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COMPETITION COMMITTEE****Hub-and-spoke arrangements – Note by South Africa**

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This document reproduces a written contribution from South Africa submitted for Item 7 of the 132nd Competition Committee meeting on 3-4 December 2019.
More documents related to this discussion can be found at
<http://www.oecd.org/daf/competition/hub-and-spoke-arrangements.htm>

Please contact Mr Antonio CAPOBIANCO if you have any questions about this document
[Antonio.CAPOBIANCO@oecd.org]

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South Africa

Background

1. The following note sets out the Competition Commission of South Africa's ("the Commission") response to the call by the Organisation of Economic Cooperation and Development ("OECD") for written submissions to inform the roundtable discussion on "hub-and-spokes" to be held on 4 December 2019.
2. The Roundtable will look at approaches by other jurisdictions on the concept of hub-and-spoke. The purpose of this paper is to provide South African experience in relation to its approach to collusion in the downstream market which is facilitated by an upstream supplier. The Commission will in this paper seek to discuss cases that it investigated in the past that involved possible hub-and-spoke arrangements.

1. Introduction

3. In South Africa, hardcore cartels and resale price maintenance are investigated under 'per se' provisions. i.e. restrictive horizontal practices for hardcore cartels and restrictive vertical practices for resale price maintenance. A hardcore cartel involves an agreement between parties in a horizontal relationship (competitors). A resale price maintenance refers to a practice between parties in a vertical relationship. Both these contraventions have price fixing elements, horizontal and vertical arrangements fix prices directly and indirectly.
4. A hardcore cartel is usually enforced by the parties to the agreement, whilst a hub-and-spoke arrangement is usually enforced by an upstream supplier on downstream parties. In other words, the upstream supplier determines prices or markets for its wholesalers/distributors. The decision by the upstream supplier is usually followed by sanctions for non-compliance.
5. The Commission has in the past prosecuted few resale price maintenance cases. However, the Commission has concluded numerous settlement agreements with vehicle manufacturers for enforcing a resale price on its dealers/ retailers.
6. The Commission has also unsuccessfully prosecuted South African largest beer producer for engaging in a "hub-and-spoke" arrangement with its independent and owned distributors.

2. Hub and Spoke in South Africa

7. The Competition Act, 89 of 1998 ("the Act") prohibits an agreement between or concerted practice by competitors to fix prices, divide markets or collude on tenders.¹ The Act also prohibits a practice of minimum resale price maintenance between parties in a vertical relationship.² The reason for this prohibition is spelled out in section 2 of the Act.

¹ Section 4(1)(b) of the Act.

² Section 5(2) of the Act.

Section 2(b) of the Act provides that the purpose of the Act is to promote and maintain competition in South Africa in order to provide consumers with competitive prices and product choices.

8. The Commission has had few cases that directly involved hub-and-spoke arrangements. In most cases, the Commission's approach to a hub-and-spoke arrangement would be to investigate it under restrictive vertical practices and/or abuse of dominance provision. The reason for this approach is that South African jurisprudence requires the Commission to show or prove "meeting of minds or consensus" in a cartel case.

9. The Commission would rather investigate a case of minimum resale price maintenance as opposed to running a cartel case, more in particular if the resale price maintenance is "backed-up" by sanctions on the "spokes" for non-compliance with the instructions of the "hub".

10. However, the Commission may still pursue the "spokes" through its horizontal per se provisions. The Commission, instead of alleging an agreement between the spokes, it may allege that the spokes are involved in a concerted practice. The Act defines concerted practice as co-operative, or co-ordinated conduct between firms, achieved through direct or indirect contact, that replaces their independent action, but which does not amount to an agreement.³ The only problem with this approach is that the "hub" will not be prosecuted or fined by the Commission, because it is not in a horizontal relationship with the spokes.

11. The only sensible approach may be to investigate the spokes for a cartel conduct and the hub and spokes for resale price maintenance.

3. Cases investigated

12. As indicated earlier, the Commission has had very few cases that dealt with hub-and-spoke arrangement or resale price maintenance.

3.1. Daimler Chrysler South Africa Holdings (Pty) Ltd and Sandown Motor Holdings (Pty) Ltd⁴

13. In 2001, Daimler Chrysler South Africa (Pty) Ltd (Daimler SA) decided to buy Sandown Motor Holdings (Pty) Ltd (Sandown Motor). Daimler SA, through its parent company Daimler Chrysler AG is an international motor vehicle manufacturer. Daimler SA distributes its vehicles in South Africa through a network of dealers, including Sandown Motor. It therefore means that Daimler SA is a manufacturer and Sandown Motor is a retailer of Daimler motors.

