



# CPI Antitrust Chronicle

October 2013 (2)

Behind the Curve? The  
Treatment of Minimum  
Resale Price Maintenance in  
South Africa

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# Behind the Curve? The Treatment of Minimum Resale Price Maintenance in South Africa

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## I. INTRODUCTION

The South African Competition Act imposes an outright prohibition on minimum resale price maintenance, and even a first time offense is punishable by an administrative penalty of up to 10 percent of turnover. Since the inception of the Act in 1999, the South African competition authorities have collected more than R49.6 million in fines from companies for imposing minimum resale prices.

## II. OUTRIGHT PROHIBITION

In South Africa, non-price vertical restraints and restrictions relating to a maximum resale price are governed by section 5(1) of the Act and judged in terms of a rule of reason standard—a complainant is required to both prove the existence of an agreement between parties in a vertical relationship and that it has the effect of substantially preventing or lessening competition in a market.<sup>2</sup>

In contrast, minimum resale price is governed by section 5(2) of the Act, which prohibits this practice outright.<sup>3</sup> It is not necessary for a complainant in South Africa to demonstrate that the practice of minimum resale actually has any anticompetitive effects, and parties to a vertical price-fixing arrangement cannot justify such restraints on the basis that they lead to pro-competitive or efficiency gains. The section 5(2) prohibition applies equally to dominant firms and those without market power.

Section 5(3) of the Act does, however, permit suppliers to recommend a resale price, on two conditions. First, the supplier or producer must make it clear to the reseller that the recommendation is not binding. Second, if the product has its price stated on it, the words “recommended price” must appear next to the stated price.

## III. THE *FEDERAL MOGUL* CASE

The seminal case adjudicated by the South African Competition Tribunal (Tribunal) to date on the meaning and scope of section 5(2) of the Act was a complaint against Federal Mogul Aftermarket (Pty) Ltd (Federal Mogul), a wholesale distributor of a range of motor-car components, including Ferodo, a leading international brand in the friction products market.

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<sup>2</sup> Section 5(1) of the Act states that “An agreement between parties in a vertical relationship is prohibited if it has the effect of substantially preventing or lessening competition in a market, unless a party to the agreement can prove that any technological, efficiency or other pro-competitive gain resulting from that agreement outweighs that effect.”

<sup>3</sup> Section 5(2) of the Act states that “The practice of minimum resale price maintenance is prohibited.”

The complaint was laid by Pee Dee Wholesalers (Pee Dee), a distributor of motor brakes and related products (principally Ferodo products). It alleged that Federal Mogul reduced the rebate—or increased the price—at which it supplied Pee Dee with Ferodo products after it participated in a price war initiated by Midas, a general distributor of vehicle parts and the largest retailer of Federal Mogul’s range of products in the Gauteng province. Pee Dee maintained that Federal Mogul’s pricing was based on a standard scale, which recognized its customer’s monthly purchases as the sole determinant of the rebate granted. Prior to the price war, Pee Dee received the maximum rebate because of its large sales volume.

The Competition Commission (Commission) referred the complaint for adjudication by the Tribunal on the basis that Federal Mogul had contravened section 5(2) of the Act. In the Tribunal hearing, Federal Mogul raised a number of arguments. First, it argued that a threshold condition for an adverse finding under section 5 is the existence of an “agreement” which, in the event of its breach or violation, is given effect to by the imposition of a sanction. In other words, there must be some element of agreement or understanding between the manufacturer and its distributors that if any distributor breaks ranks it will be sanctioned. Second, Federal Mogul denied that the rebate was reduced in order to deter Pee Dee from participating in a price war with Midas. It maintained that the rebate offered to its distributors was determined by a number of factors, including the creditworthiness of the distributor. In this case, it claimed, the rebate granted to Pee Dee was reduced because of its poor payment record.

The Tribunal found that Federal Mogul had contravened section 5(2) of the Act. The Tribunal noted that section 5(2) clearly states that the “practice” of minimum RPM is prohibited, with no reference to an “agreement” to maintain minimum prices. All that the section 5(2) therefore requires is a unilateral determination of a minimum resale price, backed up by a sanction for non-compliance.<sup>4</sup> It was therefore ultimately a “question of causation,” or a matter of determining why Federal Mogul reduced the complainant’s rebate.

