DEPARTMENT OF TRADE, INDUSTRY AND COMPETITION

NOTICE 2539 OF 2024

INVITATION FOR THE PUBLIC TO COMMENT ON THE DRAFT VERTICAL RESTRAINTS REGULATIONS IN TERMS OF THE COMPETITION ACT, 1998

I, Ebrahim Patel, Minister of Trade, Industry and Competition, hereby publish in terms of section 78 of the Competition Act, 1998 (Act No. 89 of 1998), the draft-Vertical Restraint Agreement Regulations, as set out in the Schedule hereto, for public comment.

Interested persons must submit written comments on the proposed Vertical Restraint Agreement Regulations not later than thirty (30) days from the date of publication of this Notice in the Government Gazette, to:

The Director-General
Department of Trade, Industry and Competition
Private Bag X84
Pretoria
0001
For the attention of: Ms Linda Herbst (LHerbst@thedtic.gov.za)

EBRAHIM PATEL
MINISTER OF TRADE, INDUSTRY AND COMPETITION
DATE: 27 MAY 2024

SCHEDULE

DRAFT VERTICAL RESTRAINTS REGULATIONS

Interpretation

1. In these Regulations a word or expression to which a meaning has been assigned in the Competition Act, 1998 (Act No. 89 of 1998) ('the Act'), has the meaning so assigned and, unless the context indicates otherwise:

1.1. "**Active sales**" means actively targeting customers through any means for the purpose of making a sale;

1.2. **"HDP firm"** means a firm or firms owned and controlled by Historically Disadvantaged Persons within the meaning of section 3(2) of the Act;

1.3. "**Passive sales**" means sales made in response to unsolicited requests from customers;

1.4. **"SME"** means a Small and Medium-Sized Enterprise or business, as the context dictates and as defined by section 1 of the Act; and

1.5. **"the Act"** means the Competition Act, 1998 (Act No. 89 of 1998).

2. Purpose

2.1. The purpose of these Regulations is to set out a non-exhaustive list of the relevant factors for determining whether a restrictive vertical practice is in contravention of section 5.

Section 5(1)

Prevention or Lessening of Competition

3. The non-exhaustive factors that may be considered in the assessment of a substantial prevention or lessening of competition under section 5(1) of the Act include the following where relevant:

3.1. The nature of any restraint(s) in the agreement, including whether they are exclusive or non-exclusive and if there is a combination of restraints;

3.2. The duration of the restraint(s) and rights to renewal;

3.3. The practical implementation of the agreement, including whether this introduces additional implicit restraints and/or strengthens the effect of the restraints;

3.4. The nature of the good or service subject to the restraint, including the level in the supply chain and the maturity of the market for that good or service;

3.5. The individual market shares of the parties to the agreement in their respective markets and the market coverage of the vertical restraint;

3.6. The individual shares of the parties to the agreement in particular market segments or localised geographic areas;

3.7. Whether one (or more) of the parties to the agreement is an important competitive force at one level of the supply chain;

3.8. Barriers to entry and the likelihood of entry in the relevant market at both levels of the supply chain;

3.9. The strength and importance of inter-brand and/or intra-brand competition at both levels in the supply chain;

3.10. Whether the agreement excludes SMEs and/or HDP firms in the relevant market; and

3.11. Whether there are parallel networks of similar vertical restraints amongst competing buyers or suppliers, and whether the agreement contributes to the cumulative effect of this network of agreements.

3.12. Whether the vertical relationship is a franchise arrangement.

Technological, Efficiency or Other Pro-Competitive Gains

4. The non-exhaustive factors that may be considered in the assessment of whether claimed technological, efficiency, or other pro-competitive gains qualify for the purpose of weighing up against the competitive effects, include the following where relevant:

4.1. Whether the technological, efficiency, or other pro-competitive gains have been quantified;

4.2. Whether it can be shown that consumers or customers stand to benefit from the technological, efficiency, or other pro-competitive gains; and

4.3. Whether the agreement supports or improves the ability of SMEs and/or HDP firms to enter into, participate or expand in the relevant market.

