REPUBLIC OF SOUTH AFRICA

IN THE COMPETITION APPEAL COURT OF SOUTH AFRICA

HELD IN CAPE TOWN

CASE NO: 105/CAC/Dec10

106/CAC/Dec10

In the matter between:-

SOUTHERN PIPELINE CONTRACTORS	First Appellant
CONRITE WALLS (PTY) LTD	Second Appellant

and

THE COMPETITION COMMISSION	Respondent

JUDGMENT

DAVIS JP

Introduction

[1] This appeal concerns two separate but interrelated disputes between respondent and first and second appellants respectively. Briefly, on 29 November 2010 the Competition Tribunal ('the Tribunal') held that first appellant, after admitting to contraventions of the Competition Act 89 of 1998 ('the Act') had contravened ss 4(1)(b)(i), (ii) and (iii) of the Act. It imposed an administrative penalty on first appellant of R16 882 597.00, calculated on the basis of 10% of first appellant's turnover for its 2008 financial year, that turnover being in the amount of R 168 825 969. 00.

[2] Second appellant also admitted to contraventions of the Act, in its case, a contravention of s 4(1)(b)(i) and (ii). The Tribunal imposed an administrative penalty of 8% of its total turnover, amounting to R 6 192 457, its turnover being in the amount of R 77 405 715. Both appellants have approached this court on appeal on the basis that the administrative penalty imposed on them respectively was calculated in contravention of the framework laid out in section 59 of the Act and as a result is excessive.

[3] For the purposes of this judgment, the factual disputes raised in the two cases need to be dealt with separately, although the legislative framework is

equally applicable to both appeals. Accordingly, it is necessary to deal firstly with the proper approach to s 59.

The legislative framework

[4] Section 59 provides, insofar as it is relevant to the present dispute, that:

> "(*1*) *The Competition Tribunal may impose an administrative penalty only-*
>
> *(a) for a prohibited practice in terms of section 4(1)(b)…;*
>
> *…*
>
> *(2) An administrative penalty imposed in terms of subsection (1) may not exceed 10% of the firm's annual turnover in the Republic and its exports from the Republic during the firm's preceding financial year.*
>
> *(3) When determining an appropriate penalty, the Competition Tribunal must consider the following factors:*
>
> *(a) the nature, duration, gravity and extent of the contravention;*
>
> *(b) any loss or damage suffered as a result of the contravention;*

(c) the behaviour of the respondent;

(d) the market circumstances in which the contravention took place;

(e) The level of profits derived from the contravention;

(f) the degree to which the respondent has cooperated with the Competition Commission and the Competition Tribunal; and

(g) whether the respondent has previously been found in contravention of this Act."

[5] The wording of this section is indicative of a clear structure to be followed in the determination of an administrative penalty, albeit that the numerical numbering of the section appears to have caused some confusion, in that the considerations set out in s59(3) should precede the application of s59(2)

[6] In terms of subsection (1), the Tribunal may impose an administrative penalty, once a prohibited practice in terms of section 4 has been determined.

[7] The Tribunal, having then been empowered to impose an administrative penalty, is enjoined to take account of the factors which are set out in subsection (3). Mr Bhana, who appeared together with Mr Mooki on behalf of respondent, noted the 'must' in subsection (3) does not mean that each of these factors must be considered in all cases because one or some of these factors may not be present within the context of the particular dispute. However, in a case which presents the kind of facts contained in this dispute, all of the factors listed from (a) to (g) in subsection (3) become relevant and must be taken into account in the process of the determination of an appropriate penalty.

[8] Once a determination has been made of the proposed penalty, the Tribunal is then required to determine whether the amount so proposed falls within the cap, as provided in subsection (2).

[9] Given the constitutional dispensation in terms of which the Act is located, and the further injunction of section 39(2) of the Constitution of the Republic of South Africa 108 of 1996 that, in interpreting any legislation, a court must promote the spirit, purport and object of the Bill of Rights, it is clear that the doctrine of

proportionality constitutes a further applicable factor in the determination of an appropriate constitutional penalty in the circumstances of a dispute such as that before this Court. This conclusion is fortified by a *dictum* of Harms DP in **Woodlands Dairy v Competition Commission** 2010 (6) SA 108 (SCA) at para 10 where the learned Deputy President says:

> "*The so-called 'administrative penalties' (more appropriately referred to as 'fines' in s 59(2)) bear a close resemblance to criminal penalties."*

This equation of the penalties, which may be imposed in terms of s 59 of the Act, to criminal fines did not appear to take any cognisance of the judgment of this Court in **Federal-Mogul Southern Africa v Competition Commissio**n [2005] 1 CPLR 50 CPAC at 67 nor to comparative authority cited in that judgment. Nonetheless, the approach adopted by the Supreme Court of Appeal compels, at the very least, the conclusion that a penalty which is of a criminal nature should be proportional in severity to the degree of blameworthiness of the offending party, the nature of the offence and its effect on the South African economy in general and consumers in particular. It was noted in **Federal-Mogul** *supra* at 72 that the imposition of an administrative penalty should not only promote the important objective of deterrence but that sight should not be lost of fairness to the offending party. In particular, a penalty should not be imposed in order to destroy the business of the offending party, a point confirmed by s59(2) which places a cap on the amount of a penalty which may be imposed; that is it cannot

exceed 10% of the offending firm's annual turnover in the Republic and its exports during that firm's preceeding financial year.

[10] To emphasise, the cap described in s59(2) is exactly that which it purports to be; it is the determination of the maximum penalty that can possibly be imposed. It becomes operative only after the Tribunal has taken account of the factors set out in s59(3) and decided upon a penalty. It is then required to determine whether that proposed penalty falls within the maximum allowable penalty as provided for in s59(2).

