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

31 January 2019

BUSA SUBMISSION ON FIRST DRAFT SET OF PRICE DISCRIMINATION 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.

Detailed Comments

3.1. The strict enforcement of smaller firm protection may have the unintended consequence of introducing pricing rigidity which discourages price competition, which is contrary to the advancement of competitive markets from a competition policy perspective. Economists recognise that not only is price discrimination compatible with competition, it also provides the means that compels sellers/producers to engage in differential pricing which is essential for the promotion of consumer welfare. Firms operating in competitive markets routinely price products and services with similar costs at different levels to different customers (the pricing of movie tickets to regular adults, children and seniors provides an example of this) or even to the same customer (e.g. volume discounts unrelated to cost savings).

A firm's ability to differentiate in price gives it the scope to offer / provide goods or services to different segments of customers, whose needs would not ordinarily be best served by a uniform pricing across the board. This is closely linked to a firm's desire maximise its product offering in a relevant market through the competitive means of dynamic pricing. More importantly, it must be kept in mind that firms will rather engage in a strategy to profit-maximise in hope of increasing sales and attain volume through increased sales, for so long as their price covers their costs to produce / supply.

Moreover, the capability to produce high volume of standardised product and access to technologies, designs, etc. enable suppliers to offer their customers a better value proposition due to the high investment costs involved in many sectors. This is considered a competitive advantage but may also be regarded as impeding the ability of small and medium businesses or firms controlled or owned by historically disadvantaged persons, to participate effectively in such sectors. Confirmation is required that negotiations for competitive pricing having regard to volume and access to technology and designs are not considered price discrimination but capable of justification.

3.2.1. Will firms and other stakeholders be given an opportunity to comment on these regulations, including the benchmarks for determining the application of this section? BUSA proposes that such an opportunity indeed be afforded.

4.1. These Price Discrimination Draft Regulations refer to SMEs or firms owned by HDPs as the "*designated class of purchasers*" in the economy. In BUSA's view the Price Discrimination Draft Regulations, as they are currently drafted, introduce uncertainty in that it is unclear whether the standard of impeding the ability of SMEs and HDPs to participate effectively would be tested with reference to just a single firm that can prove it is part of the designated class, or with reference to a wider group of firms in the designated class.

For instance, while section 4.4 *(Legislative Context to the Price Discrimination Regulations)* states that the dominant firm may have reference to the "*broader set of firms in the designated class to whom it sells*" relative to a "*single complainant*", section 5.1.2, however, states that, for the price discrimination provisions to be applicable, "[*t]he price differential must place* ***<u>the firm</u>*** *in the designated class at a competitive disadvantage in the broad markets in which they participate…*". Put differently, it is unclear why a single firm would have *locus standi* as a complainant in terms of Section 9 of the Amendment Bill, or whether a complainant would need to assert that a wider set of firms in the designated class has been harmed.

Further, firms which could be dominant in certain markets, do not have insight into the costs of their customers and the other factors listed in sections 5.2.1 – 5.2.6 (especially where those customers might also be competitors) and, concomitantly, the extent to which their ability to participate would be impeded by differential pricing. As such, we propose that, prior to the Competition Commission (Commission) referring a complaint, the Commission affords the dominant firm the opportunity to consider the complaint and potentially adjust its pricing such that section 9 of the Amendment Bill is no longer likely to be contravened. Alternatively, as the Commission has sufficient fact-finding powers to determine the factors listed in sections 5.2.1 – 5.2.6, the Commission should bear the onus to prove that the price impedes the ability of the SME or a firm owned by an HDP to participate in the market. Such an approach would be in the interests of open participation and engagement for all stakeholders.

