REPUBLIC OF SOUTH AFRICA

IN THE COMPETITION APPEAL COURT OF SOUTH AFRICA

HELD IN CAPE TOWN

Reportable

CASE NO: 129/CAC/Apr14

In the matter between:-

THE COMPETITION COMMISSION	Appellant
And	
SOUTH AFRICAN BREWERIES LIMITED	First Respondent
AFRICA'S BEER WHOLESALERS PROPRIETARY LIMITED	Second Respondent
BOLAND BEER DISTRIBUTORS PROPRIETARY LIMITED	Third Respondent
ERMELO BEER WHOLESALERS PROPRIETARY LIMITED	Fourth Respondent
GREYTOWN BEER DISTRIBUTORS PROPRIETARY LIMITED	Fifth Respondent
MAKHADO BEER WHOLESALERS PROPRIETARY LIMITED	Sixth Respondent
MIDLANDS BEER DISTRIBUTORS PROPRIETARY LIMITED	Seventh Respondent
MKUZE BEER WHOLESALERS PROPRIETARY LIMITED	Eighth Respondent
SOUTHERN CAPE BEER DISTRIBUTORS PROPRIETARY LIMITED	Ninth Respondent
STEFQUO PROPRIETARY LIMITED	Tenth Respondent
VRYHEID BEER DISTRIBUTORS PROPRIETARY LIMITED	Eleventh Respondent
MADADENI BEER WHOLESALERS PROPRIETARY LIMITED	Twelfth Respondent
WESTONARIA BEER DISTRIBUTORS (PTY) LIMITED	Thirteenth Respondent
THOHOYANDOU BEER DISTRIBUTORS (PTY) LIMITED	Fourteenth Respondent

---

JUDGMENT: 02 February 2015

DAVIS JP & ROGERS AJA

Introduction

[1] This appeal raises important questions both of law and in respect of the evaluation of evidence concerning the application of key provisions of the Competition Act 89 of 1998 ('the Act'). The first respondent ('SAB') is the largest clear beer producer in the country. The evidence suggests that it enjoys a market share of between 80% to 90 % of this market. The case which the appellant ('the Commission') has brought against it invokes ss 4(1) (b), 5 (1), 5(2) and 9(1) of the Act. It essentially concerns whether SAB, overwhelmingly the dominant firm in the designated market, engaged in various agreements or practices, some of which were in concert with second to fourteenth respondents, and all of which had the cumulative effect of substantially lessening or preventing competition in a downstream market, in a manner which causes harm to consumers, reducing consumer choice, increasing downstream distribution costs and increasing the costs of competitors to SAB.

The factual background

[2] By 2010, SAB held seven licences for the manufacturing of beer, with an annual brewing capacity of 3.1 b litres. Its breweries are located in Port Elizabeth, Limpopo, Gauteng (three breweries), Kwa-Zulu Natal and in Cape Town. By contrast,

its main competitor opened its first Brandhouse brewery in March/April 2010 with an initial capacity of but 3 million hectares litres.

[3] SAB sells its beer products by way of a primary distribution network from its seven breweries to wholly owned depots as well as to appointed distributors being second to fourteenth respondents. A secondary distribution channel ensures that beer is distributed by the depots and appointed distributions ('ADs') to customers. Twelfth to fourteenth respondents have concluded franchise agreements with SAB whereas second to eleventh respondents have entered into wholesaler agreements with SAB.

[4] According to an expert report compiled on 19 July 2010 by Genesis, on behalf of SAB, the core distribution system consists of some 40 wholly-owned distribution depots which are managed by SAB. They distribute around 90% of its beer volumes. This system regularly delivers to more than 30 000 licenced outlets, including restaurants, bars and liquor stores and sells to end-consumers. In addition, SAB avers that it utilizes the ADs to expand its distribution network into rural areas.

[5] The main difference between the wholesaler and franchise agreements is that a distributor, holding a franchise agreement, is not required to fund the establishment of a fully-fledged distribution business upfront, and can buy equity over time. In addition, a franchise agreement, unlike a wholesaler agreement, has an initial term of ten years. Save for this distinction, there is no material difference between wholesaler agreements and franchise agreements.

[6] The relationship between the ADs and SAB can be summarised thus: An AD is assigned an exclusive territory to service. No other AD or depot is appointed or permitted to service this territory. Personnel of SAB are stationed at the relevant AD in order to conduct the marketing functions in respect of the AD area. ADs are required to adhere to strict service standards. These include (i) stocking the full range of SAB's products; (ii) holding three days' stock as forward cover; (ii) not selling beer that is more than a certain number of days old; (iv) stocking beer in a warehouse complying with certain requirements; (v) providing at least one delivery per week for each customer ordering at least ten cases per delivery; and (vi) compliance (to the score of a at least 80%) with SAB's operational and custom service audits and customer satisfaction surveys.

[7] The ADs' operational systems are fully integrated into SAB's systems. Thus, customers of an AD place orders directly with tele-sales personnel of SAB. The ADs do not independently develop their own markets and then sell the product to that market at a margin. SAB provides the ADs with the training of management and staff and, where required, the funding on favourable terms.

[8] The remuneration of ADs takes the form of two different fees. Firstly, ADs are paid a handling fee for every unit sold. This fee compensates the ADs for warehousing expenses and provides a reasonable return on related investments. Secondly, a delivery fee is paid to an AD for every unit delivered. This fee compensates the AD for delivery expenses and likewise provides a reasonable return on related investments.

[9] The contract that the ADs have entered into with SAB imposes upon them a restriction of operating in a defined geographical area and further requires that they serve all customers of SAB in that region who purchase a prescribed minimum quantity. It also restricts ADs to distributing beer products manufactured by SAB.

[10] There is nothing in these contracts which prevents SAB from selling its products to firms which perform distribution functions and compete for the same customers as do the ADs. However, these independent distributors do not receive the same fees for distribution.

[11] At the time that this dispute was heard before the Competition Tribunal, the primary distribution of beer involved the distribution from SAB's seven breweries to 40 wholly-owned depots and to 13 ADs, being second to fourteenth respondents. In total, 91% of all of SAB's beer production was distributed through its depots and the balance through the ADs.

[12] The evidence suggests that, in certain circumstances, beer is distributed directly to customers but this only occurs when the customers are sufficiently large to receive a delivery from a 30-pallet truck and have the necessary equipment and labour to handle such direct deliveries. These direct deliveries account for approximately 2.6 % of the total distribution volume.

[13] Expanding on the function of the ADs, they perform primarily the same services as the depots. They accept orders placed by customers in their respective

distribution areas, they receive beer from the relevant brewery, which is then stocked in an insulated warehouse. They deliver the beer to customers, provide for customers to call and collect beer from their premises and they engage with the sales team of SAB in their designated areas. The ADs deliver quantities from a minimum of ten cases of beer and they do so at least weekly to customers in their defined area. Over the minimum prescribed size, they are obliged to deliver to all customers in their allocated area, regardless of where a customer is situated. Approximately 80% of the business of the ADs comprises the distribution of mainstream quarts. The size of the truck required to perform these deliveries is one that can transport 18 pallets; thus it is a large vehicle.

[14] As indicated earlier in this judgement, SAB draws a distinction between primary and secondary costs. Primary distribution costs are the costs of distributing beer from its breweries either to the depots or to the ADs. By contrast, secondary distribution costs are the costs incurred in distributing beer from the depot or the ADs to retail customers. These costs are split into two; firstly, distribution to customers that are located within a 50 km radius and secondly costs incurred in delivery to customers located beyond the 50 km radius. The 50 km radius is considered to be a free delivery zone.

The core issues

[15] This factual matrix gave rise to four separate issues which constitute the basis of the Commission’s case:

1. In terms of s 4(1)(b)(ii) of the Act, the Commission argues that respondents are in a horizontal relationship with each other. The relationship is of such a character to justify the application of s 4(1)(b)(ii) of the Act to the distribution structure adopted by SAB.

2. In the event that s 4(1)(b) of the Act is not applicable, the Commission contends that the respondents are in a vertical relationship; that is between SAB, as the manufacturer of beer, and the ADs as distributors of this beer. This relationship justifies a conclusion that there was a substantial preventing or lessening of competition as a result of these agreements entered into between SAB and the ADs.

3. In terms of s 9(1) of the Act, the Commission contends that the sale of beer products by SAB to the ADs are equivalent transactions to the sale of bulk product by SAB to independent distributors, in circumstances where both the ADs and the independent distributors provide distribution services on behalf of SAB. It is argued that, as these transactions are equivalent, the favourable approach of SAB to the ADs represented discrimination against independent distributors which discrimination has the effect of substantially preventing or lessening competition in the relevant market.

4. Section 5 (2) is invoked by the Commission to argue that SAB engaged in a practice of retail price maintenance.

The horizontal case

[16] The horizontal case brought by the Commission is based upon an alleged restrictive horizontal practice in terms of s 4(1)(b)(ii) of the Act. The section provides, inter alia: '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… (which) involves (ii) dividing markets, by allocating customers, suppliers, territories or specific types of goods or services.'

