COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No.: CR198Oct18

In the matter between:

THE COMPETITION COMMISSION Applicant

And

IRVIN & JOHNSON LTD First Respondent

KARAN BEEF (PTY) LTD Second Respondent

Panel:	Enver Daniels (Presiding Member) Yasmin Carrim (Tribunal Member) Andiswa Ndoni (Tribunal Member)
Heard on:	26 – 27 November 2019 and 20 January 2020
Order Issued on:	4 September 2020
Reasons Issued on:	4 September 2020

REASONS FOR DECISION

Introduction

[1] In this case, the Tribunal must determine whether Karan Beef (Pty) Ltd ("Karan") and Irvin & Johnson Ltd ("I&J") contravened section 4(1)(b)(ii) of the Competition Act 89 of 1998, as amended ("the Act").

[2] The Competition Commission ("Commission") alleges that the respondents entered into an agreement to not compete in the market for the supply of processed beef products. The Commission alleges that the respondents

allocated markets between them through a Manufacturing Agreement concluded in 2000 and a subsequent unsigned Amending Agreement.

[3] Karan concluded a consent agreement with the Commission which was made an order of the Tribunal on 26 September 2018, in which it admitted to contravening section 4(1)(b)(ii) of the Act and agreed to pay an administrative penalty of R2,7 million. Hence these proceedings were limited to those between I&J and the Commission.

[4] The hearing was held on 26 and 27 November 2019. Closing argument was heard on 23 January 2020.

Background to the Complaint Referral

[5] On 18 February 2013, the Commission initiated a complaint against several feedlots which were members of the South African Feedlots Association. The Commission alleged that these feedlots had entered into an agreement to fix the price at which weaner calves were purchased from farmers.[1]

[6] More than 4 years later, on 14 June 2017, the Commission conducted a dawn raid at the offices of Karan and several other feedlots and seized certain information. From this information, the Commission found that the respondents had concluded the Manufacturing Agreement in 2000 and the Amending Agreement (though unsigned) in 2002.

[7] On 12 September 2017, the Commissioner, in terms of section 49B(1) of the Act, proceeded to initiate a complaint against the respondents for alleged market division in contravention of section 4(1)(b)(ii) of the Act.

[8] On 24 October 2018, the Commission referred its complaint against the respondents to the Tribunal.

[1] CCSA's Initiation Statement (Initiation) Record, pg. 17.

[9] During its investigation, the Commission conducted interrogations with several key employees of the respondents, one of the significant ones being Mr Arnold Pretorius, the CEO of Karan. Transcripts of this interrogation were included in the trial bundle.

The Commission's case

[10] In its complaint referral, the Commission alleged that during 2000, the respondents, being competitors in the market for the "*supply of processed beef products*" concluded a Manufacturing Agreement in terms of which Karan would cease to produce processed frozen beef products for its own account and instead utilise its production capacity to produce processed frozen beef for I&J. This understanding is captured under clause 1.4 of the Manufacturing Agreement. In addition, the respondents agreed that Karan would not manufacture, market or produce any products similar to the contract products. This arrangement was captured under clause 3.12.[2]

[11] Regarding the Amending Agreement, the Commission alleged that it served to expand the respondents' alleged collusive conduct. The Commission submitted that the Amending Agreement served to reduce the restrictions that were imposed on Karan by allowing it to sell processed frozen beef products to certain food services customers as this was initially restricted. However, the respondents continued to divide markets by allocating customers between them from time to time.[3]

[12] It was argued that the vertical arrangement between I&J as supplier/distributor and Karan as manufacturer came about as an agreement between horizontal firms at the time and was therefore in contravention of section 4(1)(b)(ii). But for the agreement Karan would have continued to compete with I&J in the supply/distribution of processed frozen beef products.

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[2] CCSA's referral paras 16 to 17, Record pg. 10.
[3] CCSA's referral para 24, Record pg. 12.

[13] We make the observation here, which we will come back to later in our reasons, that in its Notice of Motion, the Commission does not plead in the alternative such as a contravention of section 4(1)(a) or section 5(1). Its entire case is predicated on the agreements constituting a contravention of section 4(1)(b)(ii) only.

I&J's case

[14] The crux of I&J's case is that it and Karan were not in a horizontal relationship, and that the Manufacturing Agreement was nothing more than a good faith vertical agreement with Karan.

[15] According to I&J, Karan took a unilateral decision to refrain from the production of processed frozen beef products for third parties even prior to I&J approaching it in early 2000.[4]

[16] I&J further contended that the Commission does not identify what market was allocated to Karan in return for the allocation to I&J of the market for the supply of processed frozen beef. In the absence of any reciprocal benefit, there is no basis for characterising the conduct as market allocation in contravention of section 4(1)(b)(ii) given the context in which the Manufacturing Agreement was concluded. In addition, Karan licensed its products to I&J when it concluded the Manufacturing Agreement which is consistent with Karan's intention to focus on its core business – that is the production of chilled and fresh beef products.

[17] With regards to the restrictions placed on Karan in the Manufacturing Agreement, I&J contended that these were restraints necessarily involved in an agreement where Karan obtained access to valuable proprietary information (IP in the form of recipes and product specifications) from I&J and which Karan was required to produce sufficient quantities of, to meet I&J's demand for processed

[4] I&J's AA para 39, Record pg. 34.

frozen beef products.[5] The true nature of the Manufacturing Agreement between the parties, notwithstanding clause 3.12 and 3.13 was that Karan was not restricted from supplying house branded products to third parties. To the extent that Annexure B contained a list of products manufactured by Karan for third parties these were erroneously included. After all, it was argued, Karan could not cede or assign the IP rights of those third parties, such as Pick 'n Pay (PnP) and Hyperama, to I&J.

