Competition Law ALERT

15 FEBRUARY 2023

CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

IN THIS ISSUE

The regulation of joint ventures under the Competition Act: Is your joint venture compliant with the Competition Act?

Joint ventures (JVs) are difficult to define from a legal perspective, compared to partnerships where our courts have laid down the essential elements. Often the layman may liken a JV to a partnership, but this is not necessarily the case. The Competition Act 89 of 1998 (Act) recognises a partnership as a firm but, because of their fluid nature, JVs may either be conducted through a legal entity (such as company) or they may constitute a looser arrangement between the parent firms. It is this fluidity, coupled with the contact points between the parent firms as a result of the JV, that makes JVs important to monitor from a competition law risk perspective.

FOR MORE INSIGHT INTO OUR EXPERTISE AND SERVICES

The regulation of joint ventures under the Competition Act: Is your joint venture compliant with the Competition Act?

Joint ventures (JVs) are difficult to define from a legal perspective, compared to partnerships where our courts have laid down the essential elements. Often the layman may liken a JV to a partnership, but this is not necessarily the case. The Competition Act 89 of 1998 (Act) recognises a partnership as a firm but, because of their fluid nature, JVs may either be conducted through a legal entity (such as company) or they may constitute a looser arrangement between the parent firms. It is this fluidity, coupled with the contact points between the parent firms as a result of the JV, that makes JVs important to monitor from a competition law risk perspective.

The formation and operation of JVs must be assessed under various provisions of the Act. In doing so, it is necessary to determine whether the formation or expansion of a JV constitutes a merger and whether the operation of the JV complies with the Act.

While JVs may be pro-competitive as they allow the parent firms (through the JV) to produce better or cheaper products by making use of economies of scale or combining resources in an efficient way, a JV may also restrict competition. In certain cases JVs could be used as a vehicle for collusion, where the parties to the JV may be found to be dividing markets or fixing prices through the JV. This risk may manifest in the case of looser JVs, where their formation has not been approved as a merger by the competition authorities.

Before delving into the intricacies of the competition law risks associated with JVs, we deal with a much more fundamental point, namely: What does competition law consider to be a JV?

What is a JV for the purposes of competition law?

Neither the Act, nor any of the regulations passed under the Act, deal with or define a JV. This means that there is no definition of what is considered to be a JV for the purposes of competition law. Accordingly, JVs must be assessed with reference to the standard competition law principles which apply to merger control and the regulation of prohibited practices.

Although not binding, the Competition Commission (Commission) published a practitioner's update in 2001 titled *"The application of merger provisions of the Competition Act 89 of 1998, as amended, to joint ventures"* (Practitioner's Update).

2022 RESULTS

CHAMBERS GLOBAL 2011 - 2022 ranked our Competition Law practice in Band 2: competition/antitrust.

Chris Charter ranked by **CHAMBERS GLOBAL 2018 - 2022** in Band 1: competition/antitrust.

Andries le Grange ranked by **CHAMBERS GLOBAL 2022** in Band 4: competition/antitrust.

Lara Granville ranked by **CHAMBERS GLOBAL 2022** in Band 5: competition/antitrust.

Albert Aukema ranked by **CHAMBERS GLOBAL 2020 - 2022** as an upcoming competition/antitrust lawyer.

TOP RANKED
Chambers
Global
2022
Cliffe Dekker Hofmeyr

The regulation of joint ventures under the Competition Act: Is your joint venture compliant with the Competition Act?

CONTINUED

In this Practitioner's Update the Commission refers to a JV as *"a separate business enterprise over which two or more independent parties exercise joint control, and is created for a specific purpose"*. This can generally occur in two instances: where the parent firms jointly form a new entity (a special purpose vehicle), or where the parent firms acquire control over an existing firm or business. It is also possible that a looser JV may be formed where the parent firms do not control a business but agree to co-operate in a particular fashion, such as engaging in joint distribution.

The Commission notes that JVs may be established for different purposes, including research and development, production, distribution, purchasing, advertising and promotion, and networking.

In the case law before the competition authorities, JVs have historically been analysed under both the merger control and prohibited practice sections of the Act. We look at these in turn.

