A Change in Approach to Excessive Pricing in South Africa?

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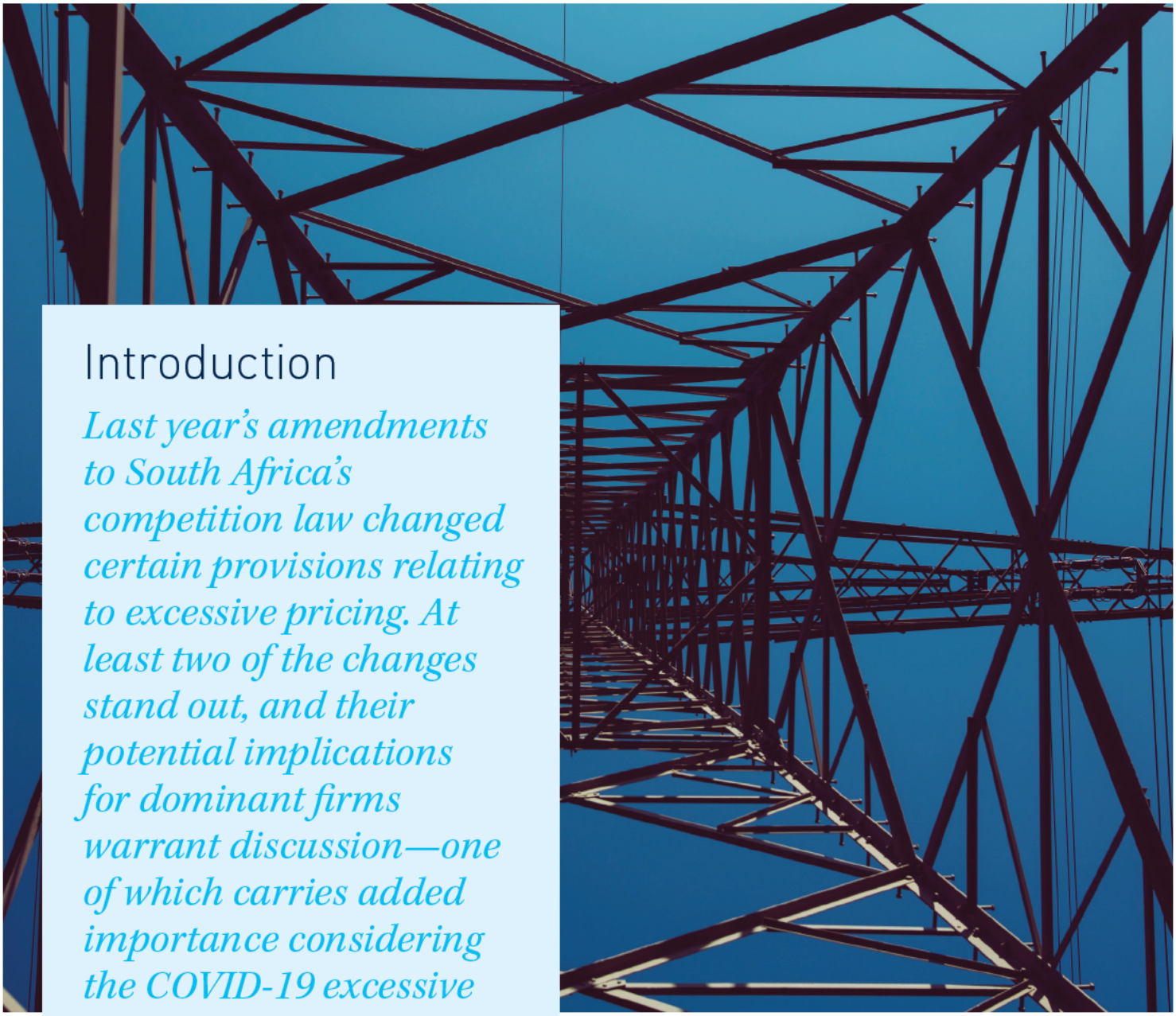