[18] To the extent that the Manufacturing Agreement restricted Karan from manufacturing products similar to the contract products, this was a reasonable restraint necessary for the object of the agreement and could not be characterised as a contravention of section 4(1)(b)(ii).

[19] In so far as the Amending Agreement is concerned, I&J averred that this agreement was never implemented, and was not needed because Karan was never restricted to supply processed frozen beef products to third parties in the first instance. In any event the restrictions that remained in place after 2002, were reasonably necessary for the nature of the contract. The enquiry must then move to whether these remaining restrictions could be characterised as being in contravention of section 4(1)(b)(ii).

[20] Lastly, I&J submitted that if any contravention of the Act had taken place then the conduct would be time-barred in relation to section 67(1) of the Act because the Commission's complaint was initiated three-years after the alleged conduct had ceased.

Witnesses

[21] The Commission called as its only witness Mr Graham Simonsen former Marketing Manager at Karan from 2001 to 2012.

[22] I&J called Mr Christoffel Schoeman. Mr Schoeman had been employed as I&J's company secretary from 1992 until 2013. A witness statement was filed

[5] I&J's AA para 42, Record pg. 36.

on behalf Mr Jankovich-Besan, the current Chairman of I&J, but he was not called to testify.

The relevant provisions of the Agreements

[23] We set out here in some detail the relevant provisions of the two agreements for purposes of our analysis.

[24] Clause 1.3 of the Manufacturing Agreement states that:

> "*I&J is desirous to utilize the skills of Karan in the processing of chilled and fresh beef and the manufacture of frozen beef products to have the contract products manufactured by Karan for and on behalf of I&J, on the terms and conditions set out in this agreement*."

[25] "*Contract products*" are defined as "*the various products, listed in Annexure A & B attached hereto, to be produced by Karan for I&J in terms of this agreement*".[6] These products include various processed frozen beef products sold through retail and food service channels.

[26] Clause 1.4 of the same agreement states:

> "*Karan is desirous to terminate the manufacturing of processed frozen beef products for its own account and utilise its core skills in feedlots, abattoirs and processing of chilled and fresh beef and the processing of frozen beef products to manufacture the contract products for and on behalf of I&J on the terms and conditions set out in this agreement."*

[27] Clause 3.1 records that I&J appoints Karan as its manufacturer on an exclusive basis in respect of:

> "*Such of the contract products stated in annexure A and B in accordance with the specification set out in Annexure C, as amended from time to time; and*

[6] Clause 2 of Manufacturing Agreement, Record pg. 49.

Such further contract products as Karan may manufacture for I&J pursuant to the provisions of 3.2".

[28] Clause 3.12 provides for a general restriction on Karan as follows:

"Karan shall not manufacture, market or produce any products that are the same or similar to the contract products."

[29] Clause 3.13 sets out a licensing arrangement over Karan's products to date as follows:

"The parties record that prior to the commencement of this agreement, Karan manufactured and marketed the products referred to in Annexure B for its own account. Karan undertakes that with effect from the commencement date of this agreement …it will cease to produce and market the products referred to in Annexure B for its own account and does hereby grant to I&J an exclusive fully paid up licence to manufacture the products referred to in Annexure B and their specification and formulation referred to in Annexure C for the duration of this agreement. Karan undertakes that it shall only manufacture such products as and when requested to by I&J, for and on behalf of I&J, in terms of the agreement for the duration of this agreement. At the termination of this agreement such aforesaid licence shall immediately terminate and Karan shall be entitled to continue manufacturing the products referred to in Annexure B for its own account and I&J shall have no right to the specification and formulation of such products."

[30] Clause 3.15 then provides:

"Insofar as Karan may have contractual commitments to customers to supply the products referred to in Annexure B for a period after the commencement date of this agreement, Karan cedes, makes over and transfers to I&J all its rights and obligations in terms of such agreements…"

[31] In terms of clause 3.18 of the Manufacturing Agreement Karan granted I&J exclusive rights to use its brands, except for the Karan logo.

[32] The Manufacturing Agreement commenced on 12 June 2000 and was intended to continue indefinitely until terminated by either party on six months' written notice, provided that the Manufacturing Agreement was to remain in place for at least one year before notice could be given.

[33] Subsequent to the conclusion of the Manufacturing Agreement, the respondents drafted another agreement as the *Amending Agreement* of the Manufacturing Agreement.[7] The relevant provision is clause 4 of the Amending Agreement which, the Commission averred, was intended to divide markets by allocating customers. Clause 4 intended to delete clause 3.12 of the Manufacturing Agreement, inserting a new clause 3.12 which reads as follows:

> "3.12 *Karan shall not manufacture, market or produce any products that are the same or similar to the contract products or any other processed beef products other than those specifically provided for therein. Karan [Beef] is permitted to manufacture certain processed beef products that are similar to the contract products on behalf of customers in the Food Service Trade, provided that Karan enters into separate manufacturing agreements with each of such customers, which agreements shall specifically provide for the manufacture of such products in accordance with such customer's manufacturing specifications and recipes, and which recipes and specifications shall not have been developed by either Karan or I&J and such products shall be packed under such customers' own trademarks*."[8]

[34] In the Amending Agreement "*Food Services Trade*" is defined as "*those customers whose primary core business is converting processed beef for immediate sale and consumption and includes, but not limited to, restaurants, delicatessens, fast food outlets and caterers who have their own trade and brand names*".[9]

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[7] CCSA's referral para 20, Record pg. 11.
[8] Amending Agreement, Record pg. 811.
[9] Clause 2.1.3 of the Amending Agreement, Record pg. 810.