14. Some of the independent retailers objected to the merger on the basis that the merger was part of an overall "hub-and-spoke strategy" in terms of which independent dealers would be forced to buy parts and overall supplies from Daimler owned retailers (owned-spokes).

15. At the end of the enquiry, the Tribunal held that where there is strong inter-brand competition, a "hub-and-spoke" arrangement may be permitted in relation to intra brand

³ Section (1)(1)(v) of the Act.

⁴ Daimler Chrysler South Africa (Pty) Ltd v Sandown Motor Holdings (Pty) Ltd, Tribunal Case no: 44/LM/Jul01

competition, because in respect of intra brand competition, the retailers do not necessarily compete on price. In fact, the hub does not permit its spokes to compete on price.

3.2. Competition Commission v Federal Mogul Aftermarkets Southern Africa (Pty) Ltd and Others⁵

16. In November 2009, Pee Dee Wholesalers (“Pee Dee”) lodged a complaint against Federal Mogul Group (“Federal Mogul”), allegedly for reducing its rebates. Federal Mogul is a wholesale distributor of a range of motor-car components, including friction products such as Ferodo products. Pee Dee is a retailer of Ferodo products. Federal Mogul also supplied its range of products to Midas Group. Midas Group was a largest retailer of Ferodo products.

17. Retailers of Ferodo products used to receive rebates of approximately 47.5% from Federal Group. In 1999, Midas started a ‘price war’ against Pee Dee in respect of Ferodo products. Pee Dee responded by reducing its prices on Ferodo products.

18. Federal Mogul (“the hub”) responded to the price war by reducing rebates that Pee Dee (“spoke”) was entitled to, from 47.5% to 40%. Although, the price war was started by the Midas Group, it was not punished by the hub, instead the smaller “spoke” was punished.

19. The Tribunal found that the conduct of Federal Mogul to reduce Pee Dee’s rebate amounted to a resale price maintenance. Federal Mogul was fined R3 million by the Tribunal.

3.3. Competition Commission v motor vehicle manufacturers

20. Between 2003 and 2004, the Commission investigated two complaints in the motor industry relating to resale price maintenance. The first complaint⁶ was against Toyota SA Motors (Pty) Ltd (“Toyota”). The second complaint⁷ was an industry-wide investigation against motor vehicle manufacturers.

21. In 2003, the Commission received a complaint from Graeme Tucker, who in the process of buying a Toyota Corolla tried to negotiate discounts with different Toyota dealers. All the dealers he went to, offered him the same discounts. Graeme Tucker decided to file a complaint with the Commission.

22. As a result of the investigation, the Commission and Toyota reached a settlement that Toyota’s conduct to enforce resale price maintenance on its retailers (spokes) amounted to a contravention of the Act. Toyota agreed to pay an administrative penalty of R12 million rand.

23. In 2004, the Commission investigated Daimler, Citroen South Africa, General Motors South Africa (Pty) Ltd, Nissan South Africa (Pty) Ltd, Subaru South Africa, Volkswagen South Africa (Pty) Ltd and BMW South Africa (Pty) Ltd for engaging in resale price maintenance in contravention of the Act. These companies settled with the

⁵ Competition Commission v Federal Mogul Aftermarket Southern Africa and Others: Tribunal Case no:

⁶ Case number: 2003May463.

⁷ Case number: 2004Apr951.

Commission and paid a cumulative administrative penalty in the amount of approximately R40 million.

24. Some of the firms did not agree that their conduct violated the Act but agreed to cease their conduct of enforcing resale price maintenance on their retailers. Retailers (spokes) were now allowed to compete on price and offer any discount to win customers from other retailers (spokes).

3.4. Competition Commission v SAB and 13 Others

25. On or about 2004, the Commission received a complaint from Big Daddy Group against South African Breweries Ltd (“SAB”) and 13 Others. Big Daddy Group is a wholesaler of SAB beers. Big Daddy Group alleged that SAB’s pricing for its beer wholesalers was the same as retail outlets.

26. During the course of the investigation, the Commission found that SAB distributed its beer through two channels. SAB used its wholly owned distributors and it also appointed third party distributors. SAB’s own distributors accounted approximately 90% of its distribution and the remaining 10% was shared by 13 Appointed Distributors (“ADs”).

