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EVALUATION OF COMPETITION CONCERNS REGARDING FRANCHISE AGREEMENTS WHERE FRANCHISORS DETERMINE PRICES FOR FRANCHISEES

by

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UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG | WITS SCHOOL OF LAW

DECLARATION

I, ___1415414_____(Student number, declare that this Research Report is my own unaided work. It is submitted in partial fulfillment of the requirements for the degree of Master of Laws (by Coursework and Research Report) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

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ABSTRACT

The franchise agreement refers to an agreement between a franchisee and franchisor, where franchisee establishes outlets that operates under the franchisor's successful name and trademark, for a fee paid to the franchisor. This places the franchisor and franchisee in a vertical relationship. The franchisor exercises a degree of control over the franchisee's business, which may cause competition concerns, particularly if regard is had to section 5 of the Competition Act 89 of 1998 (hereafter 'Competition Act'). Section 5 prohibits certain vertical practices, which limit or prevent competition between firms. This research report discusses the prohibited vertical practice of resale price maintenance in the franchise context, which occurs if a franchisor imposes prescribed prices or limits discounts to which franchisees must adhere. There are several reasons why franchisors would want to engage in such conduct. However, the practice is often anti-competitive as it bars franchisees from competing with each other in terms of price. Franchisors may, however, recommend prices to their franchisees, in line with section 5(3) of the Competition Act, and many franchisees may choose to comply with these recommendations. Monitoring franchisors for engaging in resale price maintenance can be difficult, owing to significant pressure faced by many franchisees to comply with recommended prices, resulting in much of the same price throughout a franchise network. If, after investigation, the Competition Commission is of the view that a franchisor has breached section 5 of the Competition Act, it may refer the matter to the Competition Tribunal. Among others, this report demonstrates that many resale price maintenance cases within the franchise context have resulted in settlements, rather than proceeding to a hearing before the Tribunal. This often results in the franchisor paying a reduced administrative penalty, leading to dearth of legal precedent.

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I INTRODUCTION

This research report discusses selected competition concerns that may arise from franchise arrangements. A franchise agreement is an agreement between franchisor and franchisee, where the franchisor provides the franchisee the right to use its already established, successful business model and trademark[1] in exchange for fees paid to the franchisor.[2] The franchisor often provides the franchisee with a business plan to ensure the positive image of the franchise is maintained.[3]

The franchise system offers many benefits including job creation and the introduction of new stores into the economy, which benefits consumers.[4] Franchising facilitates a greater availability of products that can be widely distributed, allowing consumers to choose between competing products in specific markets and areas.[5] The franchise system also has certain disadvantages such as limiting competition where franchise agreements specifically determine pricing and product ranges. This research report reflects on the behaviour of some franchisors regarding franchise agreements that can potentially limit competition in various industries. It examines the relationship between franchisors as upstream suppliers and franchisees as downstream distributors. It further discusses the impact on competition when franchisors set prices for franchisees, aimed at evaluating whether the provisions of the Competition Act 89 of 1998 ('the Competition Act') adequately prevents the practice of minimum resale prices within franchise arrangements. The role and effectiveness of the Competition Commission ('the Commission') in combating anticompetitive behaviour in the context of franchise agreements is also evaluated.[6]

This report examines various forms of franchising, the commercial objectives thereof, review the advantages they bring to consumers and contrast that with the objectives of the Competition Act. It also proposes how these issues can be better harmonised.

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[1] Tanya Woker 'Establishing when a franchise is actually a franchise – "If it looks like a duck, smells like an duck and quacks like a duck, it is usually a duck'" (2010) 22(1) *SA Merc LJ* 12 at 13 and Evert van Eeden & Jacolien Barnard *Consumer Protection Law in South Africa* 2 ed (2017) 205.
[2] E van Eeden & J Barnard ibid.
[3] Ibid.
[4] Ibid at 208.
[5] Tanya Woker 'Franchising – the need for legislation' (2005) 17(1) *SA Merc LJ* 49.
[6] In *Competition Commission of South Africa v Standard Bank of South Africa Limited; Competition Commission of South Africa v Standard Bank of South Africa Limited; Competition Commission of South Africa v Waco Africa (Pty) Limited* 2020 (4) BCLR 429 (CC), the Tribunal noted that the role of the Commission includes investigating prohibited forms of anti-competitive conduct (para 5).

This introduction is followed by Part II, which contextualises the relationship between franchisors and franchisees in South Africa. Part III discusses the prohibited vertical practices in terms of section 5 of the Competition Act, specifically focusing on minimum resale price maintenance ('RPM'). Some forms of potentially anti-competitive conduct are highlighted therein and the use of RPM within the franchise industry is discussed. Part IV examines the efficiency of the Commission in investigation and prosecution of franchisors who engage in anti-competitive arrangements relating to price setting. Part V concludes the discussion with recommendations for law reform.

II THE FRANCHISOR-FRANCHISEE RELATIONSHIP

(a) What is a franchise?

A franchise is a business model in which one party, the franchisor, allows the other party, the franchisee, the right to establish an outlet that will trade under the franchisor's name, trademark and business plan[7] in exchange for initial and ongoing fees.[8] Both parties contribute significantly to the distribution of the franchisor's products/services.[9]

The franchisor and franchisee are unrelated parties. A franchise agreement cannot be established between a holding company and its subsidiaries,[10] because a holding company controls the subsidiary.[11] Therefore, the subsidiary cannot be regarded as independent from the holding company. For an undertaking to be classified as a franchise, the franchisee's business must be associated with the franchisor's name and trademark and the franchisee must pay the franchisor for the exploitation of this right.[12]

Franchising provides benefits to franchisors and franchisees. A franchisor can expand its business without having to invest large capital amounts to open new outlets.[13] Franchising is therefore an economically feasible option for expansion by the franchisor. A franchisee buys into

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[7] van Eeden & Barnard op cit note 1 at 205 and E van Eerden 'Franchising' in W A Joubert (founding ed) *The Law of South Africa* vol 9 (3ed) (2014) para 218.
[8] Woker op cit note 1 at 17.
[9] *Cancun Trading NO 24 CC & Others v Seven Eleven Corp SA (Pty) Ltd* (18/IR/Dec99) [2000] ZACT 10 (7 April 2000) para 2.
[10] H Melamdowitz 'Franchising' in *Forms and Precedents Intellectual Property* vol 2 Preliminary note § 1.
[11] Dennis Davis (ed) & Walter Geach (ed) *et al Companies and Other Business Structures* 4 ed (2019) 73.
[12] Woker op cit note 1 at 17.
[13] Tanya Woker 'Understanding the relationship between franchising and the law of competition' (2006) 18(2) *SA Merc LJ* 107 at 108.

an already well-established business model rather than having to develop its own business model.[14] This affords the franchisee an advantage over those starting new businesses in the same market. The franchisor provides support and assistance to the franchisee throughout the duration of their agreement.[15] The franchisee is not faced with many of the hardships that other entrepreneurs face when starting their businesses such as marketing and earning consumer confidence, which demonstrates its economic advantages.[16]

(b) Types Franchise Agreements

There are two categories of franchise arrangements — business format franchising and trade name franchising.[17] In business format franchising, a franchisee sells the franchisor's products/services under the franchisor's trademark.[18] There is generally a strong relationship between the parties.[19] Here, franchisors usually ensure uniformity amongst all their franchisees[20] by exercising a fair degree of control over the franchisee's businesses.[21]

By contrast, trade name franchising refers to a situation where the franchisee uses the franchisor's trademark and operates as a licensed dealer under the franchisor's name.[22] The relationship between the parties is more limited compared to business format franchises, and franchisees have more autonomy in their business practices.[23]