Restraints with a strong likelihood of a substantial prevention or lessening of competition

5. A relevant factor in the assessment of vertical agreements is whether they include specific restraints that are considered likely to result in a substantial prevention or lessening of competition. These include the following restraints:

5.1. Restrictions on passive sales to customers outside of assigned territories or customer groups;

5.2. Restrictions on active or passive sales by members of a selective distribution network (including to each other);

5.3. Restrictions on the supply of spare parts, repair tools/equipment and technical information to independent repairers and service providers directly from the manufacturer;

5.4. Any direct or indirect restrictions on a buyer to manufacture, purchase, sell or resell goods and services after termination of the agreement;

5.5. Any direct or indirect restriction on members of a selective distribution agreement on selling the brands of competing suppliers;

5.6. Any direct or indirect obligation causing a buyer of online intermediation services not to offer, sell or resell goods or services to end users under more favourable conditions via competing online intermediation services;

5.7. Agreements with business infrastructure or service providers which restrict access to that infrastructure or service by third party competitors; and

5.8. Restrictive agreements that exclude SMEs and HDPs in whole or to a material extent.

Section 5(2)

6. Under section 5(2) of the Act, the non-exhaustive factors that may be considered in the assessment of minimum resale price maintenance include, *inter alia*, the following where relevant:

6.1. Whether there is a practice constituting a minimum resale price maintenance;

6.2. An agreement itself is therefore not a requirement for minimum resale price maintenance;

6.3. Whether a supplier has imposed a minimum resale price at which goods are to be resold;

6.4. Whether there is an inducement to comply with the minimum resale price and whether there is a sanction for non-compliance;

6.5. Whether there are repeated requests by the supplier for reseller(s) to adjust pricing to a minimum resale price; and

6.6. Whether there are restrictions on advertising prices below minimum resale price.

Guidelines

7. The Competition Commission may issue guidelines in terms of section 79 of the Act, in respect of its enforcement approach to section 5 in light of these Regulations.

Short Title

8. These Regulations are called the Vertical Restraints Regulations, 2023.

MEMO TO ACCOMPANY
THE DRAFT VERTICAL RESTRAINTS REGULATIONS

1. Background

1.1. The amendments to the Competition Act, 1998 (Act No. 89 of 1998) ('the Act') included a provision in section 5(4) that Regulations must be made in respect of section 5. The purpose of the Regulations is to provide greater clarity on the parameters, factors, and benchmarks to be considered when undertaking an assessment of conduct under section 5.

1.2. These draft Regulations are to be the subject of consultation with the public and the Competition Commission ('the Commission'). In order to support stakeholders in their submissions, this memo serves to contextualise and assist in the interpretation of the draft Regulations.

2. Restrictive Vertical Practices

2.1. Section 5 relates to agreements or practices between firms in a vertical relationship. Firms are in a vertical relationship when each firm is operating, for the purposes of the agreement or practice, at a different level of the supply chain. This also includes a firm from operating at multiple levels of the supply chain.

2.2. Dominance by one of the firms to the vertical agreement or practice is not required for the agreement to be assessed under section 5. Where one of the firms to the agreement or practice is dominant in a relevant market, the conduct may also be assessed under both sections 5 and 8 of the Act.

2.3. Section 5 includes a general provision under section 5(1) and then a specific provision around minimum resale price maintenance under sections 5(2) and 5(3). Section 5 reads as follows:

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

(2) The practice of minimum resale price maintenance is prohibited.

(3) Despite subsection (2), a supplier or producer may recommend a minimum resale price to the reseller of a good or service provided-

(a) the supplier or producer makes it clear to the reseller that the recommendation is not binding; and

(b) if the product has its price stated on it, the words "recommended price" appear, next to the stated price.

3. Section 5(1)

3.1. Typically agreements that contain restraint clauses are most likely to be assessed under this section, albeit that this is not an express requirement. Vertical restraint agreements sometimes arise to provide solutions for some of the practical problems that suppliers experience in the course of producing, selling and distributing their products. However, whilst they may generate potential efficiency, technological and pro-competitive gains, they may also prevent or lessen competition under certain circumstances. The harm to competition is ordinarily seen to arise through the foreclosure of actual or potential competitors; the raising of barriers that exclude rivals; the softening of inter-brand and/or intra-brand competition; and the facilitation of collusion at either the supplier or buyer level in the market.

3.2. In the South African context, such vertical restraints may also impact on the participation of Small and Medium-Sized Enterprises (SMEs) and firms owned and controlled by historically disadvantaged persons (HDP firms) in the economy. This may be potentially beneficial if the restraints promote participation, such as enabling entry through franchise agreements, or

potentially harmful if such restraints protect market incumbency through exclusivity to the exclusion of new participants.

