collusion, which would involve individuals behind the firms conducting prohibited practices, were not present. Since Labuschagne had no colluding partner, she could not collude with herself in submitting the two tenders on behalf of A'Africa CC and Mosebetsi CC.[157] The CAC consequently set aside the Tribunal's decision in respect of the complaint against A'Africa CC and Mosebetsi CC. The CAC clearly characterised the behaviour as falling outside the scope of the cartel provisions.

3.4 **Conclusion**

Although it is clear from the above that characterisation has definitely been incorporated into our law the process for characterisation is not as clear. It is not clear what aspects of the agreements may be characterised and what evidence is permitted to be submitted in this process. In the *Dawn* case the CAC characterised the actual conduct of the firms, while in the *SAB-case* the CAC characterised the relationship between the firms. Then in the *A'Africa-case* the CAC pierced the corporate veil and entered into an investigation regarding who controlled and the managed the entities.

There is no doubt that characterisation is important as it allows for instances where conduct may fall foul of section 4(1)(b) of the Act to be assessed in light of the actual intention of the section. It is my submission that the difficulty with this approach is that to some degree the certainty that is supposed to be provided by the *per se* prohibitions is removed. In instances where parties are uncertain whether they are

[156] *A'Africa* case at paragraph 72.
[157] A'Africa case at paragraph 72.

permitted to characterise their behaviour as different, they will be left with no choice but to approach the competition authorities for confirmation that they are not falling foul of the provisions of the Act.

The lack of certainty in respect of the process may be problematic for parties in dual distribution arrangements. Unless the facts fit neatly within those set out in the *SAB-case* parties in dual distribution arrangements may continue to unknowingly contravene provisions or simply steer away from pro-competitive arrangements out of fear of possibly contravening the cartel provisions.

4 CHAPTER 4 FINAL REMARKS AND RECOMMENDATIONS

4.1 Introduction

As set out in previous chapters the competition authorities have an obligation to promote the efficiency, adaptability and development of the South African economy. In addition to this competition authorities have the unique task of attempting to address the socio-economic requirements of South Africa given the historical context of the country.[158] Dual distribution arrangements may assist in this regard. Dual distribution arrangements have the potential to allow manufacturers to take advantage of efficiencies offered by distributors, while simultaneously allowing them to handle certain aspects or parts of their distribution chain.[159] This in effect allows distributors to operate in a market that they may not necessarily have had access to if the manufacturers were fully vertically integrated. Concentration levels in the South African market remain high and ownership within the economy still sits with a small group who have endless resources.[160] It is my submission that the Act, alternatively the competition authorities' interpretation thereof, limits development in so far as dual distribution arrangements are concerned.

4.2 Repercussions for Contravening the Act

The repercussions of breaching the cartel provisions of the Act are noteworthy especially for large firms who generate large revenues.[161] It is my submission that large manufacturing firms may not want to risk contravening the cartel provisions even if doing so may yield pro-competitive gains. As submitted in previous chapters, once it has been determined that parties have contravened the *per se* provisions of section 4(1)(b) of the Act there is no defence available to them. Dual distribution arrangements by their nature amount to a contravention of the Act, unless the parties

[158]In the Commission's Annual performance Plan 2018/19, the Commission states that it has a 15 year vision which takes into account South Arica's socio-economic context and seeks to Regulate for a growing and inclusive economy, in line with the aims of the National Development Plan. Further the Commission also sets out to define its role in the transformation of the South African economy and is a response to its socio-economic challenges of unemployment, poverty and inequality. The Commission's Annual performance Plan 2018/19 was accessed on 20 October 2019 from http://www.compcom.co.za/wp-content/uploads/2018/01/APP-2018-Parliament-Presentation.pdf

[159](refer to paragraph 1.2 above)

[160]Smit "The rationale for competition policy: a South African perspective" 2005 Paper read at the biennial ESSA Conference, 7-9 September 2005, Elangeni Holiday Inn, Durban, Kwazulu- Natal, South Africa https://econex.co.za/wp-content/uploads/2015/04/econex_researcharticle_10.pdf (accessed on 20 October 2019) at 3 at 2

[161](refer to page 6 above)

can provide evidence that their agreements should be characterised as different to agreements that per se prohibitions intended to prevent and prohibit.[162] Then only if the competition authorities allow and/or agree with the evidence submitted in support of this characterisation will the contravener of the Act avoid the consequences of breaching the cartel provisions.

The Act makes provision for the punishment of offenders of the cartel provisions with the aim to not only punish the offenders but also to deter other firms who may in the future consider engaging in such cartel activities.[163] There are three main punishments for the contravention of the cartel provisions: the administrative penalty, damages claims and criminal sanctions.