Business format franchising can be particularly beneficial to inexperienced franchisees since they receive training, direction and assistance from the franchisor.[24] The franchisor can also exercise more control over the franchisee when using business format franchising,[25] providing the franchisor with more control over its brand generally. However, this can be resource intensive.[26] It may therefore suit the franchisor to relinquish some control and opt for trade name franchising, particularly if the franchisee already has some business know-how. Trade name franchising also

[14] Woker op cit note 5 at 50.
[15] van Eeden & Barnard op cit note 1 at 205.
[16] Woker op cit note 1 at 17.
[17] Ibid at 13.
[18] Ibid.
[19] Ibid.
[20] Ibid at 14.
[21] Ibid at 13.
[22] Ibid.
[23] Ibid.
[24] Ibid at 13 & 18.
[25] Ibid at 13.
[26] Ibid.

allows the franchisee more independence over its business, which may be appealing to some franchisees.[27] Upon concluding either type of franchise agreement, the franchisee operates and manages the franchise itself.[28]

It is also worth noting that franchises can be categorised into four additional sub-categories, depending on how many franchised units the franchisee owns. A single unit franchise refers to a franchisee owning one franchised outlet.[29] Multi-unit franchising refers to a single franchisee owning numerous franchised stores,[30] where the number of the franchisee's outlets increases over time.[31] A franchisee can also own numerous outlets under a master franchising agreement, where several outlets are taken from the start.[32] Finally, in area unit franchising, the franchisee develops as many franchised units as it wishes within a specified region.[33]

(c) Defining the legal relationship between the franchisor and franchisee

(i) Franchisor-franchisee relationship

The franchisor-franchisee relationship is unique and complicated. In *Cancun Trading NO 24 CC & Others v Seven Eleven Corp SA (Pty) Ltd*,[34] the Competition Tribunal ('the Tribunal') described this relationship as:

> 'neither an employment relationship nor an independent contracting relationship. It rather combines elements of integration and delegation, control and independence and it is this multifaceted vertical structure...'[35]

[27] John Velentzas & Georgia Broni 'The business franchise contract as a distribution marketing system: Free competition and consumer protection' (2013) 5 *Procedia Economics and Finance* 763 at 766 and Woker op cit note 1 at 13.
[28] van Eeden & Barnard op cit note 1 at 205,
[29] Reoero Sanchez Gomez, Isabel Suarez Gonzalez & Luis Vazquez 'Multi-unit versus single unit franchising: assessing why franchisors use different ownership strategies' (2010) 30(3) *The Service Industries Journal* 464
[30] Ibid at 465.
[31] Patrick J Kaufmann & Rajiv P Dant 'Multi-unit franchising: Growth and management issues' (1996) 11(5) *Journal of Business Venturing* 343 at 346.
[32] Ibid.
[33] Gomez *et al* op cit note 29 at 464.
[34] *Cancun* supra note 9 para 2.
[35] Ibid para 3.

The Tribunal reasoned that a franchisee runs and operates its own business, which is separate from that of the franchisor.[36] The franchisee operates its business for its own benefit, rather than the franchisor's benefit,[37] although there is a level of integration between the parties.

In *Cancun*, the respondent convincingly argued that a franchise relationship should be viewed as a single business relationship and not as a relationship between parties at different levels of a vertical supply chain because of the uniformity that exists between different franchisees of the same brand.[38] This argument was based on the view that a franchise arrangement constitutes a single business entity[39] where each separate outlet is regarded as a different branch that belongs to the same entity.[40] Uniformity is an important aspect of franchising because ultimately, the success of the business model depends on all franchisees behaving similarly to ensure that the franchisor's reputation is maintained in the consumers' eyes. If there are significant differences between different franchisees, consumers will not view franchisees as part of the same brand, negating the main idea of the business model.

The Tribunal unfortunately rejected this argument and stated that the franchise relationship reflects a vertical relationship.[41] Although there is an element of a supplier-distributor relationship in the context of franchising, it is submitted that the unique model of the system and the fact that there are those who view a franchised network as a single entity gives rise to the notion that the franchisor-franchisee relationship should be treated as a *sui generis* relationship which is not bound by the precepts of the regular supplier-distributor relationship.

The Tribunal in *Cancun* made it clear that although franchisees and franchisors work together in distributing the franchisor's products, they are ultimately independent parties. Franchisees are in business for themselves and not for the franchisors.[42] This relationship attracts the application of various pieces of legislation which play a fundamental role in ensuring that the franchise industry is not only adequately regulated but there is also a legislative framework to address competition related concerns in this industry. The Tribunal's reasoning in this regard

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[36] Ibid para 37.
[37] Ibid.
[38] Ibid para 36.
[39] Michael Martinek 'Duration and reproduction of distribution contracts in the focus of antitrust law: Observations of and annotations to the relationship between contract law and competition law' (2017) 2017(3) *TSAR* 511 at 514-5.
[40] Ibid.
[41] *Cancun* supra note 9 para 2.
[42] Woker op cit note 1 at 20.

appears sound. It is therefore necessary to examine relevant legislation to determine whether there is adequate regulative framework relating to franchise agreement in South Africa.

(i) Consumer Protection Act 68 of 2008

The Consumer Protection Act 68 of 2008 ('the CPA') which contains several provisions that address franchising arrangements.[43] Section 5(6), 7 and 13(2) of the CPA specifically refer to franchising agreements. Section 5(6) states *inter alia* that a franchise agreement and any supplementary agreement to a franchise agreement as well as the supply of goods/services in terms of a franchise agreement are regarded as transactions between a supplier and distributor, to which the CPA applies.[44]

The CPA defines franchisors as suppliers and franchisees as customers.[45] This legislation offers some protection to franchisees from exploitation and abuse by franchisors, as suppliers, by providing the same protection to franchisees as to regular consumers.[46] In terms of the CPA, franchisees can seek protection of several rights that they might not otherwise do under a regular commercial relationship.[47] These rights include, amongst others, the right to select a supplier,[48] to choose and examine goods,[49] to fair and honest dealing,[50] as well as disclosure of certain information.[51] The CPA seeks to limit the powers of franchisors because franchisors often have greater market power than franchisees and may use this power to prejudice franchisees.[52] The CPA requires that certain minimum requirements be applied to franchise agreements and that certain elements be included in franchise agreements dealing with the conduct of the parties and also ensures there are no unreasonable fees placed on franchisees.[53]

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[43] Michael Martinek 'The franchise agreement under South African law' (2013) 2013(2) *TSAR* 390.
[44] Consumer Protection Act 68 of 2008, s 5(6)(*d*)-(*e*).
[45] Ibid, ss 1 & 5(6).
[46] There are also several provisions that specifically exclude franchisees from the protection offered by the CPA.
[47] Martinek op cit note 44 at 390.
[48] Supra note 45, s 13.
[49] Ibid, s 18.
[50] Ibid, ss 40-47.
[51] Ibid, ss 22-28.
[52] Martinek op cit note 44 at 391. This greater market power could be the result of the franchisor being an already large, established and successful company, while the franchisee most likely does not these resources. The franchisee is also reliant on the franchisor for success, however, the franchisor does not need to rely on any single franchisee for success.
[53] Lynn Biggs 'The franchise agreement as the cause of tensions between the franchisor and franchisee: Has the Consumer Protection Act resolved the tensions?' (2019) 31(2) *SA Merc LJ* 163 at 169.

