BEFORE THE
COMPETITION COMMISSION OF PAKISTAN

IN THE MATTER OF
APPLICATION FOR EXEMPTION OF JOINT VENTURE AGREEMENT BETWEEN M/S METRO CASH & CARRY INTERNATIONAL HOLDING B.V. AND THAL LIMITED

(NO. 2(290)/AGR/EXM/REG/CCP/2011)

Date of hearing:	December 07, 2011
Present:	Ms. Rahat Kaunain Hassan **Chairperson**
	Mr. Abdul Ghaffar **Member (C&T.A)**
	Dr. Joseph Wilson **Member (M&I.A)**
	Ms. Vaddiya S. Khalil **Member (A&I.T)**
	Mr. Mueen Batlay **Member (CP&R)**
	Mr. Shehzad Ansar **Member (B&OFT)**
On behalf of M/s Metro Cash & Carry International Holding B.V.:	Mr. Badruddin F. Villani, Advocate and Mr. D. Bonnor, Managing Director
M/s Thal Limited:	Mr. Yousaf Khosa and Ambreen Abbasi Advocates and Mr. Firdous Naqvi, Director

ORDER

1. M/s Metro Cash & Carry International Holding B.V. (the 'Metro') and Thal Limited (the 'Thal') – (hereinafter collectively referred to as the "Undertakings) through their counsels Mr. Badruddin F. Villani and Mr. Ahsan Zahir Rizvi, filed a joint application before the Competition Commission of Pakistan (the 'Commission') under Section 5 of the Competition Act, 2010 (the 'Act') read with Regulation 4 of the Competition Commission (General Enforcement) Regulations, 2007 (the 'GER') for exemption of the Joint Venture Agreement dated 15-06-2011 the (the 'JVA') from the application of Section 4 of the Act.

2. Earlier the undertakings had also filed a pre-merger application under Section 11 of the Act seeking N.O.C for the Joint Venture so created. The N.O.C was issued on 20-09-2011. It is worth mentioning here that while the JVA was assessed for its anticompetitive concerns, if any, under Section 11 pursuant to the pre-merger application and was found not to "substantially lessen competition by creating or strengthening a dominant position in the relevant market"; this application, however, is entertained to review the non-compete clause in the JVA. The non-compete clause expands the scope of restraint from the business of the Undertakings, i.e., "whole sale cash and carry" to include "retail operations", against the substantive standard laid down in section 4 of the Act, *i.e*., preventing, restricting or reducing competition within the relevant market, which has a larger ambit than that laid down in Section 11 of the Act.

3. The Commission, therefore, deemed it appropriate to conduct the hearing in the matter. Hearing notices were issued to the undertaking concerned on 29-11-2011 intimating them to attend the hearing on 07-12-2011 to explain the dynamics of the JVA and the benefits thereof.

4. Accordingly, a hearing was held on 07-12-2011. Mr. Badruddin F. Villani, Advocate and Mr. D. Bonnor, Managing Director of Metro appeared on behalf of Metro, whereas Mr. Yousaf Khosa and Ambreen Abbasi Advocates and Mr. Firdous Naqvi, Director Thal appeared on behalf of Thal.

5. The Undertakings agreed to restructure their respective subsidiaries in Pakistan, namely M/s Metro Cash & Carry Pakistan (Private) Limited (hereinafter referred to as the 'MCCP') and M/s Makro–Habib Pakistan Limited (hereinafter referred to as the 'MHPL'), respectively through the JVA.

6. In terms of the the JVA, Metro and Thal have agreed to split their business into two separate entities namely, OpCo and PropCo. OpCo will carry on the business of wholesale cash and carry distribution initially through the existing cash and carry centers; whereas the PropCo will own and manage, inter alia, the real estate detailed in the Schedule I to the JVA.

7. In clause 3.17 of the JVA the Undertakings put a non-compete clause for the parties to the JVA and their affiliates in the following terms:

> *3.17 Subject to exemption being granted by CCP, neither Party shall and each party shall ensure that its Affiliates (other than OpCo do not:*
>
> *3.17.1 directly or indirectly own, manage, operate, join, control, or participate in the ownership, management, operation or control of any company, firm or person carrying on Competitive Business in or from Pakistan or*
>
> *3.17.2 provide technical or other information to any third party concerning the setting up of any Competitive Business*
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> *Provided that notwithstanding the forgoing:*
>
> *(a) Metro and it Affiliates may operate a consumer electronics business (including e-commerce) similar to the business operated today or in the future by Media Market or Saturn, and Thal and its Affiliates may establish small retail stores having a store floor space of less than one thousand five hundred square meters;*
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> *(b) If after the expiry of the Metro AG Rental Guarantee OpCo defaults under any Tenancy Agreement for non payment of rent, then the provision hereinabove not to compete shall not apply to Thal or any of its affiliates be rendered of no legal effect.*

