COMPETITION TRIBUNAL

REPUBLIC OF SOUTH AFRICA

Case No: 18/IR/Dec99

In the matter between

Cancun Trading No 24 CC	First Claimant
Henlin Trust	Second Claimant
H & M Lindeque Trust	Third Claimant
Maltea Trading CC	Fourth Claimant
Rietvlei Trading CC	Fifth Claimant
Rosa Trading CC	Sixth Claimant
Prism Merchandise Enterprises CC	Seventh Claimant
Ritima CC	Eighth Claimant
Cancum Trading No 26 CC	Ninth Claimant
Rogal Trading CC	Tenth Claimant
Wahda CC	Eleventh Claimant
Eloff Anderson Pederson	Twelfth Claimant
Ruiker Trading CC	Thirteenth Claimant

and

Seven-Eleven Corporation SA (Pty) Ltd	Respondent

DECISION ON APPLICATION FOR INTERIM RELIEF IN TERMS OF SECTION 59 OF THE COMPETITION ACT, 89 OF 1998

Introduction

1. This application for interim relief is brought by a group of franchisees against their franchisor. Before we discuss and analyze the issues we need to understand this unique organizational form and how other antitrust authorities evaluate its economic effects.

2. Franchising is defined as a method of structuring a productive relationship between two parties in which both contribute to the production or distribution of the product and service[1]. The franchisee makes large, sunk investments in

1 Problematic Relations: Franchising and the Law of Incomplete Contracts, Gillian K. Hadfield, Stanford Law Review, Vol.42, page 931.

establishing a retail outlet which he/she then owns and operates. The franchisor, in turn, permits its trademark to be used and in, order to protect its trademark, supplies a complete business plan with which the franchisee must comply. In other words, the franchisors risk the value of their trademarks in exchange for shifting to the franchisee the risks of the sunk investments associated with establishing a retail outlet.

3. A franchise agreement is then neither an employment relationship nor an independent contacting relationship. It rather combines elements of integration and delegation, control and independence and it is this multifaceted vertical structure that paves the way for endless relational and commitment problems.

4. Two types of franchising are mainly found namely product and tradename franchising and business-format franchising. We are interested in the latter, which is sometimes called a comprehensive or entire business format franchise and is characterized by an ongoing business relationship between franchisor and franchisee. It not only includes the product, service, and trademark, but the entire business format itself consisting of a marketing strategy and plan, operating manuals and standards, quality control and continuing two way communications.

5. Antitrust authorities generally agree that exclusive supply arrangements, exclusive purchasing contracts, tie-ins and resale price maintenance may give rise to possible vertical restrictive practices that could be relevant to franchising.

Background

6. The claimants are all trading as franchised Seven-Eleven stores and are identified by Seven-Eleven logos, trademarks and general makeup. They describe the market in which they operate as convenience retail stores operating in the Western Cape.

7. The respondent is the Seven-Eleven Corporation SA (Pty) Ltd, a private company with limited liability trading as a franchisor in the retail convenience store industry operating in South Africa. It describes the market in which the franchise operates as that of neighborhood convenience stores. These stores carry a limited range of products and have extended trading hours. They are all situated at localities identified as being convenient to immediately surrounding residential areas, rather than being tenants in larger shopping malls. The stores are also distinguishable from independent café operations by virtue of their “chain store” style of operation.

8. According to the respondent it is engaged in dual distribution in that 192 Seven-Eleven stores in the Western Cape are franchised outlets and 36 stores are company-owned and managed by the franchisor. All the franchise stores are

obliged, by their agreements with the respondent, to conform to a uniform scheme in terms of, inter alia, layout, design, trade marks and livery, configuration, range and price of products, sources of supply of product, trading hours, staffing and service requirement and standards of quality.

9. The claimants rely on section 5(1), 5(2), 8(d)(i) and/or 8(c) of the Act. The claimants allege that the respondent is guilty of substantially preventing or lessening competition in the relevant market because it prevents them from purchasing identical goods and brands at better prices and on better payment terms from alternative sources in that it obliges them, in terms of the franchise agreement, to only purchase from suppliers approved by it. They also allege that the respondent practices minimum resale price maintenance in that it obliges them to sell their merchandise at prices set by it. The claimants withdrew the relief sought in paragraph 2(c) of the notice of motion.