3.3. The lack of a requirement for dominance is because vertical restraints may result in harm to competition even if the coverage of a single agreement in a market is not substantial. One such instance is where the restraints limit intra-brand competition if that is important, and where they facilitate collusive outcomes. Another instance is where such restraints are common amongst many suppliers or buyers in a market, and where the cumulative effect of these agreements does result in harm to competition and/or the exclusion of participation of SMEs and HDP firms. In such circumstances, any single agreement between parties in a vertical relationship contributes to that cumulative effect and therefore itself substantially prevents or lessens competition.

Factors in the assessment

3.4. The draft Regulations provide factors for the two essential elements of the rule of reason assessment under section 5(1), namely whether the agreement has the effect of substantially preventing or lessening competition and whether there are technological, efficiency or other pro-competitive gains that qualify to be weighed up against the competitive effects. As section 5(1) makes clear, if a substantial prevention or lessening of competition is established, the onus is then on the parties to the agreement to demonstrate any technological, efficiency or other pro-competitive gain and that such a gain outweighs the anti-competitive effect. As such, the factors identified in respect of what technological, efficiency or other pro-competitive gains may qualify for such a weighing up represent a common framework for use by the parties but also the Commission and the courts.

3.5. The factors in the draft Regulations draw on best practices from major jurisdictions and the economic literature, whilst also having reference to the purposes of the Act.

3.6. In terms of the assessment of potential harm to competition, the list of factors included in the draft Regulations are relevant to the typical theories of harm from vertical restraints. These start with the nature of the restraint itself, whether it is exclusionary in nature (such as exclusivity) and its duration, as well as the practical implementation of the restraint agreement. Economic theory also identifies that the nature of the product itself may impact on the likely effects, such as whether the product is homogeneous or not, whether it is a repeat or once-off purchase, and the price of the item. Similarly, harm may differ depending on where in the supply chain the restraint exists, as intermediaries may be more informed and less subject to branding, and the maturity of the market as dynamic growing markets may provide more scope for entry. Issues of market coverage and the importance of intra-brand versus inter-brand also impact on the extent of likely harm, which may be market-wide or within a particular market segment or localised geographic area.

3.7. In line with the purposes of the Act, the draft Regulations also clarify that agreements which exclude SMEs and/or HDP firms in the relevant market will also form part of the assessment criteria. The exclusion of SMEs and and/or HDP firms undermines the purpose of the Act which is to ensure an equitable opportunity to participate in the economy. It also has a negative competitive effect on a market by reducing consumer choice as well as new entry / expansion of firms which will contest markets to a greater extent in future through growth, i.e. a prevention of competition.

3.8. The Regulations identify another important contextual factor, namely whether there exist parallel networks of similar agreements in the market. Where parallel networks of restraint agreements exist in a market, then the coverage is far broader and the cumulative effect may substantially prevent or lessen competition. In such cases, the individual instances would contribute to the broader coverage and cumulative effect, implicating those agreements in the prevention or lessening of competition even if the individual coverage is more limited.

3.9. Another important contextual factor is whether the vertical agreement is a franchise agreement. Franchise agreements include a range of restrictions in order to ensure uniformity of the experience across the outlets and protect the earnings of franchisees. Whilst franchise agreements are not exempt from the Act, this factor is relevant to assessment under the Act.

3.10. In terms of the assessment of potential efficiency, technological and/or pro-competitive gains, the draft Regulations identify factors to be used in the determination of efficiency, technological or pro-competitive gains that may qualify for the subsequent weighing up process, rather than how that weighing up process should be undertaken. As set out in the legislation, the onus for proving that any efficiencies, technological or pro-competitive gains outweigh the anti-competitive effects lies with the firms that are party to the agreement.

3.11. These factors include the typical competition law pre-conditions that any alleged gains must be quantified to enable a weighing up process, and that consumers or customers stand to get some of the benefit of these gains. The list includes an express reference to any gains to entry, participation or expansion by SMEs and HDP firms which would be weighed against any potential harm to competition. This constitutes a pro-competitive gain and is in line with the purposes of the Act.

Restraints with a strong likelihood of an SPLC

3.12. The Regulations identify as a relevant factor in an assessment of restrictive vertical agreements whether the agreements include specific restraints which are generally considered likely to result in a substantial prevention or lessening of competition and which are typically considered more restrictive than necessary to achieve the commercial objectives. This is particularly the case where there exist parallel networks of such constraints. The specific vertical restraints identified include the following:

3.12.1. Restrictions on passive sales outside of assigned territories or customer groups. Agreements which grant exclusive rights to certain

territories or customer groups, typically in a distribution or franchise context, are relatively common but restrictions on even passive sales are overly restrictive and unnecessary to achieve the investment incentives. Passive sales mean responding to unsolicited requests and are considered to include online sales channels.

