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Economic analysis and evidence in abuse cases

Economic analysis and evidence in abuse cases in South Africa: Context matters – Lessons from the Babelegi Excessive Pricing Case

– Contribution from South Africa –

1. Introduction

1. This is a submission of the Competition Commission of South Africa (**CCSA**) to the Organisation for Economic Co-operation and Development Organisation (**OECD**)'s Global Forum, Roundtable on "*Economic analysis and evidence in abuse cases*".

2. The CCSA, the Competition Tribunal (**the Tribunal**), and the Competition Appeal Court (**CAC**) are the three institutions mandated to enforce the Competition Act 89 of 1998 (**theCompetition Act**). The CCSA has the authority to investigate complaints initiated by itselfor complainants from stakeholders regarding abuse of dominance.

3. Should the CCSA determine that a violation occurred during its investigation, it will referthe complaint to the Tribunal for adjudication. According to the Competition Act, the Tribunal as a decision-making institution also has inquisitorial powers and authority to determine whether a violation of the Competition Act has occurred and to impose a penalty or other appropriate remedy. The CAC is a special division of the High Court, which has jurisdiction to hear appeals against the decisions of the Tribunal.

4. The Competition Act addresses unilateral conduct by prohibiting a firm from abusing its dominant position in a relevant market. Part B, Chapter 2, sections 7 to 9 of the Competition Act deals with abuse of dominance. Abuse of dominance conduct in South Africa is predominantly considered under the classic rule of reason principles. In addition, the Competition Act stipulates that the abuse of dominance provisions apply to any firm whose annual turnover in, into or from South Africa is valued at or above R 5 million; or whose assets in South Africa are valued at or above R5 million.

5. In 2019, the Competition Act was amended, which introduced significant changes, all of which have a strategic impact on the functions of the CCSA namely, cartel enforcement,vertical restrictive practices, abuse of dominance, mergers and acquisitions, exemptions,market inquiries and various procedural aspects.

6. With regard to abuse of dominance, the amendments centred on introducing changes tothe economic and legal tests in the determination of excessive pricing, refusal to supply,predatory pricing and margin squeeze, and the buyer power and price discrimination provisions. The amendments therefore were focused on several aspects, but further heavily influenced by "***public interest***" considerations, which attach great importance toabuse of dominance practices and the impact on small and midsize enterprises (SMEs),and firms controlled or owned by historically disadvantaged individuals (HDIs), but also to primarily deal with the concentration and historical barriers to entry that characterise the South African economy. The Competition assessment thus considers the classic substantial lessening of competition (**SLC**) test together with the impact on public interestfactors, such

that the functions of promoting and maintaining competition are balanced with the needs of a developing state.

7. This submission specifically focuses on the CCSA's investigation of excessive pricing. As mentioned above, the Amendment Act specifically reformulated the economic and legal test for the determination for an excessive price. The new provisions did away withthe concept of *"**economic value**"* in the excessive pricing assessment and introduced anon-exhaustive list of factors, each applied based on ***relevance*** and ***evidence***, to determine whether a price is unreasonably higher than a competitive price.

8. The Amendment Act further shifts the burden of proof on dominant firms to show that a price is *"**reasonable**"* where there is a prima facie case of excessive pricing.

9. There was no penalty for a first offence. However, this has changed as the amendments have addressed the no penalty rule for first offence. A firm that is found to have engaged in excessive pricing may therefore be liable for a penalty of up to 10% of its annual turnover in, and exports from, South Africaduring its preceding financialyear and can be increased to 25% in case of repeat offences.

2. Evidence requirement for Abuse of Dominance

10. Post the amendment, the Competition Act maintained its requirement that three issues need to be considered in determining whether a firm has abused its dominant position. These include:

- ***Jurisdiction*** – in terms of section 3 of the Competition Act
- Whether the firms is ***Dominant*** or has ***Market Power*** – in terms of section 7 of the Act
- Whether ***Prohibited conduct*** has taken place – in terms of sections 8 and 9 of the Act.

11. To fully conduct these assessments, the relevant markets should be identified. The objective of defining the relevant market(s) in both its product and geographic dimensionsis to identify actual and potential competitors that are capable of constraining the incumbent firm from unilaterally increasing prices or reducing quality. Thus, the definitionof the relevant markets identifies and defines the boundaries of competition and featuresthat may restrict, prevent or distort competition within those boundaries, i.e. where is the incumbent firm dominant, and where the prohibited conduct and the harm have takenplace.

12. Therefore, the first step of any assessment of excessive pricing investigation, should consider these aspects and should any of these not apply, the test fails.

