Submissions on the proposed amendments to the Competition Act

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The Director-General: Economic Development Department

The dti Campus, Block A, 3rd Floor,
77 Meintjies Street,
Sunnyside,
Pretoria

Dear Sir/Madam,

Genesis Analytics welcomes this opportunity to submit written comments on the proposed Competition Amendment Bill 2017.

Genesis Analytics is an economics-based advisory firm that was founded in South Africa 20 years ago, and has gone on since then to work in over 20 different countries in sub-Saharan Africa, as well as countries in south Asia, the Middle East, and Europe. The Competition and Regulatory Economic practice within Genesis is a leading provider of competition and regulatory economics services in South Africa. It is also the oldest, having been established shortly after the introduction of the Competition Act and the opening of the Competition Commission's doors.

Over this period, Genesis has worked on many of the high-profile, precedent-setting cases including those that have dealt with abuse of dominance and public interest in mergers. We have also been involved in all of the major market inquiries to date. Importantly, our reputation for independent, rigorous economic analysis has afforded us the unusual position of having worked for both private firms, the Competition Commission and even the Minister on such matters. For example, we assisted SACCAWU and the Economic Development Department on the Massmart/Walmart merger and the Competition Commission on the various abuse of dominance cases against Telkom.

Our submission is focused on the economic aspects of some key focus areas of the amendments. In making this submission we have sought to draw not only on best practice economic thinking but also on our extensive experience in a wide variety of competition matters.

Although we do not comment on process and procedural points, as these are best dealt with by the legal fraternity, we believe it is important to emphasise that procedural fairness, analytical rigour and independence are all critical elements of competition policy that have underpinned the success of the relevant institutions to date. Hence, we would not support any legal or procedural aspects of the amendments that undermined these principles.

Sincerely,

James Hodge,

Managing Partner,

Competition and Regulatory Economics Practice

Genesis Analytics

INTRODUCTION

1. Competition law is ultimately underpinned and guided by economic theory. It is that theory which informs what behaviour is likely to be detrimental to the functioning of markets, consumers and overall economic welfare, and how one might test to distinguish such behaviour from that behaviour which improves welfare. The relative risks that certain behaviour might be positive or negative to competition and consumers also informs how the legal tests should be constructed in order to limit the extent of type 1 (incorrectly condemning conduct that is not anti-competitive) and type 2 (failure to condemn anti-competitive behaviour) errors. In examining potential amendments to the Competition Act, it is therefore important to have regard to the economic underpinnings of certain sections of the Act.

2. The purpose of this submission is to provide an economics perspective on certain proposed amendments to the Competition Act. The focus is therefore on the substantive provisions in terms of merger control, abuse of dominance, and market inquiries which are underpinned by economics. We have largely refrained from making comments of a purely legal drafting or procedural nature given that the legal community is better placed to do so. However, some of the issues we raise have implications for legal drafting and procedure which will hopefully be picked up by that community.

3. The primary focus of this economic submission is on the abuse of dominance provisions (ss8 and 9) and the market inquiry provisions (s43) as the amendments to these provisions are more substantive and raise many material economic issues. Each of these is dealt with separately below. We do have some comments on collusion, merger control and impact study amendments which are dealt with collectively at the end.

4. In general we welcome any amendments which both strengthen competition law and adequately address the public interest concerns articulated in the purpose of the Act. However, the manner in which some of the amendments are framed risk having the opposite effect, namely a chilling of robust competition on the merits to the detriment of consumers in general, which are also a focus in the purpose of the Act. Some of the key points emerging from this submission are as follows:

    4.1. First, the inclusion of so-called ‘buyer power’ abuses under ss8 and 9 is not only inappropriate but also unworkable. Economic theory demonstrates that buyer power predominately reduces prices to the benefit of the economy, and it is only in exceptional circumstances that buyer power harms overall economic welfare. Elevating it to a general offence with reverse onus in both cases therefore has real risks of chilling pro-competitive pressure on prices and facilitating collusion. If the concern is about the exceptional circumstances or the impact on small firms in particular sectors then the amendments should isolate it to precisely these situations. Furthermore, the reverse onus is unworkable as a buyer has no information on supplier costs and efficiencies with which to assess compliance let alone mount a defence.

    4.2. Second, the amendments to price discrimination provisions which effectively outlaw price differentiation unless justified by costs even if there is no effect on competition is equally inappropriate and risks imposing huge costs on the economy. Price discrimination, like buyer power, is found in economic theory to be generally welfare enhancing even in cases where the price difference is justified by demand

and not cost differences. The benefits include increasing output, supplying customers that would not be served at uniform prices and enhancing price negotiations. Again, if the concern is one of public interest and the impact on small firms, then the amendments need to isolate that situation and not extend the prohibition to all price differentiation to all firms.

4.3. Third, there are a number of instances where the wording in the amendments risk inadvertently opening up to prohibition or remedy firm behaviour or market structural features that constitute legitimate competition on the merits but in the process adversely affect either small firms/firms controlled or owned by historically disadvantaged individuals ("**HDIs**") or market participants in general. This risk exists with the treatment of unspecified exclusionary acts following the removal of s8(c) as exclusion is broadly defined and is no longer subject to the discipline of demonstrating anti-competitive effects. The same is true for the amendments which incorporate public interest considerations into price discrimination and market inquiries, and the adjustment to existing public interest wording under merger control. These need greater clarity to ensure only anti-competitive actions by dominant firms or market features which adversely affect competition by firms that are the focus of public interest are captured otherwise there is a risk of chilling competition on the merits to the detriment of consumers in general.

4.4. Fourth, whilst the market inquiry provisions are modelled on the approach of the Competition and Markets Authority ("**CMA**") in the United Kingdom ("**UK**"), they would benefit greatly from detailed guidelines to provide clarity on all aspects of such inquiries, from selection through to remedies, as is the case in the UK. A general legislative framework is incapable of providing certainty as to the economic and procedural standards that will be applied, necessitating guidelines. In addition, market inquiries would benefit from a more robust market selection process to ensure the efficient allocation of Commission resources on markets where the most impact will occur. This applies equally to impact studies. Greater disciplines also need to be applied to remedial actions by the Commission in the event of a finding that a market feature has an adverse effect on competition ("**AEC**"). This is not uncommon in other spheres of regulation where remedial action is assessed in terms of a cost-benefit analysis, the potential for unintended consequences and proportionate to the concerns. In such cases it is inappropriate to require that each AEC is remedied but rather that each is assessed and considered for remedy.

SECTION 8 - ABUSE OF DOMINANCE

5. The principal purpose of s8 is to protect market participants (actual or potential) from anti-competitive exclusion by dominant firms. In addition it is intended to prevent price exploitation of consumers. Therefore, to the extent that the proposed changes are meant to increase the access of small firms, firms controlled or owned by HDIs ("**HDI-controlled firms**") and new entrants to markets, changes to s8 are an important component.

6. We support the goal of increasing the access of such firms to the market. The question is whether the proposed changes to s8 would achieve this goal effectively whilst still promoting competition. In other words, will the changes improve the market access of such competitors and sharpen competition such that customers benefit from keener prices, better quality and product innovation?

7. In assessing the proposals, it should be borne in mind that market participants enter s8 in three roles: as *competitors* to the dominant firm, as *customers* in the concentrated markets in which s8 is operative and as *suppliers*. Section 8 should work for firms both as market participants and as purchasers. Further, our competition regime has multiple purpose: the Competition Amendment Bill ("**the Bill**") *retains* the existing objectives of the Act in which the interests of consumers and other customers are of at least equal weight to those of firms. Further, the general objective of economic efficiency remains important: changes that materially increase costs in the economy would likely result in social costs.

8. From an economic perspective, two proposed changes could potentially have a net adverse effect on all these fronts: on smaller firms, consumers and the cost structure of the economy. These are:

    8.1. **The treatment of unspecified exclusionary acts.** Both the current and proposed versions of s8 cater for the prohibition of exclusionary acts beyond those listed in s8(d) and its successor. We refer to this general category as *unspecified exclusionary acts* to distinguish them from those specified in s8(d) and the proposed s8(1)(d). The treatment of such unspecified exclusionary acts has changed in important respects. In our comments here we assess the likely economic impact of these changes. Our view is that the current amendments fail to properly distinguish between acts that are anti-competitive and those that are not, creating the risk of blunting the competitive process. We propose changes that will address this concern whilst strengthening the ability of the authorities to address anti-competitive exclusion.

    8.2. **The treatment of actions by buyers to bargain down prices.** In concentrated markets, the ability of buyers to place downward pressure on prices is a critical instrument for improving outcomes for customers. The consensus in competition economics is that the exercise of such buyer power is exclusionary only in exceptional circumstances. The proposed changes in s8(1)(d)(viii) and s8(2) seem to invert this view. This creates the risk of <u>up</u>ward pricing pressure in the economy to the detriment of customers, including small firms and consumers

9. We support the thrust of the other changes to s8. We do make proposals to improve the workability and clarity of the changes pertaining to *excessive* and *predatory* prices. In both cases the proposal as currently drafted may result in unintended consequences.