[17] The Commission contends that SAB together with second to fourteenth respondents (the ADs), as independent firms, entered into an agreement which involved a division of the relevant market for the distribution of beer, by allocating territories to each of the ADs and the depots, which agreements effectively prohibited the ADs from trading outside of the contractually defined territories.

[18] The Commission contends further that the agreements fell within the scope of s 4(1)(b)(ii). Accordingly, there was no need to prove that the agreements had the effect of preventing or lessening of competition. Proof of the agreements was sufficient to justify a case brought under s 4(1)(b).

[19] It becomes necessary to examine the nature of s 4 and its potential application to this case. The Commission relies on certain clauses of the wholesale agreements entered into between the ADs and SAB to justify its case under s 4(1)(b). In particular, it relies on clauses 2 and 4 of the 'wholesaler agreements' which, to the extent that they are relevant, provide thus (our emphasis):

'2.1 SAB hereby appoints the Wholesaler as its exclusive distributor of the Products within the Territory, and grants to the Wholesaler the right to warehouse, stock, distribute, sell and market the Products within the Territory and the Wholesaler accepts such appointment, subject to the terms and conditions contained in this Agreement.

4.1 In return for the appointment set out under clause 2, and subject to the provisions of this Agreement, the Wholesaler agrees to use its best endeavours to maximize distribution and sale of the Products within the Territory, which shall be achieved as follows:

4.1.1 The sale and distribution of the Products shall be confined to the Territory;

4.1.2 SAB shall not appoint the services of any other Wholesaler within the Territory nor will it solicit any orders for the Products nor sell any of the Products to customers within the Territory; provided that in the event of:

4.1.2.1 the Wholesaler failing to meet the Financial Reporting Requirements and/or Operating Performance Standards; or

4.1.2.2 in the sole and absolute opinion, (which will be exercised reasonably) of SAB, the Wholesaler through its own cause and for reasons not attributable to SAB,

not being able to supply or meet any demand for the Products within the Territory; or

4.1.2.3 SAB's competitive position not being adequately served by the Wholesaler within the Territory at any time;

then, in any of the aforementioned events SAB shall without prejudice to any other rights and/or remedies which may be available to SAB in terms of this Agreement or at law, alternatively be entitled to permit other SAB appointed Wholesalers or its nominated representatives, to distribute and sell products in the Territory.

4.2 The Wholesaler shall purchase all of its requirements of the Products from SAB, provided that in the event of SAB being unable to supply the Wholesaler's requirements, the Wholesaler shall be entitled to purchase the shortfall from any other duly appointed Wholesaler or nominated representative of SAB, for the sole purpose of eliminating stock shortages or imbalances, and on terms no less favourable than those granted to it by SAB under this Agreement and provided further that the Wholesaler shall advise SAB in writing of its intention to do so and reasons therefor prior to doing so."

4.3 Subject to the provision so clause 5, <u>the Wholesaler shall not solicit any orders for the Products from customers situated outside the Territory nor deliver or knowingly sell the Products directly or indirectly to customers located outside</u>

> <u>the Territory</u> (for the purposes of this clause – *indirectly* shall mean deliberately or wilful cross-border trading with third parties). Subject to the provision in clause 4.1.2, <u>SAB shall similarly endeavour not to engage in cross-border trading nor make its pricing outside the Territory so attractive that it encourages the Wholesalers' customers to purchase the Products from SAB</u>.'

[20] The Commission contends that an analysis of these agreements reveals that a clear prohibition was placed upon the ADs from soliciting any orders from customers situated outside of their defined territory. Further, ADs could not deliver or knowingly sell products directly or indirectly to customers outside of their defined territory. In the view of the Commission, these prohibitions constitute restraints which operate horizontally in favour of SAB as well as the other ADs. Further these restraints provide protection for SAB against competition, in this case where SAB acts in its capacity as a distributor as well as affording similar protection to the other ADs.

[21] In its determination, the Tribunal recognised the plausibility of these submissions, as is evident from the following passage:

> '77. Since it is not contested that these are the terms of the agreements, the Commission considers that it has established all the elements of the contravention. To some extent they are correct. If fourteen firms divide up territories and customers between themselves using one firm (SAB) as the hub through which the arrangement is concluded, even though they do not have separate self-standing agreements between themselves, a clear violation would have been established. Further they

> each separately contract with SAB qua distributor not to effect a division of territories between them and the SAB depot operation.
>
> 78. Thus the agreements prima facie exhibit a territorial divide in contravention of section 4(b)(ii) between distributors on the one hand (albeit indirectly through the medium of SAB), and between distributors and SAB insofar as the latter is also a distributor of its products from its depots. If we were to concede to literalism i.e. simply take the agreements at face value, then there has been a contravention.'

[22] However, the Tribunal concluded that the ADs could not be considered to be autonomous economic actors, which were independent of SAB; hence it could not be said that, but for the agreements in question, they would have been in a competitive relationship with one another. Accordingly, the impugned agreements could not be assessed on the basis of the *per se* standard as provided for in terms of s 4(1)(b) of the Act. For these reasons, the Tribunal concluded as follows (para 87):

> 'What we have concluded is that the ADs do not comprise a single economic entity with SAB; but we also conclude that they are not sufficiently independent of SAB in the manner that would make them its competitors in distribution of its products nor competitors of one another, in the sense that competitors are a requirement for section 4(1)(b) to apply.'

[23] The Commission contends that the test that the firm has 'sufficient independence' should not be imported into an inquiry as to whether the respondents are competitors. The Commission argues that this test is so vague that it would invite firms engaged in anti-competitive conduct to lead unnecessary evidence

designed to obscure their relationship and thus circumvent the *per se* prohibition. The Commission's argument noted that the Tribunal had recognised this problem when it said 'such a holding may seemingly allow contrived structures to evade s 4 (1) (b)'. However the Tribunal then determined (para 90):

> 'If [ADs] are not autonomous or separate basic economic units then this exercise in characterisation determines that at least for the purpose of section 4(1)(b) they cannot be characterised as basic economic units independent of SAB and thus capable of conspiring not to compete with it and with one another.'

[24] On the basis of this conclusion, much of the debate on appeal concerned the so called characterisation problem. As the Tribunal observed (para 83):

> 'The fundamental characterisation question to address in this case is whether the ADs constitute the basic economic units contemplated in classic antitrust law or whether they constitute something less than this.'

Characterisation

[25] This finding requires an analysis of the characterisation problem as it has evolved in South African jurisprudence.

[26] The concept of characterisation was incorporated into our law as a result of the judgment in **American Natural Soda Ash Corporation and another v Competition Commission and others** 2005 (6) SA 158 (SCA) paras 43 – 47. In their judgment, Cameron and Nugent JJA observed that an agreement that involves, amongst other

things, price fixing, is prohibited in terms of s 4(1)(b). Nothing can be advanced to justify it. However, this raises the question 'when has prohibited price fixing occurred? This is not always simple to determine' (para 43) To answer this question, the following enquiry was required:

> '[44] In the United States the enquiry is approached by 'characterising' the conduct complained of to determine whether it constitutes that form of conduct that the Courts have through case precedents labelled "price-fixing" but have not comprehensively defined. In this country, where the prohibitions is decreed by legislation rather than by judicial intervention, the prohibited form of conduct must be established by construing s 4(1)(b).
>
> [45] Once the ambit of subpara (b)'s prohibition has been established the enquiry can move to whether or not the conduct in issue falls within the terms of the prohibition. That is a factual question that must be answered by recourse to relevant evidence.'

Cameron and Nugent JJA then concluded (para 47):

> 'Whichever approach is adopted, the essential enquiry remains the same. It is to establish whether the character of the conduct complained of coincides with the character of the prohibited conduct: and this process necessarily embodies 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. In ordinary language this can be termed 'characterising' the conduct – the term used in the United States, which Ansac has adopted.'

[27] Although the court did not determine the meaning of the prohibition, as contained in s 4(1)(b), it required that the Tribunal determine for itself the nature of the evidence that the latter required to establish that the agreement raised in the ANSAC case fell within the prohibition contained in s 4(1)(b). In the present dispute, the Tribunal applied this approach to characterisation to conclude that the ADs could not be considered to be autonomous economic actors independent of SAB. Accordingly, they were incapable of conspiring to refuse to compete with SAB and with one another. For this reason, the character of the conduct complained of by the Commission did not coincide with the character of the prohibited conduct as envisaged by way of a reading of s 4 (1) (b).

[28] This principle of characterisation, which was adopted by the Supreme Court of Appeal in **ANSAC**, *supra* from an opinion of the United States Supreme Court in **Broadcast Music Inc v Columbia Broadcasting System Inc**. 441 US 1 (1979) ('**BMI**') requires analysis within its proper context.