BUSA therefore recommends, firstly, that the Price Discrimination Draft Regulations be amended to clarify whether a single complainant that is part of the designated class would have locus standi under section 9. Secondly, that the Price Discrimination Draft Regulations be amended to state that a dominant firm against which a complaint is lodged be given the opportunity to adjust its pricing, such that it complies with section 9 of the Amendment Bill, alternatively, that the Commission bears the onus of proof under this provision of the Bill – especially given the lack of insight that dominant or, for that matter, other firms have into the factors mentioned above.

Another point to bear in mind is that for many sectors in South Africa, a competitive supplier environment is critical to their long-term survival. Should the application of competition law result in a non-competitive supplier environment, the competitiveness of downstream would deteriorate vis-à-vis imported products. This impact needs to be considered in the assessment of what is in the public's best interest.

4.2. This suggests that the discrimination must apply to a "designated class of firms". Does this suggest that a single firm would not be allowed to claim discrimination? If it also applies to a single complainant firm, then the wording should probably be amended to read "a firm within the designated class of firms".

Of concern to BUSA is that the concern of sustaining higher prices for the end consumer is seemingly disregarded in the draft regulations. The amendments appear to be an "ends justify the means" approach to addressing the promotion of SMMEs and HDI firms. The subtle issue which is overlooked relates to the issue of business risk to producers. Business risk inherently costs something - that is why in all production processes, firms will attempt to adopt the less expensive way of doing things premised on the probability that a certain minimum sale quota is made in the production of the product. In fact, the business risk of low sales is a barrier to using techniques and processes that could be efficient at higher amounts of output.

Simply put production costs are influenced by expected demand and supply. Customers who contract in advance generate cost savings due to guaranteed sales. It is naïve to suppose that those buyers who contract upfront, do so for nothing. If the dominant seller can no longer incentivise buyers for fear of undermining the public interest objectives of the Act, namely the participation of the "designated class of purchasers" in the economy then there will be no incentive for buyers, to take business risks and contract upfront with the firm. Automatically this means higher costs for everybody, with ripple effect on the wider economy.

Reducing business risk allows cheaper ways of doing things for all customers. The drafted regulations seemingly do not permit these discounts, and thus they will discourage forward contracting, an outcome which may protect smaller firms but is clearly not in the consumers best interest. Competition law is premised on ensuring competitive markets and ultimately protecting the consumer and therefore section 4.2 does not advance this competition law principle.

4.2.1. This appears to contradict 5.1.2 as it will be imperative for an assessment to be undertaken into the effect on competition and the impact on consumers in order to determine whether there is a “competitive disadvantage”. Also, 4.4 expects the Respondent to have reference to the “effect of the price discrimination on the broader set of firms in the designated class.” This suggests that the firm is required to show the effect on competition. This creates confusion with regard to 4.2.1 and 4.4.

4.2.2. This appears to contradict 5.1.2 as it will be imperative for an assessment to be undertaken into the effect on competition and the impact on consumers in order to determine whether there is a “competitive disadvantage”.

4.3. This provision is unclear and, depending on the interpretation, appears to be unfair to a supplier. It is unclear whether the legislature intended for the “cost of supply” which speaks mainly to the distribution costs to mean just that or whether it is to include the efficiency gains which the supplier benefits for non-distribution costs, e.g. economies of scale to reduce production and operational costs. Most, if not all, justifications for a differential pricing is usually based on the cost of supply. If it costs more to do business with a smaller buyer, then it is unfair to expect a supplier to absorb those costs. It appears that this section of the Act requires a supplier to grant a small supermarket the same pricing as that afforded to a large retailer with a national footprint. The unintended consequence of this provision is likely to be that suppliers would have to raise prices to larger buyers in order to maintain an equilibrium and to avoid falling foul of this provision.

Furthermore, supplier capability may impact the pricing that suppliers can offer customers. Some degree of assurance is required that negotiations for competitive pricing having regard to volume are not considered price discrimination but are capable of justification.

4.4. As a general point, the information available to a Respondent (the “dominant seller”) may be limited as firms within the designated class may not be willing to share information with the Respondent.

