Case Number: 04/IR/Oct/1999

In the matter between

South African Raisins (Pty) Ltd	**First Claimant**
Johannes Petrus Slabber	**Second Claimant**

and

SAD Holdings Ltd	**First Respondent**
SAD Vine Fruit (Pty) Ltd	**Second Respondent**

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

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1. INTRODUCTION

This matter has its origins in the transition from state and producer regulation of agriculture to a market-oriented system. More specifically it originates in the conversion of a national agricultural co-operative to a company following the withdrawal of state support for the single-channel marketing systems that operated in the agricultural sector. In effecting the transition from co-operative to corporation, were many of the anti-competitive practices and structures associated with the former retained in the new form?

Until recently the agricultural sector was dominated by giant co-operatives and regulatory boards (e.g. the Dried Fruit Board). The primary function of the co-operatives was the marketing of agricultural output. However, the actual activities of the co-operatives tended to span all functions necessary to produce the product and bring it to market – financing, storage, processing, packaging, distribution, sales and exports. Producers within a specific agricultural sub-sector had to be members of the co-operative. Although the precise details of the system varied across the range of agricultural products, as a rule the producers were, on pain of criminal sanction, obliged to sell their entire crop to the relevant co-operative, which, in turn, committed itself, in good and bad years, to purchase the entire crop of their members. This was the system known as single-channel marketing, with the particular Board as the regulating authority and the co-operative as the channel.

In 1996, the Marketing Act 59 of 1968, the key statute underpinning single-channel marketing, was repealed by the Marketing of Agricultural Products Act 47. The objective of the repeal was the promotion of a free market in agricultural products. The essential contention in this case is that in one corner of the vast agricultural sector, the co-operative previously responsible for the processing, packaging and distribution of, inter alia, raisins sought to change the form in which it did business from co-operative to limited liability company but, nevertheless, to retain the same relationship between itself and the large number of producers active in this sub-sector. The claimants in the present case claim that key elements of these arrangements contravene certain provisions of the Competition Act, 89 of 1998.

The first claimant is South African Raisins (Pty) Ltd, a recently established company seeking to compete against South African Vine Products (Pty) Ltd, a wholly owned subsidiary of SAD Holdings (Ltd). The SAD group of companies was established when the South African Dried Fruit Co-operative Limited was converted to a corporate structure. The first claimant (SAR) is joined by one of SAR's directors in his personal capacity as a producer of grapes for processing into raisins (For purposes of convenience, we refer to these as "grapes-for-raisins").

The claimants allege that they are being prevented from participating and competing in the raisin market by –

(a) a horizontal agreement between grapes-for-raisins producers that constitutes a prohibited restrictive horizontal practice in violation of Section 4 of the Act;

(b) a vertical agreement between grapes-for-raisins producers and SAD and its subsidiaries that constitutes a prohibited restrictive vertical practice in violation of Section 5;

(c) SAD abusing its dominant position in the market by exclusionary acts in violation of Section 8(d); and

(d) SAD abusing its dominant position in the market by denying the claimants access to an essential facility in violation of Section 8(b).

Furthermore, the claimants allege that the circumstances of this case necessitate interim relief and have accordingly made application under Section 59 of the Act. They have proposed remedies which, in their view, would, in the interim at least, grant relief from the alleged violations, pending an investigation by the Competition Commission and possible referral to the Competition Tribunal for adjudication.

2. INTERLOCUTORY FINDING

1. We find that there is sufficient evidence that the respondents are abusing their dominance by engaging in the exclusionary act of requiring or inducing a

supplier to not deal with a competitor, as contemplated in Section 8(d)(i), and that the requirements for granting interim relief specified in Section 59(1) have been met. We accordingly allow the application for interim relief and grant the order that appears at the end of this decision.

3. REASONING

3.1 Interim Relief

In terms of Section 44 of the Competition Act, the claimants have formally submitted their complaint to the Competition Commission. The Commission will, in the ordinary course of its duties, investigate the allegations and it may then elect to refer the matter to the Competition Tribunal for adjudication. However, in terms of Section 59 of the Act, the claimants have also made application to the Tribunal for interim relief. This is the application that the Tribunal is currently considering.