The CPA generally excludes juristic persons with a pre-determined minimum asset value from the definition of a consumer. But this exclusion does not apply to franchisees who are considered to be consumers in terms of the CPA,[54] unless a specific provision excludes franchising from their ambit.[55] Martinek notes that this exclusion illustrates that franchise agreements are different to other types of commercial and distribution agreements.[56]

Generally, suppliers may not require their distributors to purchase additional goods or enter into further agreements as supply conditions.[57] However, this practice, known as tying,[58] may be permitted in franchises. Section 13(2) of the CPA provides that a franchisor may engage in tying if the goods/services that the franchisee must buy are reasonably related to the franchise agreement. Interestingly, this provision was included in the CPA since the Competition Act prohibits a dominant firm from engaging in tying.[59] The position of the dominant firm can be said to be analogous to the position of the franchisor as both wield significant market power over the other party.[60]

Further, the CPA includes provisions that may be contrary to the philosophy of franchising, which requires uniformity between all franchisees.[61] This could be exercised through a clause ensuring that all franchisees obtain their franchise products from a certain supplier. However, by attempting to protect the franchisee from abuse by the franchisor, the legislature has provided consumers, including franchisees, the right to choose their own suppliers.[62] This is also in line with the competition law principle, which prohibits a supplier from forcing its distributors to obtain goods from a specified party.[63] Rather, the distributor should be allowed the freedom to decide where it intends to obtain its products.

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[54] Supra note 45, s 5(2)(*b*).
[55] Ibid, ss 17(1), 19(1)(*a*), s3(1)(*a*), 34(1)(*a*), 38(3) & 47(1)(*a*).
[56] Martinek op cit note 43 at 390.
[57] Supra note 44, s 13(1).
[58] Ibid, s 13(2); Morne Gouws 'The injunction against vertical restraints in franchise agreements under the consumer protection Act' (2020) Dec *De Rebus* 30 at 31-2.
[59] Competition Act 89 of 1998, s8(1)(*d*)(iii).
[60] Section 7 of the Competition Act provides that a firm with a market share of 45 per cent or more is always regarded as dominant; a firm with a market share of 35- 45 per cent is presumed to be dominant and a firm with a market share of less than 35 per cent but that has market power is presumed to be dominant.
[61] Lynn Biggs 'Franchise disclosure documents through the lens of the CPA and the regulations' (2017) 29(2) *SA Merc LJ* 219 at 232.
[62] Supra note 44, s 13(1).
[63] Supra note 60, s 8(1)(*d*)(iii).

While the CPA specifically considers two forms of prohibited vertical conduct within the context of franchising, the position regarding other forms of conduct, such as RPM, has been left open.[64] When a franchise engages in one of these other forms of conduct, the Competition Act applies.[65]

(iii) The Competition Act 89 of 1998

The Constitutional Court, in *Competition Commission of South Africa v Media 24 (Pty) Limited*[66] stated that the Competition Act aims to promote consumer welfare, by establishing a market that 'generally encourages efficiency, innovation and the charging of lower prices by firms'. It also aims to address some of the negative economic consequences of Apartheid and redistribute wealth away from firms with large market shares.[67] The Competition Act endeavors to balance these two objectives by establishing a market where there is consumer choice, while promoting the economic interests of small and medium sized businesses.[68]

The Competition Act plays a fundamental role in regulating franchise agreements because of the potential competition issues that may arise in these contracts.[69] Franchise agreements may include several clauses that may be anti-competitive.[70] The Competition Act therefore attempts to bar franchisors from including these problematic clauses in franchise agreements.[71] This is achieved through section 5, which prohibits vertical conduct that limits or reduces competition. Section 8, which deals with abuse of dominance, is also relevant in this context as many of the practices mentioned in that section could also be considered to be prohibited vertical practices. A more in depth analysis of these concerns appears below.

III PROHIBITED VERTICAL PRACTICES

Having regard to the abovementioned legislation, it is necessary to consider the core anti-competitive restrictions in the context of franchising. Prohibited vertical agreements fall into one

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[64] Gouws op cit note 58 at 33.
[65] Ibid.
[66] *Competition Commission of South Africa v Media 24 (Pty) Limited* 2019 (5) SA 598 (CC) para 58.
[67] Ibid para 59.
[68] Ibid para 62.
[69] Tanya Woker 'The franchise relationship and the problem of encroachment: *Silent Ponds Investments CC v Woolworths (Pty) Ltd*' (2008) 20(3) *SA Merc LJ* 402 at 412.
[70] Bruce Lister 'The Competition Act and franchising' (2002) 10(1) *JBL* 32.
[71] Ibid at 32 & 34.

of the two categories, namely those that inhibit inter-brand competition and those that inhibit intra-brand competition.[72] Inter-brand competition refers to competition between firms, usually suppliers that sell similar substitutable products under different brands.[73] Intra-brand competition refers to competition between firms that sell the same brand of products.[74] Competition between franchisees of the same brand is classified as intra-brand competition. Such agreements may lead to a reduction of consumer choice and increased prices.[75] The ability of franchisees to compete on pricing, as a vital element of competition, would be reduced or possibly even be extinguished, when intra-brand competition is diminished.[76]

The Commission has noted several forms of vertically prohibited anti-competitive conducts that may occur in franchise arrangements, such as minimum RPM, tying, dictating specific territories where the franchisee must operate and specifying the supplier from which the franchisee must obtain its products, which may include the franchisor itself.[77] These may result in collusion, lead to higher prices to the detriment of consumers and reduce incentives to innovate.[78] For the purposes of this report, the focus will be on a problematic clause of RPM.

Section 5 of the Competition Act plays a fundamental role in the identification and prohibition of restrictive vertical practices in South Africa. Section 5(1) articulates that a vertical agreement is prohibited if it has the effect of substantially reducing or thwarting competition between firms, unless the parties can show that the positive outcomes of the conduct outweigh its anti-competitive effects.[79] Section 5(1) allows a respondent to rebut the allegations of anti-competitive effects of the conduct, by showing its pro-competitive effects.[80] Such conduct is said to be judged in terms of a rule of reason which involves 'a careful balancing test' of the pro-competitive and anti-competitive outcomes of the conduct. This determination can be quite

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[72] Minette Neuhoff (ed), Marylla Govender & Martin Versfelt *et al A Practical Guide to the South African Competition Act* 2 ed (2017) 113.
[73] Ibid.
[74] Ibid.
[75] Ibid.
[76] Martinek op cit note 39 at 517.
[77] Competition Commission 'Franchising notice' available at *http://www.compcom.co.za/wp-content/uploads/2017/11/layout.pdf,* para 2.4 & 4 accessed on 26 May 2022.
[78] Luke Kelly, David Unterhalter & Isabel Goodman *et al Principles of Competition Law in South Africa* (2021) 108-9.
[79] Supra note 59, s 5(1).
[80] Yasmin Carrim (ed) Karissa Moothoo-Padayachie & Camilla Mathonsi 'Handbook of case law: The Competition Tribunal's guide to select cases decided from 1999 to 2021' Version 2: 2020/2021 available at *https://www.comptrib.co.za/Content/Documents/Info%20Library/Tribunal%20Case%20Law/Tribunal%20Case%20Law%20Handbook%202021.pdf*, accessed on 3 March 2022 at 260; Kelly et op cit note 79 at 112.

difficult,[81] particularly in the context of franchise arrangements where the competing considerations outlined above are at play.