A more specific problem is that the complainant firm is required to establish a price difference. However, in some sectors firms go through a closed quoting process on new business opportunities with suppliers and cost is only one of the considerations. Other considerations include quality, technology, delivery performance and B-BBEE compliance. It is not also not clear how suppliers will demonstrate that the differential pricing does not impede small businesses and firms controlled or owned by historically disadvantaged persons from participating in the market. The respondent firm may not have information regarding the effect of the price differentiation on the broader set of firms in the same/similar market.

4.5.2. As per an earlier point, this implies that there must be discrimination of the class and not of the individual complainant. What happens if a single firm receives differential treatment to other firms within a class?

The computation test for abusive price discrimination is based on whether the dominant firm’s trading parties are placed at a competitive disadvantage against others, which introduces the need to identify a downstream relevant market and show a distortion and harm of competition on that market.

4.5.4. This is ambiguous and not amenable to quantification. Whilst the Draft Regulations do give a definition of “participate” below, the combination of this definition and what would constitute the ability to “effectively participate” in the context of clause 5.1 needs to be more clearly defined. Clarity is also sough on the definition of “causally impede” as both these terms can be loosely interpreted to have a variety of different meanings. It is also submitted that the reference to a vague term such as “causally impede” implies a lower threshold in assessing variant pricing of a firm’s behaviour, an assessment which would ordinarily be effects based and this could also suggest that any unjustified price difference must have some effect that is non-trivial.

5.1. The concern with section 5 is that it is counterintuitive to the principle of competition policy of promoting competition and protecting consumer welfare. It is often a complex task to determine whether transactions are equivalent. The most obvious reason for stating that two transactions are not equivalent is that the sales involve different costs for the seller. The problem is of course to determine how significant cost differences should be for two transactions to be considered non-equivalent. However, these principles are ignored in these regulations.

Clarity is required on the meaning of “participate effectively”. This is too broad and is not amenable to quantification and therefore will prove to be unworkable from a practical implementation perspective for the Commission.

5.1.2. Clarity is required on the definition of *“trivial or immaterial”.* Evidentiary proof is in the interest of competition law and regulation especially as South African competition law has been lauded internationally as embodying this regulatory certainty.

The concern is this introduces a form of firm favouritism which will likely sanction inefficient firms and protects the firm from market competition. Moreover, competition law draws a distinction between, anticompetitive business practices which distort competition and unfair practices resulting from contractual imbalances – the latter <u>does not</u> fall under the scope of competition law for the reasons provided above.

In addition, this appears to contradict 4.2 as it will be imperative for an assessment to be undertaken into the effect on competition and the impact on consumers in order to determine whether there is a “competitive disadvantage”.

5.1.3. See comments above. Clarity is required on the definition of *“competitive disadvantage”.* It is BUSA’s view that the protection afforded to firms in the designated class in this clause, falls outside the ambit of what would ordinarily be accepted as competition law jurisprudence because not does it not consider the effect of the “competitive disadvantage” but it also does not incentivise a firm to compete to the best of its financial ability.

Moreover, there is a very fine line between the terms “unable to compete” and “at a competitive disadvantage” and this is likely to lead to unnecessary legal challenges unless clarity is provided on the meanings thereof. These terms are capable of being used interchangeably.

5.2. This section is too vague to be workable for the Commission from an implementation perspective. Even when price discrimination has occurred, it remains a complex task to sort through the many different phenomena of discrimination and to evaluate their desirability. The appropriate relationship between prices and costs is extraordinarily complex. Not only is cost accounting imperfect, but prices should and do respond to a great number of factors that cannot enter any accounting of investments made or external obligations incurred. In many situations, a firm may not only increase its own profits but also promote economic efficiency by setting different prices to respond to differences in the demand for its product presented by different customers.

Moreover, Section 9 (3) (b) places the onus of proving that the action of the dominant firm does not impede on the ability of the smaller firm to participate effectively, on the dominant firm (Respondent). This may be ineffective and difficult due to the lack of information that may be available to the Respondent.