Merger control and JVs

The Practitioner's Update states that a JV constitutes a merger, as defined in section 12 of the Act, where one firm acquires control over the business of another as a result of the formation of a JV and where the monetary thresholds prescribed under the Act are exceeded. In such circumstances the formation of a JV would need to be notified and approved by the relevant competition authority before such a JV can be implemented.

If such a JV amounts to a notifiable merger, the Commission would likely consider whether the JV would lead to co-ordinated effects. In short, this means examining whether the JV would increase the likelihood of the merging parties (in this case the parties to the JV) entering into an agreement to divide markets or fix selling prices in contravention of section 4(1) of the Act. It is the structural link created between competing parent firms that gives rise to this risk.

In examining the possible co-ordinated effects of the JV, the Commission will analyse the purpose of the JV in light of the activities of the parent firms. For example, if pharmaceutical firms come together to establish a research and development JV, the Commission will examine the extent to which the JV might result in commercially sensitive information, outside the purpose of the JV, passing to the JV parties. If this does occur, the JV parties can use this sensitive information to achieve an anti-competitive outcome (such as a price fix for medicine).

This risk can be alleviated if the JV is set up with mechanisms that would prevent the sharing of commercially sensitive information that falls outside the purpose of the JV to the parent firms. This can take place by redacting information packs (to the extent necessary), insisting that certain personnel recuse themselves from meetings if sensitive information outside the JV's scope is discussed and to ensure that the managers of the JV do not sit on the boards of

The regulation of joint ventures under the Competition Act: Is your joint venture compliant with the Competition Act?

CONTINUED

the parent firms. It is also important to note that the fact that the JV has been approved by the competition authorities does not mean that future collusive behaviour between the parent firms, through the JV, will be free from prosecution.

There are also instances where JVs will not be subjected to the merger control regime. This could be the case where the JV does not pass the monetary thresholds for compulsory notification or if the JV does not amount to a merger as defined in the Act. In these instances, and in the operation of the JV post-merger, the JV parent firms should be wary of the collusion risks and other prohibited practices risks under the Act.

Co-ordination risk flowing from JVs

Section 4(1)(b) prohibits an agreement, or concerted practice (co-ordinated conduct that replaces independent action but which does not amount to an agreement), between competing firms that involves fixing a selling price, trading conditions or dividing markets. These types of collusive arrangements are so-called *per se* prohibitions meaning that pro-competitive benefits flowing from the agreement or concerted practice cannot be used as a defence to justify such behaviour. It is therefore possible for the JV to be used by the parent firms to reach these collusive outcomes.

These outcomes can generally be reached in two ways. Firstly, the JV can be used as a vehicle to exchange information and reach an agreement/concerted practice between the parent firms. Secondly, the JV itself could amount to an agreement between the parent firms to divide markets by preventing them from competing with the JV for certain customers or in certain product lines.

As is the case with partnerships, a restraint of trade is often found in a JV relationship and given the nature of JVs, it would generally be commercially rational, and often pro-competitive, for the parent firms not to compete with the JV. This is so because such restraints protect the investment of both parents in the JV, and motivates the parent firms to maximise the value to be obtained from the identified purpose of the JV.

In drawing this distinction between *bona fide* restraints and the *per se* prohibition contemplated in section 4(1)(b) of the Act, the Competition Appeal Court in *Dawn Consolidated Holdings (Pty) Ltd and Others v Competition Commission* [2018] JOL 40226 (CAC) (Dawn Case), which dealt with a similar legal entity that was viewed as a JV vehicle, drew from the principle of characterisation to hold that: *"A restraint which is commercially reasonable in the context of the transaction is not characterised as violating section 4(1)(b)(ii)."*

The regulation of joint ventures under the Competition Act: Is your joint venture compliant with the Competition Act?