Section 59 provides that the Tribunal may make an interim order effective for a maximum initial period of six months. Section 59 further stipulates that the Tribunal may grant an order for interim relief if there is evidence that a prohibited practice has occurred; if it is established that interim relief is necessary to prevent serious, irreparable damage to the claimant or to prevent the purposes of the Act being frustrated; if the respondent have been given a reasonable opportunity to be heard; and if the balance of convenience favours the granting of the order.

Assuming that there is sufficient evidence of the existence of a prohibited practice (we consider this element separately below), the Tribunal is satisfied that:

- The order is reasonably necessary to prevent serious, irreparable damage: The first claimant contends that it will suffer serious, irreparable harm if an interim order is not granted because it has entered into forward contracts to deliver raisins to buyers in Europe, and has employed staff and commenced capital projects to enable it to fulfil its commitments in terms of these contacts. While the precise scale of the committed forward contracts entered into by the first claimant is disputed, there is no doubt that the first claimant has presented itself as an active participant in the raisin market and failure to give effect to this will considerably damage its reputation, and hence, future commercial prospects. The Tribunal is particularly concerned at the impact of the first claimant's failure to participate in this season on its reputation with the suppliers of grapes-for-raisins who are cognizant of this dispute and will view it as a trial of strength between the parties. Our view on the need for granting interim relief is strengthened by our assessment that harm of this nature is likely to result in business failure that cannot adequately be compensated by a later award for damages.
- The order is reasonably necessary to prevent the purposes of the Act being frustrated: In particular the Tribunal is concerned that the purpose outlined in

Section 2(e) (to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy) will be frustrated in the event that failure to grant interim relief prevents the first claimant from participating in this season or, worse, leads to the failure of the first claimant's business.

- The balance of convenience favours the granting of the order: There is every prospect that the first claimant may lose its business in consequence of the potential harm arising from a failure to grant interim relief. The respondents, on the other hand, may lose a relatively small part of their extremely large market share for one season only. Accordingly, the Tribunal is persuaded that the balance of convenience favours the granting of the order.

The Tribunal accordingly finds that, assuming that it is satisfied that there is evidence that a prohibited practice has occurred, it is justified in granting an interim order.

3.2 Standard of Proof

Before proceeding to evaluate the evidence and arguments before us, we briefly comment on the evidentiary burden imposed on the parties to a hearing in terms of Section 59.

The Act, in Section 59(1)(a), simply requires 'evidence' that a prohibited practice has occurred. In the parties' heads of argument, they proposed different interpretations of the standard of proof required in terms of Section 59(1)(a). The claimants proposed that the requirement in this section corresponds with the common law requirement that applies to an application for an interim interdict in the High Court, which is that the claimant's right must be "at lease prima facie established". In contrast, the respondents contended that Section 59(1) "could indicate final findings of and in (sic) concerning the occurrence of a prohibited practice". The respondents argued that the legislature would have used the words "… prima facie evidence …" if it had intended the common law standard to apply.

We asked the parties to address us on whether Section 68 of the Competition Act applies to the evidence required in terms of Section 59(1). Section 68 states that in any proceedings in terms of Chapters 3 and 6, of which Section 59 is a part, the standard of proof is on a balance of probabilities. Both the claimants and the respondents conceded that they had not taken Section 68 into consideration in preparing their arguments and that Section 68 indeed appeared to apply to Section 59(1). The claimants nevertheless submitted that, on the evidence given in this matter, they had shown the prohibited practices complained of on a balance of probabilities.

Since our examination of the evidence will show that this matter can be decided on the higher standard of proof of a balance of probabilities, it is unnecessary for us to make a finding as to whether this, or some lower standard such as *prima facie* proof, is the appropriate standard to apply to Section 59(1).

3.3 **Respondents' points in limine**

The respondents submitted a number of points in limine. Certain of these will be dealt with in the main body of the decision. However, two of these points will be examined here:

The respondents submit that the Act does not apply retrospectively to any agreement lawfully entered into prior to 30 November 1998 and, more particularly, that the Act does not apply to the memorandum and articles of association of the first respondent which were approved and registered by the registrar of companies on 29 July 1998.