In determining whether such a vertical agreement is indeed anti-competitive, the Tribunal examines a counterfactual scenario, considering what the competitive landscape would look like if this conduct did not exist.[82] If consumers are harmed by this agreement, section 5(1) is breached. If, however, consumers are better off because of the agreement, the conduct does not contravene this provision. For example, an agreement between a franchisor and its franchisees allowing franchisees to apply certain discounts to their products cannot be said to be harmful to consumers and would not be prohibited.[83]

Examples of conduct that fall under section 5(1) which could be relevant in the franchising context include a supplier restricting the geographic region in which a distributor may operate; setting maximum resale prices and limiting the amount or type of stock that the franchisee may hold are all forms of.[84]

Section 5(2) prohibits minimum RPM where an upstream supplier sets minimum prices at which the downstream supplier must sell the goods/services,[85] and provides that one cannot raise an efficiency defence to justify such behaviour. Within the franchising context, this could occur where a franchisor dictates maximum discounts that its franchisees may provide to final consumers[86] or a franchisor refusing to allow its franchisees to depart from predetermined prices.[87] Minimum RPM is completely prohibited and no defence can be offered for it.[88] Section 5(2) identifies minimum RPM as the only vertical agreement that is *per se* prohibited by this Act.[89]

III RESALE PRICE MAINTENANCE

(a) Overview

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[81] Paul Coetser 'Competition Law Primer: Prohibition of 'vertical' anti-competitive competitive practices' (2006) May *De Rebus* 50.
[82] Kelly *et al* op cit note 78 at 113 and *Competition Commission v South African Breweries Ltd* 2015 (3) SA 329 (CAC) para 62-3.
[83] Kelly *et al* ibid at 105.
[84] Melamdowitz op cit note 10 Preliminary note § 2.8.
[85] Kelly *et al* op cit note 78 at 103 and *South African Breweries* supra note 82 para 100.
[86] Such behaviour was seen in *Competition Commission v Toyota South Africa (Pty) Ltd* infra note 120 and in the numerous other investigations by the Commission into the car dealership industry that followed.
[87] Such behaviour was seen in *Competition Commission v Italtile Franchising* infra note 120.
[88] *Cancun* supra note 9 para 43, Neuhoff *et al* op cit note 72 at 113 and Carrim *et al* op cit note 80 at 112.
[89] Neuhoff *et al* ibid at 113.

As previously noted, a notable feature of the franchise system includes uniformity within the brand.[90] To achieve the much sought uniformity, the franchisor may wish to dictate products the franchisee ought to buy, the supplier to be used and prices that the franchisees ought to charge.[91] This allows the franchisor to create an image of a single brand, rather than a view that its franchisees are competitors of one another.

Various prohibited practices, such as RPM, may be relevant in the franchise context.[92] The franchise system, itself, is not necessarily anti-competitive,[93] yet franchise agreements may contain anti-competitive clauses,[94] if they prevent or lessen competition between franchisees.[95] Many franchise agreements contain clauses that constitute restrictive vertical practices, but there are often justifiable reasons for such practices.[96] The mere fact that such a clause exists within a franchise agreement does not automatically mean that the agreement is anti-competitive and unlawful.[97] The lawfulness of clauses that fall within the ambit of section 5(1) are determined on a case-by-case basis[98] and may or may not be problematic. However, clauses that provide for minimum RPM and price fixing, cannot be justified under any circumstances, and are never allowed.[99]

Despite their potential unlawfulness, franchisors have several reasons for wanting to control the franchisees' pricing systems, some of which may also benefit consumers in the broader sense. Such benefits are considered below.

(b) Reasons why franchisors wish to engage in price control

(i) Uniformity

[90] Woker op cit note 1 at 14.
[91] 'Competition Commission news' October 2004 available at *https://www.compcom.co.za/wp-content/uploads/2014/09/Oct-04-Newsletter.pdf*, accessed 30 August 2022.
[92] *Cancun* supra note 9 para 5.
[93]Paul C Ridgeway 'Franchising in the common market: A survey of the Application of Competition Law of the Europeans Community to Retail Franchising' (1998) 13 *North Carolina Journal of Inte4rnational Law* 72 at 78 and Lister op cit note 70 at 36.
[94] Ridgeway ibid at 75.
[95] van Eeden & Barnard op cit note 1 at 205.
[96] Lister op cit note 70 at 36.
[97] Ibid.
[98] Ibid.
[99] Ibid.

Due to the importance of uniformity within the franchise and the fact that many people view different franchised outlets as parts of a single entity,[100] a franchisor may choose to include clauses in the franchise agreement that ensure that the franchisees comply with the franchisor's standards.[101] This allows consumers to have comfort that they will receive the same quality irrespective of which franchised outlet they visit.[102] One such clause that franchisors may wish to include could require price uniformity between its franchisees. This would result in greater consistency throughout the franchise network and creates a sense of regularity within the brand.[103]

Competition law principles recognise the importance of this uniformity and allow franchisors to exercise a certain level of control over their franchisees' businesses.[104] However, this accommodation does not extend to minimum RPM,[105] even though it is an element of this desired uniformity because minimum RPM is never allowed.[106] A franchisor may however, be able to set maximum resale prices. The commercial need for some uniformity is acknowledged in section 5(3) of the Competition Act which permits recommended pricing structures.

(ii) Protection of the brand's reputation

Franchisors may insist on certain practices and standards amongst franchisees to protect their brand name and ensure that no franchisee acts in a manner that will tarnish the brand's reputation.[107] A franchisor may want to impose certain conditions, such as price controls on franchisees to prevent a single franchisee from causing harm to the brand and the franchise network,[108] by charging prices that may harm the brand's reputation. A franchisor may wish to represent its brand as falling within

[100] Martinek op cit note 39 at 514-5. This point was also argued by Seven-Eleven in *Cancun*. Even though the Tribunal did not accept this viewpoint as affecting the legal position of franchises, it is nevertheless a significant factor worth considering.
[101] Roger D Blair & Amanda K Esquibel 'Maximum price restraints in franchising' (1996) 65 *Antitrust LJ* 157.
[102] Ibid.
[103] Rozenn Perrigot and Guy Basset 'Resale pricing in franchised stores: A franchisor's perspective' (2018) 43 *Journal of Retailing and Consumer Services* 209 at 210 & 214.
[104] Blair & Esquibel op cit note 101 at 157.
[105] Ibid.
[106] Ibid at 157-8.
[107] See T Naudé 'The impact of the CPA on franchising' in Naudé & Eiselen (eds) *Commentary on the Consumer Protection Act* (Original Service 2014) para 3; Woker op cit note 68 at 404; van Eeden & Barnard op cit note 1 at 207 and Lister op cit note 70 at 32.
[108] Woker op cit note 13 at 113.

a particular price bracket as part of a broader pricing strategy, [109] by engaging in price controls.[110] However, the Tribunal has held that protection of brand image is an insufficient justification for such conduct,[111] having regard to the grave harm brought about by the conduct.[112] It was also determined that firms cannot attempt to establish their reputations 'through a system of artificial price', because this is inimical to the objectives aimed at encouraging true competitive advantage.[113]

(iii) Franchisor profitability

Franchisees' resale prices affect the franchisor's profits.[114] A franchisor may therefore attempt to manipulate the competitive price that its franchisees charge so the franchisor can be as profitable as possible.[115] Such behaviour may cause harm to the franchisees and ultimately harm consumers due to higher prices and reduction of choice.[116]

(c) Minimum resale price maintenance in franchises

Franchisors may seek to engage in minimum RPM, which refers to a situation where an upstream supplier sets minimum prices at which a downstream distributor must sell the supplier's products. The upstream supplier forces the downstream distributor to resell the supplier's products above a certain price.[117] Minimum RPM can also take the form of price fixing where the upstream supplier sets the exact price at which downstream distributors should sell the product.[118] Alternatively, it can take the form of dictating discounts[119] or barring a downstream distributor from providing discounts.[120] Such conduct is *per se* prohibited and is not allowed under any circumstances.

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[109] *The Competition Commission of South Africa and Federal Mogul Aftermarket Southern Africa (Pty) Ltd Federal Mogul Friction Products (Pty) Ltd T & N Holdings Ltd T & N Friction products (Pty) Ltd* [2003] ZACT 43 (CT) para 175-8 and Kelly *et al* op cit note 78 at 107.
[110] van Eeden & Barnard op cit note 1 at 205.
[111] *Federal Mogul* supra note 109 para 175-7.
[112] Ibid para 173.
[113] Ibid para 178.
[114] Blair & Esquibel op cit note 101 at 158.
[115] Woker op cit note 69 at 412.
[116] Ibid.
[117] Neuhoff *et al* op cit note 72 at 114 and Kelly *et al* op cit note 78 at 107.
[118] *Cancun* supra note 9 para 43 and Phillip Sutherland & Kathrine Kemp 'Restrictive vertical practices' in Phillip Sutherland and Kathrine Kemp *Competition Law of South Africa* (2021) 6-7.
[119] Neuhoff *et al* op cit note 72 at 114. See also *The Competition Commission v Toyota South Africa (Pty) Ltd* [2006] JOL 17301 (CT) para 3.2, 3.4.1 & 5.2-5.3.
[120] *Competition Commission v Italitile Franchising* [2006] JOL 17311 (CT) para 2.4.