13. During litigation, the issue of Jurisdiction tends not to be of significant concern amongst litigants. The issues that tend to trigger considerable debates relate to the general approaches in the assessment of dominance and the prohibited abuse of dominant conduct.

14. Prior to the amendment of the Act, the CCSA had not successfully prosecuted an excessive pricing case, apart from the Harmony Gold Mining Company Ltd (**Harmony**) against Mittal Steel South Africa Ltd (**Mittal**) hence forth referred to as **Mittal Steel / Harmony Gold**[1] case. Harmony alleged that Mittal abused its dominance by charging an excessive price to South African consumers of its flat steel products and referred thematter

[1] Case No: 13/Cr/Feb04

for adjudication in 2008 to the Tribunal which was however successfully appealedin the higher court, the CAC.

15. The Tribunal in its analysis of this matter considered various scholars and decisions fromother jurisdictions in its interpretation of when a firm would be considered to have abusedits dominance by charging excessive prices. It found Mittal's pricing was tantamount to apure exercise of monopoly power as it could not be reasonably explained by competitive forces but a historical market structure (i.e., a historical state sanctioned monopoly) with limited constraints and thus the ability to price independently. On appeal, the CAC found the Tribunal's approach to be fundamentally flawed and remitted the matter back the Tribunal amid criticism that the Tribunal had failed to consider actual prices and costs and their relation to economic value.

16. Fast forward to 2020, the Covid-19 pandemic occurred shortly after the amended Act wasenacted, causing significant market disruptions and reshaping economic policies. On 15March 2020, South Africa declared the Covid-19 pandemic a national disaster under the Disaster Management Act No 57 of 2002.[2] On 19 March 2020, as part of a policy response, the Minister of Trade and Industry published Consumer and Customer Protection Regulations and National Disaster Management Regulations and Directions (price-gouging regulations). The price-gouging regulations were designed to address excessive pricing in four broad groups of products and services,[3] basic food andconsumer items; i.e., em*ergency products and services; medical and hygiene supplies; and emergency clean-up products and services during the disaster period*, all considered important in the context of a pandemic.

17. The price-gouging regulations had specific implications on the assessment of one of the abuse dominance conduct – *excessive pricing*. There were two significant cases brought to the Tribunal for prosecution in South Africa using these regulations, Dis-Chem Pharmacies Limited (**Dis-Chem case**) and the Babelegi Workwear and Industrial Supplies CC (**Babelegi case**). Both the cases were concluded during the state of national disaster in South Africa due to the Covid-19 pandemic, setting ground-breaking precedent that was subject to local and international debate.

18. The discussion will focus on the Babelegi case because the period of alleged contravention came to an end before the Consumer Protection and National Disaster Management Regulations and Directions were passed.[4] In this regard, the Babelegi case became the first finding of contravention of section 8(1)(a) (excessive price abuse of dominance) of the Act post the amendment that took effect July 2019.

19. As background on 9 April 2020, the CCSA referred a price-gouging case complaint to theTribunal. The complaint was that Babelegi charged an excessive price for the supply of facial masks. Babelegi significantly increased prices for FFP1 masks by a series of price increases from R50.60 per box of 20 to R500 per box excluding value added tax (VAT) an increase of approximately **888%**. During this time of the price increases and the costs of procuring the face masks, a future increase in procurement cost prices was anticipated.The circumstances that were prevalent in the period of the pandemic allowed for such increases. The complaint period was from 31 January 2020 to 5 March 2020.

20. We therefore use the recent Babelegi excessive pricing case to try and address some ofthe questions raised in the call for contribution.

[2] Disaster Management Act No 57 of 2002.

[3] Price gouging regulations.

[4] Government Notice R 350 in Government Gazette No 43116 of 19 March 2020.

2.1. Assessment of market power in the context of abuse of dominance, or monopolisation, cases

21. In the ordinary course the CCSA considers ***market shares*** as central to the statutory test for dominance (indicative of market power).[5] The Competition Act prescribes, a firm is **irrebuttable dominant** if it has at least **45 %**, but it may still be considered "**rebuttable dominant**" when it has **35 to 45 %,** provided that the firm can prove that "**market power**" does not exist. If a firm has "market power," it might be dominant even if its market share is less than 35%.

22. The Competition Act further defines market power as "the power of a firm to control prices, or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers".

23. In cases that have been investigated by the CCSA in the ordinary course, this assessment considers the creation or presence of market power, and all potential barriers are considered including natural or absolute barriers to entry. These include limited or constrained access to critical inputs, regulatory requirements, licensing, control of essential facilities and intellectual property rights, as well as strategic incumbent advantages, which an established firm in the industry would have as a result of being the first entrant into a market.

