BUSINESS UNITY SOUTH AFRICA

NATIONAL OFFICE
61 Katherine Street, Sandton, 2196
P.O. Box 652807, Benmore, 2010
www.busa.org.za
+27 11 784 8000

PARLIAMENTARY OFFICE
9 Church Square, 1st Floor Graaffs
Trust Building, Cape Town, CBD

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BUSA SUBMISSION ON FIRST DRAFT SET OF BUYER POWER REGULATIONS IN TERMS OF THE COMPETITION ACT AND THE COMPETITION AMENDMENT BILL, 2018

Introduction

BUSA is a confederation of business organisations, including chambers of commerce and industry, professional associations, corporate associations, and unisectoral organisations. It represents a cross-section of business, large and small, on macro-economic and cross-cutting policies and issues which affect business in all three spheres of government and at the international level. BUSA's function is to ensure business plays a constructive role in economic growth, development and transformation, and to ensure an environment in which business can thrive, expand and be competitive. As the principal representative of business in South Africa, BUSA conveys the views of its members in various national structures and bodies, both statutory and non-statutory.

General Comments

BUSA welcomes the opportunity to comment on the First Draft Set of Buyer Power Regulations. While BUSA recognises the expanded purview of the Competition Amendment Bill, 2018 in requiring special attention to be paid to the impact of anti-competitive conduct on SMEs and firms owned by Historically Disadvantaged Persons, these objectives need to be balanced with the principle of protection of public interest and the impact on the broader economy.

On the whole, the draft regulations pose certain interpretive challenges for businesses such as the notion of unfairness and inferior terms and whether this applies to a position relative to other suppliers and, crucially, how consumer interests are considered. Another area of concern is the ability of firms to assess their risk in terms of the proposed buyer power regulations as they may not have access to information about their clients' financial or market position, a point reflected repeatedly in the detailed comments below. This raises the question as to how firms can comply with the requirements while still acting in the public interest.

Another point is that there are a number of sectoral level specificities that cannot be neatly or effectively captured in the draft regulations. An example of this is in healthcare, most notably the selection of network providers and the contractual terms (in addition to price) that affect these

decisions. These are currently under consideration by the Health Market Inquiry and this would suggest that the medical schemes environment (to name one example) should be considered separately.

Detailed Comments

4.1.2. This benchmark is too imprecise and will open the flood gates for litigation as well as likely burdening the Commission with undue volumes of complaints for assessment. Differential contractual treatment may be compatible with competition. The unfair trading practice is exploitative when the harm affects the designated class of supplier's ability to compete, (e.g. harms the firm's capacity to invest and innovate) which has a detrimental impact on competition in the market and ultimately consumers, such as increased prices, decreased quality and choice in the market).

4.3.2. It is true that the state of dependence of trading partners is characteristic of a dominant position. However, the draft regulations ignore the elements which characterise buyer market power and dominance. Market share is merely a useful first indication of market structure and the importance of players active in the relevant market.

The hidden problem is the share a buyer accounts for in a supplier's turnover may be different from the market share held by that buyer in the upstream buyer market. Hence the focus is not on the buyer's market share in the upstream purchasing market but on the share, it accounts for and the importance it represents in the business portfolio of the suppliers. Simply put, the real issue is the degree of bilateral economic dependence and therefore market share may be misleading and result in false positives.

4.3.4. What about instances where a supplier (within the designated class) unilaterally offers a price to the dominant buyer, which the supplier later realises is below the market price and is unsustainable and unprofitable? Greater clarity is required.

4.3.5. In light of the comment in 4.3.4. above this may open the way for abuse by suppliers.

4.4.1. This should be strengthened to include the principle of substitutability i.e. suppliers are dependent on a buyer when there are no equivalent alternatives. The issue is determining what proportion of turnover with a given customer could not be switched to other sales channels without difficulty.

4.4.2. The buyer may be very large in a market, hence important, but this should not automatically require such buyer to deal with every supplier that comes along.

4.4.3. A dominant buyer in a highly concentrated buying market, e.g. one large buyer and a small number of very small buyers, would result in the buyer being forced to buy from the supplier as there would be no other realistic alternatives available for the supplier. This should not be the case. Would exports be regarded as an alternative channel?