UNSPECIFIED EXCLUSIONARY ACTS

10. Unspecified exclusionary acts – acts other than those named in s8(d) or the proposed s8(1)(d) – are defined in s1 of the Act. It has long been recognised that the definition is extraordinarily wide as it includes any "*act that impedes a firm entering into, or expanding within, a market*". This definition labels *any* competitively relevant act of a dominant firm, one that has an adverse effect on the market position of a competitor, as 'exclusionary'. Whilst anti-competitive acts would rightly be caught in this net, so too on the plain language would many that are clearly neutral or even pro-competitive. Examples of such competitively relevant acts that would fall within the definition are: a price cut following from production efficiencies; an increase in the area of distribution; or an innovation that better meets customer needs. In summary, the exclusionary act definition potentially covers all competitively relevant acts by dominant firms.

11. It is for this reason that 'exclusionary acts' are not prohibited – or presumed to be prohibited – under the Act merely on the basis of meeting the definition. Were it otherwise ordinary, wholesome competitive conduct would be presumptively prohibited. In s8(c), the Act sets *additional requirements* for unspecified exclusionary acts to be prohibited: one, the need to prove that the act has an anti-competitive effect; *two*, that the anti-competitive effect outweighs the technological, efficiency or pro-competitive gain associated with the act. In both cases the onus rests with the complainant.

12. The starting point of this discussion is that the drafters of the Bill have not attempted to change the definition of an exclusionary act so as to distinguish 'bad' from 'good' competition. The definition still captures all forms of competition. If anything, it has been further widened by inclusion of the notion of participation.[1]

13. Thus the need for an appropriate additional filter is retained, or even heightened. But the Bill does the opposite. By shifting the regulation of unspecified exclusionary acts to s8(1((d) the draft *removes* the filters previously employed, including the need to prove anti-competitive effect. It therefore potentially creates a presumption of illegality – albeit rebuttable – against ordinary competitive actions.

14. This change is detrimental to smaller firms, consumers and the cost structure of the economy. This is because of the critical role of large firms in the competitive process. Large firms often have advantages of economies of scale and scope which, deployed properly, are to the advantage of customers (including both consumers and small businesses) and the economy. Large firms also offer links to other markets, including export markets and access to technology. Much of what such firms do should therefore not be *presumed* to be exclusionary. If large firms are prohibited or discouraged by the threat of legal action from bringing such pro-competitive advantages to the market, customers and the economy would be worse off.

15. The value of allowing large firms to bring their advantages to the market is accentuated by the oligopolistic nature of many markets in South Africa. In such markets rivalry *between* large firms is a critical part of the competitive process. It unfortunately not clear that by stopping the largest firms from competing effectively, a legion of smaller firms would emerge to provide such competition. In many markets, size matters.

[1] Proposed s1(a) of the Bill.

16. Therefore the statute needs to strike a balance. All firms, including the largest firms, should be encouraged to compete assiduously. But actions of a dominant firm that are anti-competitive need to be prohibited. The balance is achieved by adding the filter that anti-competitive effect needs to be proven for prohibition. This is what s8(c) currently does. The language in the Bill dealing with unspecified exclusionary acts should restore the requirement on the part of the complainant to prove an anti-competitive effect.

17. We anticipate broad agreement with the principle that all competitively relevant acts of dominant firms should not be presumed anti-competitive. Two arguments of a legal nature may possibly be raised against the change we propose. The first is that the competitively relevant acts that do not have anti-competitive effects are not condemned outright, but only presumed to be anti-competitive. It is true that firms would still be allowed to defend their actions by demonstrating pro-competitive gains. But this point is not persuasive. By rebuttably presuming a large number of innocuous acts anti-competitive, competitive action by large firms would be discouraged, not least by the ready threat of litigation by those rendered less competitive.

18. The second legal argument is that there is some jurisprudence that reads into the wording of the current s8(d) the need to demonstrate anti-competitive effect. The plain language, though, seems at best ambivalent on this point. It would be strongly advisable for the Act to clarify that a demonstration of anti-competitive effect is required for a competitively relevant act of a dominant firm to be prohibited.

19. To effect this change, separate subsections for unspecified exclusionary acts and for the list of specified exclusionary acts may need to be reintroduced. This is desirable as it would also allow differential treatment of penalties for first-time offenders which seems fair given the unspecified nature of the former.

20. We believe that there is a better way to change the Act to strengthen the hand of smaller competitors and regulators against dominant firms that are excluding rivals. The operation of the current s8(c) can be changed such that once anti-competitive effects of sufficient materiality have been proven, it is for the *responding dominant firm* to demonstrate that technological, efficiency or other pro-competitive gains outweigh these effects. This would significantly reduce the burden.

21. Finally, a note on the inclusion under the definition of exclusionary acts those acts that prevent or impede a firm from *participating* in a market. As mentioned before, the definition is already wide, and may well include those aspects that the drafters had in mind. In that case there is no change and no cause to disagree. If, however, the change is interpreted to mean that dominant firms are prohibited from any actions that have any effect on market participants, including those that result from enhanced competition, this would be a significant backward step creating considerable distance between our Act and international practice. This applies equally to the exit of firms, as the exit of less efficient firms is at the heart of the competitive process. Firms, even dominant ones, should not faulted for any actions that result in such exit, only anti-competitive ones.

ACTIONS BY BUYERS TO BARGAIN DOWN PRICES

22. Section 8(1)(d)(viii) as proposed in the Bill would prohibit dominant firms from requiring a supplier to sell at "excessively low" prices.[2] The Background Note to the Bill states that this provision has been included in order to address *"the problem of monopsonies"*.[3] "Excessively low" is not defined.

23. The first concern with this provision is that it works *against* the most powerful instrument for lowering prices in markets with oligopolistic supply, namely buyer power. Both economic literature and jurisprudence confirm that buyer power is generally <u>pro</u>-competitive. Secondly, the provision appears problematic as a matter of compliance and enforcement.

24. It is important to distinguish the concept of buyer power (with monopsony at its extreme) from "seller power" (with monopoly at its extreme). The concepts are not two opposing sides of the same coin. The ability of a buyer to exert its bargaining power over upstream firms so as to lower input prices is typically pro-competitive and <u>beneficial</u> to end-consumers. In contrast, the exercise of a seller's market power to increase prices above costs is almost always <u>detrimental</u> to consumer welfare.

25. It also needs to be understood from economic literature that a fall in consumer welfare from buyer power *only* occurs when the buyer has pushed the upstream supplier so hard that the overall output of that product in the market is reduced. That is a most unusual occurrence as the downstream firm doing the purchasing usually has no incentive to reduce the quantity of input available – particularly as that would likely reduce the quantity it can produce of the downstream product. Such behaviour would be an invitation to customers to switch to competitors. It is also the case that most negotiations over lower prices are in exchange for larger quantities, an output expanding rather than reducing effect.

26. Economic literature also indicates that generally some or all of the gains extracted from the supplier through buyer power are usually passed on to downstream customers. In cases where the downstream markets are competitive (as is the case in many forms of retail), virtually all the gains are passed on to consumer. Where the downstream markets are not competitive, reduction in the prices of variable inputs (i.e. that vary in proportion to the number of products manufactured) also result in lower downstream prices for customers. The OECD's paper on monopsony and buyer power states that *"[i]f a lower price can be achieved without restricting supply, then in a competitive market place, any lower prices obtained by a powerful purchaser are likely to be passed on to consumers as part of a strategy to increase market share downstream."*[4] [5]

27. Oligopolistic market structures as one often finds in South Africa accentuate the value of buyer power. The OECD paper again states that *"[i]f there is market power on the*

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[2] The introduction of s8(1)(d)(viii) gives rise to a further reference to the "excessively low prices" in s8(2). Our proposals at the end of this sub-section deal with the inclusion of this term under both provisions.
[3] Background Note on the Competition Amendment Bill, 1 December 2017, Government Gazette No. 41294, p. 16.
[4] OECD. 2008. Policy Roundtables: Monopsony and Buyer Power, p. 258.
[5] See also the EC guidelines on horizontal mergers, which express similar sentiments: *"if increased buyer power lowers input costs without restricting downstream competition or total output, then a proportion of these cost reductions are likely to be passed onto consumers in the form of lower prices."* See: EC. 2004. Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings. 2004/C 31/03, para. 62.

upstream market, buyer power can exert important countervailing pressures against any increase in prices."[6]

28. The pre-eminent European competition economist Massimo Motta identifies buyer power, and the presence of a strong buyer in the market, also as an antidote to collusive prices upstream.[7] Further, the countervailing power of buyers is cited as a specific factor that the Commission and Tribunal must assess when considering a merger in terms of our Act.[8] This is the case in numerous other jurisdictions, with Motta stating that *"[t]he role of buyer power in constraining sellers is typically well taken into account by anti-trust agencies. In European merger cases, for instance, it has led the [European Commission] to clear mergers that would otherwise have been blocked."*[9]

29. There are certain conditions under which legitimate concerns can be raised regarding the overconcentration of buyer power. But these concerns generally do not support the notion apparently held by the drafters, namely that buyer power has an exclusionary effect upstream. There is little indication in the literature that the exercise of buyer power would result in anti-competitive exclusion of suppliers.[10] It is generally recognised that businesses with long-term supplier relationships have little incentive to exclude their partners. In South Africa, too, there is little evidence that firms have been excluded on this basis. The complaints by upstream firms in some mergers may be an indicator to the contrary – or it may simply be firms speaking to their own book.

30. Instead, the concern arises in the relatively rare situations where the concern is about reduced output and hence a fall in the overall welfare available to consumers and producers – not exclusion. Even in such cases, the authorities insist on careful assessment on a case-by-case basis and that a buyer power theory of harm is fully articulated and tested.[11] There is no presumption of adverse effect.