Nonetheless, this has not prevented franchisors from attempting this conduct, as was the case in *Cancun*, where the complainant argued that the clause in the franchise agreement that stated that the franchisees could only resell products at prices approved by the franchisor amounted to conduct prohibited by section 5(2).[121] The Tribunal found in favour of the complainant and held that the franchisor had fixed prices for franchisees, contravening section 5(2) of the Competition Act,[122] and interdicted the behaviour.[123]

It is noteworthy that the Competition Act uses the term 'practice' rather than agreement in relation to minimum RPM.[124] By using this term, this Act denotes that there is no need for the supplier and distributor to conclude an agreement for section 5(2) of the Competition Act to be contravened.[125] A supplier's unilateral decision to dictate minimum prices for its products that is binding on its distributors contravenes this provision.[126] In the franchise context, the franchise agreement itself may provide for RPM. Moreover, the term practice connotes that the setting of minimum prices must be a continuous form of conduct,[127] rather than a once off act.

Nevertheless, all that needs to be established for a firm to be found to have engaged in minimum RPM is a general understanding within the relevant industry regarding prices at which the products in question are sold,[128] that the supplier expects the supplier to sell its products at that price,[129] and the supplier employs measures to ensure that distributors comply.[130] These measures can include sanctions or threats of sanctions,[131] such as cancelling or threatening to cancel the franchise agreement upon which the franchisee relies for its business success. Evidence of such sanctions or threats of such sanctions may be *prima facie* evidence of a supplier engaging in minimum RPM.[132] The complainant does not need to show that the practice results in anti-competitive outcomes.[133]

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[121] *Cancun* supra note 9 para 24-5
[122] Ibid para 43
[123] Ibid para 47
[124] *Federal Mogul* supra note 109 para 23.
[125] Neuhoff *et al* op cit note 72 at 116.
[126] *Federal Mogul* supra note 109 para 23 and *Federal-Mogul Aftermarket Southern Africa (Pty) Ltd v Competition Commission* [2004] JOL 13062 (CAC) at 9.
[127] *Federal-Mogul* (CAC) ibid at 9.
[128] *Italitile* supra note 120 para 4.1.1.
[129] Neuhoff *et al* op cit note 72 at 116 and Kelly *et al* op cit note 78 at 108.
[130] *Italitile* supra note 120 para 4.1.1.
[131] Neuhoff *et al* op cit note 72 at 118.
[132] Ibid at 119.
[133] *Cancun* supra note 9 para 35.

Thus, should a franchisor attempt to force its franchisees to comply with minimum RPM by punishing franchisees for non-compliance with the pricing system, the franchisor would have contravened section 5(2) of the Competition Act. The franchisor may not use undue influence or coercion to force franchisees to behave in a certain manner.[134] Such penalties may include 'withholding supplies, denying distribution rights [or] discriminatory sales',[135] threatening to cancel a franchise agreement or refusing to renew a franchise agreement.[136] This can be seen from *Competition Commission v Italtile Franchising,*[137] where the franchisor sought to ensure that all its franchisees charged the same prices by threatening to terminate the franchise agreements of franchisees that determined their own prices.[138] Such conduct also appeared in *The Competition Commission v Toyota South Africa (Pty) Ltd*,[139] where Toyota South Africa sought to enforce its policy by fining dealerships that did not comply with its maximum discount policy.[140] The matter was ultimately settled between the parties, and Toyota agreed to end this conduct.[141]

When the franchisor behaves in the manner described above, franchisees often comply with the pricing restrictions set by the franchisor out of fear of being punished for non-compliance.[142] Such an outcome is certainly problematic, has an anti-competitive outcome and is in breach of the Competition Act.[143]

It is submitted that the franchisee should be allowed to determine the prices at which it sells products obtained from its suppliers.[144] Competition law strives to promote choice within different markets.[145] The practice of franchisors dictating prices to franchisees inhibits the ability

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[134] Naudé op cit note 107 para 20.
[135] Coenraad Visser 'Overview of the Competition Act (Part 2)'(2004) 12(2) *JBL* 117 at 118.
[136] Naudé op cit note 107 para 20.
[137] *Italitile* supra note 120 para 3.3.
[138] Ibid.
[139] *Toyota* supra note 119 para 3.4.3.
[140] Ibid.
[141] Ibid para 6.1.
[142] Raisa Yakimova, Martin Owens and Jorg Sydow 'Formal control, influence on franchise trust and brand supportive behaviour within franchised networks' (2019) 76 *Industrial Marketing Management* 123 at 128.
[143] This is evident from the fact that many settlement agreements require that the franchisor no longer dictate prices to their franchisees and if a franchisor does recommend resale prices to its franchisees, it must make it clear to the franchisee that such prices are not binding and the franchisee may depart from that price. This requirement falls within the broader requirement that the franchisor cease from engaging in anti-competitive conduct.
[144] Neuhoff *et al* op cit note 72 at 114 and Daniel Zimmer 'The basic goal of competition law: to protect the other side of the market' in Daniel Zimmer (ed) *The Goals of Competition Law* (2012) 486 at 495.
[145] Adrian Künzler 'Economic content of competition law: The point of regulating preference' in Daniel Zimmer (ed) *The Goals of Competition Law* (2012) 182 at 204.

of individual franchisees to choose resale prices. It also limits consumer choice since there are no lower priced products to choose from and consumers' will be forced to pay inflated prices.

If franchisors are allowed to set prices for franchisees, this may lead to collusion-like outcomes between franchisees.[146] The effect could be the same as firms 'directly or indirectly fixing purchase or selling prices', a form of collusive conduct that is *per se* prohibited in section 4(1)(*b*)(i) of the Competition Act. Although this provision applies to firms in a horizontal relationship,[147] it is worth mentioning here since it affects the franchisees of the same brand that are competing against each other — these franchisees are in a horizontal relationship.

Moreover, minimum RPM could have an overall negative impact on consumer welfare since it may lead to a general price increase,[148] which would negatively affect consumers. Without the *per se* prohibition of minimum RPM, consumer choice and freedom could dramatically decrease.[149] Competition law, which prohibits such abuses, therefore protects both the competitive process and the franchisee, the weaker party to the commercial agreement, from abuse by the franchisor.[150] Competition principles are intended to ensure that the franchisee has the ability to choose its own prices and compete with other franchisees based on price.[151] This is consistent with the notion that franchisees are in business for themselves and should be able to exercise this independence through pricing freedom.

(i) Pro-competition argument

While minimum RPM is generally regarded as a harmful form of anti-competitive conduct, there is an increasing amount of worldwide literature that suggests that there are some pro-competitive outcomes of minimum RPM.[152] These pro-competitive outcomes include evidence that it forces firms to improve service delivery since they are no longer able to compete on pricing to the same extent that they otherwise would do.[153]

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[146] Kelly *et al* op cit note 78 at 108.
[147] Supra note 59, s 4.
[148] Sanusha Govender 'The new approach to resale price maintenance — anti-trust law' (2009) 7(1) *Professional Accountant* 28.
[149] Künzler op cit note 145 at 205.
[150] Martinek op cit note 43 at 393.
[151] Perrigot & Basset op cit note 103 at 214.
[152] Heather Irvine 'Minimum resale price maintenance: Risks for companies trading in South Africa' (2018) 18(3) *Without prejudice* 16 at 17.
[153] Sutherland & Kemp op cit note 118 at 6-42.