Introduction

Last year's amendments to South Africa's competition law changed certain provisions relating to excessive pricing. At least two of the changes stand out, and their potential implications for dominant firms warrant discussion—one of which carries added importance considering the COVID-19 excessive pricing cases currently being investigated and prosecuted by the Competition Commission ("the Commission").[1]

The first is the new section 8(2) of the amended Competition Act ("Act"),[2] which introduces the concept of a *prima facie* case of abuse of dominance *because* a dominant firm has charged an excessive price.[3] The amendment places an onus on respondent firms to rebut these *prima facie* cases. The Act states that if, "… there is a *prima facie* case of abuse of dominance because the dominant firm charged an excessive price, the dominant firm must show that the price was reasonable".[4]

1 These focus on alleged 'gouging' by producers or retailers and have been made possible by special anti-gouging regulations issued in March 2020 in response to the COVID-19 crisis. These regulations are rooted in the amended excessive pricing provisions. See Republic of South Africa, *Government Gazette* vol. 657, no. 43116 (19 March 2020), available at http://www.saflii.org/images/CompetitionAct-Regulations.pdf.

2 For background on and access to the amendment act, see South African Government, Competition Amendment Act 18 of 2018 (English / Afrikaans) (updated 13 February 2020), available at: https://www.gov.za/documents/competition-amendment-act-18-2018-englishafrikaans-14-feb-2019-0000. To see which sections of the amendment act have been enacted, see South African Government, Competition Amendment Act: Commencement of certain sections (English / Afrikaans), available at: https://www.gov.za/documents/competition-amendment-act-commencement-act-english-afrikaans-12-jul-2019-0000.

3 Section 8(2) of the amended Competition Act.

4 Section 8(2) of the amended Competition Act, no. 89 of 1998.

The second is the new section 8(3), which effectively replaces the definition of an excessive price. It states that any "person determining whether a price is an excessive price must determine if that price is higher than a competitive price and whether such difference is unreasonable" by reference to a range of factors[5] that largely codify South African case law on ways to measure whether a price is excessive.[6]

The Commission has stated that the "amendments try to make it easier for the Commission to prosecute abuse of dominance by imposing reverse onuses, for example, requiring dominant firms to show, in the case of a "*prima facie*" case of ... excessive pricing that its price is reasonable".[7] While it is not clear that the amendments will achieve this, it seems likely that complainants (including the Commission) will find it easier to refer or threaten to refer complaints of excessive pricing to the Competition Tribunal ("Tribunal"). If a dominant firm must rebut a *prima facie* case of excessive pricing made out under section 8(2), then complaint referrals seemingly do not need to establish a full case of excessive pricing as per the factors listed in section 8(3).

Some findings of the final report of the Data Services Market Inquiry (DSMI)[8], and the Commission's case in the first COVID-19 excessive pricing prosecution[9], lend support to this impression. In the DSMI, the Commission argued there were *prima facie* cases of excessive pricing on two products and requested the relevant firms agree to significant price reductions or prepare to be prosecuted at the Tribunal.[10] The first COVID-19 prosecution (court decision pending) also relies heavily on *prima facie* evidence of excessive pricing, leaving out, for example, market definition and a full assessment of the respondent firm's alleged dominance.[11]

If the Commission's example in the DSMI is followed, 'regular' excessive pricing investigations and referrals (i.e. those unrelated to the special COVID-19 anti-gouging regulations) may increase. This may concern dominant firms as excessive pricing cases can: (i) cause reputational harm; (ii) require significant resources to defend on an *ex post* basis; and (iii) give rise to substantial penalties.[12] A firm's burden may be considerable where respondents are required to rebut *prima facie* evidence in a constrained period of time.

Against this background, we consider what might constitute *prima facie* evidence of excessive pricing. We then consider the potential implications of these amendments for dominant firms.

What might constitute prima facie evidence of excessive pricing?

We first consider how excessive pricing cases have been assessed typically to date. Previously, the Act stated that an excessive price was one that was higher than, and bore no reasonable relationship to, the economic value of the product or service in question. Economic value was not defined in the Act, but case law determined that it must be measured. How it should be measured has caused extensive debate. Litigated cases in South Africa focused ultimately on the economic costs of the respondent firm as a proxy for economic value and have compared the alleged excessive price to those cost estimates. The case law has discussed but not relied on evidence that might be deemed to be *prima facie* in nature (we discuss this shortly).