[35] The Amending Agreement contained other provisions which sought to amend clauses in the Manufacturing Agreement which purported to delete various annexures and effect amendments to clauses 7.2 and 7.13. These are not relevant for the case we must decide.

Analysis

[36] Section 4(1)(b)(ii) of the Act provides -

"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 and if it involves any of the following restrictive horizontal practices: … dividing markets by allocating customers, suppliers, territories, or specific types of goods or services …"

[37] The Commission asks that we look no further than the two agreements to arrive at a conclusion that Karan and I&J, by concluding these agreements, where in the first instance competitors in a horizontal relationship; and second, engaged in market division as contemplated in section 4(1)(b)(ii).

[38] While the Commission's market definition in its referral broadly places the respondents as competitors in the "*supply of processed beef products*", very little detail is provided as to the nature of competition in that market (for e.g. were there other firms competing in that market) or the closeness of competition between the respondents (for e.g. whether they competed on price, quality or customer type).

[39] Notwithstanding this, the evidence in the proceedings revealed that prior to the conclusion of the agreement both respondents were "vertically integrated" in that they manufactured and supplied processed frozen beef products to retail customers such as PnP. It was not clear whether they competed in the Food Services market, where Karan provided products to food chains such as Maxi's and manufactured a range of house brands, including for retailers such as PnP.

[40] The evidence also reveals that although I&J had disposed of its beef processing facilities when it sold its plant to McCain Foods (South Africa) ("McCain"), prior to the conclusion of the Manufacturing Agreement, it had decided to continue supplying processed frozen beef products by finding a third party manufacturer to produce the product on its behalf.[10]

[41] We will therefore assume in favour of the Commission, that the respondents were at the very least in a horizontal relationship in the market for the manufacture and the supply of processed frozen beef products immediately prior to the conclusion of the Manufacturing Agreement.

[42] It is not surprising that a competition regulator would be concerned about a vertical agreement between parties who once might have been or continue to be in a horizontal relationship as we have sketched out above. A central concern for competition regulators with erstwhile competitors concluding vertical agreements such as the case in point is whether the arrangement amounts to collusion with the purpose of limiting output and raising prices in an identified market. Vertical agreements which permit parties to compete in limited circumstances might also raise concerns about possible adverse effects on competition in identified markets.[11]

[43] However, an agreement *on the face of it* cannot, without more, propel mere suspicion into a finding of collusion. What needs to be demonstrated is whether the agreements between the parties can be *characterised* as having as their object or purpose participation in a cartel to divide markets as contemplated under section 4(1)(b)(ii).

[44] In *American Natural Soda Ash Corporation and Another v Competition Commission*[12] (*ANSAC*), the Supreme Court of Appeal ("SCA") iterated that not all agreements between competitors would contravene section 4(1)(b), and that

[10] I&J's AA paras 8.2-8.3, Record pg. 23.
[11] *Toys R Us Inc. v US Federal Trade Commission* 98-4017 (2000); D Pearlstein el al *Antitrust Law Developments* (2002) (5th) Volume 2 of Antitrust Law Developments of 81 found expression in *SAB* (Antitrust Law Developments, American Bar Association).
[12] *American Natural Soda Ash Corp v Competition Commission and Others* [2005] 1 CPLR 1 (SCA).

there were many instances in which competitors conclude *bona fide* commercial agreements. The SCA further expressed the view that any conduct alleged to contravene section 4(1)(b) must be properly characterised in order to ascertain whether such conduct squarely falls within the ambit of section 4(1)(b).

[45] The SCA set out the approach that ought to be followed in making this assessment. The enquiry involves two legs that may be pursued in any order.[13] The one leg requires a definition of the scope of section 4(1)(b), the answer to which must be determined through statutory interpretation. The other leg of the enquiry asks whether or not the conduct in issue falls within the terms of the prohibition. This is a factual enquiry that must be answered by recourse to the relevant evidence.

[46] Put another way, the question must be asked whether the conduct, properly characterised, is the kind of conduct that is to be prohibited under section 4(1)(b)(ii).

[47] In this case, we have approached the issue of characterisation as follows. We first consider what the true nature of the Manufacturing Agreement was because notwithstanding the express provisions of clause 3.13 and clause 3.15, which suggest that Karan had ceded all of its third party contracts to I&J, this was disputed by I&J. After reviewing the evidence on this issue, and arriving at a conclusion as to the true nature of the agreement between the parties we then consider whether the agreement (conduct) would be such as to fall within the scope of section 4(1)(b)(ii) as stated by the SCA and CAC.

The nature of the conduct

[48] In order to understand the true nature of the agreement some regard must be had to the context in which it was concluded. The Commission did not provide

[13] ANSAC para 46.

any context in its pleadings, its case being premised only on the provisions of the agreements themselves.

[49] However, some context is obtained from I&J through the answering affidavit and witness statements. I&J submitted that Karan had, independently of I&J, decided to exit the retail/wholesale supply of processed beef products and to focus only on the manufacturing thereof. I&J on its part was looking to outsource the processing of its frozen beef products because it had recently sold its manufacturing facilities to McCain. According to I&J, the agreement between the respondents was occasioned by an alignment of commercial interests as described more fully below.

