

CASE STUDY

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About four years ago the city of Bazaar experienced an infestation of cockroaches. As a result, the industry of home fumigation began to get rid of these pests. The industry created manufacturers of fumigation equipment and chemicals, distribution companies, and individual agents (extermination specialists) who go door-to-door to fumigate homes. There are six manufacturers of fumigation equipment and chemicals. There were five distributors in 2004 and currently only three remain in the market. There are a number of individual agents which are usually start-up SMME businesses who require the equipment and chemicals.

Two years ago a law was passed that required agents to get special certification and to undergo regular inspection to determine whether they met minimum standards of safety and best practice. The new regulation was introduced because of the dangerous nature of chemicals. Regulations specifically require that distributors only sell to certified agents and that there is regular training and inspection. There are many agents in this industry and this regulation poses one of the few barriers to entry.

Recently, the biggest manufacturer of fumigation equipment and chemicals, Bugg-Off Inc financed the setting up a distribution company called Pest-Away Distribution. Bugg-Off Inc is a 25% shareholder in Pest-Away Distribution and is the primary financier, but does not own or control the company. Pest-Away Distribution, in addition to providing the equipment and chemicals to the agents (extermination specialists) also provides them with specialized training to obtain their certificate.

The Complainant, DieHard Inc, had two divisions: (1) sells equipment and chemicals to agents and also provide some after sales service; (2) in addition the DieHard Inc provides training and assistance in order to meet the requirement of the regulation (training and inspection) for a fee so that agents can comply with the regulation introduced two years ago.

Bugg-Off has set up Pest-Away Distribution in competition with the Complainant. Pest-Away Distribution has created an association and invited agents to join so that agents of the association contract exclusively with it. The members of the association can only buy equipment and chemicals approved by Pest-Away Distribution but they receive free training and certification services in order to be compliant with the legislation.

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Pest-Away Distribution has a contractual arrangement with the Bugg-Off Inc whereby Bugg-Off pays a fee to Pest-Away Distribution which is calculated as a percentage of equipment and chemicals sold to agents. There is also an exclusive arrangement between the agents and Pest-Away Distribution, and they are not allowed to purchase equipment and chemicals from any other distribution company.

There are three manufacturers of equipment and chemicals that constitute 80% of the market that have contracted with Pest-Away Distribution, on a similar basis to Bugg-Off Inc. Agents who sign up with Pest-Away Distribution are free to choose their equipment and chemicals from the list offered by Pest-Away Distribution.

The complaint, DieHard, has complained that the agents are no longer buying equipment and chemicals from his company and has lost quite a huge amount in revenue as a result. The Complainant is not happy about the exclusive arrangement and also feels that the free certification offered by Pest-Away Distribution is inducing agents to sign up with it. In addition Bugg-Off has stopped selling equipment and chemicals to DieHard.

Analyse the facts of the case to determine whether there are any contraventions of the competition Act and advise the Complainant of the prospects of success.

DETERMINING THE TERMS OF THE VERTICAL AGREEMENT AND HOW IT OPERATES IN PRACTICE

1. What are the terms of the agreement?
2. What is the agreement restricting?
3. Is competition being eliminated by the agreement?
4. Is there any competition even with the agreement in place?
5. Does the agreement-
 - a. Eliminate competition through foreclosure?
 - b. Raise barriers to entry?
 - c. Facilitates price discrimination?
 - d. Results in the monopolization of another industry?
 - e. Cartelize an industry an industry through either a distributors or manufacturers cartel?
 - f. Raise rival's costs?
6. Evaluate whether the agreement has any likely competitive benefits?