3.12.2. Restrictions to both active and passive sales by parties to a selective distribution agreement. Once more, such restrictions are not justifiable to achieve the objectives of selective distribution, which are typically to ensure the brand quality is protected.

3.12.3. Restrictions on the sale of spares, technical information and specialist equipment to independent repairers and service providers. Such provisions completely exclude these repairers and service providers from undertaking such services, preventing competition in the repair or service markets. Whilst these restrictions have been most noticeable in automotive aftermarkets, they have been identified in many product or service markets including mobile phones, heavy duty machinery and even white goods. The claimed benefit of supporting complementary investments in skills and service standards is rarely justified by the exclusion of competition.

3.12.4. Restrictions on members of a selective distribution agreement on selling competing brands. This is overly restrictive as the purpose of selective distribution is typically to maintain quality or service levels and should not be to exclude competitors.

3.12.5. Restrictions on pricing lower in alternative online distribution channels, otherwise known as wide price parity or most-favoured-nation (MFN) clauses. In digital markets where these are common, these clauses have been identified as reducing price-based competition across different distribution channels with the claimed benefit of preventing free-riding on promotional investments as unlikely to off-set the harm.

3.12.6. Agreements with business infrastructure and services which restrict access to such infrastructure or service by third party competitors, either entirely or to a material extent. An example of such restrictions are exclusive retail lease agreements which prevent access to retail space, an infrastructure for retailers, by third party competitors to the lessee. These have been shown to prevent competition in localised markets and protect incumbent national chains at the expense of new entrants and independent traders, and not justified by investment incentive claims. Similarly, retail lease agreements which place restraints on the proportion of a shopping mall space that can be let to retailers other than national chains would be exclusionary and unlikely to be justified by any investment incentive claims. Other examples include exclusive use of storage facilities, including port facilities, or a substantial proportion of capacity at such facilities which would serve to restrict competitor distribution volumes.

3.12.7. Restrictive agreements which exclude SMEs and HDP firms in whole or to a material extent from a sales channel. This may include provisions that fall into the three preceding categories insofar as they exclude third parties or independent provides which are SMEs and HDP firms. However, they may also include selective distribution or selective service provider networks to the extent these are exclusionary of SMEs and HDP firms in whole or to a material extent.

4. Section 5(2)

4.1. Section 5(2) concerns a specific vertical restraint, namely minimum resale price maintenance ("MRPM"). Section 5(2) identifies MRPM to be treated as a *per se* contravention. Furthermore, unlike section 5(1), there is no requirement to establish the existence of an agreement in section 5(2), but rather just establishing the practice of MRPM. Section 5(3) permits the use of Recommended Retail Prices (RRPs) where these are communicated as non-binding and any price reflected on the product states "Recommended price". The mere fact that RRPs have been communicated does not preclude assessment under section 5(2). This is because the practice of MRPM includes

the practice of seeking to maintain resale prices at the RRP even if the RRP is communicated to be non-binding.

4.2. The Regulations set out a set of non-exhaustive factors to be considered in the assessment of minimum resale price maintenance where the factor is relevant to the assessment. Not all factors may be relevant to each assessment depending on the nature of the practice. Drawing on cases of MRPM, these include a variety of means that suppliers use to maintain minimum prices.

4.2.1. The first two factors listed identify that it is only required for a practice of MRPM to be established and an agreement is not a prerequisite. This is in line with the Competition Appeal Court's *Federal Mogul* decision. The determination and imposition of a minimum price is an additional factor in establishing such a practice.

4.2.2. The presence of inducements or sanctions may provide an incentive for resellers to comply with the prescribed price strongly aids the practice of MRPM. However, even repeated supplier requests for resellers pricing below the prescribed price to adjust pricing upwards, even if it is not accompanied by any inducement or sanction, can be sufficient.

4.2.3. Advertising is an important means of informing consumers about different prices in the market and in so doing promotes competition on price. A restriction placed on advertising prices below a prescribed price blunts the reward to a reseller of pricing lower and in so doing may form part of a practice to maintain prices at the prescribed price level.

5. Call for Public Comment

5.1. I hereby call on interested parties to provide representation and comment on these first draft Regulations, including comment on:

5.1.1. the general approach to these Regulations;

5.1.2. the specific wording used in the Regulations; and

5.1.3. whether the Regulations provide sufficient clarity on the factors relevant to the assessment of conduct falling within section 5.