[50] Historically, I&J was a vertically integrated firm that had upstream vegetable and beef processing capabilities and efficient routes to markets, coupled with a strong downstream retail presence. I&J's frozen vegetable business formed part of its Prepared Food Division ("PFD"). Up until 2000, I&J operated its PFD, with several processing facilities in George, Marble Hall, Delmas and Springs. Its main production facility head office of PFD was situated in Springs (Nuffield).

[51] Vegetable processing accounted for 85 to 90% of I&J's PFD with processed beef and other processed products collectively accounting for about 10 to 15%. Some of the product ranges were produced on shared equipment. This means that I&J used packaging lines and cold storage facilities mainly used for its frozen vegetable business in the production of its other processed product ranges. Although some of these products were profitable, none of them was of sufficient scale or had sufficient critical mass to justify a standalone dedicated processing facility. According to I&J, its beef and chicken processing sub-businesses were the largest and were more lucrative than the other prepared food businesses that it conducted.

[52] During early 1999, the interim manager of I&J's PFD, Mr Dennis Zipp, expressed the view that I&J ought to consider the possibility of outsourcing the I&J beef processing business to reduce the production costs by (i) finding an alternative, reliable and affordable local beef supplier as a result of South

Africa's weakened currency at the time and (ii) finding a manufacturer with sufficient capacity to whom processing could be outsourced. The rationale was that I&J would outsource production to a bigger plant which already engaged in the production of processed frozen beef products which, in turn, would experience a reduction in fixed overheads due to the additional volumes supplied by I&J.

[53] Karan was identified as a suitable contract manufacturer to execute its envisaged strategy.[14] Like I&J, Karan also produced processed beef products. Such products included, but were not limited to, beef burger patties. Karan's facilities were located close to Nuffield which was an ideal position for I&J as outsourced manufacturing would be easily managed and access to I&J's cold storage facilities would be achieved with ease. In addition, Karan met I&J's envisaged strategy as Karan was a reliable local beef supplier and operated a beef processing facility which could handle I&J's production needs.

[54] During mid-1999, I&J's erstwhile PFD manager had commenced discussions with Karan, and several drafts of a manufacturing agreement were circulated internally, within I&J, and shared with Karan. The proposed agreement was drafted primarily on the basis that Karan would be capable of producing processed beef on behalf of I&J, in addition to its own production volumes.[15]

[55] Whilst the abovementioned discussions were underway, McCain approached I&J to acquire its frozen vegetable business. I&J was of the view that its vegetable business had not performed profitably for some time, it consisted of old technology and was in dire need for re-investment; hence a decision was taken by I&J to dispose of this business. The terms of the agreements were concluded, and the sale of I&J's vegetable business was effective on 30 June 2000 subject, of course, to regulatory approval and several conditions precedent.

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[14] I&J's AA par 8.3, Record pg. 23.
[15] I&J's AA, par 15, Record pg. 26

[56] It appears from I&J's version that Karan's representatives advised I&J at this time that Karan was no longer pursuing its own processed beef business.[16] This was echoed during the hearing of Karan's consent agreement where it was submitted that by the time Karan was approached by I&J, it had already considered closing down or selling its processing plant.

[57] It is against these facts that the Manufacturing Agreement was concluded between the respondents on 26 June 2000. Annexures A and B to this agreement, which listed the products contemplated in the agreement (contract products) were attached.

[58] A subsequent Amending Agreement was drafted in 2002 by the respondents but was never signed and to this date remained in draft form.

[59] In May 2014, Karan gave notice to I&J that it no longer wished to produce processed beef products. Upon termination of the Manufacturing Agreement in February 2015, Karan ceased to produce processed frozen beef products. In fact, Karan's last production for I&J took place in February 2015. I&J submitted that most of Karan's processing equipment was sold to I&J's new supplier of manufacturing services, QPak (formerly known as QK Meats In).[17] This was to accommodate the start-up of QPak.[18]

[60] I&J notes that the Manufacturing Agreement was terminated, not because Karan sought to expand its production facilities, but because it wished to exit the market for the production and supply of processed beef products entirely. I&J further submits that this is consistent with Karan's original intention to exit the market back in in 2000, as it did not want to produce or market processed beef products.[19]

[61] The circumstances for Karan at the time of the conclusion of the Manufacturing Agreement can be gleaned from the answers given by Mr Pretorius, CEO of

[16] I&J's AA par 8.3, Record pg 23.
[17] Besan's witness statement, Record pg. 309
[18] I&J's AA par 32, Record pg. 32.
[19] I&J's AA par 40, Record pg. 35.

Karan, during his interrogation by the Commission. While Mr Pretorius was not called to testify, his testimony in the interrogations formed part of the record.

[62] According to him, Karan had purchased the manufacturing facilities for processed beef products around 1998/1999 in the hope that it could move away from being only a feedlot and supplier of fresh meat. Considerable capital expenditure was made in the abattoir and processing operations.[20] However, Karan soon found itself in difficulties, not having the required know-how for the retail trade of frozen products and finding its processed volumes below the expected tonnage for a return on investment. By the time I&J approached it, Karan was more than willing to throw in the towel on the retail trade.

[63] Mr Pretorius, during the Commission's interrogations said the following:

> "*All the retail chain business we stopped doing it because it was not a commercial proposition for us. We wanted to get out of the business. In other words, if I&J wasn't there, we would have stopped in any case*."[21] (own emphasis)

[64] During this interrogation, Mr Pretorius further stated the following:

> "*Can I tell you in short which I am telling you under oath? I am telling you what the real intention was. Not whether we could do this or that, what the real intention was. The real intention under oath, is that that business did not work for us. We couldn't do it*."[22]

[65] When asked if it was (he was) happy with the agreement Mr Pretorius stated:

> "*Absolutely. Either I&J had to take it from us, if they are interested or we would have stopped. It didn't work for us."*[23] (own emphasis).