Arguments in Limine

Application to Strike Out

10. The respondent filed an application to strike out material from the first Claimant's affidavit on the basis that it was vague and embarrassing and that it was irrelevant. At the hearing the respondent quite properly in our view abandoned this application. The Tribunal, therefore, need not consider or comment on it.

Dismissal for non-joinder

11. The respondent has argued that this application ought to be dismissed on the grounds that the Complainants have not joined their co-franchisees as respondents. The argument is that the rights of the other franchisees may be prejudicially affected by an order of the Tribunal as there is a mutuality of contractual interest between all franchisees and the franchisees have a direct and substantial interest in the outcome of this application.

12. It is common cause between the parties that the issue of dismissal for non-joinder, as raised by the respondent, is not provided for in the Rules for the Conduct of Proceedings in the Competition Tribunal ("the Tribunal Rules").

13. Rule 46 of the Tribunal Rules provides for joinder and substitution of parties. Rule 46(1) provides that:

> "The Tribunal, or the assigned member, as the case may be, may combine any number of persons, whether jointly, jointly and severally, separately, or in the alternative, as parties in the same proceedings, if their respective rights to relief depend on the determination of substantially the same

question of law or facts".

14. This rule gives the Tribunal discretion to join various parties to proceedings before it whose rights to the relief sought are dependant on the determination of substantially similar questions of law or fact as those in proceedings before the Tribunal. This does not cover dismissal for non-joinder of parties, which is what the respondent is seeking. The silence of the Rules on this issue triggers the application of Tribunal Rule 54 which provides that, where there is uncertainty as to the practice or procedure to be followed in cases not provided for by the Rules, the Tribunal may have regard to the High Court Rules.

15. Rule 10(1) of the High Court Rules, which deals with the question of joinder provides:

> "Any number of persons, each of whom has a claim, whether jointly, jointly and severally, separately or in the alternative, may join as plaintiffs in one action against the same defendant or defendants … provided that the right to relief of the persons proposing to join as plaintiffs depends upon the determination of substantially the same question of law or fact …".

16. This rule clearly deals with the right of a party to join proceedings in the High Court if the requirements of the provision are satisfied. It does not give the High Court power to order the joinder of parties or to dismiss a matter before it on the basis of non-joinder. This power of the Court is to be found in the common law, and is not covered by the High Court Rules. (The respondent referred to various cases dealing with this principle[2]).

17. The High Court, unlike the Tribunal, has inherent jurisdiction over all matters except where its jurisdiction is excluded by statute, and can rely on the common law where its Rules are silent on an issue. This inherent jurisdiction enables it not only to decide on issues not covered in its Rules but even to depart from the Rules where compliance would result in substantial injustice to one of the parties[3]. The Tribunal, on the other hand, is a creature of statute and can only exercise powers as flow from the statute and no more**.** In this regard see the recent High Court decision in *Konyn and Others v Special Investigating Unit*[4] where the Court held that a special tribunal established in terms of Act 74 of 1996 had no powers or functions beyond those granted by the statute creating it.

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2 *Morgan and another v Salisbury Municipality* 1936 AD 167 at 170; *Amalgamated Engineering Union v Minister of Labour* 1949 (3) SA 637 AD at 649; *Kock & Schmidt v Alma Modehuis (Edms) Bpk* 1959 (3) SA 308 AD at 318 *D and Segal and another v Segil* 1992 (3) 136 at 140F

3 See *Munette Investments (Pty) Ltd and Others v Administrator, Cape Province, and Another* 1973 (4) SA 491 at 493F-G and *MFV Kapitan Solynanik Ukranian-Cyprus Insurance Co and Another v Namack International (Pty) LTD* 1999 (2) SA (NM)

4 1999(1) SA 1001 (TK)

18. The Tribunal Rules are silent on the issue of dismissal of matters for non-joinder and regard to the High Court Rules is similarly unhelpful as these rules also do not cover the issue. The Tribunal cannot refer to any other statute or jurisprudence regarding this matter since Rule 54 only gives the Tribunal powers to consider High Court Rules in instances where the Tribunal Rules do not provide answers. The Tribunal therefore has no power or jurisdiction to dismiss the case of the claimants on the basis of non-joinder because its rules do not provide for it to do so.