5.2.2. See above comment.

5.2.3. Clarity is required regarding the definition of placing the designated class of firm “at a disadvantage”. Clarity is also required regarding the meaning of “competitively relevant”.
As currently drafted the regulation erodes the quality and standard of evidentiary proof by lowering the bar of *prima facie* proof before a firm is required to defend its conduct. The lowering of this evidentiary proof is not in the interest of competition law and regulation especially as South African competition law has been lauded internationally as embodying this regulatory certainty of actual harm to the market.

5.2.4. This is too vague to be workable from the Commission’s perspective of practical implementation. Furthermore, the reference to “actual performance” is vague and falls foul of well accepted and established competition law principles. This is due to the fact that if the onus is shifted to the dominant firm to exonerate itself from allegations posed against it as currently stated in these draft regulations, it would be tantamount to collusionary behaviour in terms of section 4 of the Competition Act, for a horizontal competitor to know the "actual performance" of a firm it competes with in the designated class of firms. This would imply that the dominant firm would have to understand and have good knowledge of a competitor's actual production cost and function, which would fall in the realms of a section 4 prohibited practice. Viewed holistically, this is surely not the intention of the legislature in promulgating these draft regulations. In addition, references to vague terms such as "actual performance" should be avoided at all costs.

5.2.5. The same comment as above applies here with reference to "actual performance".

5.2.6. To penalise a firm simply because it practices differential pricing to ensure that the designated class of firms are protected would be to protect firms / rivals from the effects of competition – clearly counter to competition law policy. Similarly, and with reference to the above comment on "actual performance", the same sentiments are equally raised in relation to the vague term "likely performance".

6.2. This is not correct: purchasing a significant share of the dominant seller's output is not the factor that defines economic dependence between the parties.

The buyers' market power constitutes first and foremost a competitive constraint which counteracts a dominant seller's market power. Therefore, the critical dependence of the seller on the buyer and the buyer's ability to substitute to alternative suppliers is what provides it with countervailing buyer power.

Note to section 6 of the Price Discrimination Regulations: This note is not sufficiently clear. BUSA assumes, firstly, that the proposal is that where 10% or more of the dominant firm's output is purchased by a firm that is controlled or owned by HDPs, that such purchasers are presumed to have countervailing power. If this is correct: (a) where an HDP purchaser buys more than 10% of the dominant firm's output and seeks the protection of the price discrimination provisions of the Amendment Bill, it is up to the HDP purchaser to show that it lacks countervailing power; and (b) where the HDP purchaser buys less than 10% of the dominant firm's output, it is up to the dominant firm to show that the HDP purchaser has countervailing power and therefore, should not enjoy protection under the price discrimination provisions; and secondly, in respect of the output of a dominant firm it is unclear if this relates to a particular good or service or the entire output of the dominant firm. The Buyer Power Draft Regulations seem to be limited to a relevant input. Should the Price Discrimination Draft Regulations not then be limited to a relevant output?

As regards both, we highlight that firms that purchase less than 10% of a dominant firm's output could potentially possess countervailing power on a consistent basis (especially where other purchasers buy far lesser volumes or where a particular firm buys a basket of goods from the dominant firm, such that it has greater bargaining power (assuming that *output* refers to a particular good or service and not total output)). 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. This might eliminate baseless claims and thereby allow the Commission to control the proverbial floodgates.

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

In any event, the percentage of purchases of a dominant firm is not the only factor for consideration in the economic dependency relationship between buyer and seller. Rather it is the critical nature of the input component and switching ability to substitutes for either party that dictates the importance of this economic dependency relationship and the countervailing power between the parties.

Conclusion

Whilst BUSA welcomes the public consultations process pursued by the Economic Development Department in the Competition Amendment Bill process (including the regulations arising therefore), 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. 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.