We have considered this and conclude that the Act does not purport to have retrospective effect and that it only effects practices, including relevant agreements, insofar as they have effect or continue to have effect after the coming into effect of the Act. The practices complained of in this matter fall into this latter category and are, accordingly, four square within the jurisdiction of the Act.

The respondents also submitted that the provisions in Sections 4(1)(a), 5(1) and 8(d) of the Act which allegedly reverse the onus of proof are, given the provisions of Sections 61(1)(a) and (b) of the Act, inconsistent with the provisions of Section 35(3) of the Constitution.

The Tribunal has considered this and concludes that, as it is a creature of its statute and thus confined to adjudicate matters within the ambit of the statute, it is not the correct forum to examine this constitutional challenge.

3.4 The Relevant Market

The concept of a 'relevant market' is central to the enquiry into the alleged abuse of dominance in terms of Section 8. The relevant market is the narrowest market at a given level of the supply chain in which a hypothetical monopolist operating at that level could exert a significant degree of market power.

The parties are at odds as to the appropriate level of the supply chain in which the 'relevant market' is located in the present case. The claimants consider the appropriate market to be the raisin purchasing, processing, packaging, distribution and exporting market – the "raisin market". They argue that they have been excluded from the processing, packaging and distribution market by a number of horizontal and vertical agreements to which the respondents are party and by abusive conduct perpetrated by SAD as a dominant firm in this market.

The second claimant, Mr. JP Slabbber, a producer of grapes-for-raisins, alleges that he is prevented from competing as a supplier by vertical agreements between grapes-for-raisins producers and the respondents and by the horizontal agreements between grapes-for-raisins producers as manifest in the articles of association of the second respondent.

The claimants make much of the anti-competitive practices that are alleged to characterize the market for the purchase of grapes for further processing into raisins (i.e. the 'grapes-for-raisins' market). SAD and SAR are participants in this market. SAR alleges that it is prevented from competing effectively in this market by vertical agreements between grape-for-raisins producers (the farmers who produce the 'raw material input') and the respondents (who purchase, process and package this input), by (horizontal) agreements between grapes-for-raisins producers as manifest in the articles of association of the first respondent, and by abusive conduct by SAD, the dominant firm, resulting in SAR's effective exclusion from the market.

The respondents argue, in effect, that the relevant market, for purposes of considering dominance, is the world market in which raisins are sold to final consumers.

They obviously do not have a dominant position in the world market for raisins:

- The lion's share of South Africa's output of raisins is exported. South Africa's participation in the *international sales* market for raisins is overwhelmingly dominated by the SAD group, but it also is common cause that SAD's share of this market is relatively small.
- It appears that when the *international sales* market is segmented by quality, then SAD output occupies a larger share of the high quality segment. There is, however, no commonly accepted definition of quality (although there are acknowledged quality differentials in the final product), and, in any event, it is not contended that even at this level of market segmentation can SAD be said to occupy a dominant position in the *international sales* market for raisins.

The respondents do not dispute that they are dominant in the domestic market for raisins. However, they argue – although the suggestion has been denied by the claimants - that the first claimant does not intend to sell in the *domestic sales* market, having set its sights on the export market alone, and that their dominant position within the *domestic sales* market is accordingly not at issue in this case.

In considering the parties' submissions on which is the relevant market in the present case, it is helpful to view each level of the supply process as constituting a separate market, albeit that in this case these markets are vertically integrated. On this basis, a number of market levels can be identified: the market for grapes to be processed into raisins, or what we have called the 'grapes-for-raisins' market; the market for the packing of raisins for further distribution; the wholesale market for raisins; and the retail/distributor market for raisins. The last two markets can be further subdivided into their domestic and international components.

The abuse of dominance of which the claimants are complaining (i.e. the restrictive provisions in the first respondent's articles of association alleged to require or induce grapes-for-raisins producers not to deal with the first claimant) is clearly located in the first of these markets, namely the grapes-for-raisins market. While it is not disputed that the respondents are dominant in the market at each level down the supply chain, with the exception of the international market for the wholesale and retail sale of raisins, it is the respondents' alleged abusive conduct in the primary market in which grapes are purchased for processing into raisins that secures this dominance further down the supply chain. This primary market is thus the appropriate level in the supply chain for determining the relevant market in this case.