31. We recognise that from a public interest perspective there are sometimes concerns voiced as to the treatment of small suppliers, most often in the case of retailer buyer power. However, these too are typically isolated to particular small firms in particular sectors. If there is a desire to protect such firms then the answer is not to introduce a general provision limiting buyer power but rather to address that specific concern through a public interest provision or a market inquiry.

32. Indeed, a general provision may in fact harm certain categories of small business. Smaller firms are often downstream customers for products that benefit from buyer power exerted upstream. Cement and other building supplies are ready examples. In virtually every industry, there are far more small firms purchasing downstream than are small suppliers upstream at risk of being shut out. The provision may therefore harm far more small competitors than it would protect, if such protection were needed. It would be preferable to find ways to support small upstream firms in ways that do not interdict the competitive process on which other small firms rely.

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[6] OECD. 2008, p. 257.
[7] Motta, M. 2004. *Competition Policy: Theory and Practice.* Cambridge University Press, p. 145.
[8] s12A(2)(d) of the Act.
[9] Motta. 2004, p. 122.
[10] A few theoretical suggestions are raised in Dobson, P.W. and Inderst, R. 2008. "The Waterbed Effect: Where Buying and Selling Power Come Together". *Wisconsin Law Review*, p. 345 (footnote 25).
[11] The OECD paper: *"Reductions in input prices in the case of bargaining power are typically beneficial, so requiring an explanation of how increases in bargaining power would harm downstream consumers will help to avoid inadvertently deterring pro-competitive behaviour."* See: OECD. 2008, p. 9.

33. For these reasons s8(1)(d)(viii) is at best unnecessary and more likely harmful. It may result in general upward pricing pressure in the economy, thereby strengthening the oligopoly effects the section is intended to moderate.

34. This risk is worsened by the reversal of onus effected in s8(1)(d).

    34.1. Unlike the other exclusionary acts specified in the proposed s8(1)(d), buyer power is not generally considered to be anti-competitive. Implementing such a provision under s8(1)(d) is an invitation for litigation when it is apparent that few cases exist and buyer power is usually overwhelming positive.[12]

    34.2. Equally important, a buyer would not know the costs of its suppliers, making compliance difficult if not impossible, but also difficult to defend under the reverse onus.

35. Finally, is not clear how a test under s8(1)(d)(viii) would operate. Is the "excessively low" price in question assessed against a cost benchmark? If so, which one?

    35.1. The costs of firms do differ and the rewarding of more efficient firms able to price lower is an important part of price competition to the benefit of consumers. What may be an excessively low price to an inefficient supplier may be a reasonable price to an efficient one. It would be a bizarre outcome if this provision ended up elevating prices to that of the least efficient supplier to the clear detriment of the economy.

OTHER ISSUES

Excessive pricing

36. In s8(1)(a), the drafters propose removing the requirement to show that such prices are *"to the detriment of consumers"*. It is true that such a requirement is often seen as tautologous: when would excessive prices not be to the detriment of consumers? In fact, there are some instances when prices significantly above observable costs are 'in the interest of consumers' – for example if the prices are rewarding large sunk costs and the risks borne in bringing a valuable new product to market. We note this to make the point that in some markets, particularly those with a high degree of dynamism, excessive pricing cannot be reduced to an accounting exercise. It is therefore advisable to consider the impact of the pricing from the perspective of consumers – or better still, customers if the concern is that s8(a) in its current form does not apply to intermediate products. If, on the other hand, all of these concerns could be considered under the notion of 'economic value' or the 'reasonable relationship' between value and price, the excision could be made.

37. We understand that s8(2) is intended to place on the dominant firm, rather than the complainant, the onus of demonstrating the reasonableness of a price that has been found to exceed economic value. We would support such a change and indeed the case law makes provision for firms having the ability to use price-cost tests to dispute findings based on other measures designed to test for an excessive price (such as comparators). But it could be better achieved by making that change explicit in s8(1)(a) along the lines

[12] It is not difficult to imagine suppliers to a dominant firm lodging complaints against such buyers in order to improve their relative bargaining position.

set out in the case law, rather than by introducing the imprecise and vague concept of a *prima facie* excessive price.

38. We support the issuing of guidelines by the Commission but would strongly suggest that in an area as central as pricing, the Commission be limited to guidelines that – as is the case in the Guidelines issued by the European Commission ("**EC**") – reflect law, rather than seek to make law in an undefined process, for use of an uncertain nature. And as the law changes, so should the guidelines.

Predation

39. The change to current s8(d)(iv) of the Act suggests that different cost standards for different settings may develop through the jurisprudence – an approach that we would generally endorse.

40. But upon closer scrutiny, the changes to the current s8(d)(iv) seem to weaken the prohibition without actually broadening it. The prohibition is weakened because the current bright line of average variable costs is no longer in force, removing an important protection for smaller firms. And the prohibition is not unambiguously broadened, because the cost standards mentioned – average avoidable costs ("**AAC**") and long-run average incremental costs ("**LRAIC**") – were open to inclusion under s8(c).

41. In our view the more powerful protection would be to raise the s8(d) price floor to average avoidable costs and to remove any doubt as to its applicability. AAC is widely accepted in the economic literature and other jurisdictions (such as the EC) have moved towards such a standard. It also provides more protection for smaller firms as it requires prices to reflect product-specific fixed costs, which average variable costs do not. The result would be a clearer and stronger anti-predation regime.

42. With respect to LRAIC we wish to sound a warning. LRAIC is the appropriate benchmark in certain circumstances, as it protects entrants who have yet to expend the sunk costs of entry. However, we would advise against specifying LRAIC in the Act, even in the manner done in the Bill. The reason is that sectors subject to commodity cycles (including global ones) are often forced to price below LRAIC at periods in the business cycle where there is substantial excess supply. This is not a result of predatory pricing but rather excess capacity in the market. It is for this reason that in our view it would be inappropriate to stipulate LRAIC as a general price floor. Such a stipulation – or impression – would result in higher prices during certain periods and dampen price signals aimed at generating demand to reduce overcapacity. A LRAIC standard would also be an invitation for dominant firms in concentrated markets (where they are natural price-leaders) to firmly signal that level as a focal point for tacit collusion.

43. We consider this risk to exist even with the current wording which cites LRAIC but does not impose it. As LRAIC is the higher of the pricing levels contemplated in the draft, dominant firms could claim that prudence requires them to price at that level. In our view it is better to allow for LRAIC to be imposed where appropriate via the unspecified exclusionary act mechanism as jurisprudence develops. Further, as there are many legitimate reasons why prices may be below LRAIC, it would be inappropriate to assume exclusion, even if rebuttable, as is now mooted in s8(1)(d).

SECTION 9 – ABUSIVE PRICE DISCRIMINATION

44. Currently s9 of the Act focuses on anti-competitive price discrimination as an abuse of dominance. Price discrimination occurs when two similar products are sold by a firm at different prices, but is only deemed abusive if such discrimination harms competition.

45. Price discrimination is generally seen as beneficial for consumers and the economy since it increases trade and competition between firms by allowing firms to sell at a lower price to more price-sensitive customers than it would under a uniform pricing regime. Similarly, the ability of a buyer to exert its bargaining power over upstream firms in order to lower input prices is typically viewed as pro-competitive and beneficial to end-consumers.

46. However, it is often a concern of policymakers that small firms bear the brunt of the potential negative aspects of both price discrimination and buyer power. Indeed, public perception tends to reinforce the idea that it is small firms who are treated unfairly either because they are squeezed by large buyers or receive higher prices from suppliers relative to their larger counterparts who can negotiate lower prices.

47. As a result, it has been argued that s9 should place particular emphasis on the protection of small and medium-sized enterprises. Indeed, this was the rationale behind the approach advocated by the *Tribunal in Nationwide Poles v Sasol (Oil) Pty Ltd,* where it argued that s9 should be regarded as "a hybrid of public interest and anti-trust".[13] However, the approach adopted by the Tribunal was rejected by the Competition Appeal Court.

48. Nevertheless, it is within this context that the amendments have sought to explicitly incorporate public interest concerns into s9. The drafters have done this by changing the test from one that identifies anti-competitive price discrimination towards buyers to one that essentially outlaws non-cost based price differentiation by a dominant firm towards either its buyers or suppliers. This is the case even where such a difference has no anti-competitive effect.

49. The issue with this approach is that it has taken what is primarily a public interest issue (i.e. the concern related to the negative differential treatment of small firms) and extended it to apply to all firms and situations (much like the monopsony provision in s8). We consider this extension to be highly problematic since it is likely to significantly chill price competition and eliminate the substantial consumer welfare benefits associated with both price discrimination and buyer power. This is because not only will the amendments curtail competitive price negotiations, but the inability to price discriminate will also likely result in higher prices on average, lower output and fewer customers being served.

50. We submit that given the predominantly positive effects of price discrimination, the current formulation of s9 is appropriate for identifying those instances where price discrimination is anti-competitive. Further, if one wanted to address public interest concerns that extend beyond the negative impact of anti-competitive price discrimination, this would require finding a way for the legislation to adequately isolate such instances to small firms instead of applying the blanket approach currently proposed.

51. This admittedly, is likely to be difficult as no obvious solution presents itself and may need to be the subject of further debate. However, we strongly believe that the current

[13] 72/CR/Dec03, para. 142.

approach will have clear, significant and far-reaching consequences that will outweigh any of the envisaged benefits of including public interest concerns in s9.