8. In the above mentioned clauses 3.17.1 & 3.17.2, the parties agreed to impose restriction upon themselves and their affiliates not to directly or indirectly own, manage, operate, join, control, or participate in the ownership, management, operation or control of any company, firm or person carrying on competitive business in or from Pakistan or provide technical or other information to any third party concerning the setting up of any competitive business. The competitive business has been defined under the JVA in following terms:

> *"The Competitive Business means:*
>
> *1.11.1 Hyper- markets*
> *1.11.2 Super-markets selling food and non food items with a shop floor area in excess of 1,500 square meters;*
> *1.11.3 Retail food stores with a shop floor area in excess of 1,500 Square meters*

1.11.4 Speciailty retailers of categories of goods or products which account for more than 7.5% of the gross sales revenues of OpCo other than those products which are currently produced or sold by Thal or Metro or their respective Affiliates."

9. For the purposes of this application, the Commission defines the relevant market as that of hyper-markets, retail food stores and super markets selling food and non-food items with a shop floor area in excess of 1,500 square meter within the territorial limits of Pakistan.

10. As mentioned in Para 4 above, OpCo will carry on the business of '*wholesale cash & carry distribution*', and the restrictions imposed through clauses 3.17.1 & 3.17.2 of JVA restrict both undertakings and its affiliates not to operate competitive business in or from Pakistan.

11. The Commission pointed out its concern that the restriction in terms of 3.17.1 has the effect of imposing a restriction not only to operate any competitive business within Pakistan but also outside Pakistan through a company controlled or managed from Pakistan. In this regard, we appreciate the counsel Mr. Baddrudin F. Vellani, who duly addressed the concern of the Commission with respect to clause 3.17.1 and conveyed on behalf of the parties to JVA, their agreement to delete the words **"or from"** appearing in line 3 of the clause 3.17.1 and in Schedule 10 of the JVA. Hence, the restriction on either party is applicable only not to *directly or indirectly own, manage, operate, join, control, or participate in the ownership, management, operation or control of any company, firm or person carrying on Competitive Business in Pakistan.*

12. Furthermore, the counsels for the parties and the representatives of the undertakings concerned explained the dynamics of the JVA and the reasoning for having the non-compete clause therein. The non-compete clause is to remain in force for the entire period of the joint venture i.e. upon termination of the JVA the non-compete clause will also be terminated. The Joint Venture is to remain in existence for as long as Metro and Thal are shareholders of OpCo and/or PropCo and continue paying their respective rents. By virtue of the non-compete clause in the JVA, the Parties and their affiliates are obligated not to compete in or from Pakistan in 'Competitive Business' as defined in clause 1.11 of the JVA. The 'Competitive Business' include retail establishments having a shop floor area in excess of 1,500 Square meters, so only large supermarkets and hypermarkets are caught in the domain of 'Competitive Business'.

13. Regarding the inclusion of retail business in the 'Competing Business' clause of the JVA, the counsel for the parties submitted that the Retail segment will always be a competitor, even though their main focus is on the wholesale segment; as at the time of the opening of the first hypermarket in Karachi, there were more retail shoppers and end consumers than the wholesale shoppers i.e. restaurant owners, hotels, canteen owners and other bulk customers; therefore, the retail

establishment when operated in a shop area in excess of 1,500 Sq. meters would ultimately become the competitor of the wholesale cash & carry business under the JVA. He also submitted that the undertaking concerned are also trying to discourage end consumers and retail shoppers by introducing a multi-tier pricing mechanism that will ensure better deals for those who purchase in bulk than for those who want for an example ‘a single bar of soap from a pack of six’. He further added that the joint venture would become ineffective if JVA partners are allowed to use trade secrets and ultimately compete with their endeavor, for this reason the non-compete clause has been incorporated and which would last for the lifetime of the joint venture.

14. For an agreement to qualify for exemption under Section 5 of the Act, it must meet the criteria as laid down in Section 9. Section 9 of the Act provides that the agreement must substantially contribute to:

(a). improving production or distribution;
(b). promoting technical or economic progress, while allowing consumers fair share of the resulting benefits; or
(c). the benefits of that clearly outweigh the adverse effect of absence or lessening of competition.

15. It has been mentioned in the application that the proposed joint venture under the JVA will facilitate the growth of the wholesale business as the entities will be able to combine their resources and take advantage of the resulting economies of scale, thereby becoming more competitive and benefiting the consumers. The consumers will directly benefit from the proposed joint venture as OpCo will be able to provide goods to the customers at highly competitive prices by securing reducing price margins from suppliers and passing on the benefit to the consumers. Additionally, OpCo will also maintain strict quality control rules to ensure that the products sold, particularly fresh foods, are of a high quality.