27. In terms of the Distributorship agreements, ADs (spokes) were allocated territories by SAB (hub). The ADs were not allowed to compete with each other. Further, they were also not allowed to compete with SAB’s wholly-owned distributors and vice versa.

28. In December 2007, the Commission referred a complaint to the Tribunal alleging that ADs (spokes) and SAB’s wholly-owned distributors divided markets by allocating each other territories through SAB (hub).

29. The Tribunal dismissed the complaint on the basis that the ADs (spokes) were not sufficiently independent from SAB since their share accounted to not more than 10% of SAB.

30. The Tribunal revisited its earlier decision in *Daimler v Sandown Motor*, and noted that intra-brand competition is only an issue of concern where inter-brand competition is weak.

31. The Commission had also brought a resale price maintenance against SAB, because SAB’s pricing software did not allow ADs to discount. SAB submitted that the software was developed by a third party who was never given an instruction to build rigidity into the software. SAB further submitted that it rectified the problem after it became aware that ADs were not able to discount. Furthermore, Commission’s witness testified at the hearing that ADs are able to discount. On these bases, the Tribunal dismissed the Commission’s resale price maintenance case against SAB.

32. The Commission appealed the Tribunal decision to the Competition Appeal Court (“CAC”). The CAC upheld the decision of the Tribunal on the basis that the ADs were competitors of a reduced character (*de minimis rule*).

3.5. Netstar (Pty) Ltd and Others v Competition Commission and Another

33. This case did not deal with resale price maintenance or hub-and-spoke arrangement but clarified legal principles that apply to a horizontal relationship case. The CAC held that an agreement arises from actions of and discussions among the parties directed at arriving

at an agreement that will bind them either contractually or by virtue of moral suasion or commercial interest. Its essence is that the parties have reached some kind of consensus.⁸

34. The *Netstar* judgment has made it difficult to pursue a hub-and-spoke arrangement, because the Commission is required to show that the spokes had some discussions aimed at reaching an agreement. We know that in hub-and-spoke arrangements, the division of markets or price fixing is at the behest of the hub, it therefore becomes an evidentiary burden for the Commission to prove its case.

4. Developments in e-commerce

35. With the emergence of digital economy and 4th industrial revolution, there seems to be markets that are susceptible to collusion such as ‘online travel agency market’. The Commission understands “online platforms” such as Booking.com conclude “Price Parity agreements” with hotel chains. Price Parity means a hotel group agrees to charge the same rate as Booking.com for the same room that is advertised on Booking.com’ platform. This conduct may amount to price fixing if competition authorities are of the view that platforms such as website and telephone inquiries that are owned by hotel groups compete with online travel services provided by Booking.com and others. The big debate would be on market definition. i.e. whether hotel industry over and above its provision of rooms, also provides online booking services as a separate market or complimentary to its traditional market of selling rooms.

36. Most of these online platform firms are not physically present in South Africa, which also provides difficulties in relation to jurisdiction over those firms that are located elsewhere. Enforcement of Tribunal orders may also prove to be a challenge.

37. Lastly, it remained to be tested relation to e-hailing market, whether e-hailing service providers through their algorithm system acts as hub and their drivers act as spokes when the hub determines prices for its drivers in relation to off-peak and on-peak services.

38. The Commission is yet to initiate an investigation in the online markets and/or platforms. It is also not yet clear under which section of the Act, the Commission may want to initiate complaints against online markets or platforms.

5. Conclusion

39. The Tribunal has indicated its willingness to intervene in respect of intra-brand competition cases where inter-brand competition is weak. It is for this reason that the Commission has not had many cases of hub-and-spoke arrangement, because by its very nature the arrangement involves intra-brand competition. The Tribunal refused to intervene in Daimler and Sandown merger, because of strong inter-brand competition. The Tribunal also refused to intervene in the SAB mater, because the volume of intra-brand competition that was affected by hub-and-spoke arrangement was insignificant.

40. The Commission is likely to prosecute a cartel case under its per se provision which is not reinforced by an upstream and is a clear arrangement between parties in a horizontal

⁸ *Netstar (Pty) Ltd and Others v Competition Commission and Another*: Case no: 99/CAC/May/2010 at para 25.

relationship, hence the Commission's leniency policy applies to hardcore cartel cases. In other words, the leniency policy does not apply to a resale price maintenance.

41. With the increased awareness in competition laws, an upstream supplier may prefer to enter into an exclusive arrangement with a downstream supplier to distribute its products, instead of appointing more than one distributor and impose price or market restrictions. These types of exclusive arrangements eliminate intra-brand competition between two distributors.