[29] In 1911 in **Standard Oil of New Jersey v United States** 221 US 1 (1911) the United States Supreme Court observed, with reference to ss 1 and 2 of the Anti-Trust Act of 1890 (the Sherman Act), that the legality of an agreement could not be determined by a simple test as to whether the agreement restrains competition. Having regard to the common law's attitude to restraints of trade (both in England and the United States), the statutory prohibitions against restraints and monopolisation were to be construed as proscribing only unreasonable conduct. In other words, the legality of such arrangements was to be determined by way of an application of the

so-called rule of reason. But the later emergence of per se prohibitions was foreshadowed in the court's explanation (at 65) of two of its earlier decisions which had been invoked in support of a wide and literal interpretation of the Sherman Act:

> 'This being true, the rulings in the cases relied upon, when rightly appreciated, were therefore this, and nothing more: that, as considering the contracts or agreements, their necessary effect and the character of the parties by whom they were made, they were clearly restraints of trade within the purview of the statute, they could not be taken out of that category by indulging in general reasoning as to the expediency or nonexpediency of having made the contracts or the wisdom or want of wisdom of the statute which prohibited their being made. That is to say, the cases but decided that the nature and character of the contracts, creating as they did a conclusive presumption which brought them within the statute, such result was not to be disregarded by the substitution of a judicial appreciation of what the law ought to be for the plain judicial duty of enforcing the law as it was made…'

[30] This finding raised the question as to whether the reasonableness of fixed prices could be a defence to a charge that the defendant was a member of a price-fixing cartel. In **United States v Trenton Potteries Company** 273 US 392 (1927) at 397, the court said the following on this question (at 272-273, references omitted):

> 'That only those restraints upon interstate commerce which are unreasonable are prohibited by the Sherman Law was the rule laid down by the opinions of this Court in the *Standard Oil* and *Tobacco* cases. But it does not follow that agreements to fix or maintain prices are reasonable restraints, and therefore permitted by the statute,

merely because the prices themselves are reasonable. Reasonableness is not a concept of definite and unchanging content. Its meaning necessarily varies in the different fields of the law, because it is used as a convenient summary of the dominant considerations which control in the application of legal doctrines. Our view of what is a reasonable restraint of commerce is controlled by the recognized purpose of the Sherman Law itself. Whether this type of restraint is reasonable or not must be judged, in part at least, in the light of its effect on competition, for, whatever difference of opinion there may be among economists as to the social and economic desirability of an unrestrained competitive system, it cannot be doubted that the Sherman Law and the judicial decisions interpreting it are based upon the assumption that the public interest is best protected from the evils of monopoly and price control by the maintenance of competition…

The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices. The reasonable price fixed today may, through economic and business changes, become the unreasonable price of tomorrow. Once established, it may be maintained unchanged because of the absence of competition secured by the agreement for a price reasonable when fixed. Agreements which create such potential power may well be held to be, in themselves, unreasonable or unlawful restraints without the necessity of minute inquiry whether a particular price is reasonable or unreasonable as fixed and without placing on the government in enforcing the Sherman Law the burden of ascertaining from day to day whether it has become unreasonable through the mere variation of economic conditions. Moreover, in the absence of express legislation requiring it, we should hesitate to adopt a construction making the difference between

> legal and illegal conduct in the field of business relations depend upon so uncertain a test as whether prices are reasonable -- a determination which can be satisfactorily made only after a complete survey of our economic organization and a choice between rival philosophies …'

[31] So price-fixing came to be regarded as a per se prohibition because price-fixing, in the sense contemplated in the above passage, was by its very nature unreasonable when judged by the purposes of the legislation. This finding was confirmed in **United States v Socony–Vacuum Oil Company** 310 US 150 (1940) at 218. From this point onward, American anti-trust law drew a distinction between the application of the rule of reason and a per se prohibition. But it is to be emphasised that **Trenton Potteries**, **Socony-Vacuum** and other cases to similar effect concerned price-fixing arrangements between parties in purely horizontal relationships and who were, prior to the making of those arrangements, independent competitors.

[32] A series of cases followed in which the scope of the per se prohibition was extended. For an analysis of these cases, see FH Easterbrook *Is there a Ratchet in Antitrust Law*? 1982 (60) Texas Law Review 705.

[33] When the **BMI** case came before the Supreme Court, the manner in which the case was argued required the court to provide better and fuller guidance as to the judicially constructed per se rule. The defendants (associations of persons with copyright in published music and in recorded musical performances) were alleged to have engaged in illegal price-fixing by issuing licenses to television and radio

broadcasters for the use of the associations' members' copyright material at uniform fees negotiated by the associations. The Supreme Court held that the associations' conduct did not fall within the per se prohibition against price-fixing but rather had to be assessed by the rule of reason. The following passages from the opinion of Justice White who wrote for the court[1] are instructive (references to authority omitted). By way of general introduction Justice White said the following concerning the court's earlier jurisprudence (at 7-9):

> 'In construing and applying the Sherman Act's ban against contracts, conspiracies, and combinations in restraint of trade … the Court has held that certain agreements or practices are so "plainly anticompetitive" … and so often "lack . . . any redeeming virtue" … that they are conclusively presumed illegal without further examination under the rule of reason generally applied in Sherman Act cases. This per se rule is a valid and useful tool of antitrust policy and enforcement. And agreements among competitors to fix prices on their individual goods or services are among those concerted activities that the Court has held to be within the per se category. But easy labels do not always supply ready answers.
>
> To the Court of Appeals and CBS, the blanket license involves "price fixing" in the literal sense: the composers and publishing houses have joined together into an organization that sets its price for the blanket license it sells. But this is not a question simply of determining whether two or more potential competitors have literally "fixed" a "price." As generally used in the antitrust field, "price fixing" is a shorthand way of describing certain categories of business behavior to which the per se rule has been held applicable. The Court of Appeals' literal approach does not alone establish that

---

[1] Justice Stevens, who wrote a dissent, concurred with the majority on the point now under discussion but would have found the practice in question unlawful under a rule of reason analysis.

> this particular practice is one of those types or that it is "plainly anticompetitive" and very likely without "redeeming virtue." Literalness is overly simplistic and often overbroad. …'

[34] The court then referred to certain aspects of the history of the associations' arrangements and a consent decree previously made in litigation between the government and the associations, observing (at 13):

> 'In these circumstances, we have a unique indicator that the challenged practice may have redeeming competitive virtues and that the search for those values is not almost sure to be in vain. Thus, although CBS is not bound by the Antitrust Division's actions, the decree is a fact of economic and legal life in this industry, and the Court of Appeals should not have ignored it completely in analyzing the practice... That fact alone might not remove a naked price-fixing scheme from the ambit of the per se rule, but, as discussed infra, Part III, here we are uncertain whether the practice on its face has the effect, or could have been spurred by the purpose, of restraining competition among the individual composers. …'

[35] And then, in the course of the analysis foreshadowed in the final sentence of the above passage, Justice White said the following (at 19-23):

> 'More generally, in characterizing this conduct under the per se rule our inquiry must focus on whether the effect and, here because it tends to show effect, … the purpose of the practice are to threaten the proper operation of our predominantly free-market economy - that is, whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output, and in what portion of

> the market, or instead one designed to "increase economic efficiency and render markets more, rather than less, competitive." …
>
> The blanket license, as we see it, is not a "naked restrain[t] of trade with no purpose except stifling of competition" … but rather accompanies the integration of sales, monitoring, and enforcement against unauthorized copyright use…
>
> Finally, we have some doubt - enough to counsel against application of the per se rule - about the extent to which this practice threatens the "central nervous system of the economy" … that is, competitive pricing as the free market's means of allocating resources. Not all arrangements among actual or potential competitors that have an impact on price are per se violations of the Sherman Act or even unreasonable restraints. …'

[36] Our legislature, when it passed the Act, did not favour a judicially constructed rule. By contrast, it provided expressly, in terms of s 4(1)(b), that any direct or indirect fixing of a purchase or selling price or the dividing of markets by allocating customer, suppliers, territories or specific types of goods or services or collusive tendering constituted an agreement which was prohibited.

[37] Thus, 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, drawing on their legal and economic expertise and on the experience and wisdom of other legal systems which have grappled with similar issues for longer than we have.

[38] The key characterisation question is whether an arrangement or an agreement which, as in the present case, possesses both vertical and horizontal elements stands to be examined under one or other or both of s 4(1)(b) or s 5(1) of the Act. In particular, and since the respondents were alleged to have contravened s 4(1)(b) by dividing markets, the question is whether, in the circumstances of this particular case, their conduct is to be characterised as 'dividing markets' within the meaning of s 4(1)(b). The extent of the ADs' independence is a potentially relevant factor in answering this question in the present case. However, we are of the view that the Tribunal erred in elevating this to the sole basis of the decision. By so doing, the Tribunal in effect impermissibly widened the scope of the exemption in s 4(5) of the Act and wrongly concluded that SAB and the ADs were not in a horizontal relationship with each other.

[39] The Commission contends that the intention as evinced from the wording of s 4(1) was to distinguish between conduct which would be the subject of a rule of reason inquiry in terms of s (4)(1)(a) and conduct which is *per se* unlawful and where no evidence is required of pro- or anti-competitive consequences of such conduct and which, accordingly, stands to be analysed in terms of s 4(1)(b).