The Tribunal's approach to s59

[11] From the record, it appears that Tribunal was invited by counsel for the second appellant to follow the approach which I have set out. Unfortunately, the Tribunal refused this invitation by concluding that a legislative framework 'ought not to be conflated with a formulaic methodology'. See para 47.

[12] The Tribunal then engaged in a brief examination of the approach adopted by the European Commission, the Office of Fair Trading in the United Kingdom and the approach developed by courts in the United States of America. The purpose of this investigation appears to have been designed to illustrate the

'arithmetic' approach which is set out in the applicable legislation and which governs the powers of these authorities. Take, for example the guidelines on the method of setting fines imposed in terms of article 23(2)(a) of Regulation 1/2003 of the European Union (2006/C210/02). In paragraph 10 of these guidelines the European Commission is enjoined to determine a basic amount of a penalty to be imposed on an undertaking or association which intentionally or negligently infringes articles 101 or 102 of the Treaty. The basic amount is determined by reference to the value of sales, by applying the following methodology: the Commission considers the value of the undertaking's sale of goods or services to which the infringement directly or indirectly relates in the relevant geographical area within the European Union. Paragraph 10 provides further that the Commission should normally take the sales made by the undertaking during the last full year of business of its participation in the infringement.

[13] In determining the value of sales by the undertaking, the European Commission will take that undertaking's best available figures. The basic amount of the fine will then be related to a proportion of the value of sales, depending on the degree of gravity of the infringement multiplied by the number of years of infringement. As a general rule, the proportion of the value of sales taken into account will be set at a level of up to 30% of the value of sales. In order to decide whether the proportion of the value of sales to be considered in a particular case should be at the low or high end of the scale, the Commission is enjoined to

have regard to a number of factors, such as the nature of the infringement, the combined market share of all undertakings concerned, the geographical scope of the infringement or whether or not the infringement has been implemented. In terms of paragraph 25 of these guidelines, the Commission, in addition to the determination set out will include in the basic amount a sum of between 15% to 25% of the value of sales, so defined, in order to deter undertakings from even entering into horizontal price fixing, market sharing and output limitation agreements. Once the basic amount has been set, paragraphs 28 *et seq* provide for a consideration of both aggravating and mitigating circumstances which would result either in an increase or a decrease in the basic amount of the penalty. In a similar fashion to s59(2), para 32 of the guidelines provides that the final amount of the fine shall not, in any event, exceed 10% of the total turnover in the preceeding business year of the undertaking or association of undertakings which participated in the infringement.

[14] Although not canvassed by the Tribunal, Mr Bhana also referred to the Competition and Consumer Act 2010 of Australia. Section 76(1)A of this Act provides for a penalty which shall not exceed for each act or omission to which the section applies the greatest of the following:

"(i) $10,000,000;

(ii) if the court can determine the total value of the benefits that have been obtained (within the meaning of Division 1 of Part IV) by one or more persons and that are reasonably attributed to the act or omission- 3 times that total value;

(iii) if the Court cannot determine the total value of those benefits – 10% of the annual turnover (within the meaning of Division 1 of Part IV) of the body corporate during the period (the turnover period) of 12 months ending at the end of the month in which the act or omission occurred."

[15] The provision in (iii) refers to total turnover as opposed to the affected turnover, whereas in (ii), the concept employed is the total value of the benefits that have been obtained' which would appear to be a figure which is lower than that of affected turnover.

[16] This examination of the applicable legislative framework of the European Union and Australia shows that these countries provide numerical guidelines to the relevant authorities in the determination of the appropriate penalty.

Significantly, no set of guidelines has been provided in this country which does compound the problem of a consistent determination of fines.

[17] The Tribunal then proceeded to apply the arithmetical approach, which it averred formed the basis of the EU methodology, as well as that of the Office of Fair Trading, in order to illustrate that, were a penalty in terms of s59 to be based on similar calculations, the penalty would far exceed the 10% cap provided for in terms of s59(2) of the Act. Therefore, in its view, this method could not be considered to be an appropriate mechanism for the purposes of determining a penalty to be imposed in terms of s59(1).

[18] Depending on whether, for example, the European Union takes a factor of 30% which it employs for very serious cartel offences and where the penalty is also based upon the full duration of the cartel period, the fine can be extremely high. See, for example, the analysis of *Veljonovski "Cartel fines in Europe: Law, practice and deterrence*" 2007 (30) *World Competition* 65.

[19] But an examination of the extreme fines imposed by the EU authority does not of itself justify the Tribunal in refusing to formulate the appropriate fine after a

careful application of s59(3) and then, only after such a determination, to assess whether the cap in terms of s59(2) has been exceeded. In summary, the invocation of the comparative approach does not justify a failure to separate the initial inquiry under s59(3) from the secondary inquiry in terms of s59(2). That the application of s59(3), absent clear guidelines, may prove to be difficult is no justification for eschewing its mandate. As with calculations of damages in civil cases and fines in criminal cases courts need to adopt the most plausible and justifiable means to substantiate their determination, in this case after an examination of the factors set out in s59(3).

[20] Having set out the framework which must be applied in general, a further consideration which derives from para 72 of the judgment in **Federal-Mogul** *supra* needs to be taken into account, namely that:

> "*This court does not enjoy unfettered discretion to interfere with the Tribunal's assessment and imposition of an administrative penalty. Even if we decided that a different penalty was appropriate we are not merely at large to substitute a finding for that of the Tribunal. This approach is consistent with general principle that an appeal against the exercise of its discretion by a court or a statutory body, the court on appeal has limited power to interfere. It can only do so on a certain well recognised grounds namely the court a quo exercises its discretion capriciously or upon a*

wrong principle or it has not brought its unbiased judgment in the question or it does not act for substantial reasons."