THE BENEFITS OF PRICE DISCRIMINATION

52. Price discrimination is a pervasive practice that is legitimately and beneficially employed in a diverse number of ways and across a vast array of industries. From an economics perspective, price discrimination is generally viewed as efficiency and welfare enhancing.

    52.1. First, the use of price discrimination is widespread and is not necessarily reflective of market power. Indeed, it often occurs in markets that are considered competitive and hence cannot, in and of itself, be considered to be evidence of market power or the abuse thereof.[14]

    52.2. Second, price discrimination is often welfare-enhancing and efficient, <u>even in concentrated markets.</u> This is because when a supplier is able to sell at a lower price to more price-sensitive customers than it would under a uniform pricing regime, <u>the overall level of output in the market increases as these customers are then serviced where they would not otherwise have been.</u> <u>This increase in output benefits not only the consumers but the economy as a whole due to increased employment and greater value added to the economy in manufacturing and raw input material markets.</u> Further, it is more often than not beneficial for consumers, as noted by Bishop: *"where price discrimination leads to an increase in total sales, consumer welfare is likely to be improved relative to the benchmark of uniform prices."*[15]

    52.3. Third, where a company does possess market power and engages in bilateral negotiations with customers, price discrimination can in fact be pro-competitive. This is because in such circumstances most customers will attempt to negotiate a price cut, particularly if they are concerned that other firms may be securing lower prices. However, where a supplier can plausibly commit to charging the same price to all customers, these customers will likely accept the higher price since they know that their competitors will also face such a price.[16] <u>Importantly, requiring the firm to charge a uniform price to all customers prevents such customers from being able to negotiate better prices – a natural and important part of many competitive negotiation processes.</u>

53. The fact that price discrimination occurs extensively and, in many instances, results in greater efficiency and enhanced economic welfare means that, from an economic perspective, prohibiting differential pricing without showing a negative effect on competition would run the serious risk reducing overall welfare. This is true regardless of the jurisdiction or the specific economic and social circumstances of the country.

54. The often pro-competitive effects of price discrimination and the non-trivial possibility that competition interventions could result in negative, albeit unintended, outcomes has led competition authorities in the European Union ("**EU**") to adopt a cautious approach when

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[14] O'Donoghue, R. and Padilla, J. 2013. *The Law and Economics of Article 102 TFEU*. 2nd ed. Hart Publishing: Oxford and Portland, p. 782.

[15] Bishop, S., 2005, Delivering benefits to consumers or per se illegal?: Assessing the competitive effects of loyalty rebates, in *The Pros and Cons of Price Discrimination*, Swedish Competition Authority, p. 66.

[16] See Papandropoulos, P., 2007, How should price discrimination be dealt with by competition authorities? Droit & économie, *Concurrences* N° 3, p. 37 and [16] O'Donoghue & Padilla. 2013, p. 786.

pursuing price discrimination cases. This approach is summarised by O'Donoghue and Padilla as follows:

> *"At EU level, findings of discrimination based only on differences in prices or terms offered to two or more similarly-situated customers have been an extreme rarity under Article 102 TFEU… The EU institutions' reluctance to apply Article 102(c) in cases where the only conduct alleged is a difference in price or terms to similarly-situated customers most likely reflects the fact that price discrimination is ubiquitous (including by non-dominant firms) and probably efficient in most cases, as well as the concern that a strict non-discrimination rule would likely have the perverse effect of raising prices overall, increasing scope for collusion, and preventing firms from negotiating better prices and terms. For this reason the EU institutions have never suggested that a dominant firm is under a strict obligation to offer similar prices and terms to all trading parties active at the same market level."* [17] [emphases added]

55. This caution is echoed by Areeda and Hovenkamp in the leading US antitrust treatise, where they state:

> *"… antitrust tribunals can rarely have confidence that a decree enjoining price discrimination will benefit consumers or encourage competition in any market. Such a decree ipso facto does not restore competitive pricing; it merely forces the defendant to charge a single price, which will be its profit-maximizing price given the amount of monopoly power it has. Such a decree can be justified only if the tribunal has confidence that single pricing will (1) benefit consumers as a group; or (2) hasten rivals' expansion or new entry that would reduce or destroy the monopolist's power or destroy the monopolist's power. If the monopolist's price discrimination scheme before the decree issues was output-increasing, then the decree would generally injure consumers as a group…"* [18]

56. Despite the benefits of price discrimination, it is the case that it often conjures up feelings of unfairness, especially where such difference in treatment cannot be justified by costs (or the other justifications in proposed s9(2)(b)).

57. However, as noted by the OECD, *"there is nothing intrinsically unfair about price discrimination if it can mean that more consumers are served and that those on lower incomes pay lower prices."* [19] This is because competition law is not concerned with the individual economic welfare of a single consumer but with welfare as a whole. As such, establishing whether price discrimination is an abuse is an economic inquiry where the overall welfare-reducing nature of the abusive discrimination needs to be established.[20] To the extent that public interest considerations mean particular groups are of specific concern, then that is better dealt with under a specific public interest provision that isolates the inquiry to only those circumstances rather than a blanket ban on price discrimination.

58. This is because, unlike in the case of excessive pricing, it is far from obvious that customers would be better off without the discrimination.

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[17] O'Donoghue & Padilla. 2013, pp. 811-812.
[18] Areeda, P. and Hovenkamp, H. 2016, *Antitrust Law*. Aspen Publishers, at para. 721e.
[19] OECD. 2016. Price Discrimination: Background Note by the Secretariat, DAF/COMP(2016)15, para. 32.
[20] OECD. 2016, para. 32.

58.1. In an excessive pricing case where it is demonstrated that the higher price is appreciably higher than economic value, the counterfactual to the abuse is that lower prices would have been charged and that customers will be unambiguously better off from enforcement.

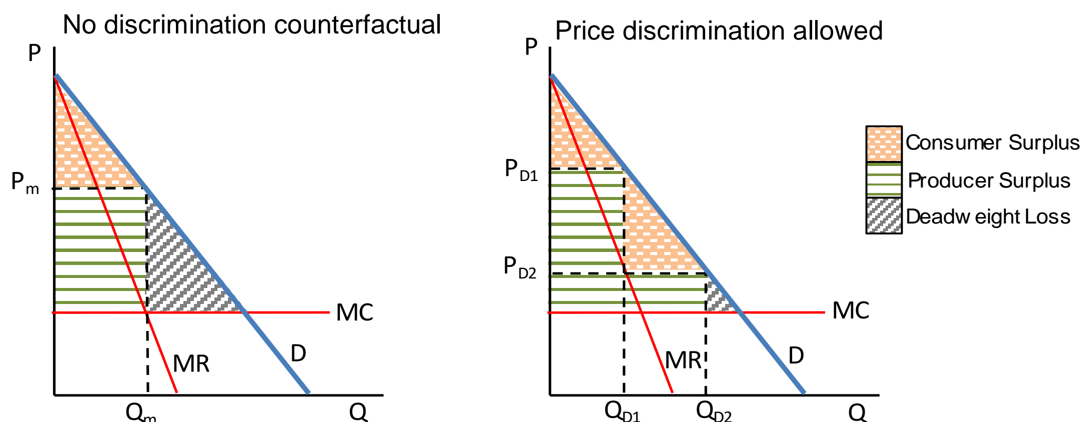
58.2. In contrast, in the case of price discrimination the correct counterfactual is simply the elimination of discrimination in pricing such that a uniform price is charged to all customers. That the welfare effects of such a measure would be positive are far from clear.

59. As the economic literature aptly demonstrates, this counterfactual does not usually imply that those charged the higher prices would have otherwise received lower prices but rather that lower priced customers would not be served at a lower price or at all. This economic logic is demonstrated in the figure below which shows a textbook example of a market with a single firm where price discrimination is allowed relative to the no discrimination counterfactual.

59.1. Under a uniform pricing constraint, the firm will set a price at a profit-maximising level of P_m. This will result in a total output produced of Q_m. This is the profit-maximising level as the firm prices where marginal revenue (MR) equals marginal cost (MC) – a standard economic outcome.

59.2. Under price discrimination, the firm will now seek to service more price-sensitive customers at a lower price (P_{D2}) as doing so does not undermine the price achieved for the existing customers (P_{D1}). In so doing, the price discrimination results in a) certain customers being served at a lower price than they would otherwise, and b) an overall expansion of output (as $Q_{D1}+Q_{D2}>Q_m$). In addition, overall consumer welfare (as measured by consumer surplus) and total welfare (which includes producer surplus too) is increased as the deadweight loss is minimised.

Figure 1: Single-firm market - welfare without and with price discrimination



Source: Genesis Analytics

60. Given the welfare-improving effect of quantity increasing price discrimination, one can only be truly confident that customers are on balance harmed as a result of price discrimination in the case where the scheme does not lead to an increase in total output. It is also important to note that other jurisdictions have chosen to avoid pursuing cases of price discrimination solely based on considerations of fairness. This is in light of the fact

that not only is price discrimination in most instances found to be beneficial due to its output-enhancing effects (and hence the default position is a welfare-enhancing one), but also that it is extremely difficult to accurately determine when this is not the case. In other words, the risk of type 1 (false positive) errors is fairly high in the legal context, and type 2 (false negative) outcomes extremely low in pursuing price discrimination cases simply on the basis of fairness.