[40] The Commission submits that the respondents have invited this court to circumvent the express legislative intention, by implicitly finding that the *per se* prohibition, as set out in s 4(1)(b), should never apply to distribution arrangements. This raises the broader question as to whether an agreement which has both vertical and horizontal elements can fall under both of the two provisions and, if so, in what circumstances. Debra Pearlstein el al *Antitrust Law Developments* (2002) of 81 summarise existing American law as follows:

> 'Restraints arising from an agreement between a manufacturer and its independent distributors were once viewed as horizontal where the manufacturer engaged in "dual distribution" i.e., it both supplied and competed with its distributors. The modern trend, however, has been for courts to treat dual distribution agreements as vertical, at least where the manufacturer designed the challenged restraint for its own legitimate purposes.'

[41] This approach has also been adopted by the European authorities. The European Commission in its Guidelines to Technology Transfers Agreements (2004) states:

> 'In order to determine the competitive relationship between the parties it is necessary to examine whether the parties would have been actual or potential competitors in the absence of the agreement. If without the agreement the parties would not have been actual or potential competitors in any relevant market affected by the agreement they are deemed to be non-competitors.'

[42] The EU approach thus provides that, if an undertaking would have not competed, absent the impugned agreement, then the agreement itself cannot be said to have been entered into between horizontal competitors but rather stands to be classified as an agreement between an upstream manufacturer who is engaged in a new distribution strategy with its downstream suppliers.

[43] This authority is of assistance in determining the scope and application of the characterisation principle in South African law to the present dispute. The agreements in this case were entered into between SAB and the ADs but were initiated by the former as the dominant manufacturer of beer with the manifest objective of distributing its beer products to best advantage. It is correct that SAB has its own distribution network. But the core relationship between the ADs and SAB remains to be described as of a vertical nature, that is between a producer of a product and distributors of this product. The true economic nature of the relationship, which the characterisation principle seeks to unlock, was, in this case, a vertical relationship between a producer and distributors of the former's product. Although the parties were also, at the distribution level, in a horizontal relationship, the horizontal elements of the agreement were incorporated in aid of the primary vertical purposes of the agreement. They were rational incidents of a vertical arrangement, not independent arrangements incorporated merely for convenience into a distribution contract. Viewed in this context, the horizontal elements, facially, have none of the features which would cause a Tribunal versed in competition economics to say that no defence should be countenanced.

[44] The purpose of the characterisation principle, in the manner in which we have outlined it, is reflective that the *per se* prohibitions contained in s 4(1)(b) are the most serious legislative prohibitions against a defendant. There is no defence which can be offered, if the requirements of the section are met. The animating idea of the characterisation principle is to ensure that s 4(1)(b) is so construed that only those economic activities in regard to which no defence should be tolerated are held to be within the scope of the prohibition. Whether conduct is of such a character that no defence should be entertained is informed both by common sense and competition economics.

[45] In the present case, the evidence indicates that the relationship between the parties is primarily a vertical one. Although there is also a horizontal component, the latter component is incidental to, and flows from, the vertical arrangement. Without the vertical arrangement, the ADs might notionally still have been competitors with SAB at the distribution level, in the same way that independent distributors are competitors with SAB at the distribution level, but the ADs would have had none of the benefits or duties flowing from the vertical arrangements. They would not have had favourable supply arrangements with SAB and they would not have enjoyed its support in setting up, expanding and conducting their operations; and they would not have had the service and delivery obligations they in fact owe to SAB. In short, they would have been competitors of a very different, and reduced character. SAB only had an interest in imposing geographical limitations on the ADs and in accepting reciprocal limitations on its depots because of the vertical relationships it had with the

ADs and the advantages which such a network held for the efficient distribution of its beer.

[46] Therefore, the conduct of the respondents is shown not to fall within the scope of s 4(1)(b), once the characterisation principle has been applied. By contrast, its application reveals that the economic substance of the relationship between the parties was a vertical one, which then stands to be scrutinized under s 5, rather than in terms of s 4(1)(b) of the Act. Put differently, the agreements between SAB and the ADs were not agreements involving 'dividing markets' as that term is used in s 4(1)(b).

[47] It may be that s 4(1)(a) could be applied to a case such as the present. In that event, the agreements would be made subject to the application of the rule of reason. However, this was not the case which the Commission sought to bring to the Tribunal. Although the Tribunal saw itself as being nevertheless free to conduct a s 4(1)(a) enquiry (which it decided adversely to the Commission), the Commission did not on appeal seek to persuade us that it should have been granted any relief in terms of s 4(1)(a). It is thus unnecessary to decide whether the Tribunal was entitled to undertake the enquiry or to comment on its s 4(1)(a) analysis.

The section 5 complaint

[48] The Commission's core argument was that the exclusive distribution agreements concluded between SAB and the ADs reduced intra brand competition

which, given the structure of the market, resulted in a substantial lessening of competition in the distribution market for beer.

[49] The Tribunal found that the Commission did not establish that SAB's distribution costs were significantly higher than they would have been, absent the ADs. Hence, there was no evidence which revealed a lessening of price competition to the detriment of consumers. Similarly, the Tribunal found that there was no evidence that the AD system had led to a greater compromise of non-price competition than otherwise would have been the case, absent the agreements.

[50] On appeal, the Commission contended that the Tribunal had erred in its approach as to whether there had been a substantial lessening or prevention of competition by restricting itself to the question whether the evidence established actual harm to consumer welfare. By contrast, the Commission contended that an anti-competitive effect could be shown either by proving actual consumer harm or showing that the conduct in question had a potential to foreclose the relevant market to competition.

[51] Applying the latter approach Mr Gotz, who appeared together with Mr Mkhabela and Mr Watson on behalf of the Commission, submitted that each AD was given an exclusive territory for the distribution of SAB's product. This exclusivity of territory undermined intra brand competition as each AD was likely to become a sole distributor of SAB's products. The argument ran thus: Given that SAB's products constitute the most substantial proportion of the clear beer market, and indeed of the

market for all alcoholic beverages, the foreclosure of independent distributors from accessing these products was likely to deny these firms sufficient scale to compete effectively.

[52] Mr Gotz submitted further that, apart from reducing intra brand competition, this set of agreements foreclosed inter brand competition by increasing distribution costs and thus the total beer costs of rivals of SAB, where the latter was viewed as a producer of beer. Expressed differently, the agreements entered into between SAB and the ADs caused both direct and indirect harm to consumer welfare as they substantially lessened or prevented inter brand competition in circumstances where SAB was the overwhelmingly dominant firm in the upstream market.

[53] In support of its argument that the AD agreements caused direct and indirect harm to consumer welfare because of a substantial lessening and/or preventing of both intra brand and inter brand competition, in circumstances where SAB was an overwhelmingly dominant firm in the upstream market, the Commission relied on the expert evidence of Dr Roberts. It is somewhat difficult to determine with precision the theory of harm which was developed by Dr Roberts in the testimony he gave before the Tribunal. Dr Roberts' main argument appeared to be one which was based upon SAB seeking to raise barriers to entry. As SAB's products constitute a substantial proportion of the beer market and, indeed, of all alcoholic beverages, the foreclosure of independent distributors from accessing the products of SAB was likely to deny these firms an opportunity to achieve economies of scale which are needed to complete effectively. This would not only impact on the distribution market but also

on the upstream production market. As SAB's production rivals would not have the capacity to set up and run their own distribution systems, they relied on independent distributors to achieve economies of scale but the efficiency of independent distributors depended upon them distributing products from competing manufacturers. By denying the independent distributors competitive access to its products, SAB was able to restrict their economies of scale which, in turn, limited the independent distributors' ability to distribute the products of SAB's competitors as cheaply as would have been the case, absent the impugned agreements.

[54] Dr Roberts testified further that a monopolist in the position of SAB has a clear interest in maximising the exercise of its market power. To achieve this objective and thus extract the maximum rent possible, a monopolist, such as SAB, needs to price according to segments if pricing power differs across segments. SAB was well aware of this objective as was evidenced in its set-up procedure for distributors, where it identified the need to group customers and to market segments which would form the basis for deciding on the ideal service package for each customer.

[55] Dr Roberts testified that it was evident from the documentation provided by SAB that it had conducted a detailed and careful analysis of the relevant potential arbitrage risks to determine 'the maximum safe price increases' in various market segments. Maximising the exercise of market power through a practice of price discrimination by geographical area was part of the strategic use of the agreements between SAB and the ADs taking into account SAB's emphasis on the prevention of cross-territory trading. Dr Roberts suggested that, given the weak level of intra brand

competition, vigorous inter brand competition was even more necessary. By preventing it, SAB was in an unfettered position to discriminate on the basis of price to the detriment to consumers.

[56] Dr Roberts also addressed the problem of double marginalisation. Briefly, double marginalisation occurs as follows: When firms possess market power they will set price above marginal cost. In turn, this decision will cause a diminution of welfare. The problem is accentuated when a firm with market power buys an input from another firm that also has market power. The producer of the input will price above marginal cost when it sells the input to the other firm, which will then also price above marginal cost when it sells the final product that requires the input. This means that the input has been marked up against marginal cost twice, once by the producer of the input and again by the firm that uses the input to make the final product.

