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Minimum Resale Price Maintenance

Franchisors to amend Anti-Competitive Contracts

In future, the Commission will only have to prove that an act of minimum resale price maintenance occurred, and not prove its anti-competitive effect in order to establish a contravention of the Competition Act 1998.

The Commission welcomed this interpretation of Section 5(2) of the Act by the Competition Tribunal in its decision in the matter against Federal Mogul Aftermarket (Federal Mogul). Section 5(2) is a per se prohibition on the restrictive vertical practice of minimum resale price maintenance.

This was the first decision on this section to be made by the Tribunal. The decision means that when dealing with matters of this nature, especially in the context of franchises, the Commission will have to prove the act and not the effect. In other words, if the Commission can prove that the retailer has been required to sell goods to customers at a price not lower than what is prescribed, that will be sufficient to prove a contravention of the Act. The Commission will not need to prove, as in most other cases, that the act has had an anti-competitive effect. This is the approach taken by competition authorities in both America and Europe.

In August 2002, the Commission referred a complaint filed by Pee Dee Wholesalers against Federal Mogul, to the Competition Tribunal with the recommendation that Federal Mogul was practicing minimum re-sale price maintenance in contravention of

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the Competition Act by imposing sanctions on Pee Dee Wholesalers. Federal Mogul was not passing on agreed-upon, uniform discounts to retail trade.
The Commission asked for a fine to be imposed on Federal Mogul. The Act provides for the imposition of a fine of up to 10% of Federal Mogul's annual turnover.
The significance of this decision for franchisees is that where franchisors impose minimum resale price maintenance on their franchisees, these contracts would have to be reviewed, as minimum resale price maintenance is a per se (outright) prohibition in terms of the Competition Act. The Commission would investigate such anti-competitive practices.

Investigating Complaints

In the interest of resolving complaints efficiently, the Commission provides specific guidelines for lodging a complaint.
Complaints should be lodged with the Commission using a CC 1 Complaint Form. A case number is allocated to the complaint and serves as ‘proof’ to the complainant that his/her complaint has been received. The case is then referred to an investigator who will investigate the alleged contravention of the Competition Act.
A case in point is the recently published All Joy/Tiger Brands complaint.
In recent months, food price inflation made countless headlines. In the wake of what many consumers see as an unfair upward adjustment to their weekly grocery bill, the All Joy and Tiger Brands feature in January 2003’s Business Report had timeous news value. However, there is more to the story than appeared in the article, claiming that the Commission had not responded to a complaint lodged by All Joy.
All Joy approached the Commission in 2001, requesting an investigation into Tiger Brands’ pricing of tomato paste that is used in manufacturing tomato sauce. The investigation resided under Section 2 of the Competition Act - governing abuse of dominance.
The Commission’s investigation concluded that having a dominant position does not necessarily lead to abuse of that position. The Commission determined that neither the prices set by Tiger Brands, nor its behaviour, impaired a pro-competitive economy by, for example, inhibiting new entrants from competing in the market.
The case received a notice of non-referral.
The Commission received further submissions from All Joy subsequent to the initial complaint and notice of non-referral. However, the submissions did not constitute a second complaint, but merely provided further support for their original case.

Commission Opposed Request for Industry Designation

The Retail Motor Industry organisation (RMI), requested industry designation from the Department of Trade and Industry (DTI) late last year. The Commission opposed this request for the 'designation' of the motor industry. (Designation of an industry is required if industry participants want to be exempted from certain prohibitions of the Competition Act).

Exemption may be granted under Section 10 of the Act if the anti-competitive agreements or practices contribute to the 'economic stability' of any industry designated by the Minister. These exemptions apply only to the restrictive agreements or practices prohibited by Chapter 2 of the Act.

The Commission was not aware of any anti-competitive agreements or practices being contemplated by the RMI in anticipation of obtaining exemption from prosecution under the Act. Nor was it clear how the 'economic stability' of the motor industry was being threatened or would be threatened. In fact, the industry was performing rather well at the manufacturing level, with exports rising fast.

As to the potential instability arising at the distribution level, there was no indication that recent changes to the relationships between manufacturers and their dealers would have any negative effect on the industry.

It was in the interest of each manufacturer to choose the most effective distribution model for its products in order to be competitive. The distribution model should benefit both manufacturers and dealers.

Recently, DaimlerChrysler (DCSA) moved towards vertical integration by purchasing 75% of Sandown Motors, and by creating brand centres amongst its other dealers. Whereas BMW adopted a policy that no dealer should have more than 10% market

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share of BMW sales. As a result, the Forza group had to dispose of its Hyde Park dealership. This led to the sale of dealerships, the termination of franchise agreements or the imposition of new terms and conditions. The Commission maintains that it would be inappropriate to intervene in the process of normal contract negotiations. If the Commission were to recommend that franchises be awarded for a certain minimum duration, or that dealers were allowed to multi-brand, manufacturers might decide to integrate vertically by purchasing or establishing their own dealers. Manufacturers have the option to integrate vertically if they are not satisfied about the prospect of sharing a showroom floor with their competitors or complying with any other unwanted terms and conditions thrust upon them by a regulatory body.

Manufacturers impose some restrictions on competition between their dealers in order to preserve brand equity. For example, BMW may grant only a few dealers the right to sell its cars in South Africa, which gives those dealers the margins required to invest in plush showrooms and customer services. On the other hand, BMW does not want its dealers to expand too much, for whatever reasons it sees fit.