As to the scope of the relevant market, neither party has suggested the existence of imports as an alternate supply of grapes for processing into raisins. Accordingly, we must conclude that the scope of the relevant market is restricted to grapes-for-raisins produced in South Africa.

3.5 Background: From Dried Fruit Board and SAD Fruit Co-operative to SAD Holdings (Ltd)

The transition of the corporate structure in the relevant market conforms, in all its essential aspects, to the process briefly sketched in the introductory remarks. The salient facts are that the first respondent was originally established in 1908 and was converted into a co-operative in 1924. The Marketing Act of 1968 established a marketing scheme for dried fruit. In accordance with this scheme the Dried Fruit Board (DFB) was established to regulate the dried fruit market in South Africa. The DFB, in turn, established a single channel market for dried fruit with the first respondent – in its previous incarnation as the South African Dried Fruit Co-operative - as that channel. Accordingly, only the first respondent could market South African dried fruit, domestically and internationally. All raisin producers were compelled to be members of the first respondent and were obliged, on pain of legal sanction, to deliver their entire output to the first respondent.

With the repeal, in 1996, of the Marketing Act of 1968, state recognition of all single-marketing channels was formally withdrawn. Accordingly, in 1998, the first respondent converted itself into a company, and in terms of the scheme of arrangement governing this corporate transformation, the shares in the new company were allocated to the producers who had been members of the erstwhile co-operative. The scheme of arrangement also made provision for certain inter SAD group transactions, one of which resulted in the sale of the first respondent's vine fruit business to the second respondent, SAD Vine Products (Pty) Ltd.

The first claimant took steps to engage in the processing, packaging and distribution of raisins in 1997 and, to this end, had established a processing plant by about February 1998. The first claimant alleges that its efforts to engage in these activities are being thwarted by restrictive practices perpetrated by the respondents. These restrictive practices are, it is alleged, perpetrated in the grapes-for-raisins market and underpin dominance on the part of the respondent in the markets further downstream, namely the processing, packaging, and distribution markets.

3.6 Restrictive Practices

The claimants allege that Sections 4(1)(a), 4(1)(b)(i), 5(1), 8(b) and 8(d)(i) of the Competition Act, 1998, have been transgressed. We deal with these in reverse order.

Section 8(d)(i)

Section 8(d)(i) prohibits firms from requiring or inducing a supplier or customer to not deal with a competitor. The claimants' submit that certain provisions of the articles of association of the first respondent provide a mechanism by which it forcibly induces its shareholders not to deal with the first respondent. The provisions of the articles of association on which the claimants rely are Articles 6.1, 88.2, 88.3, 88.5 and 21.

Article 6.1 provides that only shareholders in the first respondent may deliver agricultural products to the SAD group, of which the second respondent is part. A person who is not a shareholder of the first respondent and who wishes to deliver products to the SAD group is compelled to purchase at least one share from another shareholder.

Article 88.2 provides that a producer who is a shareholder of the first respondent and who delivers agricultural products of a specific type to the SAD group is obliged to deliver all its agricultural products of that type to SAD, failing which certain penalties would apply at the discretion of the board of directors of the first respondent.

Article 88.3 gives the board of directors of the first respondent the authority to impose the fines referred to in Article 88.2 and provides that a shareholder who transgresses is also liable for any loss or damage that the first respondent may suffer as a result.

Article 88.5 provides that, if a shareholder does not comply with its obligations or undertakings towards the first respondent, all monies owing and due and payable in future to the SAD group by such shareholder will immediately become due and payable.

Article 21 gives the board of directors a discretion to refuse to allow the transfer of shares in the first respondent.

To succeed under Section 8(d)(i), the claimants must first establish -

(i) that the turnover and assets of the respondents exceed the thresholds determined in terms of Section 6; and
(ii) that the respondents are dominant in terms of Section 7.