The Tribunal dismissed Federal Mogul’s contention that the rebates were determined by factors other than the volumes of products purchased or that the principal determinant of the rebate was creditworthiness—indeed, it noted, Federal Mogul employed a separate rebate system to encourage its customers to honor their credit terms. The level of sales attained by Pee Dee in Gauteng clearly justified the rebate granted to Pee Dee. The Tribunal further dismissed the suggestion that Pee Dee’s rebate was cut because of Pee Dee’s creditworthiness—although it had a history of tardy payments, this did not seem to be unusual in this trade. Moreover, immediately after the rebate was cut, Federal Mogul executed the largest order ever placed by Pee Dee.

Rather, the Tribunal held, Federal Mogul had reduced rebates in response to Pee Dee’s participation in a price war with other distributors, including Midas—the version recorded by Finance Director of Federal Mogul in a letter to the Commission in response to the complaint, in which he noted that “Pee Dee entered into a price war situation, which disrupted the market, causing problems for other Federal-Mogul users.”<sup>5</sup> The Tribunal accordingly concluded that

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<sup>4</sup> The Tribunal noted that it did not have to decide this point of law in the present case, because there was in fact sufficient evidence to show an agreement or understanding in the industry regarding the price at which distributors, such as Pee Dee, were obliged to sell Ferodo products to their customers.

<sup>5</sup> ¶[50].

Federal Mogul took the decision to cut Pee Dee's rebate, in order to make it impossible for it to increase the discounts it provided to its customers and participate in the price war, thereby demonstrating "the consequences of not playing by the rules" to Pee Dee (and any other would-be transgressors).<sup>6</sup>

Federal Mogul appealed to the Competition Appeal Court ("CAC") on three grounds. First, it argued that the Tribunal had erred in fact and in law in finding that section 5(2) prohibits the practice of resale price maintenance without the necessity of establishing that an agreement exists to maintain minimum resale prices, and therefore that Federal Mogul had contravened this section. It argued that the purpose of prohibiting resale price maintenance was to prevent the conclusion of agreements between manufacturers and dealers to enforce a horizontal agreement, not to prevent "manufacturers from enhancing the efficiency of their distribution structures."<sup>7</sup> There could be many pro-competitive reasons why a manufacturer might want to stipulate the price at which its goods are sold in the market, including "the prevention of free riding, the preservation of brand image, the incentivization of multi-brand dealers to trade in the manufacture's product, the avoidance of dealer concentration, the provision of an extensive availability of products [and] promotion of entry into the market".<sup>8</sup>

Even if all section 5(2) required was a unilateral determination of a resale price, however, Federal Mogul argued that the Tribunal had erred in finding that it had contravened this section. In particular, Federal Mogul's decision to cut the rebate offered to Pee Dee was primarily motivated by its creditworthiness and poor payment history, as well as the volumes sold by it and its strategic importance—rather than an attempt to enforce it to adhere to a minimum resale price.

Second, Federal Mogul argued that section 59(2) of the Act<sup>9</sup> was unconstitutional to the extent that it permitted the Tribunal, an administrative body, to impose discretionary pecuniary penalties for contraventions of the Act.

Last, Federal Mogul argued that the penalty of R3 million imposed by the Tribunal was not an appropriate penalty taking into consideration the factors listed in section 59(3) of the Act.

In a joint judgment, Davis JP and Jali JA dismissed the first ground of appeal. They noted that Section 1 of the U.S. Sherman Act and the judicial interpretation of it giving rise to the so-called Colgate principle—is distinguishable from section 5(2) of the Act. Most importantly, provision is not made for an "agreement" in section 5(2) of the Act. Whereas section 5(1) of the Act prohibits an "agreement" between parties in a vertical relationship, section 5(2) employs the word "practice." The CAC thus held that "the drafters of the Act clearly regarded resale price maintenance as an egregiously anti-competitive activity and wished to state so in terse and clear terms. The wording of the section indicates that to establish a contravention thereof, it suffices to produce evidence which shows that a supplier has imposed on its distributors a price at which its

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<sup>6</sup> (CT) at ¶ [68].

