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# COMPETITION ALERT



## IN THIS ISSUE

### Unfair pricing and trading conditions imposed by dominant firms – do the new Buyer Power Guidelines provide sufficient clarity in this novel area of the law?

The Competition Commission (Commission) has issued its final Buyer Power Guidelines (Guidelines). This comes after the amendments to section 8 of the Competition Act (Act) to introduce provisions aimed at promoting and protecting the interests of small and medium sized businesses (SMEs) and firms controlled or owned by historically disadvantaged persons (HDPs). In terms of the Act, the Commission is empowered to make guidelines to set out the general principles that the Commission will follow in assessing whether there has been a contravention of any provision of the Act and as an indication of the Commission's enforcement approach. Any such guideline will not be binding but must be taken into account by any person looking to interpret the Act (including the Competition Tribunal).

## Unfair pricing and trading conditions imposed by dominant firms – do the new Buyer Power Guidelines provide sufficient clarity in this novel area of the law?

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### Background – the Act and Regulations

The new section 8(4), which came into effect early this year, prohibits a dominant firm in a sector designated by the Minister from directly or indirectly requiring or imposing unfair prices or trading

conditions on an SME or HDP supplier (the designated class of suppliers). A dominant firm is also prohibited from avoiding or refusing to purchase goods or services from an SME or HDP supplier in order to circumvent the operation of section 8(4)(a).

The Minister published regulations (Regulations) in terms of section 8(4)(d) and designated the agro-processing, the grocery wholesale and retail and the ecommerce and online services sectors as being subject to the buyer power provisions.

The Regulations provide that in order for the buyer power provisions to be enforced against a firm:

- the supplier firm must be an SME or HDP-owned business and must account for 20% or less of the buyer's purchases of the relevant product or service;
- the buyer firm must be dominant within the meaning of section 7 of the Act, which relates to the percentage market share that a firm has of a market or its market power; and
- the buyer must impose or require an unfair price or trading condition on the supplier.

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## Unfair pricing and trading conditions imposed by dominant firms – do the new Buyer Power Guidelines provide sufficient clarity in this novel area of the law?...continued

The Commission has indicated that they will focus on goods and services that are directly relevant to the output of the designated sectors and will not seek to enforce the Buyer Power provisions in respect of those goods or services which are ancillary to those designated sectors.

The Regulations further provide for the factors to be considered in determining unfair prices and trading conditions.

### **The new Guidelines**

The new Guidelines, which are significantly different from the draft guidelines published for comment last year, provide a few notable guiding principles upfront:

- the focus of the section 8(4) inquiry will be on the treatment and welfare of SME and HDP suppliers and whether that treatment is fair or not;
- the inquiry will not involve the assessment of effects on final consumers nor will it seek to balance the welfare of suppliers against the welfare of final consumers (i.e. a benefit to consumers will not ameliorate an adverse effect on suppliers);
- the inquiry will not, in determining whether or not the price or trading condition is unfair, consider whether the SME or HDP supplier faces other challenges or is efficient or not;
- in order to establish a contravention, there need not be a specific materiality threshold in terms of the level of harm to the SME or HDP supplier.

Simply put, the inquiry in section 8(4) is whether the conduct of or treatment by the dominant firm is objectively unfair to the SME or HDP supplier rather than whether they are otherwise efficient competitors.

Further, the Commission has indicated that they will focus on goods and services that are directly relevant to the output of the designated sectors and will not seek to enforce the Buyer Power provisions in respect of those goods or services which are ancillary to those designated sectors (e.g. security services or property rental to firms in the designated sectors).

### **Dominance**

In terms of the Guidelines, the inquiry begins with a market definition for purposes of determining dominance of the buyer that is the subject of a complaint.

The Commission will seek to define a purchasing market with reference to the product and geographic market. In doing so, the Commission will have regard to generally accepted principles and approaches to defining the relevant markets. In the context of purchasing markets, the product market will include both the characteristics of the good or service supplied and the market or distributional channel through which it is sold.

If the buyer firm in question has a market share in that purchasing market of 35% or more, it is presumed to be dominant (and if that market share is more than 45% it is deemed to be dominant). If a firm has a market share of more than 15% (which the Commission indicates could be a material market share), then the Commission will investigate whether the firm has buyer power notwithstanding the pure market share considerations in terms of the Act.

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In the Commission's view, buyer power depends very much on the extent of outside options for buyers and sellers, such that buyer power might exist even if a share of the purchasing market is less than 35%.

The Guidelines thus provide that, in determining whether a buyer has power in a market, the Commission will look at factors such as the dependency of suppliers in the market on that buyer; alternative suppliers available to the buyer; and the nature of supply negotiations.

