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COMPETITION

From number plates to school uniforms: beware of exclusive contracts.

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From a commercial perspective, it often makes sense for a company to determine its optimal route to market and to enter into exclusionary arrangements with its distributors or customers. Discounts and rebates in particular are common commercial practice and a significant way in which suppliers compete on prices.

INTRODUCTION

Exclusionary arrangements refer to those contractual provisions which oblige a customer to obtain all its requirements for a particular product, from a particular supplier exclusively. Similarly, exclusionary provisions may also restrict suppliers from supplying to anyone other than a specific downstream customer. These provisions may also take the form of discount, rebate or incentive schemes where customers are afforded a reward for purchasing inputs exclusively from a particular supplier.

Although customary in commerce, exclusionary arrangements are often complex and may have anti-competitive effects. Dominant firms[1] must be especially cautious in their commercial dealings so as not to be guilty of inducing their suppliers and customers not to deal with their competitors. Even contracts which do not specifically stipulate exclusivity may be problematic from a competition law perspective if the nature of the contract is such that exclusivity results therefrom.

The issue of exclusionary arrangements has recently come into sharp focus, as is evident by a range of cases dealt with by the Competition Commission.

EXCLUSIONARY ARRANGEMENTS IN PRACTICE

Towards the end of 2015, the Competition Commission investigated the business practices of a company[2] which manufactures and supplies number plate embossing machines and number plate blanks to a group of customers known as number plate embossers. This followed several complaints received from competitors and customers of the company relating to exclusive provisions in its customers contracts. These contracts require that number plate embossers purchase all of their requirements for number plate blanks from the company.

The Competition Commission noted that the company's long term exclusive agreements with its customers has the effect of preventing competitors from gaining access to a significant number of customers. The Commission alleges that the company's customers are being denied the benefit of purchasing inputs at competitive prices from other manufacturers and the prices charged by the company, allegedly a dominant firm, are higher than those of its competitors. The Commission has now referred the matter to the Competition Tribunal for adjudication[3]. If the company is found guilty of anti-competitive conduct, it could fined up to 10% of its annual turnover in (and exports from) South Africa during its preceding financial year.

Another instance that is indicative of the Competition Commission's approach to exclusive arrangements is its recent probe into the school uniform industry where long-standing exclusive supply arrangements are being entered into between school governing bodies on the one hand, and retailers and manufacturers on the other hand. The Competition Commission has been concerned about the issue for some time and, in November 2014, announced that it is meeting with a range of stakeholders in order to promote competitive bidding in the procurement of school uniforms. As a result, the Department of Basic Education issued a circular which recommended that certain measures be adopted to prevent violations of the Competition Act.

These included, amongst others (i) that school uniforms should be as generic as possible so that they may be obtained from various suppliers (ii) that schools should appoint more than one supplier in order to give parents as many options as possible and (iii) that the agreements concluded between schools and suppliers should be of limited duration. The note urged parents to report incidents of non-compliance with the circular and, after receiving several complaints from parents regarding exclusive agreements that often result in parents not having a choice of suppliers when buying school

uniforms and being charged high prices, the Competition Commission initiated an investigation into the school uniform industry. This investigation may result in the relevant schools, retailers and manufacturers being found guilty of anti-competitive conduct in violation of the Competition Act.

In December 2016, another company[4] reached an agreement with the Competition Commission in terms of which it agreed to remove exclusivity clauses and evergreen duration provisions from its current and future contracts with its surface fluorination customers. Therefore, any customer may now approach the company, which is the monopoly supplier in the market, to procure surface fluorination services without having to lock itself into an evergreen exclusive contract.

On 27 November 2015, the Competition Commission commenced a market inquiry into the South African grocery retail sector. It said that it had reason to believe that there are features present within this sector that may prevent, distort or restrict competition. One of the aspects being investigated by the Commission is the practice of shopping centre landlords to enter into long-term exclusive lease agreements with anchor tenants (usually food retailers). These leases usually preclude the landlords from allowing competing supermarkets to set up in their shopping malls. The Commission's inquiry is ongoing.

Exclusive lease agreements in the retail sector have been under investigation by the Competition Commission for some time. In October 2014, Massmart lodged a complaint with the Competition Commission against Shoprite, Spar and Pick 'n Pay, alleging that the enforcement of exclusivity provisions between these retailers and their respective landlords have the effect of preventing Massmart from trading in fresh food and groceries in shopping malls. The matter is still pending before the Competition Tribunal.

Certain industries go so far as to outright prohibit exclusive arrangements; the Electronic Communications Act 36 of 2005 states that an electronic communications network service licensee may not enter into an agreement with another person for access to international electronic communications facilities that contain an exclusivity provision and that any such exclusivity provision would be invalid.

CONCLUSION

Although companies should not be punished for increased efficiency, a line must be drawn between competition "on the merits" and anti-competitive conduct. Insofar as the latter is concerned, companies must be cautious of including exclusive provisions in their customer, distribution or supplier contracts, especially if they or their counterparties are dominant in the relevant markets. The bottom line is that such provisions must be carefully scrutinised on a case by case basis to consider whether they have anti-competitive effects which cannot be outweighed by positive technological, efficiency or pro-competitive effects.

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[1] These are firms who (i) hold 45% or more of a particular market or (ii) have the power to exclude competition or to behave independently of their competitors, customers or suppliers.
[2] Uniplate Group Proprietary Limited.
[3] See the press release at this link.
[4] Pelchem SOC Limited. See here.

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