[21] Both appellants contend that the Tribunal has failed to apply the correct approach to s59 and, on the evidence, committed a number of serious misdirections which justify interference by this Court. For this reason, it is necessary, in the light of the legislative context outlined above, to turn to the facts of each case.

Southern Pipeline Contractors

[22] It appears that a national cartel was established by Rocla (Pty) Limited and Infraset, which now conducts business as Aveng Africa Limited. Apart from this national cartel, regional cartels were established in Gauteng, the Western Cape and Kwazulu-Natal. Cartel activities included price fixing and the allocation of contract/tenders in connection with the supply of pipes and culverts to construction companies and other customers.

[23] It appears that meetings took place in secret with venues being changed on a regular basis to avoid detection. Further measures were put in place to ensure secrecy, including cartel members being identified by a number rather than by their trade name. First appellant agreed that it would not participate in the market for manholes and culverts and, further, that it would only produce storm water and sewer pipes with a 300mm to 1800 mm diameter in Gauteng.

[24] The cartel was voluntarily terminated in October 2007. On 7 December 2007 Rocla, as a leniency applicant, furnished the Commission with information of the existence of the cartel. Pursuant to this information, the Commission initiated a complaint on 18 March 2008, alleging that Rocla, Infraset (Aveng), Cape Concrete (Pty) Ltd, Grallio (Pty) Ltd, D&D (Pty) Ltd, first appellant, second appellant, Cobro (Pty) Ltd Concrete Units and Craig's Concrete Products (Pty) Ltd had operated a cartel in the pre-cast concrete industry within South Africa. For the purposes of this judgment, it is relevant to note that second appellant's activities took place only within the Durban area.

[25] On 15 October 2008, first appellant delivered a comprehensive statement in which it detailed its participation in the cartel and furnished relevant documents to the Commission.

[26] On 13 February 2009, the Commission initiated proceedings against the ten respondents for orders couched in the following terms:

> "*1. an order declaring that the respondents have contravened s 4(1)(b)(i), 4(1)(b)(ii) and 4(1)(b)(iii) of the Act.*
>
> *2. an order directing the respondents to desist from such conduct.*
>
> 3. *an order directing the second (the first appellant), third, fourth, fifth, sixth, seventh, eighth and ninth respondents to pay an administrative penalty equivalent to 10% of each of the respondents' annual turnover for the preceding financial year*."

[27] On 12 March 2009, the general manager of first appellant, Mr Stephane Riot, admitted that first appellant, together with Rocla, Concrete Units, Infraset and Craig Concrete had contravened ss4(1)(b)(i), (ii) and (iii) of the Act. Mr Riot admitted that first appellant joined the cartel in October 1994, at a time that it operated in a 150 kilometre radius around Johannesburg. When it joined, the members of the cartel included Craig Concrete, Infraset and Rocla. Mr Riot admitted that first appellant's involvement in the cartel had been limited to a supply of concrete piping in this area and that, at no stage during its membership

had it engaged in the manufacturing and supply of culverts. After first appellant joined the cartel, it was allocated a 12.5% share which appeared to have been reduced to 11,75% from April 2001 when Concrete Units joined the cartel. In October 2001, first appellant acquired the assets of Craig Concrete and accordingly its percentage of the allocated market was increased to 27%.

[28] First appellant and the Commission could not reach agreement on the appropriate penalty to be imposed, as a consequence of which a hearing took place before the Tribunal on 2 and 3 August 2010. It appears that the essence of this dispute centred on the basis of the calculation of an administrative penalty and, in particular, a disagreement of what constituted first appellant's affected turnover for the 2008 financial year.

The Tribunal's determination

[29] The Tribunal noted that the approach that it had adopted to the determination of an appropriate penalty in previous cases:

> '*Has been to identify or connect the turnover of firm in the line of business or the market in which the contravention has taken place. This has been described as the affected or relevant turnover. While until now the*

Tribunal has calculated penalties based on the notion of relevant turnover, the Tribunal has never restricted itself to this methodology nor has it held they would treat all contraventions of the Act in same manner in all circumstances'. (paras 44 – 45)

[30] This articulation of its previous approach notwithstanding, the Tribunal proceeded to examine the dispute between the parties regarding the correct figure for affected turnover.

[31] It was common cause between first appellant and the Commission that an amount of R 44 935 988, which was derived from civil engineering activities, should be deducted from the total turnover of R168 825 969 in the 2008 financial year. First appellant submitted that a further deduction from its total turnover was justified in respect of concrete products it had supplied for the Gautrain project in the amount of R 42 834 295. In this case, the claim was resisted by the Commission which argued that there was a causal link between this amount of turnover and an earlier bid rigging agreement. Accordingly, this amount should be considered to be part of the affected turnover.

[32] A further figure of R 32 371 630, which was described in the financial statements as ‘revenue from bought – in goods sold’, was the subject of dispute. In the view of first appellant, this amount stood to be deducted from the figure of total turnover. Briefly, first appellant contended that these ‘bought - in goods’ arose from an agreement that had been concluded between first appellant and the Department of Water Affairs, (‘the department’) in terms of which first appellant undertook certain rehabilitative services on behalf of the department. For the purposes of this project, certain steel piping which was not produced by appellant was to be supplied to the department by an independent party. First appellant was required only to effect the installation.