In Europe, several cases of excessive or unfair[13] pricing have also focused on the economic costs of the respondent firm but have also considered more deeply the concept of economic value (which may be higher than economic cost due to demand-side factors).

Some of these European cases have recognised price comparison evidence, and some have not assessed costs at all.[14] In theory, price comparison evidence is less complex to implement than an economic cost test and potentially provides a source of *prima facie* evidence of excessive pricing. However, in practice, comparisons are complicated by issues of sufficiently close comparability. This may make it more difficult for respondent firms to defend their pricing given that the onus transfers to a dominant firm to rebut *prima facie* evidence.

Price comparisons in Europe can be divided into two categories. The first looks at the prices charged by the respondent firm in other geographic markets. These may be in the firm's own country or in other European Union countries. The second looks at prices charged by other firms offering 'similar' products in the same relevant product and geographic market as the respondent firm, in other geographic markets in the respondent firm's country or in other European Union countries, though deciding what is sufficiently similar is often a key area of contention.

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5 Id., Section 8(3).

6 They include the respondent firm's profitability (presumably on the product at issue, although this is not stated explicitly); comparisons to the respondent's prices in other contexts or markets, or to prices of comparable firms; duration; structural characteristics of the relevant market; and any regulations added by the Minister responsible for the competition authorities (this is currently the Minister of Trade, Industry and Competition). The Minister has already exercised the power granted by the latter factor to issue regulations targeting alleged price gouging during the COVID-19 crisis.

7 Competition Commission "Unleashing More Rivalry" (2020), p. 57, available at: http://www.compcom.co.za/wp-content/uploads/2020/01/Competition-Commission-20-year_V9.pdf.

8 Competition Commission of South Africa, *Data Services Market Inquiry [DSMI] Final Report* (2 December 2019), available at http://www.compcom.co.za/wp-content/uploads/2019/12/DSMI-Non-Confidential-Report-002.pdf. (Hereinafter referred to as the "DSMI Final Report".) The amendments came into force during the DSMI, which ran for circa two years.

9 Competition Tribunal, Competition Commission and Dis-Chem Pharmacies Ltd., case number: CR008Apr20 (2020), available at https://www.comptrib.co.za/case-detail/9112.

10 DSMI Final Report, paras. 48.1, 48.7 and 49. The Commission required Vodacom and MTN to agree to price reductions of between 30% and 50% on mobile data, particularly prepaid mobile data bundles. The Commission also required Telkom to agree to "substantial" reductions in the price of IP Connect, a wholesale input into the provision of fixed wireline broadband to end users.

11 Competition Tribunal, Competition Commission and Dis-Chem Pharmacies Ltd., case number: CR008Apr20 (2020)

12 The Amendment Act creates harsher punishment for firms that contravene competition laws, through the removal of the "yellow card" regime, higher administrative penalties (up to 25% for repeat offenders) and the extension of a firm's liability for contravening competition law to its controlling shareholders who knew or should reasonably have known about the contravention.

13 Unfair pricing in the European Union (and the United Kingdom) is much the same thing as excessive pricing in South Africa; South Africa's law is based on European and British case law.

14 Motta, M., and A. de Streel, "Exploitative and Exclusionary Excessive Prices in EU Law", in Ehlermann, C.-D., and I. Atanasiu (eds), *What is an abuse of a dominant position?*, Oxford: Hart Publishing (2006), pp. 91–125.

The relevance of price comparison evidence recently featured in a Court of Appeal decision in the United Kingdom.[15] The Court ruled that the competition authority could not ignore *prima facie* evidence including comparisons to prices of allegedly similar products. The question of comparison was one of degree, not type (i.e. were the products sufficiently similar to require the competition authority to consider the associated price comparison evidence, not whether they were comparable in any respect at all).[16]

Of course, Europe may focus on price comparison evidence—especially across Member States —because European competition law worries about the integrity of the Common Market. South African competition law is different in that respect, but price comparison evidence did feature in the case involving Sasol's polymer pricing[17] and, as we discuss shortly, in the DSMI. We see no reason why such evidence could not feature in more South African excessive pricing cases in the future.