[57] Dr Roberts testified that, in assessing the possible efficiencies which arise from agreements entered into between SAB and the ADs, it was important to establish whether there was a double margin to be eliminated in the first place. In his view, it was clear that, by preventing arbitrage opportunities, SAB's anti-competitive restraints created a bigger margin in the different segments instead of eliminating them. Where distributors are able to arbitrage and compete on the arbitrage margins, prices were expected to be lower across segments, thereby benefiting consumers. In his view, this benefit was denied to consumers as a result of the anti-competitive vertical restraints which SAB had imposed.

[58] In short, Dr Roberts' testimony was to the effect that consumers were deprived of a choice which might result in them being able to procure beer at a cheaper price from an independent distributor or from another AD. The following passage of his evidence provides a summation of this theory of harm:

> 'And so you have the base pricing in these three areas Cape Town, Durban and I think Gauteng and then you have the – you have non-base depot pricing, which is the pricing at Vredendal, Boland, Southern Cape and Knysna. So you've got those points and then within an area of 50 kilometres around each of those, so you could draw a 50 kilometre radius around Vredendal, around Boland, around Southern Cape and around Knysna that's one price. So there's a single price a 50 k radius, it used to be an 820 kilometre radius, but that's a 50 kilometre radius around each of those points.
>
> And then you have higher – you have different pricing points and higher prices radiating out from there. So just to you know maybe concretise this so you are going to have a price, you have got a single price and it is the same price as I understand it at Cape Town, Durban and Gauteng. You have then got different prices at Southern Cape, Boland and those prices are determined separately. And then you have pricing points radiating out from each of those, which are secondary distribution so you add on. So it is like different levels of pricing and secondary distribution takes place from the depots and the appointed distributors and has different sub regional if you like price points, which are determined.
>
> What this means if you are on the Southern Cape area you are going to get the price that is at the brewery at Ibhayi plus – which is Port Elizabeth price if you like, plus the price of primary distribution to the South Cape plus the price involving secondary

> distribution if you are outside 50 kilometres. So you would have those price build-ups and yet it may be much more effective and efficient for you to buy from an independent distributor located you know in Cape Town who is distributing a whole bundle of products to your area. '

Evaluation

[59] The core problem with the evidence provided by the Commission is that it was based on the argument that any restraint necessarily restrains competition. There was no significant attempt to illustrate how the effects of this alleged restraint would substantially lessen or prevent competition in the particular market. Mr Gotz contended that it was irrelevant whether the counterfactual to the present position would result in lower distribution costs in the context of an enquiry as to whether the agreements caused harm to competition.

[60] However, s 5(1) expressly refers to the effect of substantially preventing or lessening competition in a market. It must follow that some likely effect upon price, output and/or quality of product which diminishes consumer welfare should be shown to exist in order to trigger the application of s 5(1).

[61] It is also necessary to remember that the case brought by the Commission relates only to 10% of SAB's distribution, as there was no complaint before this court concerning the depots which distribute 90% of SAB's beer.

[62] Dr Roberts was closely cross-examined about the effect of the Commission's counterfactual which, apart from the depots which are not the subject of this appeal,

would allow an open market with regard to distribution of SAB's products; that is the counterfactual of allowing independent distributors to compete on an even playing field with the ADs. One scenario of an even playing field is if all distributors were granted the same discounts as the ADs. Dr Roberts was asked on numerous occasions whether he accepted that, if the same discounts were given to all distributors who could accept deliveries of at least 16 pallets, an additional cost (in the form of discounts) of R729 million would be incurred by SAB. The record reveals an extreme reluctance by Dr Roberts to answer this question, a reluctance which permits an inference that he could not deny that the counterfactual would ultimately increase costs to the consumer. Furthermore, Mr Adami said that the figure of R729 million was a minimum because buyers who could not currently handle 16 pallets could consolidate, which would push the cost to SAB above R1 billion. This was only the cost of the discounts; it did not include the disruptive costs to the supply chain (ie the removal of the ability to maximise efficiencies in logistics by central and predictable planning). Mr Adami opined that if these further disruptive effects were included the increase in SAB's costs would be at least R1,5 billion per annum.

[63] Given these costs, this particular counterfactual is not in fact the likely one. If the current AD system had to be jettisoned, the overwhelmingly probable counterfactual, as SAB asserted, is that it would take the remaining 10% of its distribution in-house, that is extend its depot system to include the areas currently serviced by the ADs. Only in this way could it continue to achieve the efficiencies which come from central co-ordination and avoid surrendering margin to the

wholesale trade.[2] It would be impossible for SAB to continue undertaking the marketing and selling functions (including promotions and customer liaison), which it currently performs for depots and ADs and which it clearly regards as critical to the maintenance and growth of its sales, if distribution in a particular area was being performed by numerous independent competing firms. The ADs, at inception, were not distributors though some of them had retail interests which SAB required them to dispose of before commencing as ADs. Essentially, therefore, the ADs as distributors were SAB's creations. Where, historically, ADs failed, as has on occasion happened, distribution was taken over by existing or new depots belonging to SAB or the shares in the AD were bought by SAB. The probable counterfactual is thus one in which all outside distributors (including the current ADs, to the extent that they survived) would be 'independent' distributors to whom SAB would have no or very only limited incentive to remunerate for undertaking distribution. This probable counterfactual, of course, is completely incompatible with Dr Roberts' theory of harm.

[64] We should add, further, that the discounts received by ADs through handling and delivery fees are not uniform discounts which could simply be applied to all distributors. Since 2001 the fees have been individualised on an annual basis to determine a fair level of return on capital to the AD concerned, the calculations being of some complexity. This approach, which accords with the conception of ADs as extensions of SAB's distribution system and which requires SAB to have intimate knowledge of the AD's equipment requirements, fair operating costs, working capital

[2] We say wholesale trade, but both Mr Wessels and Mr Adami explained that a large volume of its product was sold to informal redistributors ('IRDs') who generally had retail licenses and who not only

needs, customer profile, inventory requirements, debtors book and so forth, could not readily be transposed to a large number of independent distributors.

[65] This conclusion is fortified when the evidence led by SAB is considered. Mr Adami, on behalf of SAB, testified that over the past forty years SAB had achieved a real price reduction in its beer products of approximately 48%. In his view, the reason for this decrease in price was that SAB's business model was based on achieving high volumes through affordable, low prices. In addition, its depot and AD system of distribution allowed SAB to manage the problem of costs of returnable bottles; that is the cost of 750 ml returnable packs which would increase significantly if its centralised system were to be replaced.

[66] Mr Adami testified that the depot and AD system was beneficial to consumers in that it was economically efficient in that SAB was able to access economies of scale in its distribution function, the savings from which could be passed on to the end consumer. The SAB outsources distribution activities where it is able to do so in the interests of efficiency and market effectiveness. Further, it is effective in meeting the needs and requirements of retailers and in terms of supplying high quality products to the market. Far from restricting the supply of beer to manipulate demand, Mr Adami suggested that control over the distribution of its products enabled SAB to provide consistently superior service to its customers. In his view the system was successful in delivering more value to the liquor retailer than any other liquor or beverage supplier in the South African industry, as confirmed by independent customer surveys

---

distributed but also conducted retail operations. There would be no way for SAB to know whether

across each liquor retail class of trade. The system enabled SAB to maximise its brand availability, customer service, product quality and brand image. The distribution system constituted a key element of SAB's value chain and added a vital synergy to the overall marketing effort, including brand positioning and sale activities. In summary Mr Adami testified that the distribution system was designed to achieve lower costs of warehousing, primary distribution and secondary distribution costs and that the distribution sites were located to fulfil 100% of demand for all purchasers of more than ten cases of beer at the lowest cost.

[67] According to Mr Adami, the distribution system was regularly checked by way of a program called CAST. The importance of the CAST system is revealed in the following passage of evidence given by Mr Wessels, on behalf of SAB:

> 'ADV COCKRELL: What I did want to ask you is this, if the number of distribution points were to increase over the current number of 56, for example, because all of the independent distributors would now be performing distribution functions, what does that CAST model tell you about the likely impact on SAB's cost?
>
> MR WESSELS: Well it would first of all increase the warehousing cost, the overhead. It would – it could bring down secondary distribution cost, but it would increase primary distribution cost. And so what this is saying to us that given the customers where they are today and the volume as it is today an increase in number of distribution centres for SAB would ultimately result in increased total costs of distribution .
>
> ADV COCKRELL: And would that have an impact on the price of beer…

---

product was being bought and used for redistribution or for direct retail.

> MR WESSELS: It would flow through to the price of beer – increasing the price of beer.'