### Unfair pricing

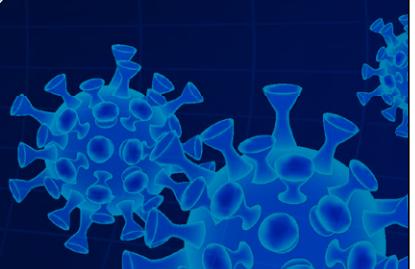
In considering whether a price is unfair, the Commission will look at two benchmarks: (1) if the price paid to a supplier in the designated class is lower than the price paid to other suppliers of like products; and (2) if the price paid to that same supplier in the designated class is lower than the price previously paid to the same supplier for their product.

The first benchmark considers whether the price paid to a supplier in the designated class is materially lower than the price paid to other suppliers of like products, especially those suppliers who fall outside the designated class. Any material differences in price are likely to be deemed unfair unless the dominant firm can show an objective justification for the extent of difference in the price paid.

The Commission will assess the per unit price paid to a complaining firm or the designated class of suppliers, which is inclusive of any rebates, commissions or discounts provided to the buyer and net of relationship-specific costs imposed on or required of the supplier by the buyer. The Commission will then look at the price paid to the largest suppliers outside of the designated class as well as the average price paid across all suppliers outside the designated class. The differences in the

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prices paid will be considered in terms of the Rand and percentage difference, as well as the total revenue quantum considering the volume of sales.

The Commission is more likely to consider the price to be unfair where a supplier from the designated class:

- is consistently paid a lower price relative to those outside the designated class;
- is paid a price which is 3% (or more) lower than the price paid to suppliers outside the designated class;
- is paid a lower price for identical goods or services (no confidence interval is applied);
- suffers the price differential for a long duration; or
- where a differential exists for all firms within the designated class.

If there is such an unfair differential, the onus is on the dominant buyer firm to show that there is an objective justification for such differential. In assessing the justification provided, the Commission will consider, amongst others, the margins earned by the dominant buyer on the onward sale of the goods or services supplied by the designated supplier (or class of suppliers); or the supply relationship (such as volumes, contractual arrangements, service levels or payment terms).

The second benchmark considers whether there has been an unfair reduction in the price paid to a supplier in the designated

class, either directly through reducing the price paid or indirectly through imposing costs on the supplier which reduces the effective price paid to an unfair level. During its investigation, the Commission will determine the existence and extent of reduction in the effective price paid together with the circumstances (i.e. was the reduction unilateral; retrospective; applied selectively amongst suppliers; due to a change in the contractual relationship; and does the contract allow for a reduction in price). The Commission will also determine whether there is an objective justification for the reduction in effective price, and if the justification warrants the extent of the effective price reduction.

In cases of a deterioration of market or competitive conditions, the Commission will consider whether the distribution of costs between the dominant buyer and its suppliers is justifiable or not and how the deterioration in conditions has impacted on margins across the value chain. As above, the onus will be on the dominant firm to provide objective justification for an apparently unfair reduction in price.

### Unfair trading conditions

The Commission will consider a trading condition to be unfair if it unreasonably transfers risks and/or costs onto the firm in the designated class of suppliers; if it is one-sided, onerous and/or disproportionate to the stated objective; or if it bears no reasonable relation to the objective of the supply agreement.

## Unfair pricing and trading conditions imposed by dominant firms – do the new Buyer Power Guidelines provide sufficient clarity in this novel area of the law?...continued

The Commission considers several trading practices as being unfair unless the terms have been agreed and any attendant payments/costs quantified and reasonable.

The Commission will assess these factors based on the specific sector and this will be informed by the types of practices identified as unfair trading practices in other jurisdictions:

1. In relation to the agro-processing and grocery wholesale and retail, the Commission considers the following to be *prima facie* unfair:
  - payment terms that are longer than 30 days;
  - cancellation of orders of perishables at short notice;
  - unilateral changes to the terms of supply agreement such as delivery terms, volume of supply, quality standards, payment terms and prices;
  - the buyer requiring the supplier to make payments to the buyer where those payments are not related to the sale of products of the supplier;
  - payments for deterioration or loss where ownership has passed to the buyer and where the loss occurred on the buyer's premises;
  - refusals by the buyer to conclude a written supply agreement;
  - the suppliers trade secrets are unlawfully acquired, used or disclosed by the buyer;
  - the buyer threatens to or retaliates commercially against the supplier, if the supplier elected to exercise its contractual or legal rights; and
  - compensation payments to the buyer from the supplier for investigating customer complaints where there is no negligence on the part of the supplier.
2. In relation to the ecommerce and online services, the Commission considers the following to be *prima facie* unfair:
  - where the terms and conditions of operating on the service are not in plain and intelligible language, especially in respect of, amongst others, the suspension or termination of the services; the imposition of restrictions on the supplier; the effects that the terms and conditions have on the supplier's ownership and control of intellectual property rights and personal data;
  - where suppliers are exclusively or primarily ranked on the basis of the direct or indirect renumeration that the suppliers pay to the intermediation services;

Additionally, the Commission considers several trading practices as being unfair unless the terms have been agreed and any attendant payments/costs quantified and reasonable. These include, amongst others:

- where buyers return unsold products to the supplier without paying for the products or their disposal;
- where suppliers are required to make payments for stocking, displaying or listing products;
- where suppliers are required to pay for the whole or part of any discounts on promotions; and
- where suppliers are required to pay the buyer for advertising or marketing.

