

COMPETITION TRIBUNAL

REPUBLIC OF SOUTH AFRICA

Case Number: 08/CR/Mar01

In the matter between:

**The Competition Commission of
South Africa**

Applicant

and

Federal Mogul Aftermarket Southern Africa (Pty) Ltd

1st Respondent

Federal Mogul Friction Products (Pty) Ltd

2nd Respondent

T & N Holdings Ltd

3rd

Respondent

T & N Friction products (Pty) Ltd

4th Respondent

Decision and Reasons for the Competition Tribunal's Decision

The Complaint

1. The Commission has referred a complaint directed against Federal Mogul Aftermarket (Pty) Ltd, which is part of the Federal Mogul group of companies, a United States corporation registered on the New York Stock Exchange, (henceforth referred to as "Federal Mogul") a wholesale distributor of a range of motor-car components, including Ferodo, the products of a large multinational manufacturer of braking equipment.¹

¹ Federal Mogul Aftermarket is responsible for the sales and distribution, as opposed to the manufacturing of, inter alia, Ferodo friction products. Distribution of Ferodo products was previously done by T&N Friction Products (Pty) Ltd trading as Ferodo. T&N Friction was de-registered in 1999 after Federal Mogul bought the T&N group of companies in 1998. The T&N businesses consisted of three different businesses being AE Engine Parts, Ferodo and Payen Gasket Manufacturing. In October 1998 Federal Mogul also acquired Cooper Automotive. Initially there was some uncertainty as to the entity, which had had dealings

2. The complaint was filed in November 1999 with the Competition Commission by Mr. Koos Erasmus, (“Erasmus”) the Managing Director of Pee Dee Wholesalers (Pty) Ltd (“Pee Dee” also sometimes referred to as ‘Pee Dee Gauteng’). Pee Dee distributed friction products (i.e. motor brakes and related products), principally Ferodo products, a leading brand in the friction products market.
3. Erasmus approached the Commission alleging that he had been effectively forced out of business as a result of Federal Mogul’s decision to reduce the rebate (or, what is the same thing, increase the price) at which they supplied him with Ferodo products. However, from the perspective of the enforcement of the Competition Act, what is significant is Erasmus’ allegation that the respondent’s action to reduce his rebate arose out of his participation in a price war – in short, Erasmus alleges that because he offered products purchased from Federal Mogul at a price lower than that imposed by his supplier, his rebate and, crucially, his margins, were cut, rendering his business non-viable.
4. At the time during which Pee Dee’s rebate was cut by Federal Mogul, it was trading in the East Rand as a wholesaler distributing Ferodo brakes and related friction products. It was also known as Pee Dee Gauteng. Erasmus had previously been employed by (and was a small shareholder in) a company, called AZ Friction Products, a member of the B&U group of companies and the largest wholesale distributor of Ferodo and other friction products in Gauteng Province. During 1998 the Midas Group Limited, a division of Dorbyl, bought AZ Friction from B&U. Midas consists of a number of divisions, each specialising in the wholesaling of a particular group of motorcar parts. AZ Friction was absorbed into the division of the Midas group specialising in the distribution of braking, or friction products. It appears that Midas’ own retail outlets operate on a franchise basis with the franchisees free to purchase their supplies from the franchisor, Midas, or to give their business to an independent supplier.²
5. Erasmus continued to run the AZ Friction business after its absorption by Midas. His Ferodo account manager was Mr Brian van der Bijl.³ (“van der

with the complainant. The first respondent, after further investigation and subsequent to the joinder of the 2nd and 4th respondents, determined that the conduct contained in the complaint occurred after Ferodo’s marketing and sales operations had been transferred to the Federal Mogul Group. Accordingly, counsel for the respondents conceded that the first respondent was properly a respondent in this matter.

² Midas naturally supplies both its own retail franchisees as well as other independent retailers.

³ Erasmus and van der Bijl had previously worked together at Ferodo. Van der Bijl left Ferodo in December 1999.

Bijl”) This was not a happy time for Erasmus. He felt his entrepreneurial style cramped by the requirements of working for a large group. He was unable to meet the standards demanded of him by his customers – which they had previously received from AZ Friction Products – because of a range of inefficiencies introduced as a result of AZ’s absorption by Midas. His company was losing market share – it appears that even Midas’ own franchise operations were turning elsewhere for their supplies of braking products. Nor, for the same reason, was it a happy time for Federal Mogul, at least, for those within the Federal Mogul operation responsible for distributing Ferodo products. As a result of the compromised efficiency of its largest wholesale distributor, the erstwhile AZ Friction Products now part of Midas, the Ferodo product was itself beginning to lose market share to competing braking products.

6. It appears that Erasmus shared his concerns with Mr. Barry Taylor,⁴ (“Taylor”), the then Sales Director - Wholesale Markets within the Federal Mogul group. Erasmus informed Taylor of his intention to quit the employ of Midas and strike out on his own. He queried with Taylor the prospect of Federal Mogul utilising him as one of its distributors in the event that he opened his own business.
7. Federal Mogul itself was going through some significant changes in 1998. A new Managing Director, Mr. Frik Nel, (“Nel”), was appointed in late 1998. Nel had previously been Managing Director of Cooper Automotive, one of the other divisions of Federal Mogul. Nel had no previous experience in the friction products part of the business.
8. On the instruction of his US parent company, Nel’s first task was to secure the more effective integration of the four divisions of Federal Mogul, in Nel’s own words, ‘to consolidate those four businesses into one’.⁵ A key pillar of Nel’s approach to his task was a reduction in the number of retail distributors utilised by Federal Mogul. It should be borne in mind – and the significance of this is demonstrated later - that Midas distributed the full range of Federal Mogul products. That is, in contrast with Pee Dee, it was not a specialist distributor of brake products but rather a general distributor of automobile parts. It was, indeed, one of the largest distributors of Federal Mogul products.
9. Cognisant of Nel’s desire to reduce the number of distributors of Federal Mogul products, but also concerned at the loss of the friction product

⁴ Mr Taylor and Koos Erasmus worked together at Ferodo during the 1980s. Mr Erasmus later joined AZ Friction while Taylor rose in the ranks of Ferodo and, subsequently, Federal Mogul.

⁵ Transcript, 27 August 2002, pages 100–104.

division's market share, Taylor approached Nel and enquired as to whether he would be willing to allow Erasmus to distribute Ferodo products. Nel, in accordance with the broader strategy that he was pursuing, rejected this request out of hand.

10. Taylor conveyed Nel's response to Erasmus. It is at this point that broad agreement on the facts gives way to raging contention. In short, Erasmus avers that Taylor told him that Federal Mogul feared that by agreeing to accept Erasmus, an erstwhile employee of Midas, as one its distributors, it risked alienating Midas, one its largest customers. However, Taylor offered to put Erasmus in contact with Mr. Peter Sutherland and his son David, long time distributors of Ferodo products.⁶ The Sutherlands operated out of Kwazulu-Natal province trading under the name of P&D Wholesalers Natal. Erasmus says that Taylor suggested that he try and persuade the Sutherlands to allow him, Erasmus, to use their trading name in Gauteng, to effectively hold out to the market, that the Sutherlands had expanded their activities to Gauteng Province. In this way Federal Mogul could hold out to Midas that they had not licensed a new distributor in Gauteng but that they had simply agreed to supply a long-standing customer who had elected to expand to Gauteng and who had employed Erasmus, well versed in that market, to manage their newly established branch.⁷

11. Peter Sutherland testified that Taylor approached him and suggested that he permit Erasmus to use P&D Wholesalers' name to trade in Gauteng as Pee Dee Wholesalers (Gauteng) because of Federal Mogul's (that is, Nel's) refusal to countenance the appointment of new wholesalers.⁸

12. However, Taylor's version differs significantly from those of both Erasmus and Sutherland. He avers that the Sutherlands had made him aware of their desire to expand to Gauteng. A letter from David Sutherland to Taylor appears to confirm this intention.⁹ Aware of Erasmus' unhappiness at the state of affairs in Midas and anxious to retain his marketing skills, Taylor had suggested to Erasmus that he make contact with the Sutherlands in order to ascertain whether there were any prospects for him, Erasmus, in the Sutherlands' expansion plans.