It is not for the competition authorities to question the everyday tactics of firms: perhaps BMW does not want its cars to be associated with the idea of mass-selling, or perhaps it wishes to prevent the emergence of countervailing power amongst its dealers. But even if that was the case, it would be difficult to see how an intervention by the competition authorities could prevent a manufacturer from exercising complete control of the product's supply chain, one way or another.

The acquisition of countervailing power amongst car dealers might be illusory. Manufacturers are in control of wholesale price levels, and their decisions on dealership margins are likely to be based on inter-brand competition (competition between different makes of cars in the company) rather than market power exerted by dealers.

The Commission would be likely to intervene if manufacturers imposed restrictions on their distributors in markets where manufacturer's market share is greater than 30%, and where pro-competitive effects are outweighed by the anti-competitive effects of the restrictions. Alternatively, the Commission would be concerned where similar restrictive practices applied by several manufacturers have a cumulative effect on competition across the relevant market.

The Commission's approach to the motor industry issue at hand is similar to the European Community's Vertical Restraints Guidelines, but less intrusive than the European Community's recently revised Block Exemption Regulation. The European situation is different, in that there are concerns about price differentials between member states, and in some instances manufacturers integrated vertically in order to overcome the legislative restraints on their methods of distribution.

The South African Taxi Industry

Taxis are the most popular mode of transport in urban areas for the majority of South Africa's population. Public transport by taxis account for 65% of the transport total, 20% by bus and 15% by rail[1].

Due to the informal nature of the taxi industry, it is has been difficult for Government to regulate the industry. However, the government through the National Department of Transport identified the vital need of formalising and regulating the industry through the National Land Transport Transition Act, Act No. 22 of 2000.

Brief history of taxi operations in SA

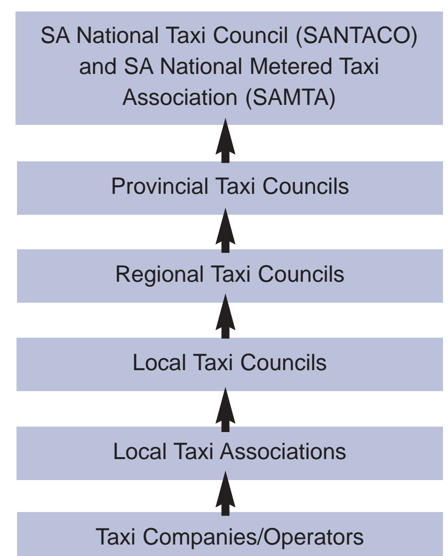
Law restricted taxi operations until 1977 to sedan motorcars fitted with fare meters. In 1977 minibuses were introduced to the taxi industry allowing one driver and fifteen passengers.

In 2000, Government introduced a four-year taxi re-capitalisation programme in its drive to formalise the industry. The programme is aimed at the individual operator offering affordable, purpose-built, safe and convenient public transport. Current minibuses will be replaced with 18- and 35-seat minibuses.

Structure

The taxi industry consists of minibuses, dominating 90% of the market, and metered taxis active in the remaining 10% of the market[2].

Minibuses and Metered Taxis Structures



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Taxi operators organise themselves into Local Taxi Associations that form Local Taxi Councils. The Local Taxi Councils in turn elect representatives from local councils per region and form Regional Councils. Representatives from Regional Councils elect Provincial Councils that in turn elects the National Council that is tasked with upholding national issues and policies.

The National Council represents the national taxi industry by mandate of conference.

Size and monetary value

The industry consists of approximately 150 000 public minibus taxis.

It is difficult to determine the number of metered taxis operating in SA due to the informal structure of the industry. The Western Cape and KwaZulu Natal taxi industry seem to be well coordinated while taxis in Gauteng in particular are not that well coordinated. Gauteng has about 3 700 metered taxis, only 1 860 of which are legal[3].

The South African taxi industry is estimated to have a turnover of approximately R16,5 billion[4]. The precise contribution of the taxi industry to the country's GDP is unknown. Many taxi operators are not registered as taxpayers, although they may well be registered with the Department of Transport as taxi operators.

Quantity restrictions and fare-setting

SA's taxis are not formally subjected to quantity restrictions, but the Department of Transport seems to have stopped issuing permits while it decides on how to formalise that process.

In the case of minibuses, different individual taxi associations appear to decide collusively on taxi fares to be charged per route, outside consultation with, or interference by, the authorities.

Note that according to Section 4(1)(b)(i) of the South African Competition Act, Act No. 89 of 1998, such agreements between competing firms, or an association of competing firms, are prohibited as they involve directly or indirectly fixing a purchase or selling price or any other trading condition.

At present, minibus commuters are charged fixed amounts for travelling on particular routes. These routes are generally known, without being published.

In the case of metered taxis, there appear to be two types of fares: metered prices and negotiated prices. The metered price is the 'official' pricing that should be complied with, and is set by the taxi associations, again apparently collusively. Illegal taxi operators charge negotiated prices because of the lack of a meter reading, while legal taxi operators often choose to charge negotiated prices for fear of losing business. It is common practice to set fares according to their perception of the customer's willingness to pay.

Current meter reading fares are charged as follows: an initial fare of R2.00, then R5.50 per kilometre and 10 cents per 20 second period of engine idling time[5]. There is no charge for the distance travelled by the taxi to the client, so the fares mentioned must cover that distance as well. Some taxi companies also offer special rates of up to 50% discount for disabled passengers and pensioners.

Unregistered 'metered' taxis that operate without a control centre acquire business by means of:

- Parking at taxi ranks and cruising past known pick-up spots
- By distributing business cards to retain regular clients. Freedom from tax liability as well as freedom from having to pay monthly membership fees of approximately R500 compensate for the lack of a control centre for unregistered metered taxis.