19. The respondent, whilst conceding this, has argued that the Tribunal is entitled to have regard to the common law principles followed by the High Courts because it is bound by its statute to conduct its hearings in accordance with the principals of natural justice. In this regard the respondent is entirely correct but it requires a logical leap of faith to infer a common law rule on joinder from the principles of natural justice and the respondent has not given us any authority on this point. Natural justice is about fairness to the joined. The High Court doctrine on joinder is about who should be joined. They do not speak to the same issue and the High Courts needed to develop a separate doctrine. We do not however need to decide this point definitively in this case because, as the claimants have cogently argued, even on the common law principle a case for non-joinder has not been made out.

20. As part of the inherent jurisdiction that a Court has over its proceedings the Courts have held that they have the discretion to order the joinder of parties who have a direct and substantial interest in the subject matter of the litigation. The Court will order joinder of other parties where the party sought to be joined has a legal interest which could be prejudicially affected by the order sought[5]. Traditionally joinder has been ordered where the parties have been co-owners, partners or co-contractors, but the Courts have also recognized a wider category of parties who may be joined on the basis that they have a direct and substantial interest in the matter. This concept has been further elucidated by later Courts who have said it means a "legal" interest as opposed to a mere financial interest which is regarded as an indirect interest.[6] Adopting this approach the Courts have refused to order the joinder of a sub-lessee in an action to evict the lessee however much the termination of that right might affect him commercially and financially.[7] No case however has been drawn to our attention in which a joinder decision related to co –franchisees. In any event it was never argued that franchisees are co-contractors. The respondent merely stated that there is a mutuality of contractual interest between the franchisees.

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5 See *United Watch & Diamond Co. (Pty.) Ltd. And others v Disa Hotels Ltd. And Others* 1972(4) SA at 415H; also *Herni Viljoen (Pty.) Ltd. V Awerbuch Brothers* 1953 (2) SA 151 (0).

6 See *Segal and another v Segal 1992 (3) SA 136 (C) at 141*.

7 See *United Watch Supra*

21. The respondent argued that in terms of the common law the other franchisees would be entitled to be joined as respondents because they have a direct and substantial interest in the subject matter before the Tribunal. They argue if the Tribunal grants the order requested by the claimants, allowing them to choose their suppliers and determine their own prices, the whole system upon which the franchise is built will collapse. The effect of the Tribunal's granting of the order sought by the claimants is that the franchisees will be at liberty to buy their supplies from whomever they chose and set their own resale prices.

22. The argument that this will result in the total collapse of the franchise is weakened by the claimants' allegations, which the respondent never denied, that the franchisor has on occasion allowed other franchisees to sell at different prices to others and has also allowed them to buy from other suppliers not listed in the contract. The franchise did not collapse. The reason given by the respondent for allowing the lessening of prices by the other franchisees was to make them more competitive. The above facts illustrate that the respondent has retained for itself the right to determine where the franchisees should buy and at what price they should sell their supplies. An order by the Tribunal granting the relief sought by the claimants will do no more than shift this discretion from the respondent to the claimants. The respondent did not put any evidence before the Tribunal to suggest that when this discretion is at the hands of the claimants it will cause harm to the other franchisees. We also take into account that the relief sought only relates to the thirteen claimants. Given its limited nature there can be no question of prejudice to other franchisees. Furthermore as the claimants have argued there is no privity of contract between them and the other franchisees. We find accordingly that the application to have the case dismissed for non-joinder does not succeed.