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[20] Hearing Transcript (26Nov), pg. 23 lines 6-11.
[21] Transcript of the Commission's interrogation of Mr Pretorius (CEO of Karan Beef), pg. 1194 of the Record.
[22] Transcript of the Commission's interrogation of Mr Pretorius, pg. 1196 of the Record, lines 3- 6.
[23] Transcript of the Commission's interrogation of Mr Pretorius, pg. 1196 of the Record, lines 8- 9.

[66] This view was supported to some extent by the Commission's witness Mr Simonsen in his testimony. His understanding when he started out at Karan in 2001 was that Karan had invested a lot of money into the production facilities and had to run volumes through it to make it worthwhile.[24] This is why Karan contracted for the manufacture of I&J volumes in the hope that they would reach an expected 300 tons a month for processed frozen beef. According to him they didn't really want to handle the frozen products because they were not good at managing the retail value chain for frozen beef patties.[25] Even during his time Karan was more comfortable with supplying fresh or chilled products.[26] But because they were keen to push through the anticipated volumes, they were willing to take back the house brands from I&J. (We deal with this issue later.)

[67] When the evidence of Mr Simonsen and Mr Pretorius is considered together, the context for Karan in which the Manufacturing Agreement was entered into can thus be summarised as follows: Karan had made a significant investment in the production of processed beef products. Its expertise however was in feedlot and chilled or fresh meat not processed frozen products. To that extent it struggled with managing the retail sales of processed frozen beef products. But for its huge investment in the production facilities, it would have exited the market. The I&J approach offered it an opportunity to combine two commercial imperatives namely to push through volumes in production and to withdraw from a sector it was struggling with, being the sale of processed frozen beef products to retailers.

[68] The context for I&J is as described above which was that it had decided to find a third- party manufacturer because of the disposal to McCain.

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[24] Hearing Transcript (26Nov), pg. 26 lines 4-8 and page 28 lines 6-9.
[25] Hearing Transcript (26Nov), pg. 24 lines 10-15.
[26] Hearing Transcript (26Nov), pg. 61 lines 20-24.

[69] None of these facts were disputed by the Commission. The Commission could also not point us to any other evidence such as strategic documents or management accounts to rebut the version put up by both Karan and I&J.

[70] This brings us then to assess the true nature of the Manufacturing Agreement or the conduct that is to be evaluated for purposes of section 4(1)(b).

The nature of the agreements

[71] Clause 3.12 states:

> "*Karan shall not manufacture, market or produce any products that are the same or similar to the contract products.*"[27]

[72] The ambit of this restriction became the focus of the hearings. The Commission alleged that Karan had handed over all its retail/wholesale customers to I&J to manage for I&J's own account. All that Karan was permitted to do was to manufacture the processed frozen beef products for I&J. A carve-out from this overall restriction was that Karan could supply its factory shops in Balfour and City Deep. The Commission's interpretation was based on clauses 3.12 and 3.15 (read with Annexures A and B which contained a schedule of products that were supplied by Karan to customers. These included Karan branded products as well as house brands that Karan supplied to large retail chains such as PnP or to restaurants such as Maxi's and Whistle Stop.

[73] Mr Schoeman, the company secretary at the time for I&J, in his evidence in chief submitted that the Manufacturing Agreement was never intended to have the effect that Karan would be restricted from supplying third party products or house brands. By way of summary, he testified that it was always the intention of the parties to permit Karan to continue supplying third parties in the food services market and house brands, and that to the extent these were contained in Annexures A and B, this was an error. In support of his contention he also

[27] Clause 3.12 of the MA, Record at pg. 593.

referred us to documents in the record such as production schedules and an email from Mandy Murphy.

[74] In our view, not much is to be gained from the evidence of Mr Schoeman, for several reasons. He admitted, during examination in chief, that notwithstanding his alleged central role in the drafting of the Manufacturing Agreement he was not personally involved in the negotiations with Karan.[28] Moreover, it transpired that he was not even present when the agreement was signed, or when the annexures were compiled.[29] He only received the signed Manufacturing Agreement a few months afterwards and in fact had not even looked at the annexures at the time and had simply filed the documents away.[30] He also admitted, in responses to questions from Mr Trengove, that the draft Amending Agreement which had been discovered on a computer (database) had been drafted by one of the then legal advisors, whose name and details he could strangely not recall, but that he was unaware of its existence.[31]

[75] The evidence of Mr Simonsen, the Commission's witness, however was of great assistance. While Mr Schoeman could, at best, testify to what he *thought* the true nature of the agreement was, Mr Simonsen, who was involved in the day to day operations of the business, had *personal knowledge* of how the agreement was understood and implemented by the parties.

[76] Mr Simonsen came to Karan soon after the agreement was concluded in 2001. He testified that when he joined, Karan was not doing any house brands for its own account but was manufacturing the volumes through its plant for I&J's account.

[77] According to him, at that time, Karan was also not supplying any third-party house brands to customers directly. In other words, Karan continued to manufacture these, but I&J held the account with the customer. The only carve

[28] Hearing Transcript (26Nov), pg. 86 lines 16-23.
[29] Hearing Transcript (26Nov), pg. 193 lines 9-21.
[30] HearingTranscript (26Nov), pg. 194 lines 19-25 and pg. 195 lines 2-5.
[31] Hearing Transcript (26Nov), pg. 115 lines 15-25 and pg. 116 lines 1-6.

out in this arrangement was that Karan could supply its factory shops at Balfour and City Deep.