THE AMENDMENTS EFFECTIVELY OUTLAW PRICE DISCRIMINATION

61. Under the current Act the justifications listed in s(9)(2) can be invoked by the dominant firm to justify its conduct if the latter was found to have a negative effect on competition as required by s9(1)(a).

62. The amendments to s9(2) significantly alter this approach by requiring that any instance of differential prices charged by a dominant for equivalent goods or services is abusive, unless the dominant firm can show both:

    62.1. no impact on competition; and

    62.2. the conduct can be justified on the basis of one of the three justifications listed in s9(2)(b).

63. In other words, the drafters have altered the test for abusive price discrimination such that it is no longer sufficient simply to show no negative impact on competition. The dominant firm must also show that the difference is justified on the basis of s9(2)(b), the most pertinent being "*a reasonable allowance for differences in cost*", even if there is no anti-competitive effect

64. The direct consequence of this is that it essentially outlaws any form of price discrimination by a dominant firm that cannot be justified by cost differences. This is the case even where such conduct has a neutral or a positive impact on competition.

65. Given that economics recognises that price discrimination can occur for a variety of legitimate reasons, often unrelated to cost differences or the other justifications in s9(2)(b), the amendments to s9 essentially prohibit price discrimination by dominant firms. The economic costs associated with such a change cannot be understated. In particular:

    65.1. The amendments will almost certainly chill price competition in the relevant upstream or downstream markets. The amendments will negatively impact on competitive negotiations thereby resulting in higher average prices, reduced output, an increase in the scope for collusion by buyers or sellers and ultimately a negative impact on the price paid by end-consumers.

    65.2. The overall welfare benefits generally, and customer welfare benefits specifically, that are associated with price discrimination will be lost. This is because under uniform pricing it is not the case that those charged higher prices will simply receive the lower price but rather that lower-priced customers would not be served at a lower price or at all.

66. The result of these amendments to s9(2)(b) are likely to have several perverse outcomes, including:

66.1. Price discrimination by a dominant firm between two similarly-sized firms as a result of a competitive negotiation process will be prohibited. This is likely to result in a significant chilling of competition between buyers/suppliers of the dominant firm.

66.1.1. For example, competition between large, low-margin grocery retailers often relies on the ability of the retailer to negotiate lower prices with its suppliers to gain the competitive edge over its large grocery retail chain competitor. The amendments would eliminate this important competitive dynamic, since it would require any dominant supplier to provide products to large retailers the same prices.

66.2. Differential treatment by a dominant firm of consumers due to different ability to pay will also be prohibited. Since consumers with a lower willingness and ability to pay would not buy the good at a higher price, this would result in a significant loss to consumer welfare.

66.2.1. For example a dominant firm charging lower prices to scholars or pensioners, or charging different prices charged for the same airline tickets, would likely fall foul of the amended s9.

66.3. Price discrimination by a dominant firm between suppliers on the basis of differing brand value will also likely be prohibited by the current formulation of the amendments. That is, a dominant firm would not be able to pay suppliers of similar goods different prices, even when the economic value of the goods supplied differs significantly as a result of differing brand values.

67. In addition, the amendment could also paradoxically result in perverse outcomes for small businesses or HDI-controlled firms.

67.1. For example, a rebate granted by a dominant firm to its customers based on their black economic empowerment ("**BEE**") status or lower prices offered by a dominant firm to new entrants, would be illegal under the current formulation of the Bill. Whilst such a policy is actually likely to promote competition and participation in the economy, it is unlikely to find a basis in the current justifications of s9(2)(b). Clearly such an outcome runs contrary to the spirit of the amendments and of the overall Act.

68. As discussed, the amendment to s9(2)(b) appears to be motivated by an attempt to incorporate into s9 public interest concerns related to the specific impact of price discrimination on small firms and HDI-controlled firms. However, the issue with this approach is that whilst such a public interest concern relates to only a subset of firms and circumstances, the resultant changes to s9 apply to <u>all</u> interactions that a dominant firm has with buyers/sellers of goods or services.

69. In light of the significant adverse consequences that are likely to result from the current amendments to s9, the key question becomes: how should public interest considerations best be incorporated into s9 or addressed otherwise?

70. One option would be to acknowledge the significant difficulties that arise from incorporating public interest into the abuse provisions and hence specify that such considerations should be dealt with via a market inquiry and leave s9 in its original formulation. This would be best placed to address small business concerns that are

isolated to specific sectors, such as retail. Indeed, the existing retail market inquiry should be able to deal with such concerns.

71. Another would be to leave the general assessment of anti-competitive price discrimination in its original formulation (since as a general rule price discrimination is not viewed as problematic) and include in s9 some form of separate or parallel public interest assessment. This assessment would need to be able to distinguish and isolate instances of price discrimination that have a specific public interest concern at their core in order not to contaminate the general application.

72. Both of these approaches, will require more careful consideration of the appropriate test for public interest concerns related to price discrimination in light of the generally welfare enhancing effect that price discrimination can have. Hence, it will be important to understand how public interest will be balanced/weighed up against the potential broader benefits or costs to the economy of price discrimination.

73. Finally, a further consideration is that the proposed amendments to s9 already include a new s9(3) which is intended to incorporate public interest into s9(3), making the more general amendment unnecessary. However, the design of s9(3) still raises questions as to whether it can achieve this outcome:

    73.1. Section 9(3) is currently fairly vague, simply stating that "*consideration must be given to*" the effect on small businesses and HDI-controlled firms when determining whether the treatment is likely to have a detrimental effect on competition. This can be interpreted in many ways, from simply ensuring the effect on small firms is assessed in the course of an investigation through to an alteration of the test of what is considered an effect on competition depending on whether the firm subject to discrimination is small or not.

    73.2. It is also not clear whether/how 9(3) will allow for a weighing up of public interest concerns related to small firms against the broader potential welfare enhancing aspects of price discrimination.

74. There is, unfortunately, no easy answer to incorporating public interest concerns relating to price discrimination into the Act. Both of the approaches suggested above will have their own advantages and disadvantages. However, what is clear is that it is extremely important that these issues are debated further so that a more appropriate balance can be struck between the positive and negative impact of the amendments.

THE SHIFT IN ONUS UNDER THE AMENDMENTS

75. Under the current Act, s9(1) requires that the complainant must demonstrate that different prices are charged for equivalent transactions and that this has the effect of substantially preventing or lessening competition. Only if the complainant is successful in establishing both elements would the dominant firm be required to defend itself by showing that the price differences could justified on the basis of proposed s9(2)(b).

76. The amendments to s9 seek to make it significantly easier for complainants to establish a case of abusive price discrimination by shifting the burden of proof regarding anti-competitive effects to the dominant firm. This change specifically address the difficulties related to establishing effect faced by the small firm complainant in *Nationwide Poles v*

Sasol (Oil) Pty Ltd. The proposed amendments to s9(1) and (2) address this by requiring that:

76.1. The complainant need only demonstrate that different prices are being charged for equivalent transactions.

76.2. The dominant firm is then required to defend itself by showing that its conduct does not have an anti-competitive effect.

77. The shift in onus from the complainant to the dominant firm proposed by the amendments will likely increase the number of price discrimination cases being brought against dominant firms. This may indeed be the intention of the drafters in making such a change.

78. However, shifting the burden of proof from the complainant to the dominant firm is usually only appropriate where the conduct in question can by its very nature be assumed anti-competitive or otherwise harmful to consumers or firms (such as excessive pricing, for example). This is not the case for price discrimination which is legitimately and beneficially employed in a diverse number of ways and across a vast array of industries. The result will be a proliferation of meritless cases, imposing costs on both the Commission and firms.

79. Changing the onus in such a manner can have very real impacts on the behaviour of firms seeking to comply with competition law. Dominant firms may be encouraged to move to uniform pricing policies and the widely accepted benefits associated with the ability to price discriminate would be lost. In particular, a focus on uniform prices is likely to result in a chilling of competition between suppliers/buyers of the dominant firm and the elimination of any consumer welfare benefits resulting from differential pricing policies currently being employed.

PURCHASE PRICES

80. The amendments to s9, much like those to s8, also seek to address perceived issues related to the exercise of buyer power by dominant firms. Whilst the amendments do not provide any context to "*the problem of monopsonies*",[21] it appears that this concern may well be rooted more firmly in public interest rather than competition considerations.[22] The amendments seek to address issues of buyer power through the proposed inclusion of s9(4) which specifies that amended s9 can be read as applying to a dominant firm as a purchaser of goods.

Buyer power is on balance a pro-competitive measure that delivers consumer welfare benefits

81. We have already addressed our concerns relating to the treatment of monopsony power as an abuse of dominance in our comments on s8. In particular, s8 highlighted in some detail why including provisions related to buyer power would run the risk of impugning the exercise of such power despite the fact that the literature and jurisprudence more often than not finds it to be pro-competitive. Indeed, the ability to play suppliers off against one another in order to get the lowest price possible is a key part of competitive market

[21] Background Note on the Competition Amendment Bill, p. 16.
[22] Background Note on the Competition Amendment Bill, p. 16.

processes. These concerns equally apply in the context of abusive price discrimination and hence will not be repeated here.

82. It is also worth noting that the specific focus of s9 on prohibiting price differences means that s9(4) could also run the risk of facilitating coordination between suppliers resulting in higher prices overall.

83. As a result, it is submitted that from a competition perspective there is no basis for treating a dominant firm's efforts to negotiate lower input costs from its suppliers as abusive even where they result in different prices for equivalent goods. Indeed, we are not aware of any findings in leading jurisdictions where price discrimination to a dominant buyer as envisaged in s9(4) has been considered an abuse of dominance.