Regulatory regime governing the industry

Illegal operators in the industry contribute to violence and tax evasion. Regulating the industry envisages eliminating violence and improving tax revenue collection from the industry.

A backlog in the administration and registration of taxis in the Department of Transport is being addressed. Permits are formally issued, and converted from radius to road-based permits. A national database is being established in conjunction with the provinces. A short-term window period to comply with legislation is being established to accommodate non-registered taxi operators, and unsuccessful applicants. These measures should provide Government with a sound base to regulate the industry.

The taxi re-capitalisation programme referred to is expected to cost R4 billion. The minibuses will include:

- electronic fare collection for tax revenue collection

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- vehicle tracking, which improves the ability to monitor and control operations more effectively, both from an enforcement and operator perspective.

These measures impact directly on commercial risks of operators, financiers and insurers, and therefore on stability in the industry.

The re-capitalisation project envisages that Government will assist taxi operators by providing subsidies to buy new vehicles. The qualifying condition for a subsidy would be that legal operators would submit their current (legally registered) vehicles for scrapping in exchange for the purchase of a new vehicle. For example, a ten-year-old fifteen-seater would be exchanged for a new 18-seater. The submission of two 15-seaters would be exchangeable for a new 35-seater. Government would issue a 30% subsidy on the value of a new vehicle.

Conclusion

The South African Taxi industry plays an important role in the economy considering that the majority of South Africans are poor and dependent on public transport. Lack of regulation resulted in a massive informal component of the industry. Current formalisation processes may help implement the proposed regulations, which will eliminate illegal operators, improve tax revenue collection and solve other problems surrounding the industry, such as safety and service levels.

From a competition perspective, however, it is not clear that increased regulation will provide benefits to consumers that will outweigh the likely inflationary effects on fares. After all, the elimination of illegal metered taxis will reduce the supply of taxis and relieve competitive pressures on the remaining participants.

1 http://www.transport.gov.za/projects/index.html

2/3 Mr N Holiday, Chairperson of the South African Metered Taxi Association, Tel 011 403 0000 or 072 397 3139.

4 Telephonic interview with Mr Phillip Taaibos, General Secretary of South African National Taxi Council. It should be noted that this amount is for minibuses only. The turnover for metered taxis is not known.

5 Interviews with different taxi companies in Gauteng, KwaZulu Natal and Western Cape provinces.

Notifying a Transaction

An issue of Control

The notifiability of any transaction to the Commission partly depends on whether there is a change in control of a firm.

Section 12(i)(a) of the Competition Act states: "For the purpose of this Act, a merger occurs when one or more firms directly or indirectly acquire or establish a direct or indirect control over the whole or part of the business of another firm".

The envisaged control can be acquired through various mechanisms, including asset swap, pooling of arrangements, acquisition of shares and/or assets, etc.

An example illustrative of the above is LNM's request to increase its shares in Iscor to 43-47%.

The question that needs to be answered is: Does the acquisition of Iscor shares by LNM give LNM control of Iscor's Board of Directors? If control is not acquired a merger, as defined in the Competition Act, is not notifiable to the Commission.

Control can be obtained by:

a) Acquiring more than 50% + 1% shares

b) Entering into a pooling arrangement with other shareholders to gain control of the Board of Directors

c) Acquiring the right or power to veto decisions of the Board of Directors, and

d) Appointing directors to the Board to influence decisions as if it is in control of the Board.

The Commission will only require notification of a transaction where any one of the factors in (a)-(d) above exist, or where a party acquires the ability to materially influence the policy of the firm as if it were in complete control of a firm.

Trade and Competition Policy Interaction

Competition in the World Trade Organisation

This article examines competition policy in the World Trade Organisation (WTO) as well as the relationship between trade and competition policy in general.

The WTO was established January 1995 after the Uruguay Round Negotiations (1986 - 1994). WTO is a rules-based, member-driven organisation with 144 members, 80 of which have competition laws. The WTO and its predecessor GATT (established January 1948) have been concerned with reducing tariff and non-tariff government barriers to trade.

Several trade conflicts have been the result of discrepancies between countries in their stances towards antitrust policy, the concept of a level playing field and the attainment of such a state. This has led to a renewed interest in national competition policy, or the lack thereof, by trade specialists and numerous international institutions such as UNCTAD[1], OECD[2], World Bank as well as the newly established International Competition Network (Jung, 2000:89). As a result, a Multilateral Framework on Competition Policy (MFC) is currently under debate.

In addition, there are three distinct reasons why the subject of an international competition agreement surfaced again:

I. Greater incentives for firms to protect domestic markets: On account of much progress the WTO and governments are searching for private practices that may restrict trade and counteract the reduction of government barriers.

II. Globalisation and the resultant multi-country effect that business transactions may have: Because of the increasing pace of globalisation and the resultant increase in cross-border business activity, the number of international competition cases increased in recent years. Mergers of multi-national corporations as well as the prosecution of international cartels require greater cooperation between competition authorities in multi jurisdictions. This is also a motivation for greater consistency in competition laws across countries.

III. Progress in the reduction of government barriers to trade: Firms may now have greater incentives to engage in anti-competitive practices in order to protect domestic markets.

Trade and Competition Policy Working Group

The Singapore Ministerial

A working group was established in April 1997 to oversee interaction between trade and competition policies. Discussions at the 1996 Ministerial Conference in Singapore served as catalyst to include competition agreements. Paragraph 20 of the declaration of the 1996 WTO Ministerial Conference states that the WTO members agree to: "…establish a working group to study issues raised by members relating to the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration in the WTO framework".[3]

The Doha Round

The latest round of WTO negotiations, the Doha Round, commenced in November 2001 and is expected to last until 1 January 2005. Negotiations on the interaction between trade and competition policy will commence only after the fifth session of the 2003 Ministerial Conference in Mexico.