<sup>7</sup> (CAC) At page 4.

<sup>8</sup> (CAC) at 52i – j.

<sup>9</sup> Section 59(2) states that "An administrative penalty imposed in terms of subsection (1) may not exceed 10 per cent of the firm's annual turnover in the Republic and its exports from the Republic during the firm's preceding financial year."

goods are to be resold and the distributors are thereby induced to comply with this minimum price on pain of a sanction for non-compliance.”<sup>10</sup>

The CAC further observed that the need to prove the existence of an “agreement” would place a greater burden on the respondent, whereas a “practice” simply connotes “a form of repetitious or habitual conduct of a kind which can be discerned from the evidence as being known and recognized to the interested parties.”<sup>11</sup> All that is required to contravene section 5(2) is thus a unilateral determination of minimum resale prices by a manufacturer, backed by a sanction for non-compliance.

The CAC held that Federal Mogul had indeed contravened this prohibition. It noted that there were a number of difficulties with Federal Mogul’s argument that its primary reason for cutting the rebate offered to Pee Dee was its creditworthiness, including the fact that Pee Dee’s credit limit had exceeded R1.5 million when it had placed a large order in October 1999, yet Federal Mogul had not withheld its supplies at that stage because of its poor payment record.

The CAC agreed with the Tribunal’s analysis of the letter sent by Federal Mogul’s Finance Director to the Competition Commission in response to the complaint lodged by Pee Dee in November 1999, in which it stated that Pee Dee entered into a price war which had disrupted the market and which would affect its relationship with its other wholesalers. This, the CAC noted, accurately described Federal Mogul’s objectives when it reduced Pee Dee’s rebate—once it entered the price war and acted contrary to the understanding regarding the pricing of Federal Mogul’s products, Federal Mogul moved to discipline Pee Dee by reducing its rebate in order to ensure that the pricing policy which it adopted was followed by its suppliers.

This version was also supported by the testimony presented by Federal Mogul’s Mr. van der Bijl, who confirmed that Pee Dee had been informed that its discount rate had been reduced because it had followed the price war, despite having been requested not to do so. The CAC agreed with the Tribunal’s observation that Federal Mogul operated a separate 4 percent discount system, which was expressly designed to encourage prompt payment by dealers. The CAC thus concluded that “The evidence before the Tribunal clearly points to the fact that the ‘customer rebates’ had nothing to do with timeous payments of the accounts by the customers of the Appellant”.<sup>12</sup>

The CAC accepted that the Tribunal had properly exercised its discretion in imposing a penalty of R3 million. It noted that “the legislature’s intention in providing for a per se prohibition against minimum resale price maintenance and for the imposition of administrative penalties against first time offenders, indicates the serious nature of the contravention and its deleterious impact on competition.”<sup>13</sup>

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<sup>10</sup> (CAC) at 54d.

<sup>11</sup> (CAC) at 54h.

<sup>12</sup> (CAC) at 57d.

<sup>13</sup> (CAC) at 71h - i.

#### IV. THE TREATMENT OF MINIMUM RPM BY THE SOUTH AFRICAN COMPETITION COMMISSION

Like the CAC and the Tribunal, the Commission has taken the view that minimum RPM constitutes an “egregiously anti-competitive activity.”<sup>14</sup> The Commission has investigated a significant number of cases involving minimum RPM and has imposed significant monetary penalties on suppliers for engaging in this practice. For example, Toyota SA paid an administrative penalty of R12 million for dictating the maximum discounts dealers were allowed to give customers on certain models manufactured by Toyota.<sup>15</sup> The Tribunal subsequently also confirmed consent agreements relating to the contravention of section 5(2) of the Act by DaimlerChrysler,<sup>16</sup> General Motors,<sup>17</sup> and the manufacturers of Citroen,<sup>18</sup> Volkswagen,<sup>19</sup> and Nissan vehicles<sup>20</sup> in South Africa.

In one fairly recent case, Oakley Athletic, the sole distributor of Oakley sunglasses in South Africa, agreed to pay a penalty of approximately R2 million in terms of a consent agreement confirmed by the Tribunal, after the Commission’s investigations revealed that Oakley prescribed a minimum retail price for its products and prevented retailers from offering discounts to consumers.<sup>21</sup> Indeed, in some cases the retail outlets requested Oakley to deliver the products with the price tags already affixed.