Practical considerations of applying the provision raise concerns

84. There are, in addition to the above, some practical difficulties associated with the addition of this provision to s9. Specifically, there will be significant uncertainty around how dominant firms can ensure compliance with s9(4) when supplier prices for equivalent goods differ.

85. In particular, a dominant buyer is unlikely to know whether such differences are compliant or defendable on the basis of cost justifications as envisaged in s9(2)(b)(i). This is because a dominant firm cannot be expected to have knowledge of its different suppliers' costs structures, either at the time of the negotiations or when it may be required to defend itself. It will ultimately be unable to assess whether any price differences are based on what would be considered legitimate differences in cost structures between such suppliers.

86. Hence, the provision places a significant burden on the dominant buyer, despite the fact that it is often unlikely to possess sufficient information to ensure that its actions are compliant. In the absence of such certainty the dominant firms may well seek to ensure that prices and terms across suppliers are the same or similar. This would likely inhibit competition between suppliers and curtail many of the positive effects that can be associated with buyer power. It also means that any favourable treatment of small suppliers or HDI-controlled firms would also pose a potential compliance risk.

87. In addition, for similar reasons to those above, a dominant firm would find it very difficult to defend itself on the basis of cost if one of its suppliers were ever to launch a complaint, despite the fact that s9 specifically allows for a firm to do so. This may well disincentivise buyers from taking on new small suppliers as they may present the dominant firm with significant litigation risk should a supplier fail.

Unclear benefits of provision are outweighed by the immense risks

88. It is clear that there is no competition basis for treating a dominant firm's efforts to negotiate lower input costs from its suppliers as abusive even where they result in different prices for equivalent goods. Nevertheless, the rationale behind the inclusion of s9(4) is likely related to concerns around public interest, specifically the development of small businesses and HDI-controlled firms. Whilst such goals are important, it is not evident that the inclusion of s9(4) is the most appropriate manner in which to deal with such objectives.

89. This is because, much like the case of the amended s9(2) prohibiting price discrimination without specific justification, s 9(4) adopts a wholesale approach to a concern that is in reality only relevant to a subset of firms and industries in the economy:

    89.1. Whilst the relevant public interest concerns are confined to the negative treatment of small businesses and HDI-controlled firms, s9(4) is not. As such, it is not clear that any potential public interest benefits that may arise could outweigh the more general risks of adverse consequences for consumers that can flow from the inclusion of this blanket provision.

    89.2. Concerns related to buyer power are often related to specific industries (for example it has been highlighted as a concern in the retail of FMCG). However, s9 is not confined to complaints in certain industries. As such, the inclusion of such a broad provision does not appear proportionate to the concern or the most appropriate way to address issues that characterise only certain markets.

90. Finally, the provision is likely to have the paradoxical effect of hurting small businesses and HDI-controlled firms. To the extent that the provision encourages dominant buyers to focus on more uniform terms for suppliers, this may negatively impact on policies which sought to provide favourable terms to small businesses and HDI-controlled firms. It may also discourage dominant firms from taking on new entrants as suppliers since they may ultimately be blamed for the failure of such suppliers. Finally, small businesses and HDI-controlled firms that operate downstream may suffer the unintended consequences of s9(4) as they are often the beneficiaries of buyer power exerted upstream.

SECTION 43 - MARKET INQUIRIES

THE PROPOSED AMENDMENTS

91. The objectives of the proposed changes is to ensure that the Chapter 4A process plays a more prominent role, in future, in promoting the purposes of the Act[23], by enhancing the focus of future market inquiries, improving their practicability, and strengthening the remedial powers of the Commission.[24]

92. The proposed amendments intend to ensure that future market inquiries are, "*… strengthened so that their remedial actions effectively address market features and conduct that prevents, restricts, or distorts competition…,*"[25] and that future market inquiries, "*… will become the chief mechanism for analysing and tackling the structural problems in a market, thereby advancing the purposes of the Act.*" [26]

93. Additionally, the proposed amendments are also intended to "… *ensure that [outcomes of future market inquiries] include measures to address concentration and transformation of ownership.*"[27] This appears to be an explicit reference to ss1(2)(e) and (f) of the Act, which are the purposes of the Act relating to opportunities for small and medium-sized businesses to participate in the economy, and to increasing the ownership stakes of HDIs.

94. In short, the proposed amendments to Chapter 4A seek to make market inquiries more effective than they have been to date at remedying competition problems that are not amenable to Chapter 2 processes. They also seek to require market inquiries to focus more closely on public interest considerations, namely ownership transformation and the participation of small and medium-sized businesses in the economy.

95. Many of the proposed changes relating to substantive issues (such as what the Commission must decide in a market inquiry, and competition test to apply)[28] are clearly and in several instances very closely based on the UK Enterprise Act (2002, Part 4, Chapter 1), and the UK's 2013 guidelines for market investigations.[29]

96. As such, the proposed amendments will place on the Commission a set of obligations that are very similar to those applicable to the UK's CMA. Of these, the following are relevant to this submission.

    96.1. The Commission will be required to establish whether any features of a market cause an AEC in that market (see the proposed new s43A(2)). The test for an AEC is not defined, but the commentary states that it is intended to be an easier test to meet than the traditional 'substantial lessening or prevention of competition' ("**SLC**") test, which is used in Chapter 2.[30]

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[23] See s1(2) of the Act.
[24] Background Note on the Competition Amendment Bill, p. 20.
[25] Background Note on the Competition Amendment Bill, p. 8.
[26] Background Note on the Competition Amendment Bill, p. 19.
[27] Background Note on the Competition Amendment Bill, p. 19.
[28] This submission does not dwell on amendments that are primarily legal in nature, but does touch on procedural issues and issues of institutional design, where necessary.
[29] UK Competition Commission. 2013. "Guidelines for market investigations: Their role, procedures, assessment and remedies."
[30] Background Note on the Competition Amendment Bill, p. 20.

96.2. As per the proposed new s43D(1), the Commission will be required to remedy each AEC that it finds in terms of proposed new ss43A and 43C.

96.2.1. The remedies that the Commission may consider include the imposition of structural or behavioural remedies by the Commission itself, which, except for a divestiture remedy, will be legally binding.[31] This new remedial power sits alongside the Commission's existing remedial powers, i.e., making recommendations to other regulators or to policymakers, or initiating Chapter 2 investigations.

96.2.2. The Commission must ensure that the remedies it imposes are reasonable and practicable in order to remedy, mitigate, or prevent each AEC that it finds (see proposed new s43(D)(1)).

96.3. For the purposes of identifying and remedying AECs, the proposed amendments explicitly permit the Commission to consider any firm conduct, in addition to market-wide features, such as market structure or market outcomes (see proposed new ss43A(3)(c)-(e)). Specifically, the Commission may consider conscious parallel or coordinated conduct between competitors that occurs without an agreement (and would therefore be beyond the reach of s4 of the Act).[32]

96.4. The proposed amendments to s43B give the Minister[33] the right to require the Commission to launch a market inquiry (rather than merely request one, as per the current law), subject to the same provisions applicable to a decision by the Commission to conduct a market inquiry.

97. The proposed amendments also introduce a specific provision, in proposed new s43C, which is not evident in the UK law or guidelines mentioned above.

97.1. In finding an AEC, the Commission must have regard to the impact of that AEC on small businesses and HDI-controlled firms (see proposed new s43(C)(2)).

97.2. The proposed amendments do not define what types of impacts must be considered in this regard, and no guidance is available from the UK as this is not a requirement in that jurisdiction.

98. The focus on making inquiries more effective and addressing legitimate public interest concerns should be welcomed, but further debate is required in order to ensure that the proposed amendments offer the most effective and appropriate means of achieving their underlying objectives.

98.1. One of the keys to the success of the proposed amendments lies in the way in which the Commission will balance competition and public interest issues in the context of future market inquiries. As we explain below, because the proposed

[31] The Commission may only recommend divestiture to the Competition Tribunal.

[32] The current wording of Chapter 4A does not prevent the Commission from assessing firm conduct in a market inquiry. However, firm conduct currently is not explicitly listed as a market feature that can be investigated. Furthermore, conscious parallel or coordinated conduct presumably cannot be investigated in a market inquiry under the current Chapter 4A process, since the 2009 amendments introduced complex monopoly as a Chapter 2 offence, subject to the SLC standard. This un-enacted amendment specifically required, in then-proposed new s10A(1)(c), that an applicant demonstrate that two or more firms conduct their business affairs in a conscious parallel manner, and that this conduct has the effect of substantially lessening or preventing competition. See Background Note on the Competition Amendment Bill, p. 6.

[33] Meaning the Minister with political oversight of the competition authorities. Currently this is the Minister of Economic Development.

amendments do not provide sufficient clarity or guidance on this question, or on what constitutes an AEC, a risk exists that future market inquiries will produce outcomes that actually harm consumers. This is obviously a core concern from an economics perspective.

98.2. A second critical area is whether there are sufficient disciplines in place to ensure the most appropriate, proportionate remedies are imposed. Related to this, whether it is necessary for the Commission to be required to remedy each and every AEC that it finds if doing so has potential unintended consequences or the first-best remedies are unavailable.

98.3. Lastly, the proposed amendments do not address a number of issues which could jeopardise the objective of improving the effectiveness of future market inquires. For instance, whether there are sufficient disciplines in place concerning the selection of future market inquiries to ensure that the employment of relatively scarce bureaucratic resources is optimised.