Interim relief

General

23. In order to grant interim relief the Tribunal must be satisfied that a restrictive practice exists; that, in the absence of an order, the claimant will incur irreparable harm or that the purposes of the Act will be frustrated; and that the balance of convenience favours the granting of an order. The Tribunal must be satisfied on all three counts failing which it is not entitled to make an order in terms of Section 59.

The Alleged Restrictive Practices

24. The claimants base their application on Clauses 6.2 and 9.1 read with Clause 6.2 of the Franchise agreement. These clauses read as follows:

> "6.2 It is recorded that all merchandise delivered by the Licensor, directly and indirectly, shall be delivered on consignment and the Licensor reserves ownership thereof until such stage as it is sold…
>
> 9.1 In order to ensure uniform profitability and uniformity in specification compliance and control, the Licensee agrees to handle, promote and/or sell only those items approved by the Licensor purchased only from the Licensor and/or such wholesalers and/or suppliers as are approved by the Licensor. The Licensee shall sell all its products only at prices approved by the Licensor from time to time."

25. The claimants aver that the application of these clauses places the respondent in violation of Sections 5(1) and 5(2) of the Act and, because, it alleges, the respondent is a dominant firm, it also claims that it is in violation of Sections 8(d)(1) and/or 8(c) of the Act.

26. Section 5 of the Act prohibits restrictive vertical practices. Section 5(1) prohibits vertical agreements that substantially prevent or lessen competition in a market unless a party to the agreement is able to prove that any pro-competitive gain resulting from the agreement outweighs the anti-competitive effect. Section 5(2) prohibits minimum resale price maintenance. Section 5(2) is an outright or, in the language of antitrust jurisprudence, a *per se* prohibition. In other words simply proving the existence of the specified restrictive practice is sufficient for making a finding under Section 5(2). In contrast with violations alleged in terms of Section 5(1), Section 5(2) does not require that anti-competitive effects be established nor does it permit of an efficiency defense.

27. Section 8 of the Act prohibits abuse of dominance. Section 8(d) specifies a number of 'exclusionary acts' that shall constitute an abuse unless the perpetrator is able show pro-competitive gains that outweigh the anti-competitive effects of the specified exclusionary act. Section 8(d)(i) specifies that 'requiring or inducing a supplier or customer not to deal with a competitor' is an exclusionary act. Section 8(c), on the other hand, prohibits all other exclusionary acts – other, that is, than those listed under Section 8(d) - but places the onus on the complainant to show that the anti-competitive effects of the exclusionary act complained of outweigh its pro-competitive effects.

28. The essential distinction between Section 5 and Section 8 is that in order to establish a violation in terms of Section 8, it is necessary to first establish that the alleged perpetrator is dominant in the market. What Section 5(1) and Section 8 have in common is the necessity to first establish the relevant market.

The Relevant Market and Market Dominance

29. The claimants aver that convenience stores in the Western Cape constitute the relevant market. They argue that convenience stores are distinct from supermarkets in that they carry a more limited range of products, their trading hours are longer, and they do not locate themselves in the large shopping malls but rather select sites easily accessible to residential areas. They also aver that they are distinct from the characteristic 'corner café' in that they carry a considerably larger range of stock. They conclude that their competitors are other convenience stores of a similar type such as the 'Eight Till Late' franchise, certain of the larger neighbourhood cafes and certain of the service station forecourt stores. They further assert that the respondent's share of this market is approximately 50%.

30. While we accept the distinction drawn between convenience stores, on the one hand, and large supermarkets and 'corner cafes', on the other, the assertion that the respondent possesses 50% of the convenience store market in the Western Cape is thoroughly unsubstantiated. Moreover, the definition of the relevant geographic market – the Western Cape – is not persuasive. If the hallmark of the convenience store is indeed convenience, then a store in Plumstead cannot be said to compete with a store in Sea Point, much less a store in Stellenbosch. Competition is provided by other stores conveniently close to the residential hinterland served by each Seven-Eleven. The conclusion then is that the relevant geographic market is considerably narrower than that suggested by the claimants rather heroic attempt at calculating market shares. On this basis, a more detailed investigation may indeed conclude that Seven-Eleven stores do enjoy dominant market shares when measured by the share of the consumer market enjoyed by convenience stores in each of the neighbourhoods in which the individual stores are located. We have, however, not been provided with sufficient evidence to sustain a narrower definition of the market than that asserted by the claimants.