The respondents did not challenge the claimants' contentions to establish the first of these prerequisites and we therefore accept it as admitted.

The second prerequisite, which relates to dominance, hinges on the definition of the relevant market. In our discussion of the relevant market above, we concluded that the relevant market for purposes of this inquiry is the primary market for the purchasing of grapes for processing into raisins. It is common cause that the respondents' have substantially more than 45% of the relevant market; the claimants put the respondents' market share at about 90%, and the respondents' have not disputed this. The respondents' are therefore deemed to be dominant in terms of Section 7(a).

We turn now to the merits of the claimants' allegations with regard to Section 8(d)(i).

The first question we must answer is whether the cited provisions of the first respondents' articles of association are exclusionary in that they require or induce grapes-for-raisins producers not to deal with the first claimant. While the wording of the provisions clearly seems to indicate this, the respondents deny that the provisions in first respondent's articles have the alleged effect. They argue that producers are not forced to become shareholders and that existing shareholders are free to 'resign as members' of the first respondent by selling their shares, upon which they would be free to deliver their grapes to whomever they pleased. As such, they argue, the producers are not 'required or induced' to not deal with the first claimant.

In reply, the claimants contend that the producers' freedom of choice as to which processor they deliver their grapes to, is spurious. They argue that SAD's dominant position, historically entrenched due to State regulation, as well as certain of its business practices, leave producers little real choice but to be shareholders of the first respondent and deliver their raisins to the second respondent. Firstly, the respondents' dominant position in the South African raisin market enables them to provide a blanket undertaking to producers to buy all their grapes-for-raisins, which their competitors and potential competitors are unable to do, at least initially. Secondly, the first respondent offers loans to its shareholders, which it can require them to repay immediately when they sell their shares.

In addition, Article 88.2 has the effect of obliging producers who wish to supply their grapes to any processor other than the second respondent to sell their shares in the first respondent before they may do so. This in itself is exclusionary in circumstances where the company applying the restriction is a dominant firm, as SAD is, since producers are not given the option to try an alternative processor by delivering part of their production to that processor; they are compelled to make a clean break and switch to the alternative untried processor in respect of their entire production. The exclusionary effect is compounded if Article 21 is also taken into consideration here. Producers who switch to an alternative processor run the risk, if Article 21 is applied, of not being able to readily switch back to the respondents should they later wish to do so.

Therefore, to facilitate competitive interaction in the grapes-for-raisins market, producers should be entitled to retain their shares in the first respondent should they wish to deliver some or all of their grapes to an alternative processor, and should not be precluded from offering their product to the second respondent if they do not hold shares in the first respondent. The roles of producer and shareholder in the first respondent ought thus to be divorced from one another. The respondents claim that such an arrangement would undermine the dividend and capital growth prospects of the SAD group, as fewer producers would supply to them resulting in their not being able to realise the scale economies they would otherwise be able to achieve. While there might very well be merit in this argument, it should be used as the basis for an appeal to shareholders to supply exclusively to the second respondent, and not as a justification for obliging shareholders to sell their shares if they wanted to supply to any other processor.

The cumulative effect of the respondents' practices of linking loans and shareholding to its exclusive-supply arrangements with producers, together with its blanket undertaking to buy all the product of individual producers, serves as a disincentive to producers to supply to any raisin processor other than the respondents and thus to exclude competitors from the market. Individually these practices are not objectionable in all circumstances, but they become a concern in circumstances, such as in the present case, where they are applied by a dominant firm to reinforce its dominance.

We are, therefore, persuaded by the claimants' argument that the real effect of articles 6.1, 88.2,88.3, 88.5 and 21 is to exclude or severely discourage producers from delivering to the first claimant.

In terms of Section 8(d)(i), this is sufficient to establish the prohibited exclusionary act unless the respondents can show technological, efficiency or other pro-competitive gains which outweigh the anti-competitive effect of the act.