Originally, South Africa and the United States of America ('USA') both adopted the same approach of total prohibition of minimum RPM.[154] However, the position has since changed in USA.[155] The United States Supreme Court ruled that minimum RPM should be analysed on a case-by-case basis in terms of a rule of reason because of the pro-competitive gains that it may offer.[156] However, in South Africa, the Tribunal has confirmed that minimum RPM remains *per se* prohibited. [157] This is justified because South Africa and USA have very different economies and competition law landscapes.[158] Moreover, litigating a rule of reason complaint is more costly than a *per se* prohibited complaint,[159] which may put a strain on the South African competition authorities' resources.

From a policy perspective, since the anti-competitive effects of minimum RPM are so severe, the legislature disallowed any defence for such conduct. It is submitted that the harm caused by this practice and its interference with the freedom to compete and consumer choice justifies such a harsh approach. The possible pro-competitive outcomes are not justly applicable in the South African context and this practice should remain *per se* prohibited.

(ii) The Competition Authorities' approach to recent cases of franchises and resale price maintenance

Many RPM referrals by the Commission resulted in settlement agreements rather than ruling by the Tribunal.[160] There is therefore still some uncertainty regarding the legal position of RPM in the franchise industry.[161] There are however, some noteworthy settlement agreements that considered RPM in the franchised industry, which provide guidance on how this issue should be approached.

In *Italtile,* the franchisor compelled its franchisees to sell products at the same price and franchisees were only allowed to offer discounts if they received-prior permission.[162] It appeared

[154] Govender op cit note 148 at 28.
[155] *Leegin Creative Leather Products v. PSKS, Inc.*, 551 U.S. 877, 127 S. Ct. 2705, 168 L. Ed. 2d 623 (2007) at 2710.
[156] Ibid at 2712 & 2721.
[157] *Competition Commission of South Africa v SBS Household Appliances t/a SMEG (Pty) Ltd* [2018] JOL 39560 (CT) para 12.
[158] Ibid para 22.
[159] Govender op cit note 148 at 29.
[160] Woker op cit note 13 at 108.
[161] Melamdowitz op cit note 10 Preliminary note § 2.8.
[162] I*talitile* supra note 120 para 3.3.

that the franchisor had threatened to terminate the franchise agreements of franchisees that failed to comply with this directive.[163] *Italtile* is a classic example of a franchisor engaging in minimum RPM to ensure uniformity within its franchise since franchisees were forced to comply with the franchisors pricing policy to avoid their contracts being cancelled. The Commission was of the view that this conduct breached section 5(2) of the Competition Act.[164] In terms of the settlement agreement, *Italtile* agreed to no longer engage in the alleged prohibited conduct, allow its franchisees to determine resale prices and not to punish or discourage any franchisees from departing from prices preferred by the franchisor.[165]

Another noteworthy settlement came about after Toyota South Africa introduced a maximum discount policy in its franchised dealerships.[166] It enforced this policy by fining dealers that did not comply.[167] The Commission believed that Toyota's conduct amounted to minimum RPM.[168] The parties entered into a settlement agreement in terms of which Toyota would no longer make use of the maximum discount policy and any prices published would have to comply with terms of the conditions set out in section 5(3) of the Competition Act.[169] Toyota also agreed to pay an administrative penalty of R12 million in settlement of any possible penalty which could be imposed on it.[170] After the investigation into Toyota's maximum discount policy, the Commission conducted an industry-wide investigation into the motor industry to determine if other franchisors were breaching the Competition Act.[171] These investigations resulted in numerous other settlement agreements between the Commission and various franchisors in the motor industry. The Commission's investigations into DaimlerChrysler South Africa, Volkswagen South Africa, Nissan South Africa, General Motors South Africa and Citroen South Africa resulted in similar findings and outcomes, with the franchisors paying administrative penalties ranging from R150 000 to R12 million, respectively. .[172]

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[163] Ibid.
[164] Ibid para 5.2.
[165] Ibid para 6.
[166] *Toyota* supra note 119 para 3.4.1.
[167] Ibid para 3.4.3.
[168]Ibid para 5.
[169] Ibid para 6.
[170] Ibid para 7.
[171] *Competition Commission v Volkswagen SA (Pty) Ltd and another* [2006] 1 CPLR 87 (CT) para 2.2.
[172] *Competition Commission v Daimler Chrysler South Africa (Pty) Ltd* [2006] 1 CPLR 73 (CT) para 7.1; *Volkswagen* supra note 171 para 7.1; *Competition Commission v General Motors South Africa (Pty) Ltd* [2006] 1 CPLR 82 (CT) para 7.1; *Competition Commission v Nissan South Africa (Pty) Ltd [2006]* 1 CPLR 93 (CT) para 7.1; and *Competition Commission v Boundless Trade 154 (Pty) Ltd trading as Citroën South Africa* [2006] 1 CPLR 68 (CT) para 7.1.

(d) Recommended resale prices

While minimum RPM is completely prohibited, a franchisor may recommend resale prices to its franchisees. The European Union Commission has been said to be skeptical of such a practice since recommended resale prices tend to have a similar effect to actual RPM.[173] The South African legislature was mindful of this and therefore specifically dealt with the parameters of recommended resale prices in section 5(3) of the Competition Act.

Section 5(3) of the Competition Act allows a supplier to recommend prices at which a distributor sells that supplier's products. However, the supplier must make it completely clear that the distributor may depart from the recommended prices,[174] If the recommended price is stated on the product, it is imperative that the words 'recommended price' be written next to the said price.[175]

If a supplier chooses to recommend prices for its products, it may not use forceful measures to ensure that the distributors adhere to the recommended prices.[176] It may not punish the distributors for charging prices other than those recommended,[177] because ultimately the resale price remains within the distributor's discretion.[178] For the price stated not to fall into the prohibition of minimum RPM, it must truly be a recommendation rather than an obligatory price disguised as a recommended price.

Franchisors may therefore recommend resale prices to their franchisees as long as franchisees retain the discretion to resell products at prices other than the recommended price.[179] It must however, be sufficiently clear that the minimum prices are not binding and a franchisor may not punish its franchisees if they do not abide by the recommendation.[180] If a franchisor recommends a resale price, even if this is done in accordance with the rules provided for in section 5(3) of the Competition Act, it is likely that a large proportion of franchisees will abide by the recommendation.[181] But, as long as each franchisee has the discretion to make its own pricing decisions, the behaviour cannot be deemed as anti-competitive.

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[173] Ridgeway op cit note 93 at 97.
[174] Supra note 59, s 5(3)(*a*).
[175] Ibid, s 5(3)(*b*).
[176] *Federal Mogul* supra note 108 para 70 and Neuhoff *et al* op cit note 72 at 115
[177] Petra Krusche and Coreen Fouché 'Minimum resale price maintenance — US Supreme Court sets new parameters' (2017) 7(7) *Without prejudice* 28 at 29.
[178] Neuhoff *et al* op cit note 72 at 115.
[179] Supra note 59, s 5(3).
[180] Woker op cit note 13 at 113.
[181] Perrigot & Basset op cit note 103 at 214.

While there are specific provisions that ensure that a recommended price is clearly a recommendation and not a forced price,[182] publishing or announcing a recommended price may make it difficult for franchisees not to implement that price.[183] National advertising is often intended to impose a single price on all franchisees to achieve the uniformity that franchisors desire.[184] This may be because consumers expect the product/service to be sold at the advertised price. If the franchisee chooses to charge above the recommended price, consumers will most likely choose to visit other franchised stores where they can purchase the product/service at a lower cost. If the franchisee chooses to charge below the recommended price, it may result in increased sales, but also may lead to people questioning the quality of the product/service, as they are unsure why it is being sold for a lower price.