[68] Mr Wessels referred the Tribunal to 'CAST scenarios for competition cases'. He testified that SAB had done an exercise to try to find cost saving opportunities within the existing distribution network. He referred to testing SAB's distribution system by running the CAST programme in a scenario (styled 'Free Uncapped') with the following assumptions: all warehousing capacity constraints at depots/ADs were ignored and customers could be allocated to depots/ADs as the programme deemed optimal (ie boundaries could be redrawn). CAST produced a result that total cost would amount to R2.501 billion per year, which is 98.1% of the existing distribution costs of R2,55 billion. This showed that the actual cost of the current system was very close to optimal costing, where such optimal costing was calculated on a basis, unrealistic in practice, which assumed no warehousing constraints at any depot or AD. Mr Wessels emphasised that this scenario still pre-supposed exclusive geographic areas but those areas were reconfigured. SAB's case was that without its depot/AD system of exclusive areas there would be a major loss of the efficiencies which came from central planning, in particular the ability to ensure that trucks in the primary and secondary distribution legs are optimally used or as Mr Wessels put it, 'So we won't get our 24/7 operation running at full capacity and full utilisation'.

[69] Mr Wessels then testified about a further model, 'the Blue Sky model'. In this case, the following information was provided to the computer programme: (i) the

location and respective capacities of SAB's seven breweries; (ii) the location of some 35 000 customers together with the demands of the latter and delivery frequencies and volume uptakes. CAST was asked to provide the optimum scenario, ie disregarding the depot and AD infrastructure which currently existed. The result of this scenario was that there would be fewer depots/ADs (42 as against the current 56) at a total annual cost of R2.49 billion, which was 97.6% of the current situation. Wessels and Adami said that the savings in the Blue Sky and Free Uncapped scenarios were mainly generated by CAST's theoretical reconfiguration of SAB's urban depots (closing down some and converting others into mega-depots, changes which were not physically feasible). The 'Blue Sky' scenario would not be practicably achievable because the existing infrastructure has been created over time at considerable cost. One cannot practically create, extend or eliminate infrastructure day by day in accordance with a changing theoretical ideal. However, this analysis provided formidable proof of the cost efficiency of the present configuration of the distribution system which was not challenged in cross examination.

[70] There were similar difficulties regarding the Commission's case concerning geographical price discrimination. To cite one example: SAB has a depot in Knysna. It supplies beer to Sedgefield which lies between George and Knysna. On the basis of the impugned agreements, the relevant AD, Southern Cape Beer Distributors ('Southern Cape'), which is based in George, cannot supply SAB's beer to customers in Sedgefield.

[71] The Commission contends that Southern Cape could, if permitted by SAB, supply beer to Sedgefield and make a margin of R4,01 per case. In this case, Southern Cape would buy the beer from SAB at a net price of R88,55 per case (the list price of R95,23 less the handling and delivery fees of R6,88 received from SAB) and would on-sell beer at a price at R95,23 per case. It would earn a gross margin of R6,68. Less the costs of distribution incurred by Southern Cape of R2,67, its net margin per case of beer sold would be R4,01. This showed that Southern Cape could potentially sell the product to Sedgefield customers at a lower price than R95,23 and still make a net margin (ie by giving up part of the net margin of R4,01).

[72] However, as Mr Wessels testified, this calculation only took account of secondary distribution costs and omitted the costs of additional warehousing and of additional primary distribution from the calculation. The following passage from Mr Wessels' evidence reveals the evidential problem:

> 'MR COCKRELL: … And you'll remember this is what the Commission prepared it's what they put before you. And what Exhibit "104" purports to show is that Southern Cape Beer Distributors in George could cross the border. They could deliver to Sedgefield, which is in the territory of the Knysna depot and they could do so for a benefit of R4,01 do you recall that broadly?
>
> MR WESSELS: Yes
>
> ADV COCKRELL: Let me ask the questions I asked in relation to "104", on this calculation have they included the costs of warehousing the beer?
>
> MR WESSELS: No

ADV COCKRELL: And if you had to find a proxy for the costs of warehousing the beer, what would it be?

MR WESSELS: R3.15.[3]

ADV COCKRELL: And if you were then to include that in the costs, what impact would it have on the margin?

MR WESSELS: The margin then drops to 85 cent, about 86 cents from R4,00 as it shows here, effectively the R4,00 less the R3,15 [comes to] the 86 cents.

ADV COCKRELL: Does Exhibit "104" have any regard to the primary distribution costs?[4]

MR WESSELS: No

ADV COCKRELL: If one were take account of primary distribution costs and secondary distribution costs, is it more cost effective to service Sedgefield from the Knysna depot or from Southern Cape Beer Distributors?

MR WESSELS: It is more cost effective via the Knysna depot. The reason being that the primary distribution comes from – in either instance comes from Ibhayi or Port Elizabeth. And in the one instance it travels all the way to Knysna or alternatively it passes Knysna to George. So you have a much longer primary distribution, whereas the secondary distribution from either George or Knysna is similar. So the big difference is going to be primary distribution.

ADV COCKRELL: If SAB's costs of distribution were to increase, would that ultimately reflect in the price paid by consumers for beer?

MR WESSELS: Yes.

[3] This refers to the cost that Southern Cape Beer Distributors would incur to warehouse the additional volumes needed to supply consumers in Sedgefield.

[4] That is, the cost of getting the product from the brewery to the relevant depot or AD.

> ADV COCKRELL: And if Southern Cape Beer Distributors were to take customers away from the Knysna depot what would happen to the average costs of the Knysna depot?
>
> MR WESSELS: It would go up.'

[73] Accordingly, so far from there being a net margin of R4,01 as suggested by the Commission, there would probably be a net loss. A similar omission to take account of additional primary distribution and warehousing costs is to be found in further examples invoked by the Commission with regard to distribution in Heidelberg and Swellendam. Viewed holistically, the case of geographical discrimination, as advanced by the Commission, that the geographical exclusivity system was inefficient, was not supported by the evidence led by the Commission.

[74] In summary, the evidence did not support the case of a significant lessening or prevention of competition, as a result of an exclusive territorial system of distribution. It did not prove an anti-competitive effect which was required in order to apply s 5(1), other than an attempt to draw an inference by virtue of SAB's dominance in the upstream market.

[75] The Commission argued that retailers would obtain a better service if there was an absence of restraint, particularly if distributors could deliver a mixed load of products manufactured by SAB as well as its competitors. But no evidential basis for this submission was laid which would be sufficient to justify the application of s 5(1) of the Act. To the contrary, the evidence viewed as a whole indicated that there would

be a diminution of consumer welfare if the Commission's counterfactual became the operating model for distribution.

Foreclosure

[76] We turn to deal with the second argument raised in terms of s 5(1), namely the question of foreclosure.

[77] The Commission contended that the AD agreements deny scale to independent distributors because the latter are refused access to the products of SAB at the same price as they are acquired by the ADs. In turn, this prevents independent distributors from obtaining bulk orders that would have promoted the achievement of economies of scale. The loss of these economies of scale prevents independent distributors from being viable competitors to the ADs. The lower costs which result from scale economies would benefit the independent distributors and, in turn, SAB's competitors upstream because the latter's products would then be brought to market at a cheaper price. In this way, inter brand competition would be enhanced as opposed to the present position where such competition is impeded.

[78] This was however not the case which was pleaded by the Commission regarding alleged infringements of s 5(1) of the Act. The Commission's case was concerned solely with the downstream market. Unsurprisingly therefore, the Commission was unable to point to any evidence which made out a case of foreclosure sufficient to justify the application of s 5(1).

[79] A further problem arises in the assessment of foreclosure effects. SAB's evidence, which accords with the probabilities, is that, if it were not permitted to continue with the current AD system, it would jettison the ADs and instead use depots throughout its distribution network, a counterfactual which certainly did not support an argument with regard to foreclosure as suggested by the Commission.

[80] The broader context of distribution agreements as they have been raised in this case can helpfully be examined through the prism, albeit briefly, of Ronald Coase's major study on the nature of the firm. See *The Nature of the Firm* (1937). Coase introduced the concept of transaction costs, namely costs from preparing, entering into and monitoring the execution of all forms of contracts, as well as costs for implementing allocative measures within firms in a corresponding fashion. Coase argued that a firm might originate when allocative measures are carried out at lower total production costs within the firm than by means of purchases and sales on the market. Similarly, a firm expands to the point when additional allocative measures cost more internally than they would if concluded in arm's length contracts in the market. If transaction costs were zero, no firms would arise. All allocation would then take place through simple contracts between individuals.

[81] In the present case, it appears, given the evidence as to its distribution model, that SAB considers that its distribution costs can be held at a lower level through depots (in-house) and the ADs (which, while not in-house, are also not at arm's length) than by way of a range of contracts entered into with independent distributors. The evidence, as outlined earlier, concerning SAB's low distribution costs supports

this analysis and demonstrates the difficulty of holding that a s 5(1) case can be made out that the impugned agreements have the effect of substantially lessening or preventing competition.