CLARITY IS REQUIRED ON PROPOSED NEW SECTION 43C

99. The explicit focus on public interest issues in proposed new s43C(2) is appropriate given the existence of ss2(e) and 2(f) of the Act, and South Africa's core economic development policy challenges. To date, these objectives of the Act have found expression primarily in merger control, and less so or not at all in enforcement processes or previous market inquiries.[34]

100. In merger control, it has been clearly established that the competition assessment and the public interest assessment of a merger are two separate and independent assessments. The relevant test is whether the outcomes of the competition assessment can be justified on public interest grounds. For example, can a merger that will have no significant impact on competition be justified if it entails significant reductions in employment?

101. The proposed new s43C does not necessarily replicate this separation, as it is not clear how proposed new s43C(2), read with proposed new s43C(1), should be interpreted.

101.1. Proposed new s43C(2) requires that, *in making its decision*, in proposed new s43C(1), as to whether any market feature generates an AEC*,* the Commission must have regard to the impact of that AEC on small businesses or HDI-controlled firms.

101.2. Since the AEC test is not defined, and since proposed new s43C(2) does not list the types of impacts on small businesses and HDI-controlled firms that may be relevant, it is not clear what role should be played by the experiences of small businesses or HDI-controlled firms in determining whether an AEC should be found under proposed new s43C(1).

101.3. Furthermore, a finding of an AEC by definition need not establish a *substantial* prevention, distortion, or restriction on competition; indeed, a requirement that an AEC be substantial may automatically preclude special consideration of small businesses or HDI-controlled firms from concerns that relate strictly to competition

[34] With the clear exception of the ongoing inquiries into public transport and grocery retailing, both of which place significant emphasis on public interest issues.

only, as such firms might not be significant or important determinants of a market's structure or performance (outcomes).

102. It is therefore possible that an AEC could be found *whenever* a feature of a market negatively affects small businesses or HDI-controlled firms (e.g. limits or prevents their growth in a market). This raises a concern that future market inquiries may inadvertently promote the protection of small businesses and HDI-controlled firms from legitimate competition on the merits. In other words, future market inquiries may inadvertently harm consumer welfare in their attempts to promote the fortunes of small businesses or HDI-controlled firms by imposing remedies that impair legitimate competition, and lead to higher market prices than would otherwise obtain.

103. The proposed new ss43C(1) and 43C(2) therefore introduce a version of one of the oldest debates in competition policy—whether it should seek to protect the process of competition only, and in so doing promote consumer welfare, or whether it should, in certain circumstances, promote specific competitors or categories of competitor, potentially at the expense of consumer welfare.

104. This degree of complexity in this debate is significant, indicating that the drafter ought to undertake to re-consider or at the very least clarify the proposed new ss43C(1) and 43C(2) before the amendment bill is presented to the legislature. There clearly is a need for future market inquiries to investigate and promote public interest issues, but the proposed amendments may not be the most appropriate means of achieving this objective.

ADDITIONAL DISCIPLINES ON REMEDIES

105. The identification and design of remedies should form part of the debate that is required in respect of the risk identified above. Specifically, in the consideration of remedies, and in light of the risk above, the proposed amendments specify no emphasis whatsoever on the promotion of consumer welfare. This omission also constitutes a significant departure from the UK law and guidelines mentioned above. The focus on consumer welfare is a prevalent theme in the UK law and guidelines concerning the remedies that emerge from market investigations. Examples include the following.

    105.1. The Enterprise Act requires that the relevant authority, "… *have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition concerned <u>and</u> any detrimental effects on <u>customers</u> so far as resulting from the adverse effect on competition*" (emphasis added).[35]

    105.2. The 2013 guidelines note that, "*AECs are likely to result in costs to the UK economy in general <u>and to customers in particular</u>. Remedies that are effective in generating competition are likely to deliver substantial benefits, by driving down prices and costs and increasing innovation and productivity, thereby facilitating economic growth and increasing the choice available to customers*" (emphasis added).[36]

    105.3. In assessing the impact of remedies, the guidelines state that 'particular regard' will be had for impacts on customers and consumers, and that regard will 'also be had'

[35] UK Enterprise Act (2002), s138(4). The 2013 guidelines define 'customers' to include consumers.
[36] UK Competition Commission. 2013, para. 331.

for the impacts on firms subject to the remedies.[37] This implies a clear prioritisation of consumer welfare such that no remedies that ultimately may harm customers or consumers would be adopted.

106. In order to avoid remedies that may promote competitors at the expense of consumer welfare, it may be desirable to clarify the welfare standard to be employed in determining remedies.

107. Related to this point, is the requirement in proposed new s43(D)(1) that the Commission must remedy each AEC that it finds.

107.1. It is well accepted in economics and the field of regulation that remedies may result in unintended consequences or impose significant implementation costs (on the regulator or the regulated). It is for this reason that in many instances the requirement for a regulatory impact assessment is stipulated on a regulator or administrative department. The purpose of such an exercise is to precisely determine whether a remedy is appropriate considering a full cost-benefit and risk assessment. In some cases the treatment is worse than the disease and regulation is not appropriate. Additional considerations in the context of a competition authority is the ability to implement and monitor any remedial action, especially across multiple markets.

107.2. Therefore, it would be prudent to allow the Commission to prioritise which AECs should be remedied, rather than being required to remedy each AEC. The identification of AECs which the Commission elects not to remedy would still be of value.

108. We further recommend that clarity be given on whether the concept of *proportionality* is covered under the terms ‘practicable’ and ‘reasonable’. If it is not, we recommend that it be inserted into the relevant proposed new section.

ENSURING THE GREATER EFFECTIVENESS OF FUTURE MARKET INQUIRIES

109. The proposed amendments either create or do not address two principle threats to the objective of increasing the effectiveness of future market inquiries. Together, these issues reduce the chances of Commission executing only the highest-impact Chapter 4A processes in future.

109.1. First, the proposed amendments apply insufficient rigour to the process of selecting markets for a Chapter 4A process.

109.2. Second, the proposed amendments do not, because they cannot, address a key challenge of the current Chapter 4A process, namely the inability of the Commission to require other entities to implement or even engage with the Commission’s recommendations.

[37] UK Competition Commission. 2013, para. 348.

The market selection process

110. Currently, a market inquiry can be initiated by the Commission if it has reason to believe that market features prevent, distort, or restrict competition; or to further the purposes of the Act. The Act provides no further guidance nor places any further disciplines on the Commission's decision of which market to investigate under a Chapter 4A process. The Commission has issued no guidelines on this topic.

111. The proposed amendments also provide no further guidance, nor place any further disciplines on this decision. They also now allow the Minister to require the Commission to conduct market inquiries (rather than merely request), following consultation with it on the two considerations mentioned above (see proposed new s43B(1)(b)).

112. Arguably, the selection of markets (and the specification of the scope of the inquiry) is the most important determinants of the impacts and success of the Chapter 4A process. Therefore, the proposed amendments should seek to create disciplines on the market selection process—and this would be advisable even if the Commission had ample resources to conduct market inquiries, which it does not.

113. The lack of guidance or disciplines in respect of the market selection process again diverges from the process in the UK.

    113.1. First, the Enterprise Act places significant limits on Ministers' powers to refer markets for investigation. The CMA's 2014 guidance on market studies and market investigations state that a Ministerial referral is only possible if a Minister is not satisfied with the CMA's decision not to undertake a market investigation, or, having taken information to the CMA considered relevant to the question of whether the CMA should instigate a market investigation, is not satisfied that the CMA will decide on a course of action quickly enough.[38]

    113.2. Second, the process of self-selection by the CMA, or referral by a sector regulator, must entail more than merely a decision that the CMA or another regulator has reason to believe that a market investigation is necessary.

        113.2.1. While a market study is not a pre-requisite for a reference to be made to the CMA to conduct a market investigation, it is a common first-stage investigative tool for determining whether a market investigation is required.

        113.2.2. Market studies are carried out under the CMA's general powers to acquire information, and, "…*are examinations into the causes of why particular markets may not be working well, taking an overview of regulatory and other economic drivers and patterns of consumer and business behaviour.*" They are inquisitorial and do not grant the CMA the power to impose any remedies—in many respects, the outcomes of a market study in the UK (recommendations, initiation of enforcement action, encouraging

[38] CMA (2014, revised 2017), "Market Studies and Market Investigations: Supplemental guidance on the CMA's Approach," para. 1.21. See also s132 of the Enterprise Act (2002). Note that, since 2013, the structure of the competition authorities in the UK has changed, with the erstwhile Office of Fair Trading and the UK Competition Commission merging into the CMA. Under the new structure, referrals are made by the CMA Board, other sector regulators, or Ministers, to the CMA Chair, who then directs the creation of a market reference group to undertake the market investigation. References from Ministers are still subject to these disciplines in the Enterprise Act (2002). In practice the role played by Ministers in the market selection process has been minimised; as the 2013 guidelines point out, no such referral had ever been made by a Minister. (UK Competition Commission. 2013, para. 22, footnote 9.)

self-regulation, *etc.*) is comparable to the outcomes of current market inquiries in South Africa.

113.2.3. In the absence of a market study, some other process of information acquisition and consideration must have occurred before a market investigation is launched. The CMA guidelines give only one example, which is that of a super-complaint from a designated consumer body.[39] The 2013 guidelines also reference complaints or super-complaints as the only other basis for considering a market investigation.[40] The 2013 guidelines characterise a market investigation as the second part of a two-stage investigative process into the functioning of a particular market.