The role of the internet as a tool for price comparisons between different franchised units makes it more attractive for franchisees to accept the recommended price.[185] Consumers can easily compare prices between different franchised outlets and choose the outlet that offers the desired product/service at the lowest cost.[186]

To be successful, franchisees may be forced to comply with the price recommended by the franchisors.[187] Although a departure from the recommended price may not result in punishment from the franchisor, it could result in punishment by consumers, which is a characteristic of the open market and should be encouraged. Compliance with the suggested price is only problematic if the result of non-compliance is punishment by the franchisor.[188] Despite it being difficult for a franchisee to charge a price other than the recommended price, where the option exists, it is submitted that there will be no RPM.[189] All that is required is for the franchisee to be able to sell at whatever price it chooses, without the franchisor punishing it for failing to do so.

(e) Maximum resale price maintenance

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[182] Supra note 59, s 5(3).
[183] Blair & Esquibel op cit note 101 at 174.
[184] Perrigot & Basset op cit note 103 at 215.
[185] Ibid at 212.
[186] Ibid.
[187] Blair & Esquibel op cit note 101 at 174.
[188] Yakimova *et al* op cit note 142 at 148.
[189] *Pick 'n Pay Retailers (Pty) Limited v Pine Valley Supermarket (Pty) Limited* [2015] JOL 33003 (KZD) para 76 & 79.

Although minimum RPM is *per se* prohibited in terms of section 5(2) of the Competition Act, a supplier may be able to dictate maximum prices for its products to distributors.[190] Such a practice may be anti-competitive but is not *per se* prohibited and will be analysed in terms of the rule of reason approach provided for in section 5(1) of the Competition Act.[191] A firm dictating maximum prices therefore should easily be able to show that the competitive gains that result from setting maximum prices outweigh the anti-competitive results of the conduct. In fact, maximum RPM generally does not cause harm to consumers.[192] Rather it often benefits them because they pay lower prices than they otherwise may have done.[193]

If there is very little, or no intra-brand competition, for example, if there is only one franchisee in a certain geographic area, this amounts to a successive monopoly,[194] where both the franchisor and franchisee have market power.[195] In such circumstances, the franchisor may choose to impose maximum resale prices to maximise its profits.[196] Although not the main goal of such behaviour, maximum RPM is such cases also benefits consumers.[197]

In *Cariba BMW Inc v Bayerische Motoren Werke Aktiengesellschaft*,[198] BMW AG, the franchisor imposed maximum resale prices on BMW Cariba,[199] the only BMW franchise in Puerto Rico.[200] Being the only BMW dealership on the island, Cariba BMW had market power, which it could exploit by dramatically increasing prices to a level that would not be sustainable to the franchisor.[201] BMW AG wanted to impose maximum resale prices on BMW Cariba to achieve the same result as what would have been the case if Cariba BMW would have been exposed to intra-brand competition.[202] As such, the franchisor's behaviour had a positive outcome as it avoided a situation of abuse of monopoly power by BMW Cariba and benefitted the consumer.

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[190] Neuhoff *et al* op cit note 72 at 115.
[191] *Cancun* supra note 9 para 43 and Neuhoff *et al* op cit note 72 at 115.
[192] Blair & Esquibel op cit note 101 at 158-9.
[193] Ibid at 159 & 162.
[194]Ibid at 163-4.
[195] Ibid at 164. See also Roger D Blair and Francine Lafontaine 'Will *Khan* foster or hinder franchising? An economic analysis of maximum resale price3 maintenance' (1999) 18 *Journal of Public Policy and Marketing* 25 at 28.
[196] Blair & Lafontaine ibid at 30.
[197] Ibid.
[198] 19 F.3d 745 (1st Cir. 1994).
[199] Ibid at 752.
[200] Blair & Esquibel op cit note 101 at 164
[201] Ibid.
[202] *Cariba* supra note 202 at 754.

The case of *Cariba* clearly illustrates that franchisors and franchisees apply different price considerations to their businesses. A franchisor's profit is based on the number of sales that its franchisees make and not the amount of profit that the franchisees make.[203] Franchisors therefore want to maximise the number of products sold by their franchisees.[204] Franchisees however make their profit by charging higher prices.[205] The rule of reason prohibition against maximum RPM provides franchisees with the freedom to determine their own prices so that they can achieve the best possible profit. However, since maximum RPM is judged in terms of a rule of reason analysis, if the pro-competitive effects of the practice outweigh its anti-competitive effects, franchisees' pricing freedom can be limited to some extent.

In summary, although franchisors may, under no circumstances, set minimum prices for franchisees, they may be able to set maximum prices.[206] This may even be desirable.[207] Further, the maximum resale price cannot be a minimum resale price in disguise or the setting of an exact price.[208] Such conduct would surely be anti-competitive,[209] and viewed in terms of the prohibitions contained in section 5(2).

IV INVESTIGATION AND PROSECUTION OF FRANCHISES THAT ENGAGE IN RESALE PRICE MAINTENANCE

Given that RPM is *per se* prohibited in South Africa, it is not surprising that franchisors may prefer to settle rather than risking an adverse finding against them and severe penalties in terms of section 59 of the Competition Act.

However, it is not quite clear how the Tribunal or even the Competition Appeal Court will deal with franchisors accused of RPM in the South African context given the unique circumstances of the franchise industry.[210] Most cases dealing with RPM in relation to franchises resulted in settlements rather than formal hearings.[211] Had there been a formal hearing, we would most likely

[203] Blair & Lafontaine op cit note 199 at 32.
[204] Ibid.
[205] Ibid.
[206] Woker op cit note 13 at 113.
[207] Ibid.
[208] Sutherland & Kemp op cit note 118 at 6-19.
[209] Ibid.
[210] Melamdowitz op cit note 10 Preliminary note § 12.8
[211] Woker op cit note 13 at 109.

have had a greater level of certainty.[212] It should be considered whether these cases result in settlements because of the franchisors accepting wrongdoing or general lack of prosecutions due to insufficient resources.

Since there are many franchises within South Africa, it may be very difficult for the Commission to monitor each franchise for compliance with the Competition Act, particularly because many franchisees adopt the same or similar pricing strategies or to comply with recommended prices.[213] The Commission may therefore need to rely on tip offs from franchisees or members of the public to inform it of possible contraventions of section 5 of the Competition Act.[214] The Commission has a duty to investigate the possible anti-competitive conduct as and when it becomes aware of any.[215] If necessary, the Commission will then refer the matter to the Tribunal for a hearing.[216] The industry wide investigation into the motor vehicle dealerships, for example, all began with a tip off from a member of the public who wished to purchase a new Toyota vehicle.[217]

(a) Settlement agreements

Section 49D of the Competition Act allows for the alleged offender to enter into a settlement agreement with the Commission, before, during or after the investigation. The settlement agreement will then be confirmed by the Tribunal, as a consent order.[218]

Under this settlement agreement, the respondent usually agrees to end the behaviour considered to be in breach of the Competition Act and take further steps to ensure the practice is terminated. The settlement should result in the allegedly prohibited conduct coming to an end. The offending firm will also commit to the ideal that should it recommend prices, it will do so in terms of the provisions of section 5(3) of the Act.