South Africa's Competition Appeal Court (CAC) first mentioned the idea of *prima facie* evidence of excessive pricing over ten years ago, in the *Mittal* decision.[18] It outlined two examples. The first involved the types of price comparisons mentioned above, with the court referencing the *British Leyland* case.[19] According to the *Mittal* decision, in *British Leyland* it was possible to conclude that the price at issue very significantly exceeded 'normal' prices for 'roughly similar' products. The second example imagined a scenario in which a dominant firm implements a substantial price increase on a product that was already earning normal profits, with no underlying increase in costs. This example suggests that relatively simple analysis of prices and accounting profits over time may provide *prima facie* evidence of excessive pricing. Indeed, such analysis was part of the competition authority's evidence in the recent UK Court of Appeal decision mentioned above.[20]

The CAC in *Mittal* argued that these two types of *prima facie* evidence may obviate the need to estimate economic costs and implement complex price-cost tests. It also suggested that the respondent firm would need to rebut such *prima facie* evidence to avoid it becoming conclusive, citing European case precedent. This line of thinking is reflected in requirements under the new section 8(2) of the amended Act.

That said, from an economic perspective, we consider that price-cost tests are still an important aspect of excessive pricing cases.

Application in the DSMI

As mentioned above, the Commission concluded that there were two *prima facie* cases of excessive pricing in the DSMI Final Report. The first related to Vodacom and MTN, with the evidence against MTN being weaker. The second related to Telkom for a wholesale fixed wireline broadband product called IP Connect. We summarise the evidence used by the Commission below.

MOBILE OPERATORS

The conclusions reached for mobile operators were based on, *inter alia*, the following:[21]

- EBIT and EBITDA[22] measures indicated that the South African operations of both mobile operators were among the most profitable in their groups and more profitable than any other country where the mobile operators' market shares were lower than South Africa.
- The ROCEs[23] generated by the operators' South African operations were higher than the weighted average cost of capital and higher than the ROCEs generated in non-South African operations, indicating excess profitability in South Africa.
- The total revenues of both operators in South Africa exceeded that required to cover operating costs, tax and the weighted average cost of capital, indicating excess profitability. The Commission estimated this excess (i.e. what the DSMI Final Report terms the price-cost mark-up) to be between 10% and 15% over the past six years for Vodacom, and between 0% to 5% for MTN.[24]

As context for this analysis, the Commission argued that South African mobile data prices were 'high' based on comparisons to prices in other countries.[25]

The Commission concluded that the "evidence above shows that Vodacom South Africa is not only a highly profitable business, but it is to such an extent that there is a *prima facie* case for excessive pricing in terms of Section 8(a) of the Competition Act".[26] For MTN, the Commission concluded that while "the margins may not be conclusive of excessive pricing, the unit costs under long-term competitive equilibrium may potentially be lower and thus the true price-cost mark-up may be larger".[27]

15 Court of Appeal judgment in an unfair pricing matter between the United Kingdom's competition authority and two producers of anti-epilepsy medication. Judgement was handed down on 10 March 2020. For more details, see Harman, Greg, and Adam Mantzos, *The Court of Appeal's Judgement in Phenytoin* (April 2020), available at https://www.thinkbrg.com/assets/htmldocuments/COVID19_Phenytoin_2020_cleaned.pdf.

16 For more details, see Harman and Mantzos (2020).

17 See the Competition Appeal Court decision in *Sasol Chemical Industries Limited v Competition Commission*, (131/CAC/Jun14) [2015] ZACAC 4; 2015 (5) SA 471 (CAC) (17 June 2015), available at http://www.saflii.org/za/cases/ZACAC/2015/4.html. The price comparison evidence was ultimately dismissed, but the fact that both parties tried to use it is an indication of how difficult such exercises can be.