Until then, the working group will see to the following:

- Core principles including transparency, non-discrimination and procedural fairness, and provisions on ‘hardcore’ offences, such as cartels.
- Ways of handling voluntary cooperation

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on competition policy among WTO member governments.

- Support for progressive reinforcement of competition institutions in developing countries through capacity building.[4]

As per instruction of the Doha Round, work must be constructed around the central theme, developmental needs.

The relationship between Trade and Competition Policy

"Competition and trade policies share a complementary underlying rationale: The elimination or reduction of barriers to, and distortions of, markets"(OECD,1999:17).

The traditional model of complementarity (OECD,1999:7-8) illustrates the relationship between trade and competition policies by examining their ultimate objectives. Trade policies, by lowering barriers to trade and thus increasing competition in markets, should result in lower consumer and input prices. Similarly, competition policies are concerned with the attainment of prices that would prevail in fully competitive markets.

The fundamental difference between the two policies is that competition policies target private actions behind the border, whilst trade policies are concerned with the actions of governments within the border.

The economics of Trade and Competition Policies

Both trade and competition policies are concerned with improving the efficient allocation of resources.

Competition policies are explicitly concerned with the attainment of economic efficiency, comprising allocative, productive and dynamic efficiency[5]. Trade liberalisation policies also contribute by removing barriers that may prevent foreign firms from competing in national markets.

Consistencies

The lowering of trade barriers theoretically enables countries to produce according to their comparative advantage, and total world welfare is maximised. This ensures countries allocate resources efficiently both across and within industries in response to actual or potential competition from imported goods and services.

Kennedy (2001) explains the process of welfare maximisation:

- Specialisation and economies of scale are possible because of secure access to a barrier-free international market.
- Increased international competition leads to product and process innovation, further reducing costs and expanding consumer choice.

National competition policies' aim is also to promote the efficient allocation of resources by ensuring open and competitive markets. Thus by protecting consumers from private firms that (either unilaterally or collectively) raise prices above those that would prevail in a competitive market, competition policy aims to achieve these efficiency objectives.

Inconsistencies

Trade policies are concerned with allocating resources at a national level whereas competition policies' concern lies at an international level. Maximisation of national welfare may not maximise world welfare. For example, export cartels are often provided exemption under national competition laws. However, this practice clearly does not lead to the maximisation of world welfare as consumers in the importing country pay higher prices.

Trade and competition policies also differ as follows: (OECD, 1999:25):

- Trade policy follows a sectoral or economy-wide approach, whereas competition policy is concerned with a specific case.
- Trade policy is generally applied ex ante (trade remedies are an exception), whilst competition policy is applied ex post (merger analysis is an exception).
- Trade policy is concerned with potential competition, whereas competition policy is concerned with actual competition.

The Way Forward

The above discussion on the consistencies and inconsistencies of trade and competition policies has shown that there is scope for a multilateral framework on competition policy to be concluded in the WTO. However, the structure of such an agreement would determine its success or failure. For example, some commentators feel that if a WTO competition agreement is concluded it should not contain a dispute settlement mechanism. However, without a dispute settlement mechanism, an agreement is unlikely to be effective. Academics and officials have grappled with these kinds of issues for a number of years and these debates are likely to continue.

Thus, it appears consensus is unlikely in the near future on the inclusion or otherwise of a multilateral framework on competition policy (MFC) in the WTO agreements. The WTO environment is highly politicised and for many countries the choice of whether to support a MFC or not is a strategic one. The EU and some Latin American countries are the most eager to conclude such an agreement, whilst the US is still against any form of multilateral competition agreement. According to South Africa's representatives at the WTO in Geneva, South Africa's MFC negotiations hinge on whether there is sufficient movement in other negotiating issues such as agriculture and implementation issues.

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WTO website: *www.wto.org.*

1 UNCTAD is the United Nations Conference on Trade and Development. The 'Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices' is a multilateral instrument that was adopted by UNCTAD's general assembly at the end of 1980 to deal with competition law and policy (UNCTAD, 2002: 41).

2 The OECD is the Organisation for Economic Cooperation and Development. In the OECD there is a committee on competition law and policy as well as a joint group on trade and competition. There are two important sets of OECD recommendations: Recommendation of the council concerning effective action against hard core cartels (1999) and revised recommendation of the council concerning cooperation between member countries on anticompetitive practices affecting international trade (1995).

3 Thus, the intention of this working group was not to establish new rules or commitments but to explore and analyse the role of competition in the WTO (http://www.wto.org).

4 From the WTO website: (http://www.wto.org/english/tratop_e/dda_e/dohaexplained_e.htm#competitionpolicy).

5 Allocative efficiency refers to efficiency in exchange whereby resources are distributed to those who place the highest value on them; productive efficiency means that a given level of output is produced at the lowest cost; dynamic efficiency refers to the process of innovation in technology, products and processes in order to satisfy changing consumer preferences.

Potential Competition Consideration

Potential entrants are those entrants that enter an industry for the first time, and offer a substitute product or service to a particular sector. Potential entrants often enter an industry approximately one year after a significant price increase.

Potential competition is occasionally considered in competitive industry analysis. Are there specific conditions that should highlight or negate concern for potential competitors?

Introduction

A notion of analysing only demand substitution constraints, as opposed to supply constraints, has come to the fore as a result of the empirical nature of evidence on demand.