[78] He testified that the Amending Agreement may have been drafted, and he did not recall seeing the document at the time, but at that time the parties had agreed that Karan should take back the third party customers and start supplying into the Food Services market. This change was implemented for two main reasons. The first was that by 2002 they were only reaching 180 tons. I&J was not delivering the anticipated volumes of 300 tons. The second was that some large retailers were unhappy with the fact that I&J was the account holder for their own house brands of what were clearly Karan branded products. It appears that at some stage the products were jointly branded with both I&J and Karan brands.[32] Customers preferred to acquire the Karan products directly from Karan. He testified that, in addition, I&J did not want to supply house branded products because it wanted to focus on retail and food services.[33] This was when Karan pitched in and took the house branded products back for its own account. Mr Simonsen testified that this culminated in the conception of the Amending Agreement.[34]

[79] Under cross-examination Mr Simonsen conceded that there were some errors in Annexure B such as "chicken schnitzel". He was also unable to speak to any of the legalese in the agreements and why the Amending Agreement had not been signed, but he still maintained his understanding of how the agreements were implemented because in his own words "*Look I keep saying you know, my knowledge I was there from 2001. I can be clear of the information*".[35]

[80] In relation to the email from Ms Murphy, Mr Simonsen was unshaken in his testimony that I&J had resigned the PnP account and that was the reason why Karan had been approached by PnP to take the account over. Before

[32] Hearing Transcript (26Nov), pg. 11 lines 15-19.
[33] Hearing Transcript (26Nov), pg. 35 lines 1-2.
[34] Hearing Transcript (26Nov), pg. 35 lines 5-6.
[35] Hearing Transcript (26Nov), pg. 45 lines 5-8.

approaching Karan, PnP had gone to other manufacturers but that did not work out.

[81] Mr Simonsen was directed to the production schedules relied upon by Mr Schoeman. He testified that Karan produced retail and food services products which encompassed Karan's "own production". In response, Mr Simonsen testified that it was his understanding that Karan was producing the house brands for I&J.[36] He re-iterated that although the production schedules indicated that Karan was producing house brands, it was not for its own account but part of the range it was producing for I&J which was picked up by I&J at Balfour and supplied through I&J's distribution system.[37]

[82] Mr Simonsen further testified that Karan produced house brands for I&J until 2004/2005 when I&J resigned the house brands to Karan.[38]

[83] On balance, we find that Mr Simonsen's evidence was both reliable and plausible because it was within his own personal knowledge which was gained from his involvement in the operations of the business.

[84] The true nature of the Manufacturing Agreement can thus be summarized as follows. Karan concluded an agreement with I&J to manufacture processed frozen beef products for I&J according to I&J's own specifications. Karan stopped supplying processed frozen beef products to retail customers directly but instead did so through I&J. Karan also stopped marketing third party house brands but ceded these rights to I&J. Karan however continued to supply processed frozen beef products to its own factory shops in Balfour and City Deep. During 2002, the agreement was amended to allow Karan to take back some (there was no evidence that it took back all) third party customers and supply frozen products to the Food Services industry directly.

[85] Thus, the Manufacturing Agreement, at least until 2002, when it was amended, precluded Karan from producing *any* processed frozen beef products for its own

[36] Hearing Transcript (26Nov), pg. 41 lines 5-8.
[37] Hearing Transcript (26Nov), pg. 41 lines 19-21.
[38] Hearing Transcript (26Nov), pg. 43 line 12.

account, including those for third party customers. It could only produce processed frozen beef products for its own account for its Balfour and City Deep outlets. Except for Balfour and City Deep, for approximately 2 years (prior to the amendment) the Manufacturing Agreement was vertical in nature, with Karan doing the manufacturing and I&J the marketing and distribution.

[86] This conclusion also accords with clauses 3.12 and 3.15 of the Manufacturing Agreement read together.

[87] After the Amending Agreement, the parties were in both a vertical and a horizontal arrangement, albeit with restraints imposed on Karan, where Karan could supply into the Food Services market and house brands but was restrained from competing head-on with I&J in the retail segment.

[88] This was the state of affairs until Karan filed a notice of termination in May 2014. The parties continued with the arrangement throughout the notice period until November 2014. After this Karan exited the market for the supply of processed frozen beef products in order to focus on its core business. I&J found another manufacturer, namely QPak.

Does the conduct contravene section 4(1)(b)(ii)?

[89] As we stated above, we have assumed that the respondents were in a horizontal or, at the very least, a potential horizontal relationship immediately prior to or at the time when the Manufacturing Agreement was concluded.

[90] However, the fact that two competitors or potential competitors conclude an agreement does not necessarily lead to the conclusion that such an agreement, on the face of it, *without more*, violates section 4(1)(b). Our Act, in section 4(1)(a) recognizes that there may be agreements between competitors that might result in a lessening of competition without necessarily being in violation of section 4(1)(b), provided there is some pro-competitive justification for such agreements.

[91] In *ANSAC* – in its assessment of the admissibility of evidence of efficiencies by a respondent defending against a section 4(1)(b) allegation – the SCA confirmed, through juxtaposition of subsection 4(1)(a) to subsection 4(1)(b), that the types of prohibitions espoused by those subsections mirrors the distinction in US antitrust law between horizontal conduct to be tested by rule of reason and a *per se* violation.[39] This distinction is also found in the EU under Article 101(1) of the Treaty on the Functionality of the EU that prohibits horizontal agreements which have as their object or effect the prevention, restriction or distortion of competition. An agreement which is restrictive by object, rather than by effect, corresponds with conduct that is *per se* prohibited by our section 4(1)(b).[40] This distinction also mimics the nomenclature of "hard" and "soft core" cartels.