The Commission concluded that Oakley’s standard retail sales agreements provided that its 800 South African retail outlets would forfeit their status as Oakley stockists, or jeopardize their future supply of products, if they diminished the Oakley brand in any way, including through offering customers discounts on Oakley sunglasses. Discounts were only permitted on discontinued or out-of-season lines. The Commission concluded that Oakley enforced this policy by conducting regular random visits to outlets. The consent order *inter alia* required Oakley Athletic not to impose a maximum discount structure in respect of sales of Oakley sunglasses, to institute a compliance program and to take reasonable steps to ensure that its stockists terminate their role in implementing the alleged anticompetitive conduct.<sup>22</sup>

#### V. MINIMUM RPM AND FRANCHISES

In its guideline regarding the application of the Act in the context of franchise relationships,<sup>23</sup> the Commission adopts the stance that “RPM is bad because it not only prevents consumers from enjoying lower prices but also undermines intra-brand competition. Worse still,

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<sup>14</sup> (CAC) at 54d.

<sup>15</sup> *Competition Commission / Toyota South Africa Motors (Pty) Ltd* [2005] CPLR 430 (CT).

<sup>16</sup> *Competition Commission / DaimlerChrysler SA (Pty) Ltd* [2006] 1 CPLR 73 (CT).

<sup>17</sup> *Competition Commission / General Motors SA (Pty) Ltd* [2006] 1 CPLR 82 (CT).

<sup>18</sup> *Competition Commission / Boundless Trade 154 (Pty) Ltd trading as Citroen South Africa* [2006] 1 CPLR 68 (CT).

<sup>19</sup> *Competition Commission / Volkswagen SA (Pty) Ltd* [2006] 1 CPLR 87 (CT).

<sup>20</sup> *Competition Commission / Nissan South Africa (Pty) Ltd* 2006] 1 CPLR 93 (CT).

<sup>21</sup> *Competition Commission / Oakley Athletic (Pty) Ltd* [2006] 2 CPLR 536 (CT) (*Oakley*)

<sup>22</sup> *Oakley* at 541.

<sup>23</sup> Notice titled “The Application of Certain Provisions of the Competition Act 89 of 1998, as amended, to Franchise Agreements” available at:

[http://www.compcom.co.za/resources/publications\\_notices.asp?level=2&child=4](http://www.compcom.co.za/resources/publications_notices.asp?level=2&child=4) (“the Franchising Notice”).

it could possibly facilitate collusion on prices and trading conditions among the franchisees, practices that are also not allowed in terms of the Act.”<sup>24</sup>

This Franchising Notice articulates the approach taken by the Commission in relation to a complaint filed against Italtile in 2001.<sup>25</sup> The complainants alleged that Italtile had engaged in various anticompetitive practices, including minimum RPM. In the course of its investigations, the Commission obtained documentation that indicated that Italtile enforced a strict pricing policy. The Commission concluded that the Italtile group compelled its franchisees to charge prices that are set centrally by the group. Franchisees were not permitted to deviate from these prices without prior approval from the group, and franchises not adhering to this policy were threatened with termination.

The Commission took the view that the Italtile group had contravened section 5(2) of the Act, and Italtile agreed to conclude a consent order with the Commission, in terms of which it undertook to pay an administrative penalty of R2 million and to take various steps to bring its conduct into line with the Act. The consent agreement was confirmed and made an order by the Tribunal in September 2005.

The approach adopted by the Commission accords with the Tribunal’s recognition in the case of *Cancun Trading/ Seven-Eleven Corporation SA (Pty) Ltd*<sup>26</sup> that “antitrust authorities generally agree that exclusive supply arrangements, exclusive purchasing contracts, tie-ins and resale price maintenance may give rise to possible vertical restrictive practices that could be relevant to franchising.”<sup>27</sup> The Tribunal granted an application for interim relief by a group of convenience retail store franchisees who complained that Seven-Eleven obliged them to purchase only from suppliers approved by it in contravention of section 5(1) and section 8<sup>28</sup> of the Act. The complainants were furthermore obliged to sell their products at prices approved by Seven-Eleven, which they alleged contravened section 5(2) of the Act.