On occasion aspects such as potential entry, and entry barriers, were seen as diverting attention from 'decisive' conditions of monopoly, which existed in structural and behavioural patterns inside the market. Problematic to this view was, however, that sufficient and one-sided quantitative data did not always exist. As a result market definition ultimately became a matter of judgement. For this reason, as well as the dichotomy between hard data (market shares) and soft evidence (on the likelihood of entry), many practitioners favour market definitions that pay more attention to the supply-side of the industry.

Producers have two options:

I. Firms that hold physical and human assets could easily adjust in order to produce substitute goods. This is referred to as 'supply-side substitutability'.

II. Firms could consider entering the market for the first time by investing in certain assets enabling them to produce goods that consumers perceive as substitute goods. This supply-side consideration is referred to as 'potential competition'.

Three dimensions can distinguish supply-side substitutability and potential competition:

I. The first dimension entails the length of time. A supply-side substitute responds promptly to price-increases, while potential entrants may take longer than a year to respond.

II. Secondly, supply-side substitution involves 'uncommitted entry', i.e. entry at low cost and without incurring an irreversible investment. Potential entry or 'committed' entry refers to entry with a substantial sunk cost. (Should sunk costs not be involved in entering a market the matter of potential competition would be assessed on grounds other than the presence of sunk costs.)

III. Thirdly, the competitive constraint imposed by supply-side substitutes has a significant impact on both pre-entry and post-entry prices. However, potential entry is felt via lower post-entry prices only. When entry involves incurring sizable sunk costs, entrants do not decide to join the market on the basis of current prices. Instead, they are concerned with the price level that will prevail in the market once entry occurred. It ultimately hinges on the fundamental characteristics of the market, and whether it is likely to support high post-entry prices or not.

Identifying and considering potential competition

Potential competition can be identified by the nature of actual entry:

- By the potential competitor into similar markets,
- By similar firms into other markets, or
- By others into the instant or similar markets.

In addition, the potential competitor's entry plans for entering the market, or a similar market, can be assessed to identify potential competition.

The entry plans might be a more reliable source, yet they are seldom readily available, whereas similar market assessments might be valuable if the market is fairly uniform, internally consistent and accurately interpreted.

When inquiring into the possibility of a particular firm being a potential competitor, the attractiveness of entry to the potential competitor, as well as its ability to enter, are useful guidelines.

Concerning entry attractiveness, entry is only likely to occur if the profit opportunity is sufficient to overcome the risks of entry. One should remember that a high average profitability could reflect transient, short-run phenomena. These should therefore be identified and sensibly discounted.

Concerning entry ability, one should enquire into the availability, as well as the cost, of capital – either the cost of obtaining finance from others, or the opportunity cost of the returns foregone from alternative uses of internal funds. Secondly, where production depends upon raw materials, the outside firm must possess, or have reasonable access to, these. Technology like capital can be purchased, but antitrust tribunals have tended to assume experience necessary in a complex field. This reflects an estimate not only of the firm's objective, but indeed of its probable intentions. Thirdly, one must also consider the vertical relationships. A court found a defendant a potential entrant, because, in part, it purchased the product. This argument relates to the universe of

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potential entrants and will be touched upon in a later section. Lastly, markets must be closely connected to suggest potential entry.

Potential competitors may have a future, but also a present effect on an industry. However, for the effects to be substantial, and potential competition to be a viable consideration, the following conditions must prevail in an industry:

Future effects

- The market must be significantly non-competitive. When a market is competitive, an additional potential entrant will only add to the insignificance of the current firms' negotiating power
- The potential entrant must enter the market within a reasonable period of time. Otherwise, it will not affect the likelihood of future entry
- The number of equally likely entrants (including the outside firm) must not exceed three (or at most, six). The more potential entrants, the less significant a particular potential entrant becomes, and
- The alternative route of entry (e.g. independent entry) must have a significant pro-competitive effect. If a potential entrant is unable to alter the competitive set-up, it is of no concern.

Present effects

- The market must be non-competitive
- One or more substantial existing sellers must perceive the potential entrant as a likely entrant. Otherwise, the presence of the potential competitor will not affect the behaviour of such firms in the market
- The perceived threat must actually influence the existing sellers' decisions
- The number of perceived equally likely entrants, including the potential entrant, must not exceed three, or at most six, and
- The alternative route of entry (e.g. independent entry) must have a significant pro-competitive effect.

Potential competition in different market structures

When contemplating various permutations in linking concentration with entry barriers, four scenarios are at stake. First, when the level of concentration and the entry barriers are both high, potential competition is indeed a consideration. Secondly, when the level of concentration and the entry barriers are both low, potential competition is not a consideration. The third scenario entails a situation where concentration is low and the entry barriers are high; and the fourth, where the opposite reigns.

In the third and fourth scenario, the considerations with regards to potential competition need to be prudently argued:

Difficult entry into a less concentrated market

It is often argued that high entry barriers cause a market to be sufficiently 'non-competitive', and that potential competition should therefore be a relevant consideration. This only counts when concentration is very high. However, demonstrable barriers cannot convert an otherwise competitive market into a non-competitive market. What high entry barriers mean is that any loss of existing firms may possibly be permanent. Potential competition will therefore not be an issue. It will only be relevant when the non-competitiveness of a market is established by its present organisation and not by the speculative difficulty of adding new entrants in the future.

Easy entry into concentrated markets

Easy entry should also eliminate concern about the presence of a particular potential entrant. Pointing towards low entry barriers is likely to establish a wide universe of potential entrants. The larger the universe of potential entrants, the more likely it is that one of them will find the circumstances suitable for entry. Therefore, the significance of a particular potential entrant reduces.