4.4.4. A dominant buyer in a highly concentrated buying market, e.g. one large buyer and a small number of very small buyers, would result in the buyer being forced to buy from the supplier as there would be no other realistic alternatives available for the supplier. A buyer should not be forced to buy from a supplier if he chooses not to. Would imports be regarded as an alternate supply?

4.4.6. Trading terms may differ significantly between different buyers based on the requirements of the buyer. For example, a buying firm may have strict delivery conditions in order to run an efficient operation. This may not be the case with other buyers. This provision may therefore have unintended consequences in that an efficient firm may be found to impose too strict terms on small buyers.

5.1. What about instances where a supplier (within the designated class) unilaterally offers a price to the dominant buyer, which the supplier later realises is below the market price and is unsustainable and unprofitable?

5.2. What about instances where a supplier (within the designated class) unilaterally offers a price to the dominant buyer, which the supplier later realises is below the market price and is unsustainable and unprofitable? The price may appear unfair but was offered by the supplier of its own free will, resulting in it not growing as fast as its competitors.

In addition, clarity is required on the definition of “unconscionable” price.

5.2.1. Given that the onus of proof under this section lies with the buyer, how is the buyer expected to take this into consideration if it does not have sufficient information to know what the supplier’s LRAIC is, which in any event may differ between suppliers based on their efficiencies.

In addition, the section appears unworkable in that This is an unworkable section- S8(2) anticipates a “prima facie case” against a firm, but also that such firm is “alleged” to be acting anti-competitively.

S8(2) places the dominant firm in the invidious obligation to disprove the negative assumption of “not impeding the ability of the supplier to participate effectively”.

Clarity is required on whose cost of production the dominant firm is expected to defend, that is, its own or that of the designated class of suppliers.

If the latter then this is tantamount to collusion, it appears unreasonable for the dominant buyer firm to understand the designated firms cost of supply before entering into a contract with the designated class of supplier.

Moreover, if the dominant firm is buying from a horizontal competitor, in the designated class of supplier, then it could be tantamount to a per se price collusion i.e. falls foul of S4(1)(b) of the Competition Act.

5.2.2. This appears ambiguous and unworkable as it is not amenable to quantification.

5.2.3. Again, this appears ambiguous and not amenable to quantification. Clarity is required on the preconditions for anti-competitive behaviour effects, rendering this unworkable from a competition law perspective.

5.2.4. Assuming that “performance of the firm” refers to the supplier firm, how is the buyer expected to obtain this information? Furthermore, there may be other explanations for the performance of the firm in the designated class of supply. The Commission cannot jump to conclusions that the firm’s performance is exclusively linked to trends in the relationship with the specific dominant buyer. There are likely to be a myriad of reasons related to the firm’s market performance and there may be indications that the firm has had fundamental business problems entirely unrelated to its relationship with its dominant buyer e.g. such as product quality and overall service levels as well as it being market competitive on price.

5.2.5. Again, how is the buyer expected to obtain this information?

5.3. The quantity of a product or service supplied is inherently related to the value of the product in light of economies of scale and should be a permissible justification for prices paid to a firm in the designated class relative to other suppliers, particularly where such a price differential does not impede the ability of the firm to participate in a market. In the context of economies of scale, the volume exclusion in section 5.3 is in direct tension with sections 5.2.1 and 5.2.2 which introduce cost considerations as relevant factors to the assessment. BUSA recommends that the volume justification be a permissible rationale for differentials in prices paid to suppliers.

Moreover, the quantity of goods or services may be highly relevant in some instances, especially where the inability of a supplier within the designated class to supply the full requirements of the buyer, may increase the costs and lower the efficiencies of the buyer. Therefore, a lower price may be offered by the buyer to offset such inefficiencies. It may be necessary to differentiate pricing based on the ownership structure of a firm, if the cost of doing business or the risk associated with managing such firm's account is greater. It may be less efficient and costlier to do business with a smaller firm, for a number of reasons.

5.4. Certain clauses, by their very nature, may appear one-sided. These are generally accepted by parties to whom they apply. A supplier may very well agree to the standard terms and conditions of a buyer and may subsequently have a change of mind. This may have unintended consequences and is open to abuse.

In addition, unfair contractual trading practices are not necessarily anti-competitive. Competition Authorities world-over recognise that competition assessment is based on evidences of the dominant buyer's practices on the competitive process and the resulting harm in the market.

