Competition law and exclusive vertical agreements in Africa

By Ann Boniwell and Lebohang Lengoasa

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Within the context of the global economy, Africa is widely recognised as a key developing market. Entry into, and expansion within the African continent is regarded by many multinational corporations as essential to their continued existence, justifying the considerable business risk with the lure of high rewards.

Hunters should be warned, however, that beyond the realm of the African savanna, their sport is carefully regulated.

COMESA

Competition rules similar to those at play in Europe have recently been introduced by COMESA (The Common Market for Eastern and Southern Africa), significantly bolstering the authority of the Competition Commission to moderate what it regards as vertical restrictive practices. Underpinned by the concept of a common market aimed at promoting regional economic integration, COMESA established an area of free trade between its member states, immediately enhancing competition in Eastern and Southern Africa and necessitating the introduction of a regional competition law regime.

Nearly ten years after its establishment in November 1993, regulations giving weight to the basic principles of competition law came into effect on 14 January 2013. As a consequence, entities who wish to commence or continue operations in any of the nineteen member states (Burundi, Comoros, the Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, the Seychelles, Sudan, Swaziland, South Africa, Uganda and Zimbabwe) will be well advised to consider whether their agreements may have as their object or effect the prevention, restriction or distortion of competition in the region. Of particular concern is the prevalence of exclusive vertical agreements.

Exclusive agreements

Exclusive vertical agreements, being agreements between a firm and its suppliers or customers, may be grouped into three distinct categories:

a. single branding agreements - typically aimed at inducing a buyer to concentrate its orders for a particular product with one supplier;
b. limited distribution agreements - which have as their main element a requirement that a manufacturer (or supplier) sells products to only one or a limited number of buyers, such as exclusive distribution agreements; and
c. market partitioning agreements - which restrict where a buyer may buy or resell a particular product.

The European Commission, competition regulator of the EU (European Union), identifies four possible negative effects arising from vertical agreements, namely: foreclosure of other suppliers or buyers by raising barriers to entry; the reduction of inter-brand competition (being competition between suppliers of different brands or substitutable products), including the facilitation of both explicit and tacit collusion; the reduction of intra-brand competition (being competition between resellers or distributors of the same brand); and the creation of obstacles to market integration. These effects are more likely to arise in instances in which either party to the agreement enjoys a market share in excess of 30-35%.

Prior to the commencement of the regulations, the European Commission's protection of a single economic market, comprising a customs or trade union, was unique to the EU. In particular, the European Commission and Community Courts have been singularly concerned about vertical agreements which lead to the division of the common market along national lines. For this reason, the European Commission has adopted a strict and near unwavering stance toward the inclusion of export bans, the maintenance of parallel trade and a reluctance to allow distributors to enjoy absolute territorial protection. It is assumed that the Commission, inspired by the objectives of the EU, will be similarly wary of such restraints enforced within COMESA.

Survival tactics

Businesses keen to venture deeper into Africa should not, however, be altogether deterred, as there is scope for justifying entry into exclusive vertical agreements on the basis that they contribute toward improving the production or distribution of goods, alternatively promote technical or economic progress within COMESA, while simultaneously allowing consumers a fair share of the resulting benefit. In doing so, firms will need to ensure that these agreements do not impose restrictions which are not indispensable to the attainment of the foregoing objectives, and do not go towards eliminating competition in respect of a substantial portion of the relevant market.

This is similar to the approach adopted in the EU where the most important objective of competition law is said to be the protection of competition in the market as a means of enhancing consumer welfare and ensuring the efficient allocation of resources.

Provided a firm can demonstrate that the exclusive vertical agreement was entered into for the purpose of achieving technological or efficiency gains, to the ultimate benefit of consumers, the agreement is unlikely to be prohibited, in the absence of dominance. Such an intention could, for example, be recorded in the agreement itself, alternatively, documentation may be kept on file which identifies the pro-competitive benefits of the arrangements such as the elimination of free-riders, reduced transactions costs, protection against price fluctuations, sales- and after-sales service investment and staff training. In instances in which either party is dominant, a careful assessment of the risk of foreclosure will need to be conducted prior to implementation.

Game plan

It is likely that in the context of the common market, the relevant enquiry will essentially be whether a vertical agreement tends to threaten or disrupt integration of the region, taking into account the economic conditions prevailing at the time and each player's relative position in the market. Agreements and conduct which might have the effect of dividing the territory of one member state from another will be closely scrutinised and may be severely punished. For this reason, prior to concluding any vertical agreement, it is important for a business to engage with its advisors to carry out an analysis of the likely effect of the proposed agreement on the common market.

ABOUT THE AUTHOR

Ann Boniwell and Lebohang Lengoasa are senior associates at [[http://www.bgafricagroup.com/ Bowman Gilfillan]], a corporate law firm providing legal solutions that make business sense, locally, across Africa.