[33] First appellant contends that it proposed to the department that it purchase the pipe, whereafter the department would reimburse first appellant for the costs. In other words, the pipes were to be supplied directly to the department by an independent entity (Group 5 Pipe) as a result of which first appellant would not make any profit on this transaction.

[34] These disputes relating to affected turnover notwithstanding, the Tribunal proceeded on the following basis:

"*It is necessary for us to decide on the dispute in respect of total turnover as the imposition of the fine requires us to know what the maximum permissible fine is*."

[35] The Tribunal examined the basis for excluding the amount for the 'in-out' transaction so as to determine whether the total turnover for the 2006 financial year was R 168 825 969 or R 136 454 369; that is the amount after the deduction of R 32 371 630, pursuant to 'in-out' transaction.

[36] The Tribunal evaluated first appellant's case with regard to this amount as follows:

"*Mr Riot under cross-examination conceded that they had agreed with DWAF to this particular mechanism in question – namely delivering the pipes and passing risk ownership directly onto DWAF – in order to obtain a direct benefit in its cash flow. But for this mechanism, DWAF would have retained a 10% retention fee. In consequence of this arrangement DWAF would waive the 10% retention which was to SPC's benefit*."

Accordingly, the Tribunal found that the amount of R 32 371 630 should have been included in the total turnover of first appellant because *'this is how it was always treated in the ordinary course of the companies business*'. (para 69)

[37] The Tribunal turned to examine the factors included in s59(3) of the Act. It concluded that, while appellant was not the leader of the cartel it was '*an active and enthusiastic member for 13 years*': (para 94). Among appellant's major clients was the department, Rand Water Board and various municipalities, all '*critical sectors for the growth and development of our country'*. Accordingly, the elevated prices caused by the cartel '*can only have caused considerable harm to the public purse and ultimately the South African taxpayer*'. (para 84) The Tribunal was thus of the view that the most weighty factors which had to be considered in the determination of the appropriate penalty were the duration, gravity and extent of the cartel, and, in its assessment, the present case '*must demand the highest sanction'*. For these reasons, it held that the appropriate penalty would be a fine equal to 10% of total turnover, being an amount of R 16 882 597.

First Appellant's case

[38] Mr Brassey, who appeared together with Mr Mundell on behalf of first appellant, submitted that the Tribunal had misdirected itself in the imposition of this penalty, essentially for three reasons:

1. It imposed a penalty based on first appellant's total turnover reflected in its 2008 financial statements.

2. It misdirected itself by accepting the Commission's calculations of first appellant's net affected turnover.

3. It misdirected itself by imposing the maximum penalty of 10% provided for in s59(2) of the Act and, in particular, failed to find that there existed mitigating factors in relation to first appellant warranting a reduced percentage in the calculation of the appropriate administrative penalty.

[39] It was common cause that, save for the amount of R32 371 630.00 which was revenue from 'bought – in' transaction the other disputed amounts, that is from the civil engineering contract and the Gautrain project, constituted part of first appellant's total turnover.

[40] I therefore turn to deal with the 'bought - in' transaction. Mr Riot testified about first appellant's contract with the department as follows:

> "*The percentages of structuring of the pipe is more than 30% of the contract. And in order to be able to be competitive as a contractor, we proposed to DWAF not to put any mark up on the steel pipe which is not at all our line of manufacturing. It is something we purchase from steel pipe companies such as Group 5 Pipe… And we proposed to DWAF to supply these pipes at cost, which has been accepted, with some deviation to the contract, which we asked for because supplying the pipe at cost was impossible for us to have retention on the price of the pipe. So they paid us the invoice of the supplier was coming. There was the escalation formula of the contract was not applicable on the pipe but the escalation of the supplier itself direct to DWAF on the contract as well.*"

Mr Riot confirmed that there was no retention in respect of this transaction. First appellant fee was charged solely for the installation.

[41] In support of first appellant's case, evidence was provided by Mr Louw, who was a partner in the firm that audited first appellant and prepared its financial statements. Mr Louw noted that an amount of R 32 371 630 had been reflected as part of first appellant's revenue for 2008 but this amount had also been

included in the costs of sales to produce a neutral return. In a report dated 16 November 2009, Mr Louw contended that the amount of R 32 371 630 should not have been so reflected in the financial statements. He justified this conclusion with reference to the South African Statements of Generally Accepting Accounting Practice ('SAGAAP') in which revenue is defined to include '*only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties such as sales, taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity and do not result in increases in equity. Therefore they are excluded from revenue*'.

[42] For this reason, Mr Louw testified that the correct accounting procedure would not have been to disclose the amount of R 32 371 630 as revenue. Hence it should not have been considered to be part of first appellant's affected turnover.

[43] Turning to the turnover relating to the Gautrain project, Mr Brassey submitted that the two special contracts concluded in 2007 and 2008 were for the provision of tunnel lining segments and noise barriers for the Gautrain project. The contracts had been entered into with Bombela Civils Joint Venture (Pty) Ltd and did not constitute a supply of products which had previously been governed

by the cartel agreement. Indeed, these particular contracts had nothing, in Mr Brassey's view, to do with the cartel arrangement nor with a proposed but aborted joint venture relating to the Gautrain project which would have involved the establishment of a joint venture with other members of the cartel and which Mr Riot conceded in evidence would have been 'essentially an extension of the cartel'.

[44] For this reason, Mr Brassey submitted that the Tribunal had completely misdirected itself by concluding that appellant had remained a party to an arrangement between Rocla and Infraset as a junior member of the Gautrain joint venture, as it never came into existence.