5.4.1. See comment under 5.4. above.

5.4.2. See comment under 5.4. above.

5.5.1. Competition law draws a distinction between, anticompetitive business practices which distorts competition and unfair practices resulting from contractual imbalances, but which do not fall under the scope of competition law.

The reason for this is that they do not entail any anticompetitive effect on the relevant market. Unfair trading practices by powerful buyers, do not automatically imply a competition transgression and must therefore be addressed through other policy legislation. S5.5 speaks to the ability of a buyer powers to extract unilateral concessions from suppliers. In general, these benchmarks are potential sources of anticompetitive conduct but are not tantamount to abusive conduct and the anti-competitive effects need to be based on facts and the resulting harm on the relevant market.

5.5.3. Some changes may be required due to regulatory changes or operational reasons of the buyer. This should only be applicable if the changes are unreasonable.

5.5.5. This is subjective. Excessively long could mean 60 days for some and 120 days for others. Guidance and clarity on this is required.

5.5.7. Negligence is included in the legal definition of "fault".

5.6. As per an earlier point, the quantity of goods or services may be relevant in some instances, especially where the inability of a supplier within the designated class to supply the full requirements of the buyer, may increase the costs and lower the efficiencies of the buyer. Therefore, different trading terms may be offered by the buyer to deal with such inefficiencies.

It may be necessary to differentiate trading terms based on the ownership structure of a firm, if the cost of doing business or the risk associated with managing such firm's account is greater. It may be less efficient and costlier to do business with a smaller firm, for a number of reasons.

6.1. As a general point, legislative drafters should not predetermine or prescribe sectors for regulation. This should be left to the Competition Commission to identify as it has the delegated legislative authority to extensively investigate and gather evidence of alleged or potentially anticompetitive conduct of dominant firms in various sectors of the South African economy.

6.3. Notwithstanding the above, in the interests of investor certainty, clarity on which sectors will be designated is critical.

7.2. This is not the only factor which is relevant to countervailing seller power. Rather it is the critical nature of the input component and switching ability to alternate substitutes for either party that

dictates the importance of this economic dependency relationship and the countervailing power between the parties.

Note to section 7 of these Regulations: This note is not sufficiently clear. We assume that the proposal is that where 10% or more of the dominant firm's purchases of a relevant input is purchased from an HDP seller, that seller is presumed to have countervailing power. If this is correct: (a) where that HDP seller accounts for more than 10% of the relevant input and seeks the protection of the buyer power provisions of the Amendment Bill, it is up to the HDP seller to show that it lacks countervailing power; and (b) where the dominant firm buys less than 10% of the relevant input from an HDP seller, it is up to the dominant firm to show that the HDP seller has countervailing power and therefore, should not enjoy protection under the buyer power provisions.

It is also highlighted that even where 10% or less of a relevant input is supplied by an HDP seller to a dominant purchaser, that seller may enjoy countervailing power e.g. where the input is cyclical, in short supply or where that HDP seller is closer to the point of manufacture than other non-HDP sellers. Once again, although the proposal includes an onus to demonstrate countervailing power or a lack thereof, it may be prudent that within 12 months (or an alternative specified period) of the enactment of the Draft Regulations, this provision be reviewed (irrespective of what the threshold is determined to be), in consultation with stakeholders, with a view to determining whether a lower presumptive threshold is appropriate. In certain circumstances, different thresholds might be appropriate for different industries. As with the Price Discrimination Draft Regulations, this might eliminate baseless claims and thereby allow the Commission to control the proverbial floodgates.

We recommend that in progressing the Buyer Power Regulations, the note should be made clearer – hopefully to reflect the understanding above. Further, the 10% or any other threshold determined should not be set in stone but should rather be determined – with input from stakeholders – on an annual and perhaps industry-specific basis.

Conclusion

Whilst BUSA welcomes the public consultations process pursued by the Economic Development Department in the Competition Amendment Bill process (including the regulations arising therefrom), it is apparent from interactions with our affiliates that the current draft regulations create significant uncertainty among the private sector and may ultimately add to the cost of doing business. While the socio-economic objectives associated with the draft regulations are laudable,

these need to be pursued in a manner most supportive of investor confidence and the ease of doing business. With this in mind, BUSA trusts the above comments will be duly considered by the Department. BUSA stands ready to engage further with the Department with a view to strengthening and streamlining the draft regulations in a manner most supportive of socio-economic growth and development.