[92] *ANSAC* confirmed that the true impact of the subsection 4(1)(a) versus (b) distinction is to remove the ability for a respondent to advance an efficiency defence for conduct falling under subsection 4(1)(b).[41] Under section 4(1)(a), a respondent is permitted to put up a pro-competitive justification; under 4(1)(b) no such defence is available and the conduct – once proven – is presumed to harm competition. Hence an offence under section 4(1)(b) is considered to be the most egregious to competition.

[93] This is all now established jurisprudence in South Africa but we find it necessary to refer to it here because it is no simple matter, as the Commission would have it, to conclude that an agreement between two parties, must be assessed only on the face of it and found to contravene section 4(1)(b) *without* engaging in a process of characterisation.

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[39] *ANSAC* at para 37.
[40] *Dawn Consolidated Holdings (Pty) Ltd and others v The Competition Commission* Case no: 155/CAC/Oct17 at par 29.
[41] ANSAC para 37.

[94] So, what then, is the character of conduct that is a *per se*, hard-core cartel? One feature is that it has, as its "object" (to borrow language from the EU), the restriction of competition. The 2014 EU technology transfer guidelines[42] the following is said about the assessment of agreements by object:

> "*Restrictions of competition by object are those that by their very nature restrict competition. … The assessment of whether or not an agreement has as its object a restriction of competition is based on a number of factors. These factors include, in particular, the content of the agreement and the objective aims pursued by it. It may also be necessary to consider the context in which it is (to be) applied or the actual conduct and behaviour of the parties on the market. In other words, an examination of the facts underlying the agreement and the specific circumstances in which it operates may be required before it can be concluded whether a particular restriction constitutes a restriction by object of competition. The way in which an agreement is actually implemented may reveal a restriction by object even where the formal agreement does not contain an express provision to that effect. Evidence of subjective intent on the part of the parties to restrict competition is a relevant factor but not a necessary condition. An agreement may be regarded as having a restrictive object even if it does not have the restriction of competition as its sole aim but also pursues other legitimate objectives.*"[43]

[95] Where a company divides the market or customers for anti-competitive reasons, empirical evidence may evince that such behaviour leads to a reduction in production and price increases, resulting in poor allocation of resources to the detriment, in particular, of consumers.

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[42] Communication from the Commission (28 March 2014) "*Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements*" English version, in Official Journal of the European Union (2014/C 89/03).
[43] EU 2014 technology transfer guidelines at para 14.

[96] The Commission says that because Karan had ceded over all of its third-party customers for I&J to manage (in other words the true nature of the conduct in the first two years), this amounted to market division in contravention of section 4(1)(b)(ii). However, the evidence does not support the conclusion that the Commission urges us to reach.

[97] The central piece of evidence relied upon by the Commission was clause 1.4 of the Manufacturing Agreement to conclude a collusive agreement, namely that the agreement as a whole was a result of a scheme between the respondents and that but for the agreement Karan would not have exited the market for the supply of processed beef products.[44]

[98] Recall that clause 1.4 reads as follows:

> "*Karan is desirous to terminate the manufacturing of processed frozen beef products for its own account and utilise its core skills in feedlots, abattoirs and processing of chilled and fresh beef and the processing of frozen beef products to manufacture the contract products for and on behalf of I&J on the terms and conditions set out in this agreement".*

[99] But when this clause was put to Mr Simonsen, the Commission's witness, he stated that he could not say whether Karan had already terminated production for its own account at the time the Manufacturing Agreement was concluded. When asked further by Mr Ngobese of the Commission to give an interpretation of the words "*desirous to terminate*", Mr Simonsen stated that it would be difficult for him to speculate on this point. Under cross-examination Mr Simonsen conceded that he had no knowledge about the circumstances surrounding the conclusion of the Manufacturing Agreement.

[100] Thus, the Commission's interpretation of clause 1.4 was not supported by its own witness.

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[44] Hearing Transcript (26Nov), pg. 8 line 25 and pg. 9 lines 1-5; Hearing Transcript (20Jan), pg. 307 lines 12-15.

[101] In any event, on an ordinary reading of clause 1.4, the words "*Karan is desirous to terminate the manufacturing of processed frozen beef products for its own account and to utilise its core skills in feedlot, abattoirs and the processing of chilled and fresh beef*" suggest a recordal of Karan's intention to terminate the manufacturing of processed frozen beef products and to focus on its core business. The clause does not lend itself to the interpretation that the Commission seeks.

[102] Certainly, the evidence of the context dealt with earlier in these reasons supports the conclusion that Karan was desirous to terminate the manufacturing of processed beef products and to focus on its core business independently of I&J. The Commission did not put up any facts or documents to rebut this.

[103] But more significantly the rationale for the agreement from Karan's perspective, based on the evidence of Mr Pretorius and Mr Simonsen, in concluding the agreement was ***not*** to reduce output or increase prices in the retail market but to ***increase*** its volumes in the manufacturing plant. This was supported to some extent by Karan taking back its customers. In its view the arrangement with I&J was not achieving the objects of increasing volumes as Karan had intended. Indeed, if the objective was to cartelise *i.e.* limit output and increase prices there would have been no need for Karan to amend their arrangement, orally or in writing.

[104] Furthermore, no evidence was put up by the Commission that I&J enjoyed some advantages pursuant to Karan withdrawing from the supply of frozen beef products. Where was the *quid pro quo* for I&J?