13. In essence, then, on Taylor's version, Federal Mogul had always viewed

⁶ It appears that Peter Sutherland and Barry Taylor, also go back to Ferodo – indeed Sutherland testified that he had signed Taylor's first employment contract with Ferodo.

⁷ Mr Erasmus resigned from Midas in March and P&D Wholesalers opened its doors in April 1999.

⁸ See transcript of 26 August 2002, page 86 where the Commission questions him on this.

⁹ See page 1 of the respondents' paginated records.

Pee Dee Gauteng as a branch of P&D Natal, as part and parcel of the Sutherlands' business. On Erasmus' and Sutherland's version, Federal Mogul was well aware that the Gauteng business was independently controlled by Erasmus and that the involvement of the Sutherlands was simply a pretence directed at Midas. Indeed, Erasmus insists – and this is corroborated by Sutherland - that Taylor, a senior employee of Federal Mogul, devised this ruse in the interests of Federal Mogul.

14. Although a welter of evidence was led on this factual dispute we are, in the end, unable to decide which version represents the truth.
15. Indeed, in the range of probabilities, the dwindling sales of Midas, Ferodo's largest distributor, suggests a third possible explanation, and that is that Taylor, anxious to revive Federal Mogul's friction products sales, a division for which he had been responsible, and confronted by the reforming zeal and inflexibility of Nel, someone who had no direct experience in the friction products business, sought to deceive Nel by conniving to retain Erasmus, a valued distributor, while at the same time holding out to Nel that he was at one with his new CEO's desire to reduce the number of distribution outlets.¹⁰ Peter Sutherland's account of his initial discussion with Taylor on this matter is instructive:¹¹

Mr. Coetzee (legal counsel for the Commission): I think perhaps explain how did it come about as far as you're concerned, that another entity opened up in the Gauteng area under almost a similar name as that of your closed corporation.

Mr. Sutherland: I was approached by Mr. Barrie Taylor who said that Mr. Koos Erasmus was thinking of leaving his current occupation and going to work for himself and had approached Mr. Taylor and asked for a distributorship of the Ferodo product. Mr. Taylor advised me that the structure that they had in place wouldn't allow for that, but if I would be happy enough to allow Mr. Erasmus to use the name, it would be alright with him.

16. And later when pressed to explain how he could have allowed Erasmus to trade using a name similar to his own, Sutherland, referring to Taylor,

¹⁰ According to van der Bijl, AZ Friction sold almost 50% of Ferodo's total turnover prior to Midas taking over. See page 22 of transcript of 26 August 2002. van der Bijl, at the time Regional Manager of Federal Mogul, also testified to the decline in the sales of Ferodo products after AZ's incorporation into Midas. He noted in his testimony Midas' concern at this situation manifest in the extent to which senior Midas managers engaged him in discussion of the issue.

¹¹ Transcript, 26 August 2002, page 87.

replies:12

‘...when you’re asked by somebody that you’ve worked with for a number of years and who said in his approach to you, there’s no other way. The exact words were that we need his (that is, Erasmus’) expertise to maintain the portion of market in Johannesburg and we need this man to do it’

And further:

“No, I was saying right from the outset, I agreed that they could use the name to get themselves established so they could hold the market share they were going to lose and it was done in all honesty and that’s all that was done”

17. Note that this explanation differs from the accounts of both Taylor and Erasmus, but appears to have a logical consistency that both alternative explanations lack – that Taylor was concerned about Ferodo’s decline in market share as a result of Midas’s poor performance is not denied as is his high regard for Erasmus’ salesmanship; that Nel would not allow new distributorships is clearly admitted; and so, Taylor contrived to find a way around Nel’s strictures while simultaneously reviving Ferodo’s fortunes. Not only is this view consistent with the admitted facts, but it may have worked had Midas, and then Erasmus, not upset the applecart by breaking the rules of the game.
18. However, despite the quantum of evidence devoted to this issue we, like Mr. Brassey for the respondents, have to be reminded of its significance in relation to our task. Mr. Brassey suggests that the Commission needs the complainant’s version to be accepted in order to establish the lengths to which Federal Mogul would go to satisfy Midas. A failure on the Commission’s part to establish this would, argues Mr. Brassey, not allow it to explain why Federal Mogul would choose to punish Erasmus for a price war which, on all versions it appears, was initiated by Midas. We disagree. We will show later how the evidence and the incentives clearly establish why Federal Mogul would have sought an end to the price war by bringing Erasmus rather than Midas to book.
19. We do not, in short, believe it necessary to establish whether Pee Dee Gauteng was part of, or independent of, the Sutherlands’ Kwazulu-Natal operation. Even if we accept the respondent’s version that Federal Mogul believed in good faith that Pee Dee Gauteng and PD Natal were strongly

12 Transcript , 26 August 2002, page 99 and 107, respectively.

associated and, indeed, that they were so associated, it remains our finding that the respondent has contravened Section 5(2) of the Act.

20. At the risk of stating the obvious, what the evidence must establish is whether or not the practice of resale price maintenance has occurred. It is necessary to turn to an examination of the requirements for successfully sustaining a charge of resale price maintenance.

Resale Price Maintenance

21. The Commission alleges that Federal Mogul is in contravention of Section 5(2) of the Competition Act. Section 5(2) prohibits the practice of minimum resale price maintenance. It may, for consideration of the argument presented to us, be worthwhile reproducing Section 5 of the Act in its entirety. It reads:

5. Restrictive Vertical Practices Prohibited

- 1) An agreement between parties in a vertical relationship is prohibited if it has the effect of substantially preventing or lessening competition in a market, unless a party to the agreement can prove that any technological, efficiency or other pro-competitive, gain resulting from that agreement outweighs that effect.*
- 2) The practice of minimum resale price maintenance is prohibited.*
- 3) Despite subsection (2), a supplier or producer may recommend a minimum resale price to the reseller of a good or service provided –
 - (a) The supplier or producer makes it clear to the reseller that the recommendation is not binding; and*
 - (b) If the product has its price stated on it, the words “recommended price” appear next to the stated price.**

22. Respondent's counsel has sought to persuade us that a threshold condition for an adverse finding under section 5 is the existence of an agreement, which, in the event of its breach or violation, is given effect to by the imposition of a sanction. He acknowledges the wide meaning given by the Act to 'agreement' but nevertheless insists that '...there must be some element of understanding between Federal Mogul and say, Midas, or say, the distributors generally, that if anybody breaks ranks he will be sanctioned.' An argument is then made for this interpretation that seeks to rely on the structure of the Act by distinguishing between, on the one

hand, those offences that arise out of the unilateral action of a dominant firm – the Section 8 offences - and, on the other hand, those ‘exceptional situations’ that arise ‘where one person, as it were, cleaves onto himself market power by association with another’. These latter are, in counsel’s estimation, the offences provided for in Section 4 (‘horizontal restrictive practices’) and Section 5 (‘vertical restrictive practices’) of the Act.

23. However section 5(2) does not, on the face of it, accord with this interpretation. It states plainly that the ‘*practice* of minimum resale price maintenance is prohibited’ with no reference to an ‘agreement’ to maintain minimum prices. However, we do not have to determine this because we will show that even on the respondent’s interpretation there has been a violation of Section 5(2), which is to say there is sufficient evidence of an understanding in the industry regarding the price at which the distributors, such as the complainant, are generally obliged to on-sell Ferodo products to their customers. However, even if there is insufficient evidence of an understanding, a unilateral determination of a minimum resale price backed up by a sanction for non-compliance still falls foul of Section 5(2).¹³ On either test we agree with Mr. Brassey that it is ultimately a ‘question of causation’, a matter of determining why the respondent, Federal Mogul, reduced the complainant’s discount. ¹⁴

24. It is to this question that we now turn.

Why did Federal Mogul reduce the rebate at which it supplied Pee Dee Gauteng?