[82] The point is made in **European Night Services v Commission** [1998] 5 CMLR 718 at para 136 that, when examining the concept of 'effect' of lessening competition, if an agreement does not have, as its object, the restriction of competition, it is necessary for the Commission to demonstrate that it would have a restrictive effect which is a much more onerous test. In this connection the Court said:

> 'It must be borne in mind that in assessing an agreement under Article [101(1)] of the Treaty, account should be taken of the actual conditions in which it functions, in particular the economic context in which the undertakings operate, the products or services covered by the agreements and the actual structure of the market concerned … *unless it is an agreement containing obvious restrictions of competition such as price-fixing, market sharing or the control of outlets…* In the latter case, such restrictions may be weighed against their claimed pro-competitive effects only in the context of Article [101(3)] of the Treaty, with a view to granting an exemption from the prohibition in Article [101(1)] (emphasis added).'

[83] This observation, coupled to Coase's insight into the firm, illustrates the reasons for the requirement that more than the existence of dominance by a firm in the upstream market is required to justify a case based upon a vertical restriction. On the basis of the evidence presented, this is a case where the Commission has not

discharged the requisite onus. Accordingly, it is not necessary to examine the balance of the argument presented with regard to efficiency justifications.

Price discrimination

[84] In the founding affidavit, the Commission contended that SAB treats independent liquor distributors differently from the ADs. In particular SAB's wholesale discounts and delivery fees are awarded only to ADs and are not available to independent distributors. As a result, independent distributors are not provided with these benefits, but must inevitably purchase SAB's product at the same prices as do their potential customers (retail outlets including taverns and shebeens). As a consequence, independent distributors are prevented from earning a sustainable margin on the sale of SAB's products. They lose market share to second to fourteenth respondents which has the effect of substantially lessening intra brand competition.

[85] In his evidence, Dr Roberts contended that harm to competition is evident in the manner in which SAB's differential treatment of ADs and independent distributors are part of the strategy to take market share away from independent distributors in order to capture the wholesale margin and tie up distribution channels so as to make upstream competition far more difficult.

[86] On appeal, Mr Gotz sought to develop this contention. He submitted that there was discrimination in this case because SAB compensates the ADs for expenses incurred in performing the handling function, by way of a trade discount. Further, a

delivery fee is paid for actual deliveries made by the ADs to the trade. It was common cause that the independent distributors do not enjoy either the trade discounts or the delivery compensation. As SAB is a dominant firm, it has breached s 9(1)(c), because its conduct plainly involves discrimination between purchasers in terms of the grant of discounts, allowances, rebates or credit given or allowed in relation to the supply of the goods or payment for services provided in respect of these goods.

[87] The Tribunal dismissed the Commission's s 9(1)(c) case. It held that when SAB contracted with the ADs, in economic terms it had engaged in two separate transactions, one as the seller of goods and the other as the purchaser of distribution services. When it acted as a seller, it sold beer to its customers, the ADs. In the second transaction, it purchased distribution services from the ADs for which, as purchaser, it paid by way of the discounts it afforded the ADs.

[88] According to the Tribunal, the fact that there were simultaneous transactions did not mean that they could be considered to be one indistinguishable transaction. It followed that, as SAB did not need to purchase distribution services from the independent distributors, save on certain specified occasions, it did not afford the latter a discount but treated them as ordinary purchasers and not as sellers of distribution services. To the extent that there may have been any competition concern about this conduct, the could raise the question of a refusal to deal with independent distributors, a potential s 8 contravention, but this was not the case brought by the Commission against SAB.

[89] On appeal, Mr Gotz submitted that this finding by the Tribunal constituted an error of law. In order to examine the question of equivalence, the Tribunal should first have asked whether the products sold to the different customers were comparable. Second, it should have inquired whether the transactions, viewed as a whole, could be regarded as reasonably analogous. In conducting this enquiry, regard should have been had to the substance of the transactions rather than to the form thereof. Thus, the Tribunal should have examined the essential economic features of the transactions in order to determine the requirement of 'equivalence'.

[90] In this regard, Dr Roberts testified that independent distributors were offered stock at the same price that SAB sold to retail outlets, which allowed them no margin on sales. This offer stood in contrast to ADs who were permitted to make a 'fair' profit by means of the discounts and delivery compensation they received from SAB. This differentiation meant that the independent distributors were not in a position to offer any discounts to retailers without incurring a loss, a situation which ADs did not face. Accordingly, the ability of independent distributors to compete was constrained as a result of those discriminatory terms. Dr Roberts' suggested that a 5% difference in the effective price was important in a market of narrow margins, especially in respect of quarts.

[91] In our view, there is no need to interrogate the evidence on equivalence and to determine whether, from an economic effects perspective, the ADs and the independent distributors were engaged in equivalent transactions. The Commission failed to establish that the alleged price discrimination would have the likely effect of

substantially preventing or lessening of competition. Initially the Commission's case was that all independent distributors should get the same handling and delivery fees as did the ADs. The evidence, particularly of Mr Dodson, on behalf of Metcash, and Mr Pitsiladi, on behalf of the Big Daddy Group, suggested that the independent distributors, at present, exact higher margins from their businesses than do the ADs. Under cross-examination, Mr Dodson was confronted with questions as to whether his group was 'a particularly eligible candidate to replace the ADs, given the margins that Metcash sought and the quality of delivery which would be sought by SAB. In short, he was asked the question 'why should SAB be required to say or view, well, let's just hand you a 5% additional margin, diminish the scale of my existing ADs for a firm that as we have seen, is not a particularly efficient deliverer of products, you are just inefficient.' He was pressed further as to the existence of a plausible reason why SAB would replace the incumbent ADs in favour of his firm, a large independent distributor, given the latter's price structure.

[92] Mr Dodson was constrained to answer that, given a chance, his organisation may well be able to reduce the margins that they required to that which would be comparable to ADs. At present, the evidence revealed that the base margins of ADs were lower by between 4,3 % – 12,2%. This meant that the ADs' pricing was significantly more competitive than that of independent distributors.

[93] SAB calculated that the cost of complying with a s 9(1) remedy would be in the order of R729 million per annum; that is if SAB would be compelled to pay handling

and delivery fees to all independent distributors, its costs would increase by R729 million per annum.

[94] Presumably, as a result of the difficulties encountered with this evidence, the Commission concentrated its arguments on the role of urban redistributors ('URDs') which perform a particular function as a 'one stop' liquor shop for on-consumption establishments such as restaurants and bars (with SAB's products typically being only a small part of the such outlets' liquor basket). Mr Gotz referred to the evidence of Mr Wessels, on behalf of SAB, that the URDs were offered distribution discounts on convenience packs but no discounts on quarts. At the very least, he submitted, as a result of denying the distribution discounts to URDs in relation to the sale and distribution of quarts, SAB had excluded these URDs from participating in the distribution of quarts. Although convenience packs make up the bulk of the URDs' sales, quarts form a critically important and growing role in the beer market and account for approximately 80% of the beer volume. According to Mr Gotz, Mr Wessels conceded that SAB had recognised the importance of URDs' performance of distribution services from SAB to retailers and the URDs should have been promoted rather than having to suffer restraints.

[95] Mr Gotz also referred to the evidence of Mr Adami who had conceded that SAB had re-engaged the URDs because the former needed to gain access to certain on-consumption outlets to which, absent URDs, it did not have access. Although URDs only contributed 2% of SAB's sales, the fact that they were re-engaged by SAB

meant that the latter had recognised the importance of their role in market efficiency as distributors.

[96] Mr Gotz submitted that there did not appear to be any distinction between transactions conducted between SAB and the URDs on the one hand and SAB and the ADs on the other. In Mr Gotz's view, they were economically equivalent. Furthermore, the fact that the URDs were being prevented from gaining access to discounts in the key market for quarts showed that there was a lessening of competition that would have taken place but for the restrictions of which the Commission complained.

[97] As Mr Unterhalter, who appeared together with Mr Cockrell and Mr Sisilana for SAB noted, URDs do *not* perform the same function as the ADs. URDs, who are customers of the depot or AD's serving their area, largely distribute SAB's premier brands to hotels, restaurants and bars. Patrons of these establishments do not consume quarts. Further, the URDs do not perform bulk distribution, which was the basis of the ADs' business nor, given the size of the bulk distribution operation, would they be able to do so. There were only four URDs in the areas in which the ADs operated. They account for no more than 1% of the total volume of distribution. They traded in non-returnable bottles, whereas 80% of the ADs' business concerned returnable bottles. URDs were therefore not geared up operationally to perform the same services as ADs. Mr Adami said that URDs were engaged not because they could distribute more efficiently (only below fairly modest drop sizes would the URDs' delivery be more cost-efficient than direct delivery by the depot or AD) but because

they could offer superior convenience to a particular type of outlet (on-consumption restaurants and bars) for whom convenience was more important than price and in order to increase the presence of SAB's premier brands at these outlets. This basis for offering discounts was quite different from the depot/AD system's rationale. As to the argument of payment to the URDs of handling and delivery fees for quarts, at the very least, the evidence did not show that SAB would be paying an equally efficient distributor for a service it required.

[98] Applying the same test to 'it is likely to have the effect of substantially preventing or lessening competition' as the phrase appears in s 9(1)(a) and in s 5(1), there was no evidence that, absent the present structure with regard to pricing in general and in particularly the provision of the equivalent trade discounts and delivery compensation to all who distributed SAB's products, there would be a price reduction and a concomitant improvement of the services provided for consumer.