[45] Mr Brassey also submitted that certain of the considerations taken into account by the Tribunal in its assessment of aggravating factors were not justified on the evidence. The Tribunal held that first appellant had joined the cartel for fear of being undercut and hence driven out of business. While that conclusion accorded with the evidence of Mr Riot, it did not support the conclusion that '*a fear of competition can never be a justification for engaging in contraventions of the Act*.'

[46] Mr Brassey pointed out that Mr Riot's explanation was to the clear effect that, in the face of the cartel activity, a business such as appellants' would have failed as a business entity and it was therefore compelled to join. Mr Brassey also attacked the Tribunal's finding that the cartel had come to an end in October 2007, owing to the fear on the part of its members of exposure and sanction. He submitted, by contrast, that Mr Riot had testified that first appellant gained limited financial benefit or profit from the cartel and that its membership was financially unrewarding. This evidence had been supported by a graph produced by Mr Riot which reflected that the average increase in the selling price of concrete price correlated closely with the average increase in the manufacturing costs, the implication being that the members of the cartel had not derived excessive profits. Mr Myburgh, who testified on behalf of the Commission, confirmed, under cross examination, that the cartel '*was not producing result for the members that they would have hoped'*.

Evaluation

[47] Although the Tribunal did consider certain of the factors which were set out in s59(3), it never even commenced a process of determination of an appropriate penalty, pursuant to the criteria set out in s59(3) which represent a framework within which its discretion should be exercised. Rather, its reasoning is confined to certain considerations relating to the nature and duration of the offence and

generalised comments about the harm caused '*to the public purse and ultimately to the South African taxpayer*'. The Tribunal concluded that this was the most serious possible case which could come before it, and thus it demanded 'the highest sanction'. Without more, it then imposed a penalty, in effect, based on the cap in terms of s59(2) of the Act.

[48] This is manifestly an incorrect approach for the reasons which have been set out in our analyses of s59. The architecture of s59 does not permit a substantive circumvention of s59(3) without any attempt by the Tribunal to complete the comprehensive enquiry mandated in terms of this subsection before a penalty can be imposed. It is only after such an inquiry has been completed that the cap pursuant to s59(2) becomes relevant.

[49] Although the EU guidelines differ to a significant extent from the strictures of s59(3), some initial calculation of affected turnover as is employed in the EU guidelines, together with a calculation of the years in which the particular member of the cartel has participated therein, could present a promising basis to develop an initial calculation of an appropriate penalty; that is in terms of s59(3).

[50] It was common cause, however, that in this case, the affected turnover for any period other than the 2008 financial year was not available. For this reason, this Court is compelled to work exclusively with the 2008 figures.

[51] The concept of 'turnover' is not defined in the Act and is only referred to in s59(2), being annual turnover. There is thus some uncertainty as to the precise meaning of 'turnover'. However, s59(3) refers on more than one occasion to 'the contravention'; in particular, in dealing with the nature, duration, gravity and extent 'of the contravention', the loss or damage suffered as a result, of 'the contravention' the market circumstances in which 'the contravention' took place and the level of profit derived from 'the contravention'. Thus, there is a legislative link between the damage caused and profits which accrue from the cartel activity. The inquiry, in terms of s59(3), appears to envisage that consideration be given to the benefits which accrue from the contravention; that is to the amount of affected turnover. By using the base line of affected turnover, the implications of the doctrine of proportionality that is between the nature of the offence and benefit derived therefrom, the interests of the consumer community and the legitimate interests of the offender can be taken more carefully into account and appropriately calibrated.

[52] Hence, it appears that affected turnover can be used in the initial determination as to a penalty to be formulated in terms of s59(3). Significantly, an ICN report ('Cartels working Group: Selling of fines for cartels in ICN jurisdiction (2008)') summarises the position thus:

> "*As regards fines imposed on companies, the measure quoted by most of the responding agencies, as a basis for the determination of the fine in cartel cases, is related to the concept of turnover/volume of commerce/affected sales in the cartelised product/service. The advantage of such data is that it is relatively easy to obtain, normally collected and audited and kept as record by the companies*."

[53] Affected turnover should be employed in the initial formulation. In my view, the Tribunal misdirected itself with regard to the quantum of the affected turnover. It may be that there are cases where a transaction is employed as a 'loss leader' so as to accrue a profit from a related transaction which would justify the inclusion of the former transaction in the computation of affected turnover. Further, while the provisions of SA GAAP are not definitive, they do provide a useful justification for what should be included in actual turnover. Even Mr Bhana on behalf of respondent, contended that affected turnover meant total business sales or gross revenue. Viewed accordingly, the so called 'in - out' transaction should not have been included in the affected turnover. It was not correct, on the

strength of the available evidence, for the Tribunal to conclude that this is how such a transaction '*was always treated in the ordinary course of the companies business for all purposes*'.

[54] The Tribunal also misdirected itself in its inclusion of the R 42 834 295 which flowed from the Gautrain contract. It did so because it conflated the work done independently by the appellant with a joint venture that would have been part of the cartel but which never came to fruition.

[55] In addition, it was common cause between first appellant and respondent that the civil engineering turnover of R 44 935 988 did not form part of affected turnover. Accordingly, the total amount of affected turnover was R 43 684 056. That figure should have been employed as a base line factor in the initial process employed to calculate the appropriate penalty. Thereafter, consideration could be given to the 13 year period in which first appellant participated as a member of the cartel in order to increase the initial proposed figure.