Background

25. The price at which Federal Mogul supplies the wholesale distributors of

¹³ Phillip Areeda in Antitrust Law, Volume VII, page 61, par 1443d refer to this as the “implied acceptance agreement theory”. According to Areeda “..the implied agreement theory requires proof of three elements. First, there must be an announced condition, or its equivalent, on future dealing. Second, the sanction for non-compliance must be credible. Third, the plaintiff would have to show that the market effects are similar to those associated with express enforceable agreements, namely widespread compliance with the manufacturer’s specifications.” Also see Nkosinathi Ronald Msomi and others v BAT, Tribunal Case No. 49/IR/Jul02, footnote 37 on page 13.

¹⁴ Note that this does not mean that the offence only occurs when the sanction is imposed. Knowledge on the part of the retailer of the price at which the wholesaler or the manufacturer wishes them to trade coupled with knowledge that retribution may be exacted in the event of their failure to comply with this wish falls foul of Section 5(2)

Ferodo products is determined by the size of the rebate that it gives off its announced list price. These distributors, in turn, supply the product to their customers at the Federal Mogul list price less a rebate that is, naturally, smaller than that extended by Federal Mogul to the wholesale distributor. The difference between the wholesaler's rebate and the retailer's rebate is the former's margin. As we will show, a significant grouping of Federal Mogul's wholesale customers, including the complainant, received a rebate of 47.5% off the list price and then on-sold this to their retailer customers at the Federal Mogul list price less 35%, earning, in the process, a margin of 12.5% of the list price. There were, it appears, additional rebates available to the wholesalers from Federal Mogul, notably one of 4% to encourage timeous payment, but this need not detain us for the moment. What is principally at issue is the size of the rebate at which the respondent supplied Ferodo products to its wholesale distributors.

26. It is common cause that at a meeting held on the 1st October 1999 in the office of the complainant, Erasmus, Taylor informed Erasmus that the rebate of 47.5% which he had received from Federal Mogul since he had commenced business in April 1999 was immediately to be reduced to 40%.¹⁵ Erasmus insists that this was done because of his participation in a price war initiated by Midas, his erstwhile employer and the largest retailer of Ferodo products in Gauteng. In other words, Erasmus, contrary to the established practice in the industry and the express wish of his supplier, Federal Mogul, had provided Ferodo products to his customers at a rebate greater than 35%. Federal Mogul, for its part, avers that the rebate was cut because of Erasmus' poor payment record. Taylor, in his affidavit, explains that Federal Mogul wanted to reduce its exposure to Pee Dee as a result of the increased credit risk it posed.¹⁶

The Determination of Federal Mogul's Rebate

27. The complainant insists that Federal Mogul's pricing of Ferodo products operates off a standard structure of rebates, with the scale of monthly purchases the sole determinant of the rebate actually received by any given customer. The top discount rate available to the larger purchasers of Ferodo products is 47,5%. The respondent, on the other hand, insists that the size of the rebate offered to any given customer is determined by a number of factors, critical amongst them is the customer's volume of purchases and his payment record or creditworthiness. The respondent effectively disputes the existence of a standard rebate structure. At least

¹⁵ Mr Erasmus, Mr Taylor and Mr van der Bijl were present at the meeting.

¹⁶ See par. 35.2, page 33 of the answering affidavit of Barry Taylor where he explains this.

the respondent insists that the determination of a particular customer's place on the rebate structure is complex – on the respondent's version a large customer with a poor payment record could be afforded a lower discount rate than a small customer with an acceptable payment record.

28. The record supports the complainant's version. The schedule on page 35 of the record, to which Nel refers on page 141 of his testimony,¹⁷ appears to confirm this. A glance down that schedule confirms that the largest wholesalers receive the top rebate of 47.5%. Smaller distributors receive smaller discounts. Purchasers of impeccable creditworthiness, but smaller volumes – for example, the multinationals, Ford and Robert Bosch – receive lower rebates than Erasmus or the Sutherlands bearing out the contention of the complainant and that of several of the witnesses that the volume of purchases, rather than the creditworthiness of the customer, determined a given distributor's ranking on a standardised scale of rebates.¹⁸
29. Several of the witnesses were examined on precisely this question. Hence, under searching cross-examination from respondent's counsel, van der Bijl, who was employed in the marketing of Ferodo products from 1987 until 1999, insisted that the rebates were standardised and determined solely by volumes purchased. These exchanges bear repetition:¹⁹

Mr. Brassey: Now these discounts are massaged by reference to the credit worthiness of the purchaser, the amount of goods that will be purchased, the volume and sales, etc., aren't they? There is not a standard discount given by Ferodo to its purchasers?

Mr van der Bijl: The initial discount off the wholesale price for the major distributors was a standard discount we would give and the forty-seven and a half was a discount for a larger...

Mr. Brassey: For a major purchaser?

¹⁷ Transcript dated 27 August 2002.

¹⁸ See pp 147ff for Mr. Nel's wholly unpersuasive explanation of why companies like Ford and Robert Bosch, their creditworthiness notwithstanding, received smaller rebates than did other less well-resourced companies. In the end Nel seems to suggest that he had simply managed to 'get away' with extending a lower level of rebate to these companies, to dupe them, despite what several witnesses conceded was general awareness in the market of Federal Mogul's rebate structure. More plausible is that these companies did not demand a larger rebate because they understood that their volume of purchases did not qualify them for an additional concession.

¹⁹ Transcript, 26 August 2002, pages 42-44 and 46, respectively.

And further:

Mr. Brassey: *If you started to default in your payments...then if you as a purchaser started to default in your payments, then Ferodo would have another look at the discounts wouldn't it?*

Mr. van der Bijl: *I've never known it to be like that. Obviously we would address it with the purchaser. We'd never say look you know you're getting forty-seven and a half and we need to reduce because you're not paying.*

And further:

Mr. van der Bijl: *...I've never been to a major distributor and had to say, you can't qualify for that discount.*

Mr. Brassey: *But it was one of the means in which Ferodo could effectively respond to inadequacies in its purchasers, was by cutting the discount?*

Mr. van der Bijl: *I think they could have if one wasn't meeting their sales volumes that they expected. It was purely... You know those discounts we used to call a volume related type discount, you know if a major distributor qualified. We've had a smaller one, we've had a couple of smaller ones. You qualified for a forty-five because their purchases were smaller, but it's in line with what they're purchasing.*

And further:

Mr. Brassey: *If we look at the discount levels starting from the bottom, is it fair to say that the smaller you are and the less creditworthy you are, the less is your discount rate. And I'm concentrating only on the rebate at 1999 for the moment. Would you say that's a fair conclusion to draw?*

Mr. van der Bijl: *It's not the way we based it as far as I can remember. As I say it was purely on credit...was purely on the size and the volumes one could move. It was volume related. All our discount structures were volume related at that...to qualify.*

30. This account of the manner in which the rebate is determined is borne out

in the following exchange between Taylor and the Commission's legal counsel on page 102-103 of the transcript dated 28 August 2002:

Mr. Coetzee: ...if I can look at the payment terms, settlement discount, credit limit to be approved, and the discount, who decides on those aspects?

Mr. Taylor: Well it was company policy at the time. Our payment terms were standard so it wasn't a question of making a decision. So the regular terms would have been thirty days and the four percent²⁰ and in terms of the discount structure, it was also pretty known....It was standard.

Mr. Coetzee: When you say that the discount was pretty standard, what do you mean by that?