16. During the review of the JVA under section 11, merger specific efficiencies were duly considered. In general, efficiencies stem from an integration of economic activities whereby undertakings combine their assets and expertise to achieve what they could not achieve as efficiently on their own. We note from the documents (balance sheets) provided to us along-with the application that both MHPL and MCCP, due to lack of optimum operations, are losing revenues, and in order to continue operations, the JVA appears necessary. Hence, with reference to the first condition, we conclude that the JVA may create efficiencies by allowing the undertakings concerned to perform their functions, in particular the running of the wholesale cash & carry stores at lower cost or with higher added value for consumers.

17. It was further submitted in the application that the JVA will substantially contribute to the promotion of economic progress (through reduced prices on

account of economies of scale, providing increasing opportunities for local suppliers, etc.) and by passing on the benefits of such synergies achieved by the undertakings concerned to the consumers in the form of lower prices, greater product range and high standards in respect of products, as well as service. It is further provided in the application that the JVA enhances 'efficient allocation of resources' and 'consumer welfare' by:

(a). supporting the parties' long term and stable investment leading to development of the Pakistani wholesale sector;

(b). combining their assets, resources and know-how to increase the efficiencies and to support the development and continuous improvement of a consumer friendly sales and service network throughout Pakistan.

18. There seems merit in the submissions that the parties will bring in not only their expertise in the wholesale business but will also combine their assets in order to form the joint venture, which ultimately may result in reduced prices on account of economies of scale, providing increasing opportunities for local suppliers, etc.; hence we are of the view that the second condition in the instant matter is also satisfied.

19. We note that, typically, non-compete clause is argued as being imperative to the success of a Joint Venture or necessary in order to ensure that the amalgamated or newly formed undertaking thrives and can conduct its business smoothly, to prevent "free riding" and to secure trade secrets and knowledge shared between parties. While agreeing that such clauses may have the effect of foreclosing the market or constituting a breach of the competition law, parties to such agreements generally take the stand that the non-compete clause is merely *subordinate* to the joint venture agreement(s), and therefore, while being an integral part thereof, is collateral and separate from the actual transaction in the sense that it serves to make the main transaction more effective in accomplishing its purpose.[1]

20. It was submitted by the parties that, as joint venture partners both Thal and Metro have full access to all data, including sensitive information like marketing plans and business strategies. Such data, if used by either Metro or Thal to set-up a similar or competitive business will undoubtedly cause economic losses to OpCo. Additionally, by Thal, Metro or their affiliates after having had access to such confidential information relating to business plans and strategy and passing it on to a competitor of OpCo would amount to an unfair advantage and could be regarded as hindering fair competition. Hence, under the given facts, the restriction contained is reasonably necessary in order to achieve the efficiencies.

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[1] Judge Bork: Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 224 (D.C. Cir. 1986); *see also* **EU Commission Decision of 7-08-1996 (IV/M.727-BP/Mobil, paragraph 51); EU Commission Decision of 6-04-2000 (COMP/M.1832-Ahold/ICA Förbundet/ Canica, paragraph 26) and EU Commission's Decision dated 03-01-2011 (*COMP/M.5846 - SHELL/ COSAN/ JV)***.

21. Further, we appreciate that the non-compete provision is not absolute in terms of the restrictions imposed as both Thal and Metro (including their affiliates) are free to set up and operate various other businesses, such that they do not directly impact the wholesale cash and carry business of OpCo.

22. Given the above rationale and justification by the representatives of the undertakings concerned, we are of the considered view that the restrictions imposed by the undertakings upon each others would ensure efficiency and are essential for the smooth operation of the Joint Venture so created. Even otherwise, the non-compete obligation exists only with reference to the 'Competitive Business' and the Parties are free to conduct other businesses such as Metro and its affiliates are allowed to operate a consumer electronics business (Including e-commerce) similar to the business operated today or in the future by Media Market or Saturn and Thal and its Affiliates are allowed to establish and operate small retail stores having a store floor space of less than one thousand five hundred (1500) square meters that do not fall within the category of 'Competitive Business'.

23. In view of the foregoing, the Parties having addressed the concerns, are granted exemption in terms of Section 5 of the Act and we direct the Registrar of the Commission to issue the exemption certificate for the JVA with a condition that the non-compete obligation would only continue to have effect during the life of the Join Venture under the JVA.

24. For the purposes of our record, the Parties are directed to submit a copy of the finalized executed agreement with the Office of the Registrar within a period of thirty (30) days.

(Ms. Rahat Kaunain Hassan) **Chairperson**	(Mr. Abdul Ghaffar) **Member**	(Dr. Joseph Wilson) **Member**
(Ms. Vadiyya S. Khalil) **Member**	(Mr. Mueen Batlay) **Member**	(Dr. Shehzad Ansar) **Member**

ISLAMABAD THE JANUARY 09, 2012