24. We contrast this with the Babelegi case which occurred in the context of the Covid19 pandemic, wherein the CCSA, the Tribunal and subsequently the CAT considered this in their assessment of market power – i.e., *first a global health crisis, second, steps taken to combat COVID-19 and finally the significant economic effects*.[6]

25. The assessment for dominance, in this case, is section 7 (c) of the Act, applicable to firms with less than 35% share of the relevant market but with market power.[7] The CCSA argued that the Covid-19 circumstances conferred market power on Babelegi during the complaint period. The CCSA further argued that Babelegi's ability to effect material price increases during the complaint period is indicative of market power.[8] The rebutting from Babelegi is that its market share, even grossly overestimated – is less than 5%.[9] Generally, SA competition authorities understand that firms tend to have some degree of market power in the short run and do not warrant competition intervention. The fact that Babelegi was found to have temporary market power was therefore indicative of the importance of context in the assessment of dominance.

26. In normal conditions, the CCSA would have to consider the small but significant non- transitory increase in price (SSNIP) test, but also several other factors, when assessing whether a firm's prices are excessive, including, inter alia, its profit margins, its return on capital, its prices for other products, the prices charged by its competitors for similar products, and the structural characteristics of the market.

[5] Section 7.

[6] Case No: CR00Apr20.

[7] Case No: CR00Apr20, par 43.

[8] Case No: CR00Apr20, par 55.

[9] Case No: CR00Apr20, par 59.

27. However, in the Babelegi case, the supply and demand for masks were affected during the complaint period and therefore the CCSA argued that the SSNIP would not be the appropriate test, which was accepted by the Tribunal. The CCSA argued that market power assessment in the instance of Babelegi should not be considered as that in ordinary time, rather under un-ordinary market circumstances, where the surge indemand was driven by panic buying directly linked to Covid-19.

28. The South African authorities have also considered the firm's profitability in analysing theissues above, particularly in the context of excessive pricing cases. In the case of Sasol Chemical Industries /Competition Commission[10] and Mittal Steel / Harmony Gold,[11] the Tribunal also considered the extent of prior state ownership. Similarly, in the Babelegi case, the Tribunal considered the structural characteristics of the relevant market, including the degree of contestability of the market, barriers to entry and past or current advantage that is not due to the respondent's commercial efficiency or investment, suchas direct or indirect state support for a firm or firms in the market.

2.2. What is the role of economists when collecting evidence? What types of evidence do you find particularly helpful in these cases?

29. The **Market Conduct Division** within the CCSA is the core division that focuses on investigation of restrictive vertical practices and the abuse of dominance conduct. The division is constituted of both legal and economic analysts who investigate abuse of dominance cases with focus on prioritized sectors of the economy, to enable the divisionto probe and gain insights into complex markets which have a high impact on the economy and consumers at large. The priority sectors are identified for enforcement action in the institution's Strategic Plan and are selected based on impact on consumersand level of competition in particular sectors, but also in this context informed by Covid- 19 pandemic and the policy framework for economic recovery.

30. In order for the Market Conduct Division to analyse both the financial and economic information collected as evidence, it makes use of both internal and external economiststo assess the information. There are currently sixty-seven (67) economists in the CCSA which are allocated to various roles in the organisation to support investigations. The division is also supported by the Economic Research Bureau division, which houses specialist economists for the CCSA, which provide detailed research and analysis for investigations. These economists are also critical when requests for information (**RFIs**) for analysis are being developed to frame the theory of harm that is being pursued. Basedon the complexity of the matters and capacity constraints, the CCSA also contracts external expert economists to provide similar support, but also to act as expert witnessesduring litigation.

31. When the CCSA receives a complaint, it is obligated to conduct an impartial investigationto determine whether the allegations are in contravention of the Act. As part of the investigation, the CCSA contacts market participants (competitors and consumers) and other relevant stakeholders (e.g. sector regulators if applicable) that it believes are in possession of information/documents that may have a bearing on the investigation.

[10] Case No. 48/CR/Aug10.

[11] Case No. 70/CAC/Apr07.

32. In terms of section 49A of the Act, the CCSA is empowered to summon any person whois believed to be able to furnish information on the subject of the investigation. The CCSAtherefore always endeavours to collect information from stakeholders voluntarily withouthaving to rely on its statutory powers, but there are instances where it is left with no choice but to exercise those statutory powers.