The universe of potential entrants

Two types of firms should presumptively be considered within the universe of potential entrants.

The first entails firms producing the same product in a different geographic market, in which inter-regional exportation could easily take place. They may be the natural new producers in the geographic market under consideration, and may be more alert to the expansion possibilities in their industry. Psychologically, they are more likely to make the leap, and could already possess the necessary experience. Yet, one cannot automatically presume all such firms are likely entrants, because some may be too remote, too small or too poor. But nearby firms certainly deserve consideration as possible potential entrants, especially where local brand differences or distribution difficulties do not create unusually heavy obstacles.

Secondly, producers of other products may be even better equipped for entry than producers of the very product in question. It may happen that an upstream firm may have the equipment available for producing the product, although not usually directing the business to its manufacturing.

Conclusion

Clearly, potential competition is not a matter of concern in every industry. In addition, clues to identifying its relevance can even be ambiguous or contradictory. It is of cardinal importance that competition authorities must take account of the conditions under which potential competition need to be considered while simultaneously keeping the bigger picture in mind as many exceptions to the rules might exist.

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Commission Cases

Commission calls for complainants in TAC Matter

The Commission received a complaint from the Treatment Action Campaign (TAC) on 17 September 2002 alleging pharmaceutical firms GlaxoSmithKline South Africa (Pty) Ltd and others were dominant in the sale of antiretroviral medicines, and were charging excessive prices for these drugs to the detriment of consumers. The complaint alleged a contravention of the Competition Act 1998 (the Act).

The complaint pertained to the sale of AZT (branded as Retrovir), AZT/lamivudine (branded as Combivir), Lamivudine (branded as 3TC) and Nevirapine (branded as Viramune). TAC alleged that the respondents were abusing their dominance in the market in selling antiretroviral medicines in South Africa by charging excessive prices to the detriment of the consumer, in contravention of Section 8(a) of the Act.

The complainants argued that should the price of antiretroviral medicines be reduced, treatment would be attainable by more people living with HIV/Aids.

An invitation was extended to submit similar complaints to the Commission by end December 2002.

The Commission subsequently received a number of complaints in response, and is conducting this investigation impartially.

Should the Commission be of the opinion that a breach of the Act occurred, the matter will be referred to the Competition Tribunal for determination.

Non-referral Notice against Afrox

The Commission received a complaint against African Oxygen Limited (Afrox). It was alleged that Afrox abused a dominant position in the gas market by making use of exclusive agreements that could hinder the efforts of competitors to enter and compete in the market. The complainant elected to remain publicly anonymous, as is its right.

The Commission's investigation concentrated on several clauses in Afrox agreements that raised competition concerns.

The first clause required customers to obtain their full requirement of gas exclusively from Afrox. Such a clause could limit a customer's freedom to buy gas from other suppliers and thus frustrate the entry of new competitors into the market.

The second clause allowed customers, under certain circumstances, to seek better prices from Afrox competitors, but required them to present the details of the lower quote to Afrox, which had the option to match the offer. Such a clause may give customers the benefit of a better price, as well as prevent cheating and collusive agreements to fix prices.

A third clause automatically extended the initial contract period for an additional two years, unless customers gave six months notice before the expiration of the initial contract period. This could force customers into a further two-year contract period.

During the course of the investigation Afrox stated that it had already changed several of these terms in its new contracts, to comply with its reading of the Competition Act, and gave certain undertakings with respect to existing contracts. Afrox undertook to waive the contractual provisions that required a customer to purchase all its gas requirements from Afrox, and granting Afrox a right of first refusal to supply a customer's gas requirement.

Afrox further undertook to appoint an independent third party to whom

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customers can present competing price quotations, and to amend the clause that automatically extended the initial contract period. Afrox also undertook to inform its customers of these waivers and amendments, and to provide annual reminders to each of its existing customers. Afrox will also ensure that all new contracts conform to the undertakings.

The Commission was satisfied that Afrox's previous reformations of its contracts and its undertaking to waive the problematic provisions in existing contracts served to further the Commission's ultimate objective — to promote competition — and address the specific concerns identified during the investigation. Furthermore, should Afrox at any time fail to abide by the undertakings, the Commission will be able to refer to the Competition Tribunal a complaint that addresses the same issues. A non-referral* notice was issued.

The investigation also revealed that Afrox's competitors might also use the clauses that raised competition concerns.

** A notice of non-referral is a notice issued to a complainant if the Commission's investigation concluded that the alleged contravening practice did not constitute a prohibited practice as defined in the Act. In the event of a notice of non-referral being issued, complainants are afforded the opportunity of referring the matter to the Competition Tribunal, within a prescribed period.*

Non-referral Notice in Pharmaceutical Complaint

The Commission received a complaint by Cipla-Medpro (Pty) Ltd (Cipla-Medpro) against a group of respondents, namely Wellcome Foundation Limited (Wellcome), Biochem Pharma Incorporated (Biochem), Glaxo Group Limited (Glaxo), Glaxo Wellcome South Africa (Glaxo Wellcome), Boehringer Ingelheim Pharmaceuticals Incorporated (Boehringer), Dr Karl Thomae GmbH (Dr Thomae) and Ingelheim Pharmaceuticals (Pty) Ltd (Ingelheim).

The complainant, Cipla-Medpro, alleged that the respondents were engaged in collusion, restrictive vertical practices and excessive pricing in contravention of the Competition Act, No. 89 of 1998 (the Act).