18 See the Competition Appeal Court decision in *Mittal Steel South Africa Limited and Others v Harmony Gold Mining Company Limited and Another* (70/CAC/Apr07) [2009] ZACAC 1 (29 May 2009), available at http://www.saflii.org/za/cases/ZACAC/2009/1.html

19 British Leyland plc v EC Commission (1987) 1 CMLR 185.

20 See the Competition Appeal Court decision in *Mittal Steel South Africa Limited and Others v Harmony Gold Mining Company Limited and Another.*

21 See DSMI Final Report, section 4.3.2, "Profitability Measures" to test for excessive pricing, pp. 94-107 (2019).

22 Earnings before interest and tax (EBIT) and Earnings before interest, tax, depreciation and amortisation (EBITDA).

23 Return on capital employed.

24 DSMI Final Report, Tables 19 (Vodacom) and 25 (MTN).

25 DSMI Final Report, chapter 3.

26 DSMI Final Report, para. 248.

27 Id., para. 252.

From there, the Commission recommended that, notwithstanding "the most recent price reductions, Vodacom and MTN must independently reach agreement with the Commission on substantial and immediate reductions on tariff levels, especially prepaid monthly bundles, within two months of the release of the report. The preliminary evidence suggests that there is scope for price reductions in the region of 30% to 50%".[28] The Commission added that with "respect to the above recommendations on the level and structure of pricing, should an operator fail to reach the required agreements with the Commission within the specified timeframes, the Commission will proceed to prosecution under the appropriate sections of the Act".[29]

TELKOM

The Commission's *prima facie* case of excessive pricing on IP Connect rested on, *inter alia,* the following evidence:

- The Commission calculated a product-level EBITDA margin for IP Connect and concluded that it was high compared to the EBITDA margins for the overall businesses of Vodacom and MTN (which the Commission had concluded were themselves high).[30]
- The Commission compared the price of IP Connect to products the Commission claimed were comparable, provided by competing broadband access network providers including Vumatel and Frogfoot. The Commission concluded that the price of IP Connect was much higher than the prices of these products.[31]
- The Commission concluded that a price-cost test on IP Connect for one financial year, provided by Telkom, suggested excessive pricing.[32]

The Commission accordingly invited Telkom to reduce the price of IP Connect or prepare for prosecution in the Tribunal.[33]

Outcomes of the Commission's approach in the DSMI and potential implications for dominant firms

Vodacom, MTN and Telkom have all settled with the Commission.[34] The mobile operators announced reductions in advertised prices of up to 33% on some products, while Telkom agreed to introduce new products to address the concerns around IP Connect.

Choosing to settle does not necessarily indicate agreement by the respondent that it had set excessive prices; there are many reasons why firms choose settlement over litigation. In fact, as we explain below, the Commission's analysis appears to be insufficient to bring a successful prosecution. But it is significant that the Commission created enough pressure to settle only by building a *prima facie* case of excessive pricing, which is a new development in South Africa's competition law, facilitated by the introduction of section 8(2).

If the Commission's approach in the DSMI to establishing a *prima facie* case of excessive pricing provides an example to be followed in future, by the Commission or other complainants, dominant firms will need to assess the strength of the *prima facie* evidence considered by the Commission. With respect to the DSMI, we note the following concerns:[35]

Whole firm versus specific product. The Commission's analysis of profitability for mobile operators does not appear to drill down to the specific product in question (i.e. mobile data). Instead, the Commission's analysis appeared to consider the total revenues and total costs across all services including voice, data, messaging, equipment and other. The analysis went no further than implying that the results based on aggregate data would likely apply to mobile data separately. Hence, it is possible that the accounting profits of a multiproduct firm could be used in a *prima facie* case against one of a firm's products. However, we consider that there is limited economic justification for such a conclusion for many multiproduct firms.