[56] There are further considerations that require examination in the assessment of the appropriate penalty. First appellant's participation in the

cartel activities was limited to Gauteng and further to the specific sale of concrete pipes. Unlike other members of the cartel, it did not actively engage in cartel activities in the Western Cape, Kwazulu-Natal or any of the adjacent countries. First appellant did not derive the magnitude of business from the cartel as was enjoyed by either Infraset or Rocla. As to the benefits which were enjoyed by first appellant pursuant to the cartel, Mr Riot was vigorously cross-examined on his statement 'that there is no evidence of any direct loss to competitors, contractors or consumers," but, on the record, there was very little evidence to suggest that there had been significant consumer losses pursuant to first appellant's activity. While it was fair to draw an inference that competitive prices were not paid by consumers for first appellant's products, little concrete evidence was placed before the Tribunal to indicate the extent of any significant increase in profit which flowed to first appellant, which could, in turn, have been determined by a ratio analysis based on figures provided in the financial statements. In an annexure to Mr Riot's witness statement, it was suggested that the increase of costs of the manufacturer for the period 2002 - 2007 had been higher than the increase in the return enjoyed by first appellant during that period. No further evidence was made available.

[57] The Tribunal was not provided with adequate evidence regarding significant considerations which it was mandated to take into account, including loss or damages suffered as a result of the contravention, the level of profit

derived from the contravention and the effect on the market. However as a body which enjoys inquisitorial powers, the Tribunal could have demanded that further and better evidence be provided by the parties, particularly respondent in order to assist it in its mandated determination. In the result, the evidence which is available cannot sustain the conclusion that this is the most egregious kind of cartel behaviour envisaged by the Act. Furthermore, even in the case of parties who had participated to a greater extent and within the context of a larger market in the cartel, penalties which, were lower than 10% of turnover, were imposed. Infraset agreed to pay a penalty of R46 277 000 which represented 8% of its turnover in the previous financial year (it is not entirely certain whether this turnover figure was affected turnover or total turnover, excluding turnover attributable to paving products). Although substantial fines, were imposed on other participants, the amounts charged were considerably less than the maximum penalty which could have been so imposed. This supports a conclusion that the Tribunal was unjustified, in terms of the evidence placed before it and without significant and careful justification, to rely on the default position in terms of s59(2) for its determination of the penalty imposed upon first appellant.

[58] Nonetheless, penalties for participation in a cartel and, particularly where the participation has inured for a lengthy period, should be significant and certainly sufficiently onerous to act as a deterrent. The achievement of an

effective deterrence requires careful consideration. Apart from the possibility of being discovered, successful deterrence depends on the extent to which the expected benefit of the conduct can be significantly reduced by a penalty which is so imposed. As Motta has noted (2008 (29) *European Competition Law Review* 209) a successful fine depends on a consideration of the expected benefit of the conduct and the possibility of being so discovered. In turn, the possibility of being discovered depends on the work of the enforcement authority, in this case the Commission.

[59] A calculation of the expected benefit will, of course, have to take into account not only the problem of discovery of the relevant documentation to support a justifiable finding but also the extent to which the competition institutions, in this case the Tribunal and ultimately this Court, are prepared to ensure that the benefit which flows directly or indirectly from participation in cartel activity will have to be disgorged by the appellant.

[60] In summary, s59(3) provides for seven factors, of which account must be taken in the determination of an appropriate penalty. While s59(2) refers to 'annual turnover', that is total turnover, this concept does not appear in s59(3). However, the linkage contained in s59(3) between certain of the listed factors and

'the contravention' indicates that turnover in the relevant product market which is affected by the anti-competitive conduct should form the basis of the initial formulation of the penalty; that is prior to the final determination as to whether the proposed penalty falls within the cap as provided in s59(2). If the consideration of the seven factors leads to a conclusion that the conduct of the offending party constitutes a particularly egregious case, then a higher percentage of affected turnover can be employed as a relevant factor to increase the proposed penalty. To illustrate by way of a simple example: Affected turnover of the cartel member amounts to R400. Total turnover is R1000. After a consideration of all the factors contained in s59(3), a factor of 30% is employed on affected turnover to produce a penalty of R120. That must be reduced to R100 by virtue of the cap in terms of s59(2).

[61] Although not strictly necessary for determination in this case, I tend to accept the approach adopted by Sutherland and Kemp Competition Law of South Africa at 12 – 11 that a plain reading of s59(2) supports a conclusion that the base year for the determination of the cap is the financial year preceeding that in which the penalties are imposed. This conclusion therefore illuminates the animating idea that the legislature was concerned that the penalty, although severe, should not, on its own, be destructive of the offending party's business; hence the restraint of the cap.

[62] In my view, a fine equal to 20% of the nett affected turnover is appropriate in the present circumstances to meet both the objectives of the Act and the overriding considerations of proportionality, in turn determined after a careful consideration of the factors envisaged in s59(3). In sum therefore, the penalty of R 8 720 000 is an appropriate penalty, given the circumstances of this case.

Conrite Walls (Pty) Ltd

[63] Second appellant commenced business in 1967 in Durban. It appears to have focussed its business activities almost exclusively within this geographical area. It currently manufactures and sells pre-cast concrete toilets which comprised ⅔ (two thirds) of its turnover in its most recent financial year ending February 2010, as well as steel palisades, concrete palisades, gates and wire fencing. It never produced or sold pipes, culverts or pre-cast concrete sleepers which are the products relevant to the other members of the cartel.

[64] In 1999 second appellant entered the market for the manufacture and sale of pre-cast concrete manhole rings. It appears that this is the only product market which is relevant to its admitted contravention of the Act and further to the issues which had been raised in these proceedings.