## Unfair pricing and trading conditions imposed by dominant firms – do the new Buyer Power Guidelines provide sufficient clarity in this novel area of the law?...continued

**Buyers cannot ask suppliers for detailed cost structures in order to analyse the buyer's compliance with these provisions.**

- where the ecommerce or online service provider favours or treats in a differential manner the goods or services supplied by itself or companies in which it has an ownership stake;
- where a supplier is restricted from offering the same good or services to consumers on other platforms other than that of the ecommerce or online service provider;
- where a supplier is restricted from offering their own ancillary goods and services (this refers to products that typically depend on, and are directly related to, the primary good or service in order to function), including through the ecommerce or online service;
- where the ecommerce or online service provider uses data and information gathered on the supplier's sales (incl. pricing, volume, customer sales) to enter in competition with the supplier; and
- where a supplier is required to automatically waive its rights as a juristic person under the Protection of Personal Information Act, (Act No 4 of 2013) in order to supply on or through the ecommerce or online service.

In preparing the list of unfair trading conditions in ecommerce and online services, the Commission has considered principles contained in the EU Regulations dealing with online intermediation services, however the Commission's list of unfair terms seems to have a more extensive application.

### Other principles applied in enforcement of the buyer power provision

The Commission will assess if the price or trading condition only applies to suppliers in the designated class or, in instances where the condition applies uniformly, whether that condition has a greater impact on designated suppliers.

Volume discounts are unlikely to fall foul of the unfair pricing provisions if the discount is mutually beneficial to the parties.

Buyers cannot ask suppliers for detailed cost structures in order to analyse the buyer's compliance with these provisions.

The Commission notes that there is no obligation to purchase from a specific SME or HDP supplier, but buyers should not circumvent application of the provision by avoiding purchasing from the designated class altogether. Further, there is no obligation to pay suppliers in the designated class higher prices. However, even uniform trading terms may be a violation if they impose an undue burden on designated suppliers.

The Commission also indicates in the Guidelines that a supplier development programme in favour of SMEs or HDPs is acceptable, provided that it does not fall foul of the provisions. However, such a programme will not necessarily be seen as a mitigating factor in the face of a legitimate complaint (i.e. if a complainant does not benefit from the programme, or only benefits to a limited extent, the mere existence of the programme will not absolve the dominant firm from all liability).

## Unfair pricing and trading conditions imposed by dominant firms – do the new Buyer Power Guidelines provide sufficient clarity in this novel area of the law?...continued

**The Commission will initially focus more on advocacy than enforcement and penalties during the early stages of enforcing these provisions.**

The Commission will initially focus more on advocacy than enforcement and penalties during the early stages of enforcing these provisions. In particular, in this initial period of the provisions being in force, if a firm reviews its procurement conduct and contracts for compliance with the Guidelines, then the Commission will be more sympathetic towards that firm. Furthermore, if on being approached by the Commission, a firm immediately takes steps to rectify its conduct, the Commission will consider such firms to have co-operated. Otherwise, a contravention of the buyer power provisions will attract a penalty of up to 10% of the dominant firm's turnover in South Africa.

### Conclusion

Overall, the Guidelines provide considerable detail and insight into how the Commission will enforce the Buyer Power provisions. However, the Guidelines are complex in places, and will require a period of application to fully appreciate their import and effect. It is clear that the buyer power provisions are quite novel,

therefore regular review of the Regulations and Guidelines may be required as complaints are investigated, prosecuted, and the law developed accordingly.

In the meanwhile, all buyers occupying an important outlet for products and services in the designated sectors of agro-processing, groceries and ecommerce are effectively on notice to start interrogating their trading terms and conditions in light of the new Guidelines. Armed with the Guidelines, one can expect an increased level of complaints and enforcement.

Finally, it is worth noting that the Commission is also expected to finalise the Price Discrimination Guidelines in the near future (in respect of the changes made to section 9 of the Act). These will impact on how dominant firms charge customers and in particular, the prices that they charge to firms who are SMEs or HDP firms. We will provide a further update once those guidelines are published.

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