Mr. Taylor: Well within the discounts that were operating at the very time, this was the discount level that prevailed. There weren't, apart from one or two other levels, depending on where you sat in our business profile, it wasn't an ad hoc situation that you could just apply a discount that seemed appropriate on the occasion.

31. It is left to Nel to assert, in a highly implausible account, that the rebate was determined by a complex of factors in addition to volumes purchased, indeed, that the principal determinant of the rebate was creditworthiness, followed by 'the strategic nature of the account', and then, finally, by 'what volume, potential volume that they would require as part of the process'.²¹ However, later on, Nel himself tries to weaken the effect that creditworthiness has on the rebate by saying that "creditworthiness is only one leg of it (the discount). The volume is what thereafter determines it." As already intimated, Nel's inability to render a plausible account, in terms of relative degrees of creditworthiness, is manifest when he is unable to account plausibly for why organisations like Ford and Robert Bosch, clearly customers bearing no credit risk whatsoever, are receiving a lower rebate than many of Federal Mogul's larger, though, from a credit perspective, more risky, customers. Clearly, where the determination of Federal Mogul rebates is concerned, size does not merely count, it is all.

32. Indeed, Federal Mogul employed another payment instrument to ensure that their customers were encouraged to honour their credit terms. We refer to the settlement discount which customers received if they settled their accounts timeously. Note Nel's account of why highly creditworthy customers like Ford and Robert Bosch did not receive settlement

²⁰ This refers to the settlement discount intended to promote timeous settlement.

²¹ Transcript, 27 August 2002, page 122.

discounts:

Mr. Nel:But if I can refer to creditworthiness, if you go to the Samcor Ford account, you'll see there's no settlement in there at all, because I have no doubt in my mind that we're going to get our money there. I don't have to entice them to pay on time. I know I'm going to be paid and I know my money is sure. If you go to the Delta account you'll see there's no settlement discount, because I know I'm going to get my money and I will get it on time, no problem with that either. And that's really how we structure the whole process.²²

33. On the evidence presented to us, it is clear that the scale of purchases is the pre-eminent, indeed the sole, determinant of the level of the rebate afforded a Federal Mogul customer. This does not, of course, mean that Federal Mogul was somehow prevented from using, in selected cases, a reduction in the rebate to punish a customer for a poor payment record, that is, for poor creditworthiness. This will have to be established by the evidence. However, where all the evidence suggests that the rebate is volume related and that the settlement discount is designed to encourage timeous payment or creditworthiness, one must approach sceptically the respondent's insistence that in this single case it reduced the rebate because of considerations related to creditworthiness.

34. We should add that on the evidence it is also clear that the level of sales envisaged and attained by Pee Dee Gauteng justified, on Federal Mogul's own practice, the scale of rebate afforded Erasmus. It has been suggested by the respondent that this was so only as long as Pee Dee Gauteng's sales were aggregated with those of P&D Natal. However a glance at the schedule on the record shows that Erasmus' sales significantly exceeded those of the Sutherlands, in fact they were double that of P&D Natal, and were, on their own, in the top five of sales in the country in 1999.²³ The following exchange between Taylor and counsel for the Commission, though somewhat ambiguous, bears out the proposition that Erasmus received the maximum rebate because of the sales volume attained by Pee Dee Gauteng:²⁴

Mr. Coetzee:I'm asking you did you give him this forty-seven or did the company which we term PD Gauteng get the forty-seven and a half percent discount, based on the fact that David

²² Transcript, 27 August 2002, pages 144 – 145.

²³ See page 35 of the Respondent's paginated bundle.

²⁴ Transcript, 28 August 2002, page 105.

Sutherland was part of the operation?

Mr. Taylor: He got the forty-seven and half percent because the level that he was intending to trade at, the creditworthiness and the association. It was a combination of factors. It transpired later in his dealings that he was able to stand alone on that forty-seven and a half percent. (our emphasis)

Pee Dee Gauteng's Creditworthiness

35. We should make clear at the outset, and we will return to this issue in greater detail, that, evidence aside, Nel's claim that the level of rebate is determined by creditworthiness is unconvincing purely as a matter of conventional business logic and experience. The rebate is determined upfront – indeed the term 'rebate' is somewhat misleading because the level of rebate is simply synonymous with, it is actually the sole determinant of, the basic price at which Ferodo products are sold to the wholesale distributors. It is common business practice and makes perfect business sense to determine price in relation to the volumes purchased. However, it is certainly not conventional business practice to charge a premium price to a customer deemed, for whatever reason, to be a credit risk thus reducing his potential margins and increasing, if anything, the level of credit risk. If a customer is deemed not to be creditworthy then this assessment will surely be reflected in the volume of credit extended. It is also common and sensible business practice to ameliorate the credit risk by the provision of targeted incentives, such as the settlement discount offered by Federal Mogul.

36. It is surely then trite that estimates of relative creditworthiness will impact most directly on the level of credit actually extended. When Pee Dee Gauteng made its initial purchases during April 1999 from Federal Mogul the bill was invoiced for payment to P&D Natal. Note that a new credit application form was not completed because, avers Nel, he had understood that it was part of the P&D Natal's account.²⁵ Both Erasmus and Sutherland have testified that this was immediately rectified with Federal Mogul – they both, in other words, aver that the intention was always that payment be made by Gauteng.²⁶

²⁵ This averment strikes us as somewhat implausible or, at least, indicative – and by no means the only indication – of Federal Mogul's rather cavalier attitude to the extension of credit. Even if we accept that Nel thought that the newly opened Gauteng entity was trading on the Natal account, the additional amount of credit required was very significant and the business against which it was extended was an entirely new business venture. While we do not know the extent of PD Natal's credit limit, judging from the volume of sales of PD Natal and Pee Dee Gauteng, the credit required to support the new Gauteng venture must have equalled or exceeded the credit limit for the long established Natal operation.

²⁶ See transcript: Sutherland on page 89 of 26 August 2002 and Erasmus on page 17 of 27 August 2002.

37. A separate account for Pee Dee Gauteng was opened during May after Federal Mogul was approached with such a request via Van der Bijl. We were not told who made the request or why it was made, although it appears that requests of this type were not unusual. It appears that Federal Mogul's policy dictated that once a new account was to be opened – even if only a new branch account – a new credit application had to be completed.²⁷ This was done and Erasmus completed it on the 3rd May 1999 although Taylor requested that David Sutherland as the sole director of the company provide a resolution granting Erasmus the authority to complete the credit application. However, the Deed of Suretyship required when granting credit is manifestly defective as Erasmus and not Sutherland signed it. Moreover, there is no indication that P&D Natal was standing surety for Pee Dee Gauteng.²⁸ And yet when, at the end of the credit application process, the responsible Federal Mogul staff recommended a credit limit for Pee Dee Gauteng of R1 million, Nel, of his own volition, upped the limit to R1.5 million! Clearly, at this stage then – May 1999 – Federal Mogul, and Nel in particular, clearly did not doubt the creditworthiness of Pee Dee Gauteng.
38. The respondents insist that they believed that P&D Natal stood behind the account and that this is established by the fact that Taylor requested a resolution from David Sutherland.²⁹ However, it is noteworthy that this credit application arose out of both Sutherland and Erasmus indicating clearly that the Gauteng operation would be responsible for footing its own bills. Moreover, the credit check that was done as part of the new credit application does not reflect an evaluation of P&D Natal's creditworthiness. Again this either represents a remarkable degree of confidence in the Sutherlands and/or Erasmus or an extremely cavalier attitude to extending significant trade credit. Clearly it does not reflect the slightest concern at the creditworthiness of Pee Dee Gauteng.
39. This appears to have been brought home to Federal Mogul by Erasmus' tardy history of payment in the months that followed. The evidence placed before us appears to indicate that Erasmus had to be hounded in order to persuade him to pay his bills. However, this does not appear to have set

²⁷ See transcript, page 123 – 124 of 27 August 2002 where Nel explains Federal Mogul's policy.