Accounting versus economic profits. Whilst the Act lists profitability as a factor to consider in excessive pricing cases, EBIT and EBITDA margins should be used with care. EBITDA margins provide short-run measures of accounting profit, which often have limited relevance to the concerns underlying excessive pricing prohibitions in competition law. Importantly, there is no reliable way to judge whether EBITDA margins are 'high' from a theoretical perspective (a ROCE methodology is often preferred, as it has a more robust theoretical underpinning). However, we accept that significant increase in EBITDA over a short period may invite scrutiny, unless it can

28 Id., para. 48.1.
29 Id., para. 49.
30 Id., para. 642.
31 The Commission compared IP Connect prices to prices of products provided by Vumatel and Frogfoot that the Commission considered to be comparable to IP Connect. See DSMI Final Report, paras. 626–627.
32 DSMI Final Report, para. 638.
33 DSMI Final Report, para. 48.7.
34 See the following: Tech Financials, "Vodacom Agreement Settlement Welcomed" (10 March 2020), available at: https://techfinancials.co.za/2020/03/10/vodacom-agreement-settlement-welcomed/; BusinessTech, "MTN announces massive price cuts and free data" (20 March 2020), available at: https://businesstech.co.za/news/telecommunications/383443/mtn-announces-massive-price-cuts-and-free-data/; Gavaza, Mudiwa, "Telkom to reduce broadband prices at IP Connect", Business Day (25 March 2020), available at: https://www.businesslive.co.za/bd/companies/telecoms-and-technology/2020-03-25-telkom-to-reduce-broadband-prices-at-ip-connect/
35 Our analysis is based on our assessment of the DSMI Report using publicly available information. If we had regard to confidential data, we may have reached alternative conclusions.

be shown that the increase was required to achieve the level of profits that would be considered normal or fair in a competitive market.

The Commission's analysis of mobile operators' ROCE over the past six years also did not necessarily indicate excessive pricing, as the test failed to consider whether returns significantly exceed the opportunity cost of capital over the life cycle of the entire investment. This is particularly important in an industry like telecommunications, which is characterised by economies of scale, large upfront fixed investments and significant losses in the early stages.[36] It is also debatable, by reference to case precedent, whether an estimated price-cost mark-up of up to 15% for Vodacom would be deemed "unreasonable" by the Tribunal or the CAC.[37]

Relevant market and dominance. In relation to Telkom's IP Connect, the Commission did not define the relevant market, which is typically a prerequisite for an abuse of dominance case. While it may not be required for a *prima facie* case of excessive pricing under the amended law—which remains to be tested—it seems reasonable to expect that some *prima facie* evidence of dominance or market power in the specific product of concern might be available where excessive pricing may be suspected. The Commission's comments on Telkom's dominance were not specific to any relevant market (because none was defined) and focused on its historical position as a state monopoly, which it has not been for some time.

Price comparisons. The Commission's *prima facie* case against Telkom rested partly on comparisons to prices of other products which it deemed comparable to IP Connect, but without knowing the relevant market and the products in it, it is difficult to assess the validity of these comparisons. As mentioned above, determining whether another product is sufficiently similar is often complex and, in the context of a *prima facie* case, a dominant firm may not have the opportunity to engage properly with the price comparison evidence relied upon by a complainant.

Conclusion

The approach taken by the Commission in the DSMI may signal a new regulatory environment for excessive pricing for dominant firms, and one which they should be considering carefully, because their pricing decisions could be challenged more easily than before. These challenges may prove difficult to defend absent adequate preparation.

Such preparation may entail an *ex ante* analysis of new prices, informed by what might constitute evidence of excessive pricing, *prima facie* or otherwise. Firms that have done so will be better prepared should a complaint investigation or a *prima facie* case be referred against them. Of course, there will be a trade-off between adequate upfront planning and having to rebut *prima facie* evidence of excessive pricing, potentially in a hurry and without the necessary evidence to hand. Without proper preparation, a dominant firm might believe it necessary to settle, even where weak evidence has been adduced by the Commission, when the better response would have been to accept the Commission's invitation to prosecute.

36 Church, J., and A. Wilkins, *Wireless competition in Canada: An Assessment*, University of Calgary SPP Research Papers, vol. 6, no. 23. (2013).

37 CAC stated that "a price which is significantly less than 20% of the figure employed to determine economic value falls short of justifying judicial interference in this complex area" (para 175).

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