The allegation of restrictive horizontal practices, which is collusive behaviour among competitors, was based on the allegation that the respondents had consistently adopted a uniform response pertaining to HIV/AIDS enquiries. Furthermore, the complainant alleged that Biochem and Wellcome had appointed the same licensee (Glaxo Wellcome) to exploit their respective products within South Africa.

The Commission's investigation revealed that, with respect to the market for anti-retroviral drugs, the respondents were not competitors. The section prohibiting restrictive horizontal practices, therefore, did not apply to the respondents. In addition, the Commission's investigation revealed no evidence to support the allegation that the 'uniform response pertaining to HIV/AIDS enquiries' is as a result of collusion between the respondents. The complainant was also unable to substantiate this allegation.

The allegation of restrictive vertical practices suggested that the patentees, by allegedly entering into exclusive licensing and/or agency agreements with Glaxo Wellcome and Ingelheim, precluded other entities from marketing or distributing products in competition with Glaxo Wellcome and Ingelheim. (Glaxo Wellcome and Ingelheim are in a vertical supplier-customer relationship).

In this regard, the investigation revealed that the parties referred to were not in a vertical relationship and, in any event, the investigation revealed no evidence that the agreements referred to were exclusive, as alleged by the complainant. Furthermore, there was evidence that the agreements in fact resulted in certain pro-competitive gains.

The complainant further alleged that the respondents charged excessive prices for their patented drugs to the detriment of consumers. The complainant claimed that, if granted a licence, it would provide the generic version of the drugs in South Africa at prices that are substantially lower than those charged by the respondents.

The Commission's investigation found no evidence that the prices were excessive. There are several pro-competitive functions of high prices: to induce entry and innovation, and reward higher quality or convenience, as well as to encourage research and development through the granting of patents.

Consumers were the ultimate beneficiaries of competition law and the Commission perceived allegations like those stipulated above very seriously. However, in this case the Commission found no evidence to support the allegations and issued a notice of non-referral.

Commission Recommends Fine on Edcon

The Commission recommended to the Tribunal that a fine be levied against Edgars Consolidated Stores Limited (Edcon) for failing to notify the authorities of a merger.

The merger between Edcon and Retail Apparel Group (RAG), which had been placed under provisional liquidation, exceeded the threshold requirement constituting a large merger transaction, which was referred by the Commission to the Competition Tribunal.

Edcon concluded an agreement with liquidators to purchase the book debts against RAG and certain of its subsidiaries. The debtors' book sale was concluded in advance of the proposed merger and implemented immediately.

This constituted a contravention of the Competition Act, which requires notification, under Section 12 (1) "...when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm."

It is common cause that 'debt book' in accounting principles is recorded as a commercial asset (as accounts receivable). The Insolvency Act 24 of 1936 did not refer specifically to fixed deposits and so consequently, in a 1980 case, the court determined that book debts constituted a fixed deposit and were an asset in themselves.

The Commission concluded that the sale of the debtors' book constituted a sale of an asset of a business and was therefore a merger as defined and contemplated in the Act. It becomes a notifiable transaction as an intermediate merger when the target firm's value exceeds R30 million, and as a large merger when the target firm's value exceeds R100 million, which was the case in the acquisition of this asset.

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Non-referral Notice for Lafarge

The Commission issued a notice of non-referral following a complaint by Eagle Roof Tiles (Pty) Ltd (Eagle) and Inca Masonry Products (Pty) Ltd (Inca) against Lafarge Roofing (Pty) Ltd (Lafarge).

The complainants, both manufacturers of concrete roof tiles, alleged that Lafarge was dominant and engaging in predatory pricing tactics aimed at removing them from their respective target markets. Lafarge, which the Commission found to be the dominant firm in the relevant market, manufactures both concrete and clay roof tiles.

One of the primary objectives of competition policy is to promote competitive processes to the extent that the welfare of consumers is improved. Practically, effective competition should bring about low prices or price reductions. Predatory pricing is a form of anti-competitive conduct by a dominant firm that prices its products at a level so low that permanent damage is done to the competitive process. The difficulty for competition authorities is to correctly identify excessively low prices arising from a predatory strategy as opposed to low prices arising in a 'healthy' competitive environment.

Eagle alleged that in 2001, Lafarge lowered its prices on certain roof tile profiles to below cost levels. Similarly, Inca cited specific examples where sales allegedly have been lost as a result of predatory price-cutting by Lafarge.

The Commission's investigation could find no evidence that the average price had fallen below reasonably anticipated average variable costs (AVC). The lowest single price at which tiles were sold was also greater than AVC. There was therefore no contravention of the Competition Act. In addition, the average price of a tile was actually higher in the year that the alleged predatory conduct took place, and output was lower, when compared to the previous year. These facts did not support an allegation of predatory pricing.

It appeared that the pricing policies of Lafarge (and the complainants) had actually promoted competition. Furthermore, there had been no substantial lessening of competition, nor was it expected that there would be less competition in future.

On the basis of these conclusions, the Commission issued a notice of non-referral.

Commission recommends approval for Edcon acquisition of CNA

The Commission was notified of the merger between Edgars Consolidated Stores (Edcon) and Consolidated News Agency (CNA).

The primary acquiring firm was JSE-listed Edcon, which trades predominantly in the retailing of clothing, footwear and accessories. Edcon's major retail formats are Edgars, Jet, Sales House, Red Square, Cuthberts, Smiley's Warehouse and ABC. The primary target firms were Consolidated News Agencies (Pty) Limited and Central News Agency (Pty) Limited which had more than 300 branches nationwide, and a diverse product range.