114. In South Africa, certain market inquiries have been launched on the grounds that the Commission has received numerous complaints about which it could do little under Chapter 2 processes. This was the basis of the Banking Enquiry, for example. The grounds for certain other market inquiries have been less clear.

115. Basic disciplines could easily be introduced into the market selection process, by borrowing from regulatory best-practice in the sector regulation arena. For example, common disciplines include the following questions:

115.1. Has the Commission received a substantial number of complaints about the market concerned?

115.2. Are competition problems likely to exist given the structure of the market, the nature of barriers to entry, the existence of a history of collusion, or other standard competition screening measures?

115.3. Would the benefits of intervention be material? Some considerations relevant to this question include the size of the market, its importance into the future, and the consumer groups affected by potential competition problems (e.g. low income consumers).

115.4. Would intervention promote the economic policy objectives of the government, including the acceleration of growth and the reduction in inequality, poverty, and unemployment?

The relationship with regulators and policymakers

116. Sector regulators, policymakers, and legislators will all continue to be key determinants of the effectiveness of market inquiries, as they are able to introduce *ex ante* pro-competitive reforms and regulations, while the Commission cannot. It is also the case that existing regulations are often the source of many of the AECs found in market inquiries, which similarly require action by other regulators or policy-makers to change or remove.

117. The proposed amendments do not (and could not) render the Commission any more capable than it is currently of requiring other regulators, or policymakers or legislators, to implement new regulations, reforms, or laws that the Commission may deem necessary to remedy any AECs that it identifies. As is the case currently, the Commission would be empowered only to make recommendations to these entities.

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[39] CMA. 2014 (revised 2017), para. 1.12.
[40] UK Competition Commission. 2013, para. 23.

118. In respect of sector regulators, the following specific issues are apparent.

118.1. Sector regulators must each follow their own legal processes before they are permitted to introduce new regulations including any pro-competitive regulations the Commission might identify as being necessary. These processes are not guaranteed to reach the same conclusions as those reached by the Commission in a market inquiry.

118.2. In addition, no sector regulator may introduce regulations on the basis of a finding of an AEC. For example, the Electronic Communications Act ("**ECA**") requires the Independent Communications Authority of South Africa ("**ICASA**") to establish that competition in a market is ineffective before it may introduce pro-competitive regulations.

119. Despite the jurisdictional challenges that exist between the Commission and other organs of state, it may still be possible for the proposed amendments to create or encourage a structure whereby other regulators, or policymakers, are required to at least engage, publicly, with the Commission's recommendations.

120. For example, in the UK, "*The Government has made a commitment to give a public response to any recommendation made to it within 90 days of the publication of a CC report. In its response, the Government will set out where it does or does not propose to make changes in light of the report, or where it proposes to consult on options. The Government will take into account all public policy and welfare considerations, including considerations of Better Regulation, in making its assessment.*"[41]

THE NEED FOR GUIDELINES

121. Many of the issues identified above could be clarified through guidelines of the Commission. Such guidelines would also provide an opportunity to clarify how the Commission will approach each of the procedural and evidence issues that may have been raised by the proposed amendments, and which will receive the attention of South Africa's legal community. The guidance available in the UK for market investigations (and also market studies) is extensive and provides a good example for the Commission to consider.

122. The proposed amendments do not require the Commission to publish guidance on the execution of future market inquiries. The proposed amendments to the excessive pricing provisions of Chapter 2 do nevertheless require the Commission to publish guidance on what constitutes an excessive price. This could be transferred to the proposed amendments to Chapter 4A with minimal risk to any party involved.

[41] UK Competition Commission. 2013, para. 95.

OTHER SECTIONS OF THE ACT

SECTION 4 - COLLUSIVE BEHAVIOUR

123. The only proposed amendment is the addition of 'market shares' to the list of market division activities. Whilst this may provide greater clarity from a legal perspective, it has always be considered a form of collusion in the economics literature and formed part of enforcement practice in our experience. Indeed, such a practice is primarily seen as a means to soften price competition (aggressive pricing would result in market share growth) and therefore may be seen to already be catered for under s4(1)(b)(i) – directly or <u>indirectly</u> fixing a purchase or selling price.

SECTION 12 - MERGER CONTROL

124. The amendments to the merger control provisions seek to clarify the weighing up of public interest provisions as per settled case law, add certain further considerations to the list of factors to be considered in the competitive assessment, likewise for the public interest assessment and finally to deal with creeping mergers.

    124.1. To the extent that the addition of cross-shareholding and common directorships provide for greater disclosure and transparency of these factors in merger filings, and ensure systematic analysis by the Commission and Tribunal then they are to be welcomed. These factors have the potential to restrict competition and hence should form part of merger assessment (and in our experience already are), but they also may not result in competitive harm and hence are factors to take into account in an SLC assessment as per s12A(2) but not determinative in any way.

    124.2. Perhaps more controversial is the inclusion of '*any other mergers in the preceding three years*' as a factor that needs to be considered in assessing whether the <u>current</u> merger will result in an SLC or not. This would seem to be designed to address the concern that merger control is not effective in dealing with many small merger transactions which may individually fail the SLC test (as each acquisition is not substantial) but cumulatively may have a material effect on the structure of a market. This concern more frequently arises in markets where substantial numbers of small market players may exist making such a strategy possible. We agree that there needs to be a means to address such 'merger creep' in particular sectors of the economy. However, it is also important that such analysis is subject to proper disciplines in order to isolate effectively where there is a genuine concern from where there is not. Otherwise this factor could chill productive merger activity in the economy as firms seek to delay possible efficiency-enhancing transactions until such time as previous mergers fall outside the time period stipulated. Whilst identifying this concern, we consider the legal fraternity to be best placed to determine if such disciplines should be left to emerge in the process of applying this provision before the competition authorities, or alternatively may best be given greater guidance as part of the amendments themselves.

    124.3. The additions to the public interest provisions seek to align the factors for consideration more closely to the wording in the purpose of the Act (s2). The challenge will be how these factors are given specific expression in the merger

provisions rather than as part of general purposes to be addressed by the full suite of competition law provisions.

124.3.1. As already identified in the discussion of s8, the term '*participate in*' is a potentially very broad term and it will be important for the institutions to determine what this may encompass. From an economics perspective, it is important that the interpretation remains focused on factors that may inhibit the ability of small and HDI-controlled firms to compete (i.e. anti-competitive potential) rather than the potential adverse effects on competitors from the strengthening of competition as a result of a merger (i.e. enhancements to competition on the merits).

124.3.2. The second factor, '*the promotion of the greater spread of ownership*' also may provide interpretation challenges within the specific context of merger control. If it is interpreted broadly such that any merger which does not actively increase the spread of ownership might fall foul of this provision, then this could have a serious adverse effect on productive merger activity. Typically the approach taken to date has been that merger activity should not actively harm public interest objectives rather than that it must actively advance such objectives.

124.4. The final element is the addition of s12B to deal with mergers by way of a series of transactions. We understand this to be concerned with merger creep of a different sort, namely acquiring control through stealth and avoiding the consequences of the merger control provisions. We also understand that this provision is modelled on a similar provision in the UK Enterprise Act (2002) s29. These are largely legal considerations and not substantive economic issues.

NEW SECTION 21A - IMPACT STUDIES

125. The proposed amendments seek to include a new s21A in order to provide the Commission with powers to request information in order to undertake impact studies of previous decisions by any of the competition institutions (Commission, Tribunal and Appeal Court). The proposed amendments stipulate that these studies must then be submitted to the Minister, who in turn must submit them to the National Assembly.

126. Impact studies are capable of providing valuable insights into the functioning of certain markets and the efficacy of different types of remedies deployed in both merger and abuse cases. It is for this reason that we have actively encouraged greater use of such *ex-post* assessments in order to improve future decision-making by the competition authorities[42]. As the insights to be gained from such studies does depend on the quality of information and data available, providing some powers to source such information may be appropriate.

126.1. First, as with market inquiries, we consider that there should be some selection process in order for the Commission to justify undertake an impact study. This is desirable in order to provide some prioritisation and efficient allocation of Commission resources to impact studies that are likely to deliver important insights on material issues for future decision-making by the authorities. Factors may

[42] Alves, P. and Fiandeiro, F. 2016. Ex-Post Evaluations As Learning Opportunities, *Prepared for the 10th Annual Conference on Competition Law, Economics and Policy (University of Cape Town, South Africa)*

include where the market dynamics in an industry are poorly understood or contested making merger control difficult, or where concerns have been expressed over the efficacy of certain types of behavioural remedies. Such a process not only ensures appropriate prioritisation, but it may also provide a sound basis for any information requests and their assessment by the Tribunal as per the new s21A(7).

127. Second, the causal impact of specific events on a range of market factors is often particularly difficult to determine given the range of other factors that might also have an impact on the market. Controlling for these other influences in order to isolate the causal impact of a single factor is often the subject of much dispute between economists and has been the source of many developments in economic and statistical techniques. For this reason, it is entirely appropriate that any such study conducted by the Commission should at the very least be subject to some procedural processes which permit the firms subject to the impact study to review and comment on a draft report of the Commission, and for any analysis to be tested by other economists as is now the norm for journal articles that use data analysis. This is especially the case where such studies are to be published and placed before the National Assembly.