[99] The evidence did not, on the probabilities, show this to be the case. Accordingly, the Commission failed to meet the first requirement necessary to invoke s 9(1), namely evidence to show that the alleged price discrimination was likely to have an effect of substantially preventing or lessening of competition, of a kind which would undermine the competitive process and ultimately harm consumers. Indeed, the more cogent evidence in this case pointed to a contrary conclusion.

Section 5 (2) case: resale price maintenance

[100] Section 5(2) of the Act prohibits the practice of minimum resale price maintenance. It classifies the practice of minimum resale price maintenance as a restrictive vertical practice; that is a practice involving firms which operate at different levels of the supply chain. The practice is prohibited *per se*. There is no opportunity for a firm which employs such practices to justify its conduct by referring to efficiency benefits that may flow therefrom. By contrast, a supplier can recommend a minimum resale price, provided that it makes clear to the purchaser that this recommendation is not binding. This recommended price should appear next to the stated price if the product bears a price (see s 5(3) of the Act)

[101] The Commission's case can be summarised thus: The transactions involve a sale between SAB and an AD in respect of SAB's product and a second transaction in terms of which an AD 'on sells' to retail customers. Until the end of February 2008, SAB's centralised SAP computer system (which depots and ADs were required to use) was employed as a mechanism for the enforcement of the prices determined by SAB. Prices were centrally controlled by the computer system which did not permit an AD to sell at a reduced price; that is below the price 'recommended' by SAB. While ADs were not expressly prohibited from offering a further discount, this was not practically possible, as the computer system would not permit the depot or AD to issue an invoice at a price lower than the programme's price for that product. All the prices of SAB's products were centrally loaded and controlled by SAB. The Commission contended, further, that SAB sent price lists to the depots and ADs

which did not comply with s 5(3) because the lists did not make clear that the listed prices were merely ‘recommended’ and were not binding.

[102] Accordingly, the Commission argued that the computer system was an effective tool for ensuring compliance with predetermined prices. The Tribunal found that SAB had effectively implemented resale price maintenance but ‘there was no evidence … that SAB would impose sanctions for non-compliance’. Accordingly it dismissed the complaint.

[103] Mr Unterhalter submitted that the Commission’s case was based on an inference, namely it sought to have the practice of resale price maintenance inferred from the existence of a computer configuration. In his view, this inference could only be drawn if it was the only inference to be drawn and if there was no evidence contradicting it. He referred to the evidence of Mr Chiliza, who represented an AD and who testified that, even before the change to the computer system, the ADs had the ability to price below the recommended selling price. He testified that he had offered discounts below the recommended selling price and had never been reprimanded by SAB for so pricing below the recommended resale price.

[104] It was only on 4 March 2008, a date subsequent to the referral of the complaint to the Tribunal, that SAB addressed a letter to the ADs in which it advised that changes had been made to the computer system which permitted the ADs to load product prices of their own choice. This letter reads thus:

> 'Functionality has been added to SAP to provide Distributors, at site level, with the facility to affect changes to their product prices within their organisations. The implication of this system change is that distributors will have the capability to load product prices of their choosing to their respective distribution territories. This change came into effect in mid-January 2008.
>
> In order to utilise this functionality, each distributor will be required to select a user(s) for training on the pricing update process and to grant the user(s) the requisite access in order to affect pricing changes in SAP. Should a distributor wish to make use of this functionality then requests for once–off training and user access should be done through the Regions' OSM.
>
> The training format will consist of a two-day classroom session. The number of sessions to be conducted will be determined by the number of users to be trained. Training will take place from April 2008 and upon completion, the users may request access via the Online Application Form on Beernet.'

[105] Until the generation of this letter, SAB had run a computer system which, it is common cause, did not allow for the lower price to be coded into the system by the ADs.

[106] The question of resale price maintenance received very little attention in the Tribunal. The matter was dealt with relatively briefly in the first report filed by SAB's economic experts, Genesis. Because the issue was thought not to require economic analysis, the Commission's economic experts did not address the matter in either of their reports. Neither of the lead experts touched on the question during their oral testimony. Of the two factual witnesses called by the Commission who dealt with this

complaint, the one, Mr Chiliza, conceded that that he had seen himself as being free to grant discounts and had in fact done so. The other witness, Mr Mabanga, claimed to have thought he could not charge less than the list prices although he conceded that methods of discounting were possible and may have been used by other ADs. Despite the centrally controlled computer programme, there were ways in which lower prices could in effect be charged by the ADs, for example by issuing free cases of beer, by extending the period qualifying for early settlement discounts, by crediting the customer's account via the same programme used in generating the invoice or simply by accepting short payment.

[107] Mr Wessels said in his witness statement (which he confirmed at the commencement of his testimony) that the inability to generate an invoice at a lower price was 'an unintended consequence of the control measures implemented by the IT department'. Precisely what this meant was not explored with Mr Wessels in chief or in cross-examination. The statement appears to indicate that SAB did not have the desire or aim of prohibiting the ADs from selling product at prices below those loaded for purposes of the invoicing system (which was in turn simply one of many features of the programme in question). This is consistent with the analysis by the economic experts for SAB demonstrating the absence of any economic incentives for SAB to have imposed minimum reselling prices on the ADs.

[108] Although the ADs were required to use the programme in question, the contracts between SAB and the ADs contained the following standard clause:

’10.2 The [AD] shall sell the Products at prices and on terms and conditions as the [AD] sees fit, provided that the [AD] shall:

10.2.1 not sell the Products for a price which exceeds the recommended selling price as set out in the SAB recommended sales price list and territorial specific price list, as amended by SAB from time to time; and

10.2.2 provide settlement terms no less favourable to the customer than offered by SAB to its customers as confirmed in writing by SAB from time to time.’

[109] Although the price lists supplied by SAB to the depots and ADs did not explicitly state that the list prices were merely recommended, the price lists also did not say that the list prices were a mandatory minimum. Where a supplier supplies a product which has a price stated on it, s 5(3)(b) requires the words ‘recommended price’ to appear next to the stated price. This particular requirement is not applicable in the present case, because the products themselves did not carry a price. In regard to s 5(3)(a), the price lists must be read together with the contracts between SAB and the ADs to whom the price lists were sent. The price lists would have been understood by the ADs as being the recommended selling prices as contemplated in clause 10.2. The price lists did not suggest that the prices were mandatory minimum prices, and clause 10.2 was quite explicit in giving freedom to the ADs to charge any price they saw fit provided such price was not higher than the list prices.

[110] Because of an apparently unintended consequence of the centralised programme, effect could not be given to the freedom which ADs enjoyed to charge lower prices in the normal way; that is through an invoice at a lower price. However,

and although there would have been very limited economic incentives for ADs to charge lower prices, it was possible to do so by one or other of the somewhat more circuitous methods previously mentioned. There was evidence from a former AD that he had in fact done so. Having regard to the provisions of clause 10.2, SAB would have had no contractual right to take action against an AD which chose to sell product at a lower price by issuing no invoice in respect of a portion of the customer's order or by agreeing with the customer that the invoice at the higher amount would be corrected through a credit via the online system or that short-payment would be accepted. We also satisfied that SAB would have had no incentive to discipline an AD in such circumstances.

[111] In **Federal Mogul Aftermarket Southern Africa (Pty) Ltd v Competition Commission & Another** 2005 (6) BCLR 613 (CAC) this court rejected the view that resale price maintenance had to involve a vertical agreement between supplier and distributor; unilateral conduct by the supplier might suffice. The essence of the practice of resale price maintenance was held to be the imposition by the supplier on its distributors of a price at which goods are to be resold, with the distributors being induced to comply with this minimum price on pain of a sanction for non-compliance (at 618). The elements of imposition and inducement entail some conduct by the supplier directed at ensuring compliance with a minimum price. The supplier need not be aware that its conduct violates the Act but it is difficult to see how there can be price maintenance as defined in **Federal Mogul** without some intention on the part of the supplier to maintain a price.

[112] To repeat: terms of the contracts between SAB and the ADs are quite explicit in allowing the latter to charge prices below the list prices. The contracts were not shown to have been simulated. In the absence of satisfactory countervailing evidence, the contractual terms represent the best evidence of the parties' intentions, including those of SAB as supplier. Self-evidently, those terms are entirely inconsistent with the imposition by SAB of a minimum price or an inducement, against pain of sanction, to comply with the minimum price. The configuration of the computer programme gave rise, we consider, to an unintended administrative difficulty in giving effect to the intention of the parties in the most obvious way but did not prevent ADs from discounting. We would add that, in the light of the express terms of the written contract, an AD that wished to discount by issuing an invoice at a price below the list price would have been entitled to insist that SAB modify the programme so as to allow invoices at lower prices to be issued. In the absence of such modification, an AD could not have been obliged to use a computer system inconsistent with the AD's contractual rights.

Conclusion

[113] For these reasons, the appeal is dismissed with costs, including those attendant on the employment of two counsel in the case of the first respondent and one counsel in the case of the second to fourteenth respondents.

DAVIS JP

MOLEMELA AJA concurred