31. The claimants, in paragraph 70 of their replying affidavit, tentatively suggest an alternative basis for market definition. In arguing that the respondent possesses market power the claimants suggest that the market should be defined by the relationship between franchisor and franchisee, rather than, as is suggested in the more traditional relevant market analysis, by the interplay between the franchisee and its customers. In this formulation it is then not the market share of Seven-Eleven stores that will determine dominance or the effects on competition in the market but rather the relationship between the franchisor and franchisee and the ability of the former to dominate and impose anti-competitive practices on the latter. This concept of the relevant market and the dominance implied by it – a phenomenon referred to in the literature as 'relational dominance' - is increasingly considered in antitrust investigations involving franchise. However, although obliquely suggested by the claimants here, the Tribunal has not been provided with a sufficient legal or empirical basis to sustain a decision on relational dominance.

32. The Tribunal, therefore, holds that it has not been presented with a persuasive view of the relevant market. Given the failure to identify the relevant market, it is not possible to make a finding on dominance, a necessary precursor to proving a claim under Section 8 of the Act. Accordingly, the Tribunal cannot find abuse of dominance in terms of section 8(d)(i) and/or 8(c).

33. Furthermore, in order to make a finding in terms of section 5(1) the claimants have to provide evidence that the respondents are lessening competition in a market. Since they have failed to establish the relevant market the Tribunal must reject the claim made in terms of section 5(1)

Section 5(2)

34. We now deal with the claim under Section 5(2) of the Act, the *per se* prohibition of minimum resale price maintenance. The practice complained of here relates to the wording in clause 9.1 of the franchise agreement which states

> " The Licencee shall sell all its products only at prices approved by the Licensor from time to time."

35. Adjudication of this claim does not require a prior decision on the relevant market. It refers to a specified act that is prohibited. There is no requirement to show anti-competitive effects and there is no pro-competitive defense available to the respondent. The respondent concedes this but has raised two defences as to why the section is not applicable to it.

36. Firstly the respondent argues that a franchise operation must be viewed as a single business entity or association, that is not in a vertical relationship as contemplated by the Act, but which operates as a chain of stores in the market with uniform products and prices. It submits that the determination of a ruling price for any item within a business organization or association (an intra-firm price determination) can never constitute minimum resale price maintenance, which is why a single proprietor chain store could not contravene section 5(2).

37. This argument is not acceptable to the Tribunal. It is generally accepted all over the world that franchising should be analyzed simply as a contractual means of vertical integration.[8] It is also accepted that the nature of franchising is inconsistent with traditional concepts of the nature of agency that are based on a relationship of consent. The franchisee invests his own capital in his own business, pays and is liable for operating expenses, absorbs losses incurred and

8 See Maximum Resale Price Restraints in Franchising, Antitrust Law Journal Volume 65, page 157.

enjoys net profits. He works for his own benefit and profit. An agent, on the other hand, works for the benefit of and in place of his principal and as his fiduciary. He does not conduct the business primarily for himself and his own profit. In light of this franchise distribution operations are not considered as single entities analogous to supermarket chain stores. Prohibitions on resale price maintenance are commonplace in other competition jurisdictions as is the phenomenon of franchising. Yet we can find no authority, nor has the respondent referred any to us, where the franchise relationship has been treated as a single firm and, where, on that basis, vertical price fixing has been condoned. On the contrary the authorities appear to take as a given that these prohibitions may be applied to franchises.

38. Commentators such as Fels in "Franchising and the Law, an Overview written for Corporate Counsel and Management"[9] categorically state

> "that a franchisor may not control resale prices by arrangement with its franchisees (vertical price-fixing) nor by arrangement with its competitors (horizontal price-fixing). Such restraints are per se, in violation of section 1 of the Sherman Act; and defenses in justification – reasonableness or "purity" of motive, business need or purpose or lack of anticompetitive effect - are not given consideration. No exception to the above *per se* rule with regard to price fixing exists, however, a franchisor may suggest prices if he uses neither coercion nor collusion with others to compel dealer adherence. Price lists and attractive menus (with prices) may be sent to franchisees. If adherence to prices clearly is not mandatory and if there is no consensual price arrangement such practices should be permissible."