[65] In or about the end of 2000 or early 2001, D&D (Pty) Ltd, Cobro (Pty) Ltd and second appellant agreed to divide the Durban market for manhole rings on the basis of the respective firms productive capacity. According to this agreement, second appellant was allocated 15% of the market. In July 2005 second appellant announced its intention to exit the manhole rings market. In response, Cobro and D&D suggested that it manufacture manhole rings for them. However, second appellant had already decided to focus its core business on the manufacturing of walls and fencing and expanding into the market for pre-cast toilets. In 2005 and 2006 second appellant sold its existing stock of manhole rings to Cobro and D&D. At this time it was agreed between the parties that they would split Conrite's erstwhile 15% market allocation and, upon Cobro and D&D's suggestion both firms would pay second appellant a monthly amount for mould rental or usage in the amount of R 30 000 plus VAT and R 10 000 plus VAT respectively. These payments were made from August 2005 until February 2008 and were reflected in second appellant's financial statements. It appears that Cobro and D&D sought to ensure that second appellant would not return to the manhole ring market, and it was for this reason that these payments were made. The total amount of payments which were made according to second appellant's audited annual financial statements amounted to R 1 456 033. The total turnover from manhole rings, inclusive of these payments, was in the amount of R 3 637 626.54, for the period 2002 – 2008.

[66] The proceedings before the Tribunal were concerned with the imposition of an administrative penalty on second appellant. Respondent sought a penalty of 10% of second appellant's annual turnover in its preceding financial year. Second appellant tendered payment of the receipt of R 1 456 033 together with a 25% premium on this amount.

The Tribunal's determination

[67] The Tribunal acknowledged that second appellant's total turnover for the 2008 financial year amounted to R77 405 710. It then turned to the determination of affected turnover. It noted that certain turnover was unrelated to concrete products and '*this amount should be deducted from total turnover'*. It considered whether all concrete products should constitute the affected turnover or '*only that which formed which formed the expressed subject matter of the cartel agreemen*t'. On the basis that affected turnover was limited to manhole covers, the total amount would be R440 000.

[68] Working with an affected turnover of R 440 000 and applying both the approach adopted by EU and the UK's Office of Fair Trading, the Tribunal concluded that penalties of R 792 000 or R 264 000 would have represented the

product of the EU or the OFT calculations respectively. Either amount, in the Tribunal's view, 'seems wholly under deterrent'. (sic)

[69] The Tribunal then sought to apply its 'broad discretionary approach' to the facts as they related to second appellant. It placed considerable emphasis on the evidence of the managing director of second appellant, Mr Robert Speirs, and, in particular, his alleged inability to explain why competitors to second appellant would have been willing to pay it some R 40 000 per month to stay out of the market, in circumstances where he had averred that second appellant had enjoyed little success.

[70] The Tribunal examined the 'phenomenal growth of approximately 635% over the period of 2006-2008' in second appellant's participation in the toilet seat market. It noted that second appellant had commenced producing toilet seats at approximately the same time that it exited the 'manhole rings' market. It therefore drew the conclusion that second appellant's exit from this market permitted it to focus its productive activities on the 'toilet seat' market where it achieved great success.

[71] The Tribunal described the second appellant's contravention as 'the most egregious' which had persisted from 2001 to 2007. It then took account of the fact that '*that a collusion related only to the toilet seat/manhole market in KZN and was not as extensive as the cartel in Gauteng or the national cartel*.' On the basis mainly of duration and the extent of the cartel, it then imposed a penalty of 8% of second appellant's total turnover of R 77 405 710, which amounted to a penalty of R 6 192 457.

Conrite's submissions

[72] Mr van der Nest, who appeared together with Ms Le Roux on behalf of second appellant, submitted that the Tribunal had misdirected itself by not taking careful account of the fact that second appellant was only part of a smaller cartel and specifically in the area of Durban. It was neither part of the national cartel nor a regional cartel and accordingly the more extensive activities of the national or regional cartels could not be imputed to second appellant. The reasoning employed by the Tribunal however did not distinguish this more limited role sufficiently from the conduct of the national cartel. For example, the Tribunal describes second appellant as part of a KZN cartel and the nature of its participation as follows:

> "*In this case we do not see Conrite's participation as misguided as it purported to be. The nature of the contravention has already been described as the most egregious*."

The description employed to describe the national cartel is used, without explanation, to categorise the conduct of second appellant.

[73] Second appellant contended that critical evidence given by Mr Speirs was ignored by the Tribunal. In particular, Mr Speirs testified in his answering affidavit that, although second appellant had been allocated 15% of the Durban market, '*there was no guarantee of any work in this market cause Rocla, first appellant, Infraset, Grallio and Grinaker Ltd were not parties to the verbal agreement and consequently Conrite still had to compete with them.*'

[74] Mr Speirs testified further that second appellant did not enjoy considerable benefit from the cartel. As he stated:

> "*In the middle of 2005 we were at our meeting and it had been boiling up where we had been slipping behind in our market allocation in terms of tonnage and we got so far behind that they would have had to have stopped production for 6 months and given us all the work and we didn't*

have the capacity to do it. By this time we had lost interest in the manhole market. It wasn't producing the results that we had hoped and we had moved into the pre-cast concrete toilet market by that stage."

[75] In answer to a question from the chair of the Tribunal as to why it was so difficult for second appellant to break into this market, Mr Speirs said that second appellant was known as a fencing contractor and '*the manhole is a very small part of the pipes and the culverts, and the various other things they would need on these particular projects*'.