Although the respondents assert efficiency gains in the form of economies of scale, they do not provide any evidence to support their assertion. In paragraph 5.2.2 of their answering affidavit, they merely state that large-scale production is of the utmost importance – indeed, a necessary condition - for enterprises that wish to compete internationally. In paragraph 35.5 they again make the mere assertion that the obligation on producers to supply to the respondents' processing facility simply makes economic sense because the greater the output of the facility, the lower the cost per kilogram of output produced. But nowhere do the respondents attempt to justify their assertions regarding scale efficiencies or cost savings, nor do they attempt to show that any such efficiencies outweigh the anti-competitive effects of their business practices.

In the context of a competition enquiry, the obligation to provide evidence in support of an argument based on scale economies is particularly strong. The argument could otherwise be, and often is, advanced as a catch-all defence of monopolisation. Scale is, to be sure, often a pertinent factor in generating economies. But it is clearly not the only factor. Nor is it always necessary or effective. There are numerous examples of successful small firms participating in international markets. Moreover, there are respectable arguments that focus on the efficiency-enhancing character of flexibility rather than scale. And there are many examples of large, dominant firms whose efficiency has been retarded by the absence of competition in their chosen realm. In order to trade off the efficiency gains, if any, of large scale with the efficiency losses consequent on a lack of competition, more than mere assertion is required.

In summary, the respondents have not provided convincing evidence of scale economies and, accordingly, have not discharged the onus provided for in Section 8(d)(i).

Section 8(b)

The claimants allege that the wooden crates used for the delivery of the farmers' output to the second respondent's processing plant is an essential facility as defined in Section 1 of the Act and that the respondents' refusal to allow farmer's to deliver their product to the first claimant in these crates violates Section 8(b).

As we are able to grant the relief that the claimants request in remedy of the alleged violation of Section 8(b) on the basis of the violation of Section 8(d)(i), it is unnecessary for us to make a ruling on whether the crates are indeed an essential facility and whether Section 8(b) has been transgressed.

The relief that we grant in this matter based on our findings in respect of Section 8(d)(i) includes the right for the farmers to deliver product to the claimant in the respondents' wooden crates for the period of the interim order. This does not imply that we have made a finding on the essential facility claim. Rather this ruling recognises that, in the interim, and given established practices in the industry, the relief granted would not be effective if the farmers would not be permitted to deliver their products to the claimant in the respondents' crates. By the same token the farmers are, in the interim, entitled to deliver their product to the respondent in those wooden crates belonging to the claimant. However, neither the respondent nor the claimant are entitled to rely on this ruling to use the crates of their competitor to store product on their premises. In summary, this aspect of the relief granted flows from the transgression of Section 8(d)(i) and does not imply or constitute a ruling on the claim under Section 8(b).

Sections 4 and 5

As we are able to make a ruling in favour of the claimants and award the relief they request on the basis of Section 8(d)(i), it is unnecessary for us to consider the alternative grounds for their application based on Sections 4(1)(a), 4(1)(b)(i) and 5(1).

3.7 ORDER

The claimants' application for interim relief in terms of Section 59 of the Competition Act 89 of 1998 is granted in respect of the respondents' alleged contravention of Section 8(d)(i) of the said Act.

The Competition Tribunal orders that –

1 the first respondent is interdicted and restrained from requiring any of its shareholders to abide by Articles 6.1, 88.2, 88.3 and 88.5 of its articles of association;

2. the respondents are interdicted and restrained from requiring or inducing producers of grapes-for-raisins not to deal with the first claimant -

   (a) by taking action against or in any way penalising producers of grapes-for-raisins who deliver raisins to the first claimant;
   (b) by taking action against or in any way penalising producers of grapes-for-raisins for using the respondents' containers for the purposes of delivering grapes-for-raisins to the first claimant; or
   (c) in any other way;

3. this order comes into effect on 24 November 1999 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 respondents; or
   (b) the date that is six months after the date of the issue of this order;

4. the costs of the application are reserved for determination by the Competition Tribunal at a hearing pursuant to a referral in terms of Section 51 of the Act or, in the event of no such referral being made, the parties shall bear their own costs in the application.

5. the first respondent communicate this order to its shareholders before 6 December 1999, by post or any other means of communication acceptable to the Competition Tribunal.

(Signed) 24 November 1999

D. H. Lewis **Date**
Presiding Member

Concurring: C. Qunta and F.C.v N. Fourie