²⁸ In fact the space is left open where 'P&D Wholesalers (Natal)' should have filled in its name had it been providing surety. See page 6 of the Respondent's records as well as the transcript of 28 August, on page 34, where Nel says that in his mind the resolution tied P&D Natal to the suretyship.

²⁹ Indeed, it is also consistent with the version that has Taylor, who requested the resolution from Sutherland (and who requested that Sutherland become a director of Gauteng), attempting to deceive Nel (who would have ultimately had to sign off on the credit application)

him apart from the rest of the trade, indeed from the rest of the retail trade, who have much to gain from holding back payments to suppliers for as long as they are able to get away with it – in Nel's own words 'if we don't chase the money, you just don't collect it'. What is rather more remarkable is how Federal Mogul, on numerous occasions, allowed Erasmus both to pay late and retain his settlement discount.

40. The evidence shows that the first payment for the opening order (April) was due at the end of June 1999. That payment was in time, however Federal Mogul was told that the payment in respect of the May order would be late.³⁰ This was paid around the middle of July and although it was late a 5% settlement discount was nevertheless allowed. Nel avers that this was done in error. The payment due at the end of July was only received on the 3rd or 4th of August and on this occasion the settlement discount was given after Erasmus went to see Mr Moll, ("Moll") the Finance Director of Federal Mogul. This happened again at the end of August and September.
41. The most that we can conclude from the evidence before us is that Erasmus was indeed a tardy debtor.³¹ Federal Mogul, on the other hand, seems to have been a remarkably easy touch where credit was concerned and this is verified both by the generous credit limit granted in the first place and by Federal Mogul's persistent reluctance to use the settlement discount for the purpose for which it was expressly and solely intended, namely to rein in tardy debtors. Instead they used an instrument – the rebate – that, even on the respondent's account, was determined by multiple criteria but which the evidence and business sense suggest was, in fact, wholly determined by purchase volumes.
42. However, in order to successfully sustain a prosecution under Section 5(2), the applicant must still establish that a minimum price was enforced by the respondent against the complainant.
43. It is common practice in the industry to grant the customers of the wholesale distributors a rebate of 35% thus ensuring a 12,5% margin for those wholesalers who received the top rebate of 47,5%.³² Erasmus

³⁰ According to Erasmus he was given 45 days to pay for the order in respect of the second month of trading. Mr Nel avers that that this is not true- see transcript of 27 August, page 36-39.

³¹ Erasmus' version differs from this. According to him he and Taylor agreed to a credit facility of 60 days on the first purchase, 45 days on the second purchase and from then onwards 30days- see transcript of 26 August 2002 page 140. Taylor, in his answering affidavit, in par. 31.3 mentions that Erasmus requested payment terms of 40 days, which was given for payments expected after September. However, he doesn't mention when Erasmus made this request.

³² See par.11.5, page 12 of Mr Nesidoni's Filing Affidavit and confirmed by Van der Bijl on page 51 of

readily acknowledges that there were limited exceptions to this rule with each wholesaler from time to time allowing special customers slightly larger discounts. We are nevertheless satisfied that the convention in the industry was that the price charged by the wholesalers to their retailer customers equated to 35% of the Federal Mogul list price.

44. There was no need to monitor this particularly closely. The convention appears to have been well established, pricing practices appear to have been transparent, and there was a mere handful of distributors to monitor. Nevertheless, ad hoc price meetings were held between the large distributors and members of the Federal Mogul management.³³ One such meeting was held on 28 May 1999.³⁴ Erasmus, Mr Hilt from Stop-It Friction, Mr Le Roux from Midas, Taylor and Van der Bijl attended the meeting which took place at Erasmus' request. According to Taylor Erasmus had requested him to attend the meeting so that all the players could discuss the ongoing price war. While van der Bijl, an active participant in these meetings, denies that their purpose was to set the resale price, he acknowledges that they were intended to ensure the competitiveness of Ferodo in the market. Erasmus' account portrays them as meetings at which the pricing practices of the wholesalers were closely scrutinized. Certainly, once the price war commenced, the wholesalers utilised this forum to exhort Federal Mogul to discipline Midas. Taylor acknowledges that the price war was discussed but claims that he was only asked to act as facilitator at the meeting held on 28th May 1999. He denies however that he acted upon any requests.³⁵
45. Once again we have two conflicting factual accounts. We should note that the mere fact of the existence of the pricing convention lends credence to Erasmus' version.³⁶ Indeed Taylor's attempt to dismiss them as mere gripe sessions is, when placed in context, incriminating, suggesting that there was a convention and that the participants in the convention met, at very least, to gripe about flouting of the convention. Erasmus testified that Taylor communicated to the wholesalers the consequences of stepping 'out of line': *'Barrie het net gesê in die meetings vooraf waar ons bymekaar gekom het, soos wat ek nou-nou gesê het, he who steps out of*

the Transcript of 26 August 2002.

³³See transcript of 26 August 2002 on page 56-57 where van der Bijl refers to these price meetings.

³⁴ See transcript of 28 August 2002, pages 121-3 and Taylor's answering affidavit paras 34.3-35.1 where he refers to this May 28th meeting.

³⁵ See footnote 34.

³⁶ See Commission's Filing Affidavit, Annexure JNN5: par 10 of Erasmus' Affidavit and transcript of 26 August 2002 on page 171, where Erasmus discusses this.

line, ons kan sy afslag sny, of we're going to put him on stop supply'.³⁷ It is common cause that both van der Bijl and Taylor attempted to dissuade Erasmus from participating in the price war.³⁸ Taylor avers that he did this in order to ensure that Erasmus and the other distributors did not cut their margins to commercially non-viable levels, although he does not explain how he expected them to remain commercially viable with Midas competing away their customer base.

46. However, we do not have to determine which of these accounts of the price meetings is correct. We are satisfied – and this has never been denied with any conviction – that the conventional 35% discount was well known and this, coupled with evidence of sanction for violation of the convention, is sufficient to secure a finding against the respondent.
47. Moreover, there is, in our view, clear evidence that the rebate was reduced in response to Erasmus' participation in the price war. This evidence is contained in the meeting at Erasmus' office on the 1st of October 1999 with Taylor and van der Bijl and in Moll's letter to the Commission of the 19th of November 1999.³⁹ This version is corroborated by a further exchange of correspondence between Erasmus, his attorneys and Moll in late October regarding the possible re-instatement of the rebate at the initial level.
48. The salient facts concerning the meeting of the 1st of October 1999 are:

- A meeting between Federal Mogul and Midas took place on 6 September 1999, according to Taylor. Taylor, in his affidavit,⁴⁰ admits that this meeting was held for the purpose of conducting a business review with one of the first respondent's larger distributors and where the price war was also discussed. Reference is also made to such a meeting by Erasmus and by Van der Bijl who testified that he knew that 'they did address it (the price war) to try and put a lid on it to try and get it back to normality'.⁴¹
- Van der Bijl avers – and this has not been denied – that Taylor and Nel

³⁷ Transcript of 26th August 2002 on p171. .

³⁸ See transcript of 26 August 2002 on page 59 and transcript of 28 August 2002, page 112.

³⁹ See Annexure JNN12 of the Commission's Filing Affidavit.

⁴⁰ See Taylor's affidavit on page 251 of the record, par. 35.1.