33. Some of the information that the CCSA relied on and found helpful in this investigation include financial information/documentation – relevant for the comparison of the price and cost in order to assess mark-ups and margins. To ascertain whether the price charged is excessive the CCSA considered the firm's price, profit margins and mark-up, and whether the increase was justified by any cost increases from suppliers further up the value chain. Economists play a huge role in this assessment. The CCSA also requests strategy and internal company documents, that could guide the assessment in terms of understanding the pricing strategy and policies.

34. Subsequent, to the CCSAs assessment, *prima facie* evidence that the price charged by Babelegi was excessive was established. Section 8(2) was applicable shifting onus Babelegi to show that its price charge was reasonable. Section 8(2) of the Act introducesa reverse onus concerning excessive pricing prosecutions, requiring the allegedly dominant firm to refute the *prima facie* case against it by showing that prices charged arereasonable. The evidential burden shifted to Babelegi to show that the price wasreasonable. The CCSA finds the shift in the evidential burden, enabled by the amendments in the Competition Act, but also the context of a pandemic in abuse of dominance cases, helpful.

2.3. What types of analytical techniques does your agency employ when assessing effectsin abuse of dominance cases, and how resource-intensive are they?

35. The new provision in section 8(1)(a) states that: "It is prohibited for a dominant firm to charge an excessive price to the detriment of consumers or customers", where section 8(3) sets out that "Any person determining whether a price is an excessive price must compare that price to a competitive price determine if that price is higher than a competitive price and whether such difference is reasonable, determined by taking into account all relevant factors". Section 8(3) proceeds to provide a list of factors which include comparative prices, profitability measures and market structural features. Section 8(2) furthermore states that "If there is a prima facie case of abuse of dominance becausethe dominant firm charged an excessive price or required a supplier to sell at a price which impedes the ability of the supplier to participate effectively, the dominant firm mustshow that the price was reasonable. In this regard, a theory of harm relating to this shouldbe framed, that would guide the investigation and assessment.

36. Prior the amendments, the Competition Act referred to detriment only to consumers. Theinsertion of customers adjusted the requirement to show that an excessive price is detrimental to final consumers and incorporates customers such as intermediate firms. In the previous excessive pricing cases such as Sasol Chemical Industries /Competition Commission,[12] the interpretation of consumers was among the points of debate. Sasol Chemical Industries argued that the consumer included only the product's end-user and subsequently did not consider the harm caused to downstream manufacturing. However,post studies conducted showed that since downstream products are often components of more complex products, the detrimental effects of excessive pricing conduct were moreapparent in

[12] Case No. 48/CR/Aug10.

the downstream industry (manufactures).[13] The inclusion of customers has brought certainty with regards to the incorporation of full assessment of harm.

37. In the Babelegi case, given the pandemic, the assessment of the detrimental impact of the price increases took into account the impact on "*poor individuals, families as well assmall businesses*".[14] The Tribunal also considered *excess profits* made by Babelegi during the complaint period. In summary the analysis considered the context of the complaint period, *theory of harm, the nature of the product, consumer choice during this period, economic* and *other circumstances*.

38. In line with the Mittal Steel / Harmony Gold case where the CAC stated that Competitionproceedings ought to involve the public interest and under the Competition Act, and thatthe Tribunal has an active role to play in protecting that interest.[15] Lastly the assessmentof detriment requires a value judgement in the context where the conduct is occurring.

39. Abuse of dominance cases are internationally known for being complex, resource intensive, and having various levels of interpretation and standards in investigations. Accordingly, these challenges are not unique to South Africa. Further, the hurdle for proving abuse of dominance cases are significant, they require extensive legal and economic analysis, which therefore requires resources. Significant resources are therefore put towards these and with the new amendments and jurisprudence, the CCSAwill make effort to successfully pursue these matters.

40. The CCSA further faced a challenge of cases taking too long to be heard by the Courts – on average 18 months after referral, even longer in cases of appeals, with some takingup to 10 years to complete. These are prolonged as instead of the courts proceeding to hear matters on the merits, respondents generally resort to technical legal challenges, where some matters have played themselves up to the highest court – the Constitutional Court, thus taking several years to be heard on merits. These types of challenges thus have a significant impact on resources.

3. Conclusion

41. With the enabling provisions in the Competition Amendment Act, the CCSA anticipates anincrease in the types of complaints related to abuse of dominance- a complex prohibitionto investigate.

42. It is therefore important for the CCSA invest in sufficient capacity and resources to be able to undertake these investigations.

[13] Source: Beare et al. (2014).

[14] Case No: CR00Apr20, par 162

[15] Case No. 70/CAC/Apr07, par 74.