[76] In second appellant's view, the Tribunal did not appear to take sufficient cognisance of the evidence of Mr Speirs, under cross examination when asked specifically as to why the second appellant insisted on being paid rent for the moulds. Mr Speirs replied:

"*I never insisted on it. They made the suggestion and if somebody was going to pay me some money for doing nothing, I was quite happy to receive it, because in the discussion and the meetings it was rental for moulds as such and to me I didn't … again, I realise now I'm in*

contravention, but I did not believe that we were doing anything wrong at the time."

Had the respondent wanted to contest this evidence, it could have called representatives of the D&D or Cobro to probe the motivation for the payments to second respondent. In particular, as Mr Speirs mentioned, the person who could have provided further and better evidence was Mr Ted Brown of Cobro but he was never called as a witness.

[77] Mr Speirs was asked by the chair of the Tribunal about second appellant's toilet seat business which had commenced in 2006, and in particular the reasons also why other firms had not entered 'such a lucrative market'. To this question Mr Speirs answered thus:

"*I think that the reason for our success, and I know we've got Rocla and various other people in the room here, but I think that the reason for our success there has been that we've been prepared to go and set up many factories and create work in the rural areas where these toilets are actually required and we have job creation and we purchase. Our purchasing power goes into the local area in terms of aggregates, sand and so on. Cement comes from a basic source, but we purchase local and we employ local people, i.e. in Kaserne, we have a factory in Kaserne. We have a*

factory in Empangeni. We have a factory down on the south coast. We have a factory down in East London and this has been our business model, that if an area is prepared to give us a big enough order, we are prepared to come and invest and put a factory in their thing and of late we have started to joint venture with a lot of municipalities."

[78] Mr Speirs testified further that there had been no agreement with any other firm that second appellant would exit the manhole market in order to enter the toilet market. Further, given the machinery possessed by Cobro and D&D, they would have been entitled and able to have entered the same market, had they so chosen. In Mr van der Nest's view, this represented a complete answer to the attempt to link the exit from the cartel with the success in the toilet market.

Evaluation

[79] Unlike the approach adopted by the Tribunal to first appellant, it appears that when it came to determine the penalty to be imposed upon second appellant, it inexplicably relied solely on a concept of affected turnover. Its major concern was whether this figure should include all concrete products. Much of its assessment of the penalty turned on the reasons for why second appellant had

been paid by Cobro and D&D and for its success in the toilet market subsequent to its exiting the cartel. Absent clear evidence to support these findings, the conclusion reached was, in effect, the product of speculation which was not grounded in the evidence placed before the Tribunal. Indeed, in the case against second appellant, there was no clear evidence of the amount of affected turnover, save for the payments made to it by D&D and Cobro. These amounts represented affected turnover and, absent further evidence from respondent, had to form the basis upon which the s59(3) calculation was to be undertaken.

[80] As in the case of first appellant, the Tribunal failed to begin its determination of an appropriate penalty by a careful recourse to the factors set out in s59(3). Had it done so, it would have concluded that second appellant was part of a small cartel which serviced a relatively small market for a fairly short period of time. It would have taken into account, for example, the fact that, in the 2008 year, of a total turnover of R 74 977 039. 03, only R 440 000.00 related to manhole rings and ancillary products. Indeed, during the period 2006 – 2008, second appellant's turnover for manhole rings constituted 1.9%, 0.9% and 0.6% respectively of its total turnover.

[81] A careful consideration of the factors set out in s59(3), which were required to be taken into account in order to arrive at an appropriate penalty, could never justify a penalty which appears to have been based on a small reduction from the maximum penalty which could be imposed, pursuant to the cap in terms of s59(2).

[82] This is a case where the approach adopted by the EU affords helpful guidance. The turnover from the manhole rings for the period 2002 - 2008 was in the amount of R2 181 593.41 to which must be added the payments of R 1 456 033 made by Cobro and D&D which gives a total amount of R 3 637 626.54. This represents the total affected turnover for the entire period in which second appellant participated in the cartel.

[83] If this figure is multiplied by 8, being the years of participation in the cartel, the base figure becomes R 29, 101m. Given that second appellant operated for a relatively short period in the cartel and that it did not enjoy huge benefits, and further that a significant portion of the benefits flowed from payments it received from its two competitors and that the overwhelming portion of its total turnover related to businesses which could not be imputed directly or indirectly to its cartel activities, a figure of 7% of R29 101m would constitute an appropriate factor by which to determine the penalty. This gives rise to an amount of R2 037 070.00.

[84] This amount is slightly higher than that which was tendered by second appellant, being an offer to disgorge itself of the payments received by Cobro and D&D of R 1 456 033.15, together with a further penalty of 25%, thus constituting a total penalty of R 1 820 041.43. However, the penalty imposed, in terms of the approach that I have adopted, follows more carefully upon a framework which could be usefully employed in the future, given the kind of evidence available and achieves a more justifiable balance in terms of the factors set out in s59(3) as outlined above.

Conclusion

[85] In the result the following order is made:

1. The appeals of both first and second appellants are upheld with costs, including the costs of two counsel.

2. The orders of the Tribunal are set aside and replaced with the following:

    2.1 First appellant is found to have contravened s4(1)(b)(i), (ii) and (iii) of the Act.

2.2 An administrative penalty of R 8 720 000, being 20% of R 43 684 056 is imposed upon first appellant.

2.3 Second appellant is found to have contravened sections 4(1)(b)(i) and (ii) of the Act.

2.4 An administrative penalty of R 2 037 070.00 is imposed on second respondent, being 7% of R 29 101 000.00.

3. The penalties must be paid to the Competition Commission within 20 days of this order.

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DAVIS JP

DAMBUZA and ZONDI JJA agreed