⁴¹ For Erasmus' testimony in this regard see transcript of 26 August 2002 on page 176 and Van der Bijl page 55 of the same transcript.

had a further meeting with Midas managers, to discuss the issues relating to the price war, on the day before Federal Mogul took the decision on the 30th of September, at their regular end of the month review meeting, to cut Erasmus' rebate.⁴²

- Subsequent to the decision taken at a regular review meeting between Federal Mogul executives on the 30th September, Taylor phoned Van der Bijl early on the following morning, the 1st of October, and told him that he was required to accompany Taylor to Erasmus' office in order to inform the latter of Federal Mogul's decision to cut his rebate. Van der Bijl avers – and this is not denied – that he remonstrated with Taylor, expressing the view that it was not fair to punish a follower, Erasmus, in the price war, while allowing the leader, Midas, to escape unscathed. It is instructive that the question of Erasmus' payment record was apparently never raised in the disagreement between the two Federal Mogul managers. Certainly, in van der Bijl's recount of this conversation he assumed that the reduction in the rebate arose out of the price war and there is no evidence of Taylor disabusing him of this.
- It is common cause that Taylor opened the meeting by accusing Erasmus of participation in the price war. Erasmus called in a member of his sales staff, Ms. Cindy Esterhuysen, and asked her to produce sales records that would establish his innocence. Esterhuysen confirmed that she had done as instructed – she produced the documentation required and it established that Erasmus had charged the customers in question at the conventional 35% of Federal Mogul's list price.⁴³ Taylor informed Erasmus that he nevertheless had instructions to inform him that his rebate was to be cut to 40% with immediate effect. Taylor suggests that the discussion of the price war was simply a preliminary discussion of business issues before getting down to the real purpose of the meeting. Mr. Brassey insists that raising this issue was consistent with the explanation offered by the respondent for cutting the rebate – Erasmus' margins, and hence his ability to pay his debts timeously, were under threat as a result of his participation in the price war. Hence, respondent's counsel argues, it made sense for the meeting to commence with a discussion of the price war.⁴⁴

⁴² See his witness statement made on 15 August 2002, page 8 par 17.

⁴³ Transcript of 27 August 2002, page 2

⁴⁴ Note that this latter explanation was advanced by respondent's legal counsel. Taylor, the respondent's witness who actually testified as to this meeting simply portrayed the discussion of the price war and the

- The 1st October was the day on which payment for Erasmus' August purchases was due. Not only does there not seem to have been any discussion of Erasmus' tardy payment record at the meeting – unless, of course, one accepts the explanation that discussion of the price war was in reality discussion of the debt – but Taylor departed without any attempt to collect the money owing to Federal Mogul. Indeed, as will be elaborated below, within a few days of this meeting Federal Mogul received and processed the largest order that it had ever received from Erasmus despite the fact that he had still not paid his account. We find this quite extraordinary – it belies the concern that Taylor's overwhelming concern was with Erasmus' creditworthiness.
- There was also a clear indication from Taylor that the reduction in the rebate would not be of a lengthy duration, not, in other words, of the sort of duration required to re-establish Erasmus' creditworthiness or to reduce his purchases to a level Federal Mogul would consider sustainable. This is elaborated below.

49. It is our firm view that the meeting of the 1st October is sufficient to establish the complainant's contention that his rebate was cut because of his participation in the price war. However, there is a second piece of evidence that lends further credence to this view. We refer to the letter addressed to the Commission by Moll, the respondent's financial director.

50. On the 12th November 1999, the Commission addressed a letter to Nel.⁴⁵ This letter, entitled 'alleged anticompetitive conduct by Federal Mogul Aftermarket Southern Africa (Pty) Ltd', laid out the complaint received by the Commission from Pee Dee Wholesalers (Pty) Ltd. It informed the respondent that the complainant's allegation 'might constitute a contravention of the Act' and requested Federal Mogul to assist the Commission with its enquiries by furnishing specified information including 'the company pricing and/or marketing strategy', the 'criteria for giving discounts', 'the rationale for decreasing the discount offered to Pee Dee by Federal Mogul', and 'any business or/and public interest justification for the above conduct'.

51. It appears that Nel was out of the country when this letter was received and Moll, a senior executive, perceiving the urgency of the request – the

question of Erasmus' alleged involvement therein as mere preliminary chatter.

⁴⁵ See Annexure LSD 4 page 80-81 of the record.

Commission explicitly requested a response by no later than the 19th November – took it upon himself to address the Commission’s queries. This he did in a letter addressed to the Commission on the 19th November.⁴⁶

52. Moll’s letter is revealing. It is also, we believe, particularly and refreshingly candid, drafted without prior legal advice and based entirely upon the working knowledge of a senior member of the respondent’s staff.⁴⁷

53. In response to the Commission’s request for an explanation of ‘the rationale for decreasing the discount offered to Pee Dee by Federal Mogul’, Moll wrote:

‘The discount originally offered to Pee Dee was as a result of them trading as part of the P&D group which qualified them for a discount based on the volumes which would have been purchased by this group. After discussion with Pee Dee, it was clarified that Pee Dee was not part of P&D Wholesalers cc (confirmed by P&D Wholesalers cc) and therefore would not enjoy the volume discounts applicable to a group of that size. Conditions of supply were based on the credit application, suggesting that the companies were connected. Pee Dee entered into a price war situation, which disrupted the market, causing problems for other Federal-Mogul users.’ (our emphasis).

54. In response to the Commission’s request for ‘any other information that may be of assistance to the Commission in this regard’ Moll wrote:

‘The complainant left the business of one of our other customers, where he was a senior employee. On the basis of attracting new business Federal-Mogul agreed to supply him, but it soon transpired that his focus was his previous employer’s customer base.’

‘Whilst this is acceptable:

⁴⁶ See Annexure LSD6 page 84-87 of the record.

⁴⁷ Note that Moll had been present at the debtors meeting at the end of September at which the decision to cut Erasmus’ rebate was apparently discussed. Note too that, despite the fact that upon Nel’s return he was shown the Commission’s letter and Moll’s reply, no attempt was made to disavow it – this was only done in the papers filed for the hearing of the complaint. Indeed, although Moll claimed that Nel was ‘...so unhappy with the contents of that letter that he was going to refer it to legal advice’, Nel himself testified that ‘in fact I read the letter afterwards, after, and upon my return and by and large I was fairly, reasonably happy with our response. There was no reason for me to outrightly reject it’ and that Moll had, in Nel’s estimation, responded ‘...honestly and as he saw it at that point in time based on the knowledge that he had.’

- *The price war that Pee Dee embarked on was causing other customers to follow suit and reduced gross margins to 12%. Several appeals were made with the complainant to adjust his pricing as the margins attainable were insufficient to conduct business effectively. In terms of free enterprise, it was unacceptable to Federal-Mogul as his appointment as a distributor was to attract new business and grow our market share.*
- *The complainant's payment record has been erratic and has consistently requested extension on his credit terms. In October he failed to meet an extended deadline for payment resulting in him being put on stop supply and we have subsequently had to obtain a court order to uplift unpaid for inventory'*

The salient aspects of Moll's response to the Commission's queries are:

- In the paragraph explaining why the rebate was cut, Moll explains that the initial discount was based on the assumed relationship with P&D Natal and the volumes that were consequently attributed to the combined operation. We have already dealt with this. When, at the end of the paragraph, Moll turns to rationalising the reduction of the rebate he states quite unambiguously that Pee Dee 'entered into a price war situation, which disrupted the market, causing problems for other Federal Mogul users';
- Read together with the second extract cited it is clear that the 'other Federal Mogul user(s)' for whom Pee Dee's action was 'causing problems' was in fact Midas, because despite the fact that, avers Moll, Federal Mogul had appointed Erasmus to attract new business '...it soon transpired that his focus was his previous employer's customer base';
- Moll's letter corroborates the evidence already on record that attempts had been made to dissuade Erasmus from participating in the price war, or, in Moll's words, 'to adjust his pricing', and;
- The retribution exacted by Federal-Mogul for Erasmus' 'erratic' payment record was, in fact, the termination, in

October, of his supply – ‘in October he failed to meet an extended deadline for payment resulting in him being put on stop supply...’