The Tribunal held that the complainants had not placed sufficient evidence before it to enable them to define the relevant market and, hence, to make a finding in terms of sections 5(1) or 8 of the Act. However, the Tribunal granted the application for interim relief in relation to section 5(2) of the Act. The Tribunal recognized that the application of the prohibition of minimum RPM in the franchise context may pose particular difficulties, in that a franchise relationship is a “unique organizational form” which is “neither an employment relationship nor an independent contracting relationship. It rather combines elements of integration and delegation, control and independence and it is this multifaceted vertical structure that paves the way for endless relational and commitment problems.”<sup>29</sup>

However, the Tribunal dismissed Seven-Eleven’s argument that a franchise relationship must be viewed as a single business entity or an association, on the basis that “we can find no authority ... where the franchise relationship has been treated as a single firm and, where, on that

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<sup>24</sup> Franchising Notice at par [4.7].

<sup>25</sup> *Competition Commission / Italtile Franchising and others* [2005] 2 CPLR 399 (CT)

<sup>26</sup> [1999–2000] CPLR 173 (CT) (“*Cancun Trading*”).

<sup>27</sup> *Cancun Trading* at 175.

<sup>28</sup> Section 8 prohibits various abuses of dominance.

<sup>29</sup> *Cancun Trading* at 174.



basis, vertical price-fixing has been condoned. On the contrary, the authorities appear to take as a given that these prohibitions may be applied to franchises.”<sup>30</sup> The *Cancun Trading* and *Italtile* decisions have prompted debate in South Africa about whether particular legislation should be enacted to exclude franchise relationships from the application of the Act but to date, no such amendments have been proposed.

## VI. SHOULD THE ACT BE AMENDED?

The South African approach to minimum resale price maintenance appears to be significantly stricter than that adopted by the U.S. courts, which recognize the unilateral ability of a manufacturer to suggest retail prices and to choose retailers with whom it wishes to do business in terms of the *Colgate* policy. A growing body of international economic literature suggests that minimum RPM may in fact be pro-competitive and should therefore be subjected to analysis in terms of the rule of reason standard. The outright prohibition contained in section 5(2) of the Act, coupled with the risk of a substantial fine, even for a first-time offense, seems to be out of step with this international trend.

However, there may be good reasons for retaining this approach to minimum resale price maintenance in South Africa. Ours is a developing but highly concentrated economy,<sup>31</sup> in which competition law enforcement is relatively new. Cartels remain rife, despite valiant efforts by the Commission to stamp them out, including by employing a highly effective Corporate Leniency Policy and innovative fast-track complaint settlement procedures. The U.S. experience demonstrates that minimum RPM can potentially be used—and indeed, sometimes is used—as a cover for horizontal price-fixing. Thus, the possibility that minimum RPM may facilitate the scourge of collusion seems to pose a significant risk in the highly concentrated South African economy. This alone might justify the retention of the *per se* prohibition in our Act, even if it is dispensed with in other less concentrated, developed economies.

Furthermore, a change to the *per se* approach to minimum RPM may significantly alter the balance of power between powerful suppliers, on the one hand, and South African regulators and consumers on the other. As the South African Commission’s experience since the inception of the Act demonstrates, it is very difficult for our regulator to establish a contravention of the rule of reason prohibitions. Not a single case adjudicated in terms of the rule of reason standard has been won by a complainant to date. Hence, a decision to amend the *per se* prohibition set out in section 5(2) of the Act will not only affect the nature of the evidence which complainants must lead in these cases, but might effectively fundamentally stack the odds against South African consumers. Prosecuting more cases in terms of the rule of reason standard will also place a significantly heavier burden on the Commission, which is already over-burdened and under-resourced.

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<sup>30</sup> *Cancun Trading* at 181.

<sup>31</sup> Competition Commission ‘Competitiveness and Job Creation : Bedfellows or Enemies’ available at: <http://www.compcom.co.za/resources/newsletter%20-%20dec04/html/pages/2%20Competitiveness.html>