The Tribunal has the exclusive power to impose an administrative penalty which may not exceed ten percent of the firm's annual turnover. In respect of repeat offenders, the Tribunal may impose a penalty of up to twenty five percent of the firm's turnover.[164] The administrative penalty is a method of deterrence and is regularly used by the competition authorities. There has been some debate on the effectiveness of an administrative penalty. As set out by Aproskie[165] trade unions have raised their concerns that fines on companies irrespective of their size do not punish those directly responsible for the price-fixing.[166] The Congress of South African Trade Unions in a statement expressed the view that the money used to repay fines may be recouped by the companies found guilty of a contravention by simply increasing prices, which has the effect of defeating the purpose of imposing a fine.[167] That said however, Aproskie also acknowledges and states that administrative penalties are specifically designed to be severe in order to deter firms from repeating an offence, engaging in similar offences and deterring other firms who may consider engaging in similar behaviour from doing so. The fine could potentially

[162](refer to chapter 3 above)
[163]Aproskie "Administrative penalties – Impact Alternatives" Journal of Economic and Financial Sciences 2011 at 13 (hereinafter referred to as Aproskie)
[164]Administrative penalties are provided for in section 59 of the Act. On 12 July 2019 certain provisions of the Competition Amendment Act, No 18 of 2018 (the "Amendment Act") came into effect following a presidential proclamation. Section 2A of the Act was inserted by section 33 (c) of the Amendment Act. In terms of section 2A of the Act, "[A]n administrative penalty imposed in terms of subsection (1) may not exceed 25 per cent of the firm's annual turnover in the Republic and its exports from the Republic during the firm's preceding financial year if the conduct is substantially a repeat by the same firm of conduct previously found by the Competition Tribunal to be a prohibited practice."
[165]Aproskie at 135
[166] (Cosatu press statement on 4 February 2010 - accessed through http://www.cosatu.org.za/show.php?include=docs/pr/2010/pr0204c.html&ID=2882&cat=COSATU%20Today). (hereinafter referred to as the Cosatu Statement)
[167]Costau Statement

have severe consequences on the finances of a company. Aproskie provides us with two examples of the severe consequences on the finances of companies, being [168]

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> *"1.The most dire possible impact on the offending firm would be that the fine would force the firm to exit the market. The fine may be sufficiently large to result in bankruptcy or insolvency such that the firm ceases to operate as a going concern. This may be a particular concern if a firm is highly leveraged and the fine prevents it from meeting its debt obligations.*

2. The fine may impact the firm's finances such that its investment decisions are affected. The firm may simply have insufficient capital to engage in investments that it otherwise would have or be forced to consider possibly suboptimal funding mechanisms like debt financing at unfavourable terms such that investments are delayed, downscaled or simply not made."[169]

For the reasons provided by Aproskie it is easy to see why paying an administrative penalty would have the effect of deterring parties who may not be certain of the legality of their arrangement from entering into such arrangement.

In addition to the administrative penalty, section 65(6) of the Act provides that once a firm has been found guilty of contravening the cartel provisions any third party who is of the view that they have suffered damages or loss as a result thereof may approach a civil court. If a firm were required to defend such a claim, it would have to utilise a large amount of its resources defending the allegation. This may further be exacerbated by the fact that civil courts have no authority to scrutinise the merits of the competition law aspects relating to the damages claim based on cartel conduct by firms who have been found to have engaged in such conduct.[170]

Lastly, section 73A of the Act imposes criminal sanctions in respect of the "cartel offence". Section 73A of the Act was inserted into the Act by the 2009 Competition Amendment Act and came into force on 01 April 2013.[171] In terms of this section, a

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[168]Aproskie at 136
[169]Aproskie at 136
[170]Munyai "Claims for damages arising from conduct prohibited under the Competition Act, 1998" De Jure 2017 at 22
[171]The Competition Amendment Act No 1 of 2009. Section 73A of the Act was inserted by section. 12 of the Competition Amendment Act No. 1 of 2009, insofar as it relates to sub sections. (1) to (4) under Proclamation No. 25 of 2016 in Government Gazette 39952 dated 22 April, 2016: 1 May, 2016

person commits a criminal offence if, while being a director of a firm or while having management authority within the firm, such person causes the firm to engage in prohibited cartel activities or knowingly acquiesces in the firm engaging in such activity. If any of these two aspects can be proved then the parties may face criminal charges. Beaton-Wells and Parker state that a key justification for cartel criminalization is that a fear of criminal sanctions and jail in particular, will deter potential offenders.[172]

Thus the repercussions for contravening the Act cannot be disregarded. True to their purpose they could deter any sound business from contravening the Act. They would however, and unfortunately so, certainly also deter businesses from entering into pro-competitive dual distribution arrangements.