55. Moll was naturally cross-examined at some length by the Commission. He proved to be a highly defensive, evasive and implausible witness. Consider, for example, the following exchanges between Mr. Alan Coetzee, the Commission’s legal counsel, and Moll:⁴⁸

Mr. Coetzee: ...what did you mean with the words ‘which disrupted the market?’

Mr. Moll: Disrupting payment to me on account. It indicates a possible situation of late payment, cash flow problems.

Mr Coetzee: But the word market then...

Mr. Moll: Market is the general market.

Mr. Coetzee: General market. And how would the late payment by a client affect other Federal Mogul users?

Mr. Moll: Well then all, Federal Mogul’s probably not the right word there, its Ferodo users would be involved in the price war. Brake pad purchases, customers, people involved in the brake pad market.

Mr. Coetzee: But reading that sentence as it is written there the price war disrupts the market and this disruption in the market is the concern to other Federal Mogul users so my question to you is, how would the disruption in the market affect the other users?

Mr. Moll: It’s....a price war would affect all the players in that market.

Mr. Coetzee: And how would that be problematic.

Mr. Moll: They would be, there would be cutting of prices in that market.

Mr. Coetzee: And would that be a concern to Federal Mogul or

⁴⁸ See Transcript, 28 August 2002, pages 72 and 80, respectively.

would that be a concern to the users?

Mr. Moll: I don't know. I couldn't answer you. It would be a concern from the creditor's point of view, yes.

And further:

Mr. Coetzee: How did you understand that the appeals to adjust his pricing would contribute to his credit or payment, to his payment of the account?

Mr. Moll: Well the appeals would be to improve his cash flow and therefore to pay his account.

Mr. Coetzee: But here in this letter you saying 'several appeals were made to adjust his pricing'?

Mr. Moll: I can't really comment further on my wording there but my intention was that to improve his cash flow, to sustain his business. Unsustainable business would affect his cash flow.

56. Moll's difficulties are considerable. His efforts to cast some of the highly incriminating remarks contained in his letter as expressing an intent to force Erasmus to trade at a lower level and so improve his cash flow and, thus, his creditworthiness, are clumsy and disingenuous. However, this has not discouraged Nel from repeating this argument.

57. Nel's account reveals that it is not only the evidence that conflicts with the respondent's version, but so too does business logic. On Moll and Nel's version the company had concluded that the extent to which margins had been cut in the price war was increasing the credit risk entailed in supplying Pee Dee Gauteng. In these circumstances the supplier responded, or so they would have us believe, by taking action designed to cut Erasmus' margins further. This approach would, if anything, predict a higher level of trading – thin margins are only profitably sustainable at very high volumes, at volumes that generate high cash flows. For example, a large grocery chain can sustain the notoriously low margins that enable it to price competitively because of the volumes at which it trades; the corner café, on the other hand, charges higher prices because volumes are low and high margins are required to generate sufficient cash flow.⁴⁹

⁴⁹ Indeed, so implausible are Nel's arguments that he is finally left to advance the truly ridiculous proposition that the intention of the rebate cut was to force Erasmus to market a greater share of the product of Federal Mogul's competitors.. This is the first – and may well be the last – occasion on which we have

58. In this context it is interesting to note that immediately after his rebate was cut Erasmus placed, and Federal Mogul executed, the largest order ever placed by Pee Dee with Federal Mogul. This transaction in fact resulted in Pee Dee exceeding its agreed credit limit. The respondent has attempted to cast this as an error on its part and fraud on the part of Erasmus who never paid for these goods.
59. However, if error it be, then it was an error of the most startling dimensions. Nel would have us believe that there was massive concern at board and senior executive level regarding Erasmus creditworthiness. Urgent and unusual steps were then taken with the express intent, we are told, of forcing Erasmus to trade at a lower level. However, despite the senior executives' apparent pre-occupation with this problem, despite the fact that they were careful to communicate their decision to cut the rebate to their operational staff⁵⁰, they managed, a mere four days after they had cut his rebate allegedly because of his tardy payment record and poor creditworthiness, to allow him to make an order that exceeded his credit limit. At the stage when this unusually large October order was executed Erasmus had not even paid the considerable sum due to Federal Mogul on the 1st October.
60. This may be an error. But on a balance of probabilities, a more likely explanation is that the reduction in the rebate was never intended to force Erasmus to trade at a lower level or to improve his payment record and so, despite the executives' assiduous attention to their dealings with Erasmus, these aspects of the relationship were not monitored. This is because the reduction was not concerned with these matters. It was rather intended to convey a short, sharp message to those involved or prospectively involved in the price war with Midas. The entry of Pee Dee into Gauteng had achieved its purpose – it had finally woken up Midas which was now trading robustly, albeit that it had been compelled to break the rules of the game by resorting to price cuts in order to restore the status quo ante in which they were Federal Mogul's largest customer for, inter alia, Ferodo products.
61. However, a number of other distributors, including Erasmus, who had, as a result of offering a superior service, prospered at Midas' expense, were not willing to return their hard-won gains to Midas. Accordingly, they

been asked to accept that the objective of a given strategy was to encourage the customer at whom it was directed, a customer, moreover, who everyone acknowledges to be a particularly gifted trader, to support the competitors!

⁵⁰ The purchases made in early October were at the reduced discount decided on a few days earlier.

resisted Midas' price cuts by responding, albeit reluctantly, in the same currency, the currency that some dub 'price war' but which others, of less melodramatic inclination, identify as 'competition'. But Federal Mogul was having none of this. The rejuvenated Midas was going to be given the opportunity to regain 'its' lost customers and Erasmus and the others, having provided the necessary prod to Midas, were expected to focus their attention on winning new custom from among Ferodo's competitors rather than from raiding the customer base of Federal Mogul's most important client. It is common cause that Federal Mogul attempted to discourage Erasmus and the other distributors from their efforts to match or better Midas's price. When their exhortations failed they imposed the most powerful sanction available to them: they increased the price (reduced the rebate) of their product.

62. There are, in fact, strong indications that both Erasmus and, more important, Federal Mogul, understood that the reduction in the rebate would be of a short duration, of considerably shorter duration, that is, than the time needed to establish lower trading levels or even to restore creditworthiness.

63. Consider Taylor's testimony regarding the meeting of the 1st October, the meeting at which Erasmus was informed of the reduction in his rebate:⁵¹

Mr. Taylor: ...I said Koos I'm sorry, but the decision our Board has taken is that your discount is going to be reduced to forty percent (40%). Naturally there was a bit of stunned silence and I think rather in shock he said well for how long? I said actually I don't know. I said you need to go and reflect on this and decide how you're going to conduct your business. I said I don't even know, we didn't cross that bridge, but I undertook to phone him back later in the day which I did, regarding the question of how long.

Mr. Manoim: And how did you answer the 'how long' question?

Mr. Taylor: I said to him when I phoned him back that we hadn't discussed that and the decision was certainly not permanent, but it would need to be re-evaluated after we'd got ourselves through the current predicament.

64. This is further borne out by another exchange of correspondence involving Federal Mogul, Erasmus and Erasmus' attorneys. On the 27th October –

⁵¹ See Transcript, 28 August 2002, pages 128-129.

a mere 27 days after Federal Mogul informed Erasmus of the reduction in his rebate – Moll addressed a letter to attorneys representing Erasmus. This letter states

'I have had discussions with Mr. Nel regarding your client's complaint. We are willing to discuss the restoration of the original discount to your client and would request a meeting with him to discuss this matter'

65. On the following day Erasmus addressed the following facsimile to Moll:

'A note to confirm our tele-conversation of the 27/10/99 and avoid any misunderstandings.'

'In accordance with your fax dated 27th October indicating your willingness to discuss restoring my discount, you confirmed that you would liase with Mr. Nell (sic) and Mr. Taylor and contact me back with a view of setting up the proposed meeting at P&D's offices with the mentioned two gentlemen A.S.A.P.'