The offending firm will also pay an administrative penalty, which is usually less than the maximum ten percent prescribed in section 59 of the Competition Act.[219] The firm is therefore still

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[212] Ibid
[213] Perrigot & Basset op cit note 103 at 214.
[214] Supra note 59, s 49B(2).
[215] Ibid, s 49B(3).
[216] Ibid, s 51.
[217] *Toyota* supra note 119 para 1.4.
[218] Supra note 59, s 49D(1).
[219] Section 59 of the Competition Act provides that if a firm is found to have breached section 5(1) or 5(2) of the Act, an administrative penalty of up to ten percent of its annual turnover in South Africa and from its exports out of South Africa, from the previous financial year, may be imposed on that firm.

punished for engaging in anti-competitive behaviour but the penalty is less than what it was likely to have been had the matter continued to a formal hearing, encouraging parties to quickly terminate the harmful conduct. In the case of RPM by franchisors, the settlement process seems to be quite successful, as many referrals to the Tribunal have resulted in settlements. The penalty amount prescribed in section 59 of the Competition Act is substantial and one can understand why firms may wish to settle rather than risk such a harsh penalty.

(b) Exemptions

Due to the unique business model of franchises,[220] there have been calls for the franchising industry to be excluded from the ambit of the Competition Act.[221] It has been argued that an over-regulation of the franchise industry could inhibit economic growth of franchisees and the industry should be allowed to govern itself without 'intrusion' by competition authorities.[222] Further that franchising promotes business opportunities for historically disadvantaged persons and the Competition Act may inhibit them from developing in their respective industries.[223] This is particularly problematic as one of the goals of the law regulating competition is to eradicate unlawful barriers to entry in different markets of the South African economy,[224] including the franchise industry.

Nonetheless, the Competition Act allows for exemptions from the provisions of Chapter 2 (sections 4-10) of this Act to be granted.[225] These exemptions can either be granted in relation to a category of agreements or to a specific agreement.[226] This would, in theory, allow for an exemption to either be granted for all franchise agreements or for a particular franchise agreement to be exempt from the provisions of section 5 of the Competition Act. The 2018 amendment to the Competition Act now allows for exemptions to be granted if *inter alia* the practice results in promoting entry and participation or expansion in the market for small and medium sized businesses or for firms controlled by historically disadvantaged persons.[227] This provision notes the socio-economic benefits of franchising, which have been recoginsed by the South African government, including job creation, reducing poverty levels and facilitation of Broad Based Black

[220] Melamdowitz op cit note 10 Preliminary note § 2.8
[221] Franchising notice op cit note 77 para 2.1.
[222] Ibid para 2.2.
[223] Ibid para 2.3.
[224] Supra note 59, preamble.
[225] Ibid, s 10.
[226] Ibid, s 10(1).
[227] Ibid, s 10(3)(*b*)((iv).

Economic Empowerment.[228] It is also one of the easiest ways for a new firm to enter into the market.[229] This is also in line with the aspiration of the Competition Act to establish an economy where all South Africans have a fair opportunity to participate.[230]

The Competition Act does not provide a blanket exemption to the franchise industry.[231] The Commission has confirmed that it will not provide such an exemption. As such, the franchise industry remains bound by the provisions of the Competition Act.[232] It may however, be possible for individual franchises to apply for their franchise agreements to be exempt from the provisions of Chapter 2 of the Competition Act.[233] In deciding whether to grant an exemption, the Commission will most likely be guided by the objectives of the Act, found in the Preamble.[234]

It may be possible that individual franchises receive an exemption if many of their franchisees are small and medium sized businesses controlled by historically disadvantaged persons. It is submitted that individual exemptions would be preferable rather than an industry wide exemption since it would only apply to franchisees that are less established in the defined market, thereby satisfying the section 10(3)(*b*)(ii) requirement.[235] However, it is doubtful whether an exemption against price controls by franchisors will assist these franchisees. It may only benefit the franchisor. It does not seem that price controls will facilitate the ability of such franchisees to enter the market. In fact, it may hinder their ability to compete as it places an unnecessary burden upon these franchisees. Furthermore, this would be costly and time-consuming.[236] It is therefore submitted that such exemptions should not be given as they would frustrate rather than assist in achieving the aims of the Competition Act.

The Commission's stance of refusing to exempt the franchise industry from Chapter 2 of the Competition Act is commendable. Although uniformity within a franchise is a hallmark of the system,[237] the harm caused by the practices listed in Chapter 2, including RPM is considerable.

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[228] Franchising notice op cit note 77 para 2.3 and Lister op cit note 70 at 35.
[229] van Eeden & Barnard op cit note 1 at 208.
[230] Supra note 59, preamble.
[231] Woker op cit note 13 at 119-20.
[232] Franchising notice op cit note 77 para 1.1 and Kelly *et al* op cit note 78 at 104.
[233] Woker op cit note 13 at 119-20.
[234] Melamdowitz op cit note 10 Preliminary note § 2.8
[235] Section 10(3)(*b*)(ii) provides 'The Competition Commission may grant an exemption in terms of subsection (2)(*a*) only if the agreement or practice concerned, or category of agreements or practices concerned contributes to any of the following objectives — (ii) promotion of the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive'.
[236] Woker op cit note 13 at 120.
[237] Martinek op cit note 39 at 514-5.

Thus, to comply with the aim of achieving 'a more effective and efficient economy'[238] and providing 'for markets in which consumers have access to and can freely select the quality and variety of goods and services that they desire',[239] exceptions should not be granted so that the franchisors' desires are met. The Commission's decision not to grant an exemption to the franchise industry appears to be correct.[240] The desire for uniformity and protection of brand image does not justify an exemption which would allow the harmful practice of price controls to continue.

An adequate balance must be struck between ensuring effective competition and promoting the benefits arising from franchise arrangements. Effective competition is important in a free market as it promotes economic growth and prevents exploitation of consumers.[241] Franchising is regarded as the form of business that offers the greatest opportunities for growth[242] and it has numerous benefits that cannot be undermined. It reduces poverty, increases employment, promotes broad based black economic empowerment and encourages the development of small and medium sized businesses.[243] It also makes products/services more easily available.[244] It is possible to strike this balance and establish a system where many franchises exist. This will enable franchisors, franchisees and consumers to benefit from a franchise system that complies with the Competition Act.[245] However, when parties behave in an anti-competitive manner, the Competition Authorities should, and do, terminate to such conduct.[246]

While the Competition Act does place limits on the operation of franchises, it is unlikely that the limits will bring an end to this form of business practice, and the numerous benefits it offers.[247] The Competition Act should however be used to avoid abuse by franchisors, where they bully franchisees into acting in a manner that distorts competition.

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[238] Supra note 59, preamble.
[239] Ibid.
[240] Kelly *et al* op cit note 78 at 104 and Franchising notice op cit note 77 para 1.1. This is also confirmed by the numerous investigations into franchised outlets by the Commission, and possible later referrals to the Tribunal.
[241] Woker op cit note 13 at 110.
[242] Naudé op cit note 107 para 1.
[243] Martinek op cit note 43 at 491; Woker op cit note 5 at 49 and Franchising notice op cit note 77 para 2.2.
[244] Woker ibid.
[245] Franchising notice op cit note 77 para 6.2.
[246] Ibid para 6.7.
[247] Lister op cit note 70 at 36.

V CONCLUSION

This report has considered one of the possible anti-competitive outcomes that may result from the franchise arrangement, namely RPM. It has been argued that the decision to treat franchisors and franchisees as separate parties in the supply chain is correct as each of these parties are in business for themselves, even though there is a level of reliance between them. The supplier-distributor relationship should be respected and franchisors cannot expect franchisees to behave in a manner that reduces competition between the various franchisees, such as by requiring its franchisees to engage in minimum RPM.

Although it can be quite difficult to determine whether RPM occurred, it would be unwise to ignore possible contraventions of section 5(2) of the Competition Act because minimum RPM is extremely harmful to consumer welfare. It is therefore recommended that the Commission conduct a market inquiry into the franchise industry in terms of chapter 4A of the Competition Act, to obtain information about practices in the industry, to determine whether firms are engaging in prohibited resale price maintenance or merely making use of the recommended price provision. From the information obtained, the Commission should, if necessary, take action in an effort to stop firms from engaging in this harmful practice.

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