39. The OECD in its report on Franchising found that all countries are very suspicious of restrictions that aim to limit the franchisee's freedom to choose their own price, and "it is difficult to find another topic where there is such unanimity. Resale price maintenance is virtually always unlawful".[10]

40. EU antitrust law has also found price fixing to be *per se* illegal in the context of franchising. In the *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* case[11], a European Union case, the Court remarked that "the fact that the franchisor makes price recommendations to the franchisee does not constitute a restriction of competition, so long as there is no concerted practice between the franchisor and the franchisees or between the franchisees themselves for the actual application of such prices."

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9 Fels, J.L. 1993, "Franchising and the Law", London: International Franchise Association
10 OECD, Competition Policy and Vertical Restraints, Franchising Agreements, page 162
11 *Pronuptia v Schillgalis*, (1986) ECR 353

41. What this authority establishes is that franchising is nowhere regarded as an intra-firm transaction immune from laws placing restraints on price maintenance.

42. Secondly the respondent also argues that it is not applying minimum resale price maintenance but is merely fixing the price although it acknowledges in the same breath that its franchisees may not sell at a lower, or for that matter higher, price than what it prescribes. The Tribunal rejects this argument.

43. Other jurisdictions and anti-trust commentators support prohibition of vertical price-fixing agreements, in particular agreements that fix minimum prices. In US antitrust law it had long been held that agreements to fix prices, whether vertical or horizontal are illegal *per se*.[12] Efficiency argument will therefore not be considered. More recently however the United Sates Supreme Court has held that maximum resale price maintenance is to be judged by a rule of reason whilst minimum resale price maintenance continues to be illegal *per se*. In this respect the respondent is correct in contending that our law is the same as the United States on resale price maintenance. In our Act only minimum resale price maintenance is prohibited *per se* in terms of section 5(2), whilst maximum resale price maintenance would have to be scrutinized under the general vertical prohibition to be found in section 5(1). Where a price is fixed as in the present case the effect is to impose a minimum resale price and hence the language of clause 9.1 of the agreement falls squarely within the scope of section 5(2). In light of the above we reject both the respondent's defenses and find that the respondent is in contravention of section 5(2) of the Act.

44. We are dealing here with one of a small class of restrictive practices deemed so pernicious an antitrust violation that it is prohibited *per se*. The factual basis on which our conclusion was based was common cause. The parties only differed as to the legal interpretation to be applied to those facts. These circumstances support a finding that continuation of this practice will frustrate the purposes of the Act and that the balance of convenience favours the granting of an order prohibiting the practice.

Costs

45. Although the claimants have only been partially successful, the respondents fared no better with the two unsuccessful in limine issues raised. We don't consider a costs award to either party is appropriate.

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12 *United States v Socony Vacuum Oil Co.*, 310 U.S. 150, 228 (1940), Dr. Miles Medical Co. v John D. Parke & Sons Co., 220 U.S. 373,1408 (1911)

ORDER

46. The claimants' application for interim relief in terms of section 59 of the Competition Act 89 of 1998 is granted in respect of the respondent's alleged contravention of section 5(2) of the said Act.

47. The Competition Tribunal orders that –

1. The respondent is interdicted and restrained from compelling the claimants to sell any merchandise stocked in their Seven Eleven stores at minimum selling prices determined and fixed by the respondent.

2. This order comes into effect on 7 April 2000 and remains in force until the earlier of-

(a) the conclusion of the hearing into the prohibited practices alleged by the claimants to have been committed by the respondent; or
(b) the date that is six months after the date of the issue of this order.

3. There is no order as to costs.

_____ _____

D.H. Lewis Date
Presiding Member

Concurring: N.M.Manoim

C Qunta dissented, her reasons will follow later.