4.3 **Recommendations**

As submitted by Lemley and Leslie, if competition authorities continue to focus on the vertical or horizontal character of a restriction imposed by an agreement there may be unintended consequences.[173] The focus of competition authorities should instead be on the actual or potential anti-competitive effects in the context of the agreement.[174] The categorisation process of classifying conduct as either vertical or horizontal may in some instances result in the end of the investigation with no enquiry into the effect of such conduct on competition or on consumers. Further, as submitted by Lianos, the proposal is not that we do away with the current categories that categorise agreements as either horizontal or vertical.[175] These categories are useful in providing legal certainty, *albeit* limited in some circumstances. As observed by Lianos, the categories *"provide the basis for bright-line rules' and for the optimal allocation of the burden of proof."*[176]

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[172]Beaton Wells C and Parker C "Justifying criminal sanctions for cartel conduct: a hard case" Journal of Antitrust Enforcement 204

[173]Lianos at 165 makes reference to the observations of Professors Lemley and Leslie who observe that "(t)he purpose of distinguishing horizontal and vertical restraints is judicial efficiency. If a restraint is horizontal, then courts are more likely to condemn it under the per se rule. This saves time and resources because such horizontal restraints are likely or almost always likely to reduce competition in a manner that antitrust cares about, while vertical restraints often serve legitimate business purposes. However, given the consequences of a restraint being labelled horizontal, the focus of antitrust litigation often shifts away from whether or not the restraint is unreasonable to whether the restraint is properly categorized as horizontal." Lemley and Leslie, "Categorical analysis in antitrust jurisprudence" 2008 IOWA Law Review 1208 at 1232
Working Paper No 348 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1026967 (accessed on 29 October 2019

[174]Lianos at 186

[175]Lianos at 186

[176]Lianos at 186

The incorporation of the characterisation principle into our law is helpful in interpreting arrangements that do not neatly fit into one category. Unfortunately not all cases have the luxury of being heard by the judges of the CAC who can then apply their vast legal know-how to determine whether behaviour can be correctly characterised as not contravening the provisions of the Act. As can be seen from the cases used in the discussion of the characterisation[177] principle our competition authorities, especially the Commission, do not always know when and how to characterise arrangements as different.

In respect of dual distribution arrangements, the *SAB-case* provided some guidance on when dual distribution arrangements can be characterised as not contravening section 4(1)(b) of the Act. The *SAB-case* also, to some extent, limits the characterisation principle in so far as dual distribution arrangements are concerned. In its characterisation the CAC in the *SAB-case*, highlighted that the distributor's existence was as a result the agreement. Since the distributor's existence was the result the agreement the CAC found that the agreement was mainly vertical in nature.[178] It is not clear if the competition authorities would allow a dual distribution arrangement to be characterised if both parties engaged in a horizontal relationship prior to the conclusion of a dual distribution arrangement which imposed vertical restrictions.

It is my recommendation that our competition authorities consider adopting an approach that is similar to that of the EU. As set out in Chapter 2 of the Treaty on the Functioning of the European Union makes provision for the creation an indicative list of the types of agreement that will prevent, restrict or distort competition. As a result agreements will only contravene the law if they have the objective or the effect of preventing, restricting or distorting competition.[179] This approach is not without its difficulties, as the courts are still required to examine which agreements have the objective or the effect of preventing, restricting or distorting competition. It may

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[177](refer to paragraph 3.3 above)
[178](refer to note 132 above)
[179](refer to note 32 above)

accordingly be useful for our legislators to consider incorporating a specific exemption within the Act for dual distribution arrangements.

Alternatively, the Commission which is the first point of contact when a complaint is made, must provide the public with some certainty. Section 79 of the Act makes provision for the creation of guidelines. Section 79 of the Act was substituted by section 40 of Competition Amendment Act and came into operation on 06 July 2019.[180] In terms of section 79 of the Act, the Commission may prepare and issue guidelines to indicate the Commission's policy approach to any matter within its jurisdiction. In terms of section 79(3), before issuing such a guideline the Commission must publish a notice in the Gazette: (i) stating that a draft guideline has been prepared; (ii) stating the place, which may include the Competition Commission's website, where a copy of the draft guideline may be obtained; and (iii) inviting interested parties to submit written representations on the draft guideline. A guideline specifically setting out which dual distributions arrangements contravene the provisions of section 4(1)(b) of the Act would go a long way in assisting the public to sufficiently understand specific instances when the competition authorities will not prosecute them for a contravention of the Act when firms are party to dual distribution arrangements. In fact pre-engagement with firms within the South African economy on the necessity of such arrangements and a detailed discussion on the pro-competitive benefits of such arrangements may be largely useful before the Commission issues such guidelines.

Once these engagements have occurred, the Commission will be in a position to provide appropriate guidelines on which dual distribution arrangements can be characterised as different or what type of distribution arrangements are explicitly exempted from the per se prohibitions.

[180] The proclamation was published in Government Gazette 42578 dated 12 July 2019.

4.4 Conclusion

Dual distribution arrangements could potentially have the effect of promoting competition developing the economy. The Commission has a duty to further the aims of the Act. By providing some certainty on the treatment of dual distribution arrangements the Commission could prevent unintentional contraventions by members of the public and ultimately the promotion of free and fair competition.

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