[105] No evidence was put up by the Commission that the agreements impacted adversely on competition in any segment of the market, such as increased prices to customers or improved volumes for I&J's own brands.

[106] The conduct of the two respondents also did not accord with that usually associated with cartelists such as secretive arrangements or meetings. On the contrary, at some point of the first two years the products were jointly branded,

with the Karan logo depicted on the I&J product. Hence, customers and the public alike were aware of this.

[107] Finally, a piece of evidence not dealt with by Commission at all in these proceedings was the fact that Karen did indeed exit the market for the manufacture of processed beef products after it terminated the agreement with I&J.

[108] The Commission argues that notwithstanding the context in which the agreements were concluded, once a firm agrees to exit from a market (as Karan did here) in favour of a competitor such as I&J for improved volumes or margins this is sufficient to bring the agreement (conduct) within the ambit of section 4(1)(b)(ii).

[109] We disagree with this proposition. If this indeed were the case, then virtually all legitimate efficiency improving commercial activities could fall foul of section 4(1)(b)(ii). Something *more* must be shown by the Commission for us to conclude that firms have crossed the line between legitimate commercial arrangements and cartel conduct.

[110] In this case, having regard to all the evidence in its totality we conclude that the conduct of the parties in the first two years of the Manufacturing Agreement is not the type of conduct contemplated in section 4(1)(b)(ii) and that the Commission has failed to bring it within the ambit of section 4(1)(b)(ii).

Did the subsequent restraints, from 2002 until the termination of the agreement in 2014 contravene section 4(1)(b)?

[111] Recall that I&J's submissions on the Amending Agreement were that in the first instance it was unnecessary for the parties to conclude an amendment but argued in the alternative, that after 2002 the restrictions placed on Karan by the Manufacturing Agreement, read with the Amending Agreement, were reasonable.

[112] However, the Commission did not present any case as to the reasonableness or otherwise of the restraints during this period, as it ought to have done in accordance with its legal duty or onus. It merely persisted with the argument that the restrictions amounted to more market division in the form of customer allocation and were merely an extension of the market allocation agreement between the parties established in the Manufacturing Agreement. As a matter of logic, if the main agreement is found not to fall within the scope of agreements that section 4(1)(b) prohibits; then a subsequent narrowing of the ancillary restraint of that same relationship cannot be found to constitute a contravention of section 4(1)(b).

[113] Thus, we conclude that the Manufacturing Agreement, read together with the Amending Agreement, assessed in its context and purpose, does not contravene section 4(1)(b)(ii). The fact that this arrangement between the respondents might have contravened another section of the Act such as section 4(1)(a) or 5(1) is not something for us to consider because, as we indicated early in these reasons, the Commission did not mount an alternative case.

[114] We must emphasise, in arriving at this conclusion, that cartel conduct is considered to be the most egregious and harmful to competition and consumers alike and must be treated with the appropriate attention and sanction by competition agencies.

[115] However, the priority given to the combatting of this conduct must be balanced against the edicts of procedural fairness norms and the Constitution. In the *NPC-Cimpor*[45] case the CAC says this about striking that balance:

> "*That cartel activity represents the very worst strain of anti-competitive conduct is surely trite. Courts need to be vigilant in ensuring the prohibition of this conduct. This is again manifestly obvious. Indeed, this Court in cases which were cited in argument in this case, in particular*

[45] *The Competition Commission v NPC-Cimpor (Pty) Ltd & Others* (Case No: 178/CAC/Dec19)

Videx, MacNeil Agencies, and Netstar, supra has developed a responsive jurisprudence for the curbing of cartel activity. But this does not mean that the rule of law does not apply to cartel cases, and can be elided over in favour of a result. That the Commission must discharge the burden that the Act imposes upon it to produce relevant evidence that shows that the nature of the conduct of the impugned party is such that it justifies a finding that the conduct so proved falls within the scope of s 4(1) (b) of the Act." (emphasis added.)

Conclusion

[116] Given the serious implications of a finding of a section 4(1)(b) contravention for a respondent, when assessing the probabilities, this Tribunal will have to consider that the more serious the allegation, the more cogent will be the evidence that is required.

[117] The Commission bears the burden to prove, on a balance of probabilities, that a contravention of section 4(1)(b) has occurred.[46] In our view, the Commission has failed to discharge its burden of proving that the Manufacturing Agreement and the subsequent Amending Agreement resulted in the division of markets between two competitors *as contemplated in section 4(1)(b)(ii)*.

[118] Accordingly, we make the order as set out below.

Order

[119] The Competition Commission's complaint referral against I&J (the First Respondent) under case number CR198Oct18 is hereby dismissed.

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[46] *Competition Commission v Thembekile Maritime Services (Pty) Ltd & Others* Case no: CR067May17, par 53. Also see *Competition Commission v Geometry Global (Pty) Ltd & Another* Case no: CR182Dec16, par 63.

[120] There is no order as to costs.

Signed by: Yasmin Tayob Carrim
Signed at: 2020-09-07 15:15:28 +02:00
Reason: Witnessing Yasmin Tayob

Yasmin Tayob Carrim

Ms Yasmin Carrim **4 September 2020**
Date

Mr Enver Daniels and Ms Andiswa Ndoni concurring

Tribunal Researcher:	N Ndlovu, K Kgobe and M Tshabalala
For the First Respondent:	W Trengove SC and M Engelbrecht instructed by Herbert Smith Freehills
For the Commission:	M Ngobese and K Monareng