66. Moll was asked under cross-examination to explain what motivated this apparent change of heart. His response is a model of evasion, being mostly taken up with a rather irrelevant effort to distinguish between being willing to restore the discount and being willing to *discuss* restoring the discount.

67. Once again the unfortunate Moll's difficulties are easily appreciated because this exchange of correspondence is a further indication that the intent of the rebate cut was not to force Erasmus to reduce his trading levels – per definition this objective cannot have been achieved at the stage that they expressed their willingness to restore the rebate. In fact, at that stage Erasmus, who was still on 'stop supply', had not yet settled the amount owing to Federal Mogul as of the 1st October and he had received a large additional volume of stock in the first week of October for which he had not paid.⁵² And yet Moll 'requests', on behalf of Nel, a meeting with Erasmus to 'discuss the restoration of the original discount', with nary a mention of 'creditworthiness' or 'trading levels'.

68. We can only conclude that the reduction in the rebate was intended to illustrate to Erasmus and other actual or would-be transgressors the

⁵² Although much of the stock delivered after the 1st October had already been repossessed.

- consequences of not playing by the rules. What was required of Erasmus was some evidence of his willingness to adhere to the pricing conventions in the industry – we infer that this is the ‘conduct’ that Taylor cryptically asked Erasmus to ‘reflect on’ when they met on the 1st October.
69. The respondent has made much of the fact that Pee Dee has been singled out for retribution when it is common cause that Midas had initiated the price war and it appears, moreover, that other distributors (additional, that is, to Pee Dee) participated therein. Why then take action against Pee Dee? Why not act against Midas?
70. It is not clear that this question has to be resolved, although it is already largely answered. We have already outlined the elements of the practice of resale price maintenance – an understanding regarding the pricing conventions governing the activities at issue; and a credible sanction in place to enforce it. It is not clear that a finding on a section 5(2) violation requires that the choice of the precise target of the sanction be explained. Had Federal Mogul chosen to ‘make an example’ of Midas or, for that matter, any of the other participants, it would have been equally culpable of contravening Section 5(2) of the Act. Strictly speaking, this is not our concern – our concern is not with the harm suffered by Erasmus, but, rather, with the harm inflicted on the competitive process.
71. However, the respondent implicitly suggests that if we are unable to isolate a motive for making Erasmus a scapegoat for his involvement in the price war, then there must be some other reason for the rebate cut inflicted on Erasmus alone. The respondent effectively contends that, in the absence of an explanation related directly to the price war for why Federal Mogul singled out Pee Dee for retribution, we should infer that the true motives underlying Federal Mogul’s action were rooted in Erasmus’ trading levels and creditworthiness.
72. It is nevertheless clear why Federal Mogul would not have acted against Midas, just as it is clear why Erasmus was the preferred target for retribution.
73. Midas was Federal Mogul’s largest customer, not merely of the latter’s friction products division but of the range of products supplied by the respondent. Moreover, Midas’ status as a ‘full-line’ wholesaler squared neatly with Federal Mogul’s strategic direction as mapped out by its US shareholders and executed by the new CEO of its South African operation, Nel. Recall Nel’s testimony in which he outlined how he had been instructed by his shareholder to combine the four South African

businesses into one, and how a pillar of Nel's approach to this task was a reduction in the number of the distributors of his company's products. It requires no great insight to conclude that a full-line wholesaler like Midas as opposed to a single-product specialist like Pee Dee was the natural complement to Nel's strategy. Federal Mogul's new strategic direction dictated that its long-term interest lay with Midas.

74. The problem, of course, was that Midas, or, at very least, its friction products division, was floundering and losing market share to Federal Mogul's competitors. This had to be addressed urgently, an imperative that was clearly perceived by Taylor, if not necessarily by Nel himself. Enter then Erasmus, a skilled trader with wide experience of the Gauteng market.
75. Erasmus was, from the point of view of Federal Mogul's immediate interest, a heaven-sent opportunity. He immediately made a significant contribution towards arresting the decline in Ferodo sales as evidenced by the rapid ascent of his new business. However, contrary to Federal Mogul's stated preference, he did not confine his efforts to regaining business lost by Midas, but he also took business away from his erstwhile employer – recall both Moll and Taylor's disquiet at the fact that Erasmus did not confine himself, in Moll's words, to 'attracting new business', but that he also encroached on 'his previous employer's customer base'. From his recent experience in the leadership of Midas' friction products business, Erasmus understood, like no other, the shortcomings in Midas' competitive offering. He offered to the market what Midas was unable or unwilling to provide and so won market share from his much larger and better established competitor.
76. By challenging Midas in this way Erasmus provided the necessary competitive fillip to his under-performing competitor, Midas. Midas responded by decreasing the price of Ferodo products in a clear, and, from the perspective of those interested in promoting competition, perfectly legitimate effort to regain lost market share and to prevent further erosion of its customer base.
77. Erasmus and the other Gauteng wholesalers were deeply offended by Midas' actions. They had played by the rules – in their efforts to compete with Midas they had not initiated a price war but had simply offered better service. However, Midas responded by initiating a price war. Erasmus and his colleagues prevailed on Taylor to restore order. But by this time the short-term problems encountered by Federal Mogul occasioned by Midas' travails were rapidly receding. Midas, which for all the reasons

outlined above, was Federal Mogul's preferred interlocutor, was reasserting itself. No doubt Midas, once it had secured its existing customer base and regained its lost market share, would raise its price thus restoring order to pricing in the industry. Calm would then be restored to the friction products realm – prices would be stable and Midas would be top dog. Erasmus and his colleagues would be provided with incentives to go out into the market and win new business for Ferodo, Midas' share having been effectively ruled out of their bounds.

78. Accordingly, the only response that Taylor was willing to make to the entreaties of Erasmus and others was to exhort them to desist from participating in the price war, to desist, in other words, from competition with Midas. Eventually Erasmus and, it appears, certain other distributors, responded to Midas' price cutting strategy by cutting their own prices. Erasmus clearly played a leading role in this. He had gained most immediately from Midas' underperformance. He had already proved himself eminently capable of taking business away from Midas without resorting to the expedient of price competition. To now permit him to cut prices not only renewed the threat to Midas but may have also sounded the death knell on orderly pricing in the friction products business.

79. For all these reasons Erasmus was the obvious rogue that Federal Mogul had to discipline if calm was to be restored. Federal Mogul did not necessarily wish to drive him from the market altogether and so they did not attempt to withhold supply even though his tardy payment record may have afforded them the opportunity to do so. Instead, Federal Mogul cut Erasmus' rebate, effectively rendering it impossible for him to increase the rebate that he, Erasmus, offered to his own customers. In so doing Federal Mogul would be signalling to the other participants or would-be participants in the price war that this sort of conduct had no place in the long-term future of the business. And they would be confirming to Midas (and to the other wholesalers) that, in terms of Nel's long-term strategic vision, it, Midas, was the preferred partner of Federal Mogul.

Conclusion and Finding

80. We find, then, that the distribution of Ferodo products was governed by a well-known and clearly understood convention regarding pricing. In terms of this understanding wholesalers made Ferodo products available to their customers at a price equivalent to 35% of the Federal Mogul Aftermarket list price. Moreover, it has been established that periodic meetings, the so-called 'price-meetings', were held, involving both Federal Mogul and the wholesalers of Ferodo products for the purpose of monitoring

compliance with this understanding. It was, furthermore, understood that if the rebate that the wholesalers granted their customers was not maintained in accordance with this understanding, that this conduct would invite a form of sanction from Federal Mogul. Finally, on the evidence before us we are persuaded that, in order to enforce this understanding regarding pricing, Federal Mogul increased the price at which Ferodo products were made available to the complainant in this matter.

81. We, accordingly, find that the first respondent has acted in contravention of Section 5(2) of the Competition Act.

28 January 2003

D. Lewis

Date

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