The proposed transaction was not likely to substantially prevent or lessen competition in the retail market. Although the parties raised the 'failing firm' defence in support of the merger, the Commission did not consider the defence as the transaction did not raise any competition concerns.

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Competition in Retail Sector

The Commission's investigation found that despite high levels of concentration in the retail sector, it was a highly competitive sector. Competition was based not only on price, but also on service differentiation, especially with upper to higher income groups. Service differentiation in retail involves the development of a 'shopping experience' for customers by offering bigger product ranges in more diversified shopping environments, providing product and service-related information, and even diversifying, for example, to financial services.

The parties submitted that the proposed merger would not have a negative impact on competition because their respective market shares were low in the cellular telecommunication products market, and there was no other overlap. Moreover, even if Edcon-owned Super Mart and CNA were considered to be in the same relevant market in respect of stationery products, the increase in the market share of the merging firms and concentration levels in the relevant markets concerned were below the thresholds that would indicate that the transaction required closer scrutiny.

'Failing Firm Doctrine'

In addition, the parties submitted that the 'failing firm doctrine' applied i.e. CNA's failure was an important additional factor in favour of finding that the merger was unlikely to lessen competition. Imminent lessening of competition in the relevant markets was a consequence of CNA's failure, and not of the proposed transaction. They argued that since CNA was currently in liquidation it was beyond dispute that it would be unable to meet its obligations in future, and that it would therefore have exited the market in any event.

Furthermore, the liquidators of CNA decided to sell CNA to Edcon following an extensive bidding process in which three other bidders participated. Two bids were not commercially realistic. Consequently Edcon's bid was accepted as opposed to the bid of the remaining participant, ThisDay – a Nigerian-based newspaper publishing enterprise. Both Edcon and ThisDay's bids were in the region of R140 million. The liquidators opted for Edcon's bid as Edcon boasts a superior retailing track record, and a better probability at realising a turnaround in CNA's business.

Retrenchments and Public Interest

Retrenchments were as a result of CNA liquidation, and were not related to the merger. In fact, the merger offered approximately 1 130 CNA employees employment with Edcon. The negative impact of the CNA liquidation on employment had therefore been ameliorated.

Taking into consideration the effect of the merger on stakeholders:

The merger was unlikely to substantially lessen competition, and would not negatively affect consumers. Should the merger not take place, CNA shareholders and creditors would be detrimentally affected since the remaining value in the company would not be realised. The merger was essential to ameliorate employees affected by the CNA liquidation.

The public interest in general would be better served by merging Edcon and CNA.

Commission recommends prohibition of SAB acquisition

The Commission received notification of the merger between Coleus Packaging (Pty) Ltd and Rheem Crown Plant, a division of Highveld Steel, and Vanadium Corporation Limited.

Coleus Packaging (Pty) Ltd (Coleus) is a wholly owned subsidiary of South African Breweries Limited, and would acquire the business of Rheem Crown, which is a division within Highveld Steel and Vanadium Corporation Limited.

Rheem Crown manufactures crowns (metal bottle closures) used by beverage companies to seal bottles.

SAB and Guinness/UDV is a prime customer in the crown manufacturing market. Others making use of crowns are Coca-Cola bottlers, in particular ABI Limited (which is controlled by SAB), and Distell.

The Commission was of the opinion that the vertical integration that would occur as a result of the transaction would substantially prevent or lessen competition, since Rheem is part of SAB's supply chain. Only two

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participants are currently active in the crown market, Rheem Crown and Metal Closures Group (Pty) Ltd (MCG). Various concerns were received by the Commission from both customers and competitors of both merging parties relating to the proposed deal.

The major issue of contention for the Commission related to the effect of the merger on the operations of MCG. The transaction could cause MCG to be precluded from obtaining SAB or any of its subsidiaries (i.e. ABI) as future customers. This could cause MCG to exit the crown market, and in turn cause Rheem to obtain monopoly status in that market.

In the event that MCG remained active in the market it would be the only independent (non-integrated) firm in the crown market. Competitors of SAB would not want to obtain a critical packaging product from their competitor, since this would reveal sensitive product information to SAB. Competitors would rather obtain crowns manufactured by an independent supplier.

The Commission also considered public interest issues, in particular the effect of the merger on MCG, controlled by empowerment group WIP Capital, and its ability to become competitive.

The Commission was of the opinion that the foreclosure MCG would face as a result of the merger would affect its ability to remain competitive.

The Commission recommended a prohibition of the SAB acquisition. The Tribunal, however, recommended a conditional approval.

The conditional approval of the merger entails:

- SAB should sell not less than 40% shareholding in Coleus to a black economic empowerment firm within 2 years from date of the order. Further, a controlling stake in Coleus should be sold as soon as the Crown plant has been rehabilitated.
- SAB entered into a supply agreement with MCG Packaging (Pty) Ltd. The agreement will be effective from 31 March 2003. The agreement stipulates that SAB would acquire no less than 250 million units of crowns from MCG.
- All employees and directors of Coleus shall be obliged to sign confidentiality agreements in relation to volume forecasts, new product launches and promotional activities of Coleus' customers. This condition relates particular to the concerns raised by the competitors of SAB.
- Coleus will ensure that appropriate steps are taken to benchmark its technology and performance against industry standards.

Competition Authorities Conference 2003

The third Competition Authorities Conference will be held 6 March 2003 at the Hilton Hotel, Sandton. The theme, Competition and Development – Promoting Competition in a Protected Economy, promises insightful discussions.

*For more information visit **www.compcom.co.za** or contact the Information Officer on 012 482 9066.*

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Towards a free and fair economy for all