CONTINUED

In testing whether this is the case, the character of the restraint must be viewed in the context of the agreement as a whole and in the circumstances in which the parties concluded the agreement. The test was further articulated as follows:

> *"(a) Is the main agreement (i.e. disregarding the impugned restraint) unobjectionable from a competition law perspective?*
>
> *(b) If so, is a restraint of the kind in question reasonably required for the conclusion and implementation of the main agreement?*
>
> *(c) If so, is the particular restraint reasonably proportionate to the requirement served?"*

Such restraints preventing parent firms from competing with JVs have been considered to be commercially justifiable in the context of merger control by the Competition Tribunal (Tribunal) in the past and they fulfil a legitimate commercial purpose. However, in terms of the precedent that has developed in this area of competition law, it is necessary to "*characterise*" the restraint of trade in each JV relationship on a case-by-case basis.

The uncertainties

The question of whether the parties to a JV are competitors or stand in a vertical relationship, for example, a supply relationship, provides an important starting point to analyse the risks. Where the parties are competitors or potential competitors, the risks of being found guilty of collusion under the Act, as a result of the formation or provisions of the JV requires careful consideration.

Where JVs are notified as mergers, greater legal certainty can be obtained that the formation of the JV enjoys the approval of the competition authorities. However, as stated in the Dawn Case, the Tribunal (and by implication the Commission) would not be able to approve a merger if it were to contravene section 4(1)(b) of the Act. The restraints of trade which apply to the JV parties would still require a separate assessment from a risk perspective post-merger. This is so as the Tribunal has held in *Life Healthcare Group (Pty) Ltd & Joint Medical Holdings Ltd* (74/LM/Sep11) [2012] ZACT 88 that notification and approval of a merger by the competition authorities does not necessarily grant the merging parties, as joint controllers of the JV, immunity from prosecution under section 4(1) of the Act.

Looser JVs or greenfield JVs may not be required to be notified as mergers, and in these cases the parties would be advised to take advice regarding compliance with the Act. In certain cases, where the JV may risk contravening section 4 of the Act, the parties may be able to apply for an exemption for the arrangement.

In addition, there may be provisions in the JV agreements, such as exclusivity provisions, information exchange provisions and co-operative relationships between the parents of the JV that would require further careful analysis.

Andries Le Grange and Reece May

OUR TEAM

For more information about our Competition Law practice and services in South Africa and Kenya, please contact:

Chris Charter
Practice Head & Director:
Competition Law
T +27 (0)11 562 1053
E chris.charter@cdhlegal.com

Sammy Ndolo
Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com

Albert Aukema
Director:
Competition Law
T +27 (0)11 562 1205
E albert.aukema@cdhlegal.com

Lara Granville
Director:
Competition Law
T +27 (0)11 562 1720
E lara.granville@cdhlegal.com

Andries le Grange
Director:
Competition Law
T +27 (0)11 562 1092
E andries.legrange@cdhlegal.com

Susan Meyer
Sector Head: Healthcare & Pharmaceuticals
Director: Competition Law
T +27 (0)21 481 6469
E susan.meyer@cdhlegal.com

Njeri Wagacha
Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E njeri.wagacha@cdhlegal.com

Leago Mathabathe
Senior Associate:
Competition Law
T +27 (0)11 562 1927
E leago.mathabathe@cdhlegal.com

Reece May
Senior Associate:
Competition Law
T +27 (0)11 562 1071
E reece.may@cdhlegal.com

Duran Naidoo
Senior Associate:
Competition Law
T +27 (0)21 481 6463
E duran.naidoo@cdhlegal.com

Nelisiwe Khumalo
Associate:
Competition Law
T +27 (0)11 562 1116
E nelisiwe.khumalo@cdhlegal.com

Mmakgabo Makgabo
Associate:
Competition Law
T +27 (0)11 562 1723
E mmakgabo.makgabo@cdhlegal.com

Alistair Dey Van Heerden
Associate Designate:
Competition Law
T +27 (0)11 562 1680
E alistair.dey-vanheerden@cdhlegal.com

Taigrine Jones
Associate Designate:
Competition Law
T +27 (0)11 562 1383
E taigrine.jones@cdhlegal.com

Ntobeko Rapuleng
Associate Designate:
Competition Law
T +27 (0)11 562 1847
E ntobeko.rapuleng@cdhlegal.com

Shandré Smith
Associate Designate:
Competition Law
T +27 (0)11 562 1862
E shandre.smith@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE
This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.
Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI
Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114
E cdhkenya@cdhlegal.com

STELLENBOSCH
14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA