

An economic perspective on the new South African buyer power provision and enforcement guidelines

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Introduction

On 13 February 2019, the South African Competition Amendment Act 18 of 2018 (the ‘Amendment Act’) was signed into law by President Cyril Ramaphosa. This legislation amended the Competition Act No 89 of 1998 by, among other changes, inserting a buyer power provision (contained in section 8(4)). This provision prohibits a dominant buyer in a designated sector from requiring or imposing unfair prices or trading conditions on small and medium businesses (SMEs) and firms controlled or owned by historically disadvantaged persons (‘HDP firms’).

Although the notion of buyer power and the ability of firms to abuse such power is by no means a new concept in competition economics, the South African buyer power provision presents a novel way of thinking about such an abuse. This is largely due to the combination of three features:

- first, it considers buyer power in the context of protecting the public interest rather than the traditional consumer welfare framework;
- second, the provision is included under section 8, which deals with abuse of dominance; and
- third, it is expansive in that it covers not only unfair trading terms but also unfair prices.

The unusual combination of these factors has raised a number of questions as to how the provisions should be applied from an economic perspective. To address this, the Amendment Act was followed by the publication of the Buyer Power Regulations (2020) (the ‘Regulations’)¹ as well as a set of Buyer Power Enforcement Guidelines (2020)² (the ‘Guidelines’) by the South African Competition Commission (the ‘Commission’). Both of the Regulations and Guidelines, and the latter in particular, have sought to provide further clarity on the factors or benchmarks for assessing a buyer power abuse.

In what follows we discuss the three features of the buyer power provision, the difficulties associated with each feature from an economic perspective, what the Guidelines have suggested as the approach for dealing with each and what challenges are likely to remain.

Buyer power as a public interest consideration

Buyer power refers to the ability of downstream firms to affect the terms of trade with upstream suppliers.³ From the perspective of identifying anticompetitive conduct based on a consumer welfare standard (the traditional approach), input prices that are too low because of the exertion of buyer power are rarely a concern. This is because the likelihood that such conduct will have a negative impact on consumer welfare or competition is extremely low. In most instances, the use of bargaining power tends to be efficiency enhancing as it can be used to counterbalance seller market power via a transfer of profits from suppliers (who have been keeping supra-competitive profits) to buyers.

Further, the economic literature indicates that some or all of the gains extracted from the supplier through buyer power are usually passed on to downstream customers and therefore are consumer welfare enhancing (not detrimental).⁴

1 Regulations on Buyer Power made by the Minister under Competition Act, 1998 (Government Gazette No 43018).

2 Competition Commission, ‘Buyer Power Enforcement Guidelines’ (2020).

3 OECD, ‘Policy Roundtables: Monopsony and Buyer Power’ (2008) p 21.

4 For example, an article published by the OECD states: ‘If 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.’ *Ibid*, p 258.

Indeed, the concern with buyer power as an exploitative abuse of dominance under a consumer welfare standard only arises in the rare situations of monopsony power. This is where market power on the part of the dominant firm in both the buyer and downstream seller markets leads to a reduction in output, causing a fall in the overall welfare to end consumers and input producers.

However, in addition to protecting competition, the Competition Act also seeks to achieve certain public interest objectives, which may be broadly summarised as improved and more equitable access to the economy. It is this public interest objective that led to the inclusion of the buyer power provision in the Amendment Act. This brings an entirely different dimension to the consideration of buyer power. Indeed, the motivation for the inclusion of the buyer power provisions as section 8(1)(d)(vii) of the Act is described as follows:

‘Subsection (1)(d)(vii) is introduced to protect suppliers to dominant firms, especially small and medium businesses or a firm owned or controlled by historically disadvantaged persons, from being required, through the abuse of dominance, to sell their goods or services at prices that impede their ability to participate effectively.’⁵

In other words, the provision is not only concerned with the detrimental impact that monopsony power can have on consumers but also with a much broader concern, namely, the potentially unfair and exploitative nature of bargaining power. The concern is that this power allows buyers to extract surplus from SME/HDP suppliers through unreasonable trading terms or prices that are too low, transferring undue risk to suppliers or putting their profits and margins under pressure.

The effect of this is a supplier-centric approach that seeks to elevate the welfare of particular economic actors (other than consumers), namely SMEs and HDP firms based on public interest. This approach, however, can result in an uncomfortable tension for the welfare purist – conduct that is neutral or positive for consumers could still be found to be an abuse because it has a negative impact on certain suppliers, or even a single supplier. In other words, the amendments suggest an intentional prioritisation of the welfare of SME/HDP firms over that of consumers in instances where these are in conflict.

The Guidelines do not try to resolve the tension between the competition and public interest consideration. To the contrary, they explicitly indicate that the Commission does not consider the provision to require an assessment of the effects on final consumers to establish a contravention:

5 Competition Commission of South Africa, ‘Background Note on the Competition Amendment Bill’ (Government Gazette No 41294) p 16.

‘An inquiry under section 8(4) is whether the prices and trading conditions imposed on suppliers in the designated class by a dominant firm are unfair or not. The focus of the inquiry is therefore on the treatment and welfare of suppliers in the designated class, and the application of a fairness principle to that treatment.’

The inquiry does not, in the Commission’s view, require an assessment of the effects on final consumers. For instance, it is not relevant whether an unfairly low price achieved through the exercise of buyer power is passed through to consumers or not. The legislation does not require any weighing up of the welfare of suppliers in the designated class against final consumers.’⁶

The fact that the Guidelines do not try to resolve the aforementioned tension is not a mistake, nor should it be surprising for those who are familiar with the South African context where such trade-offs are not particularly novel. Indeed, the South African merger control regime requires an independent assessment of public interest factors such as the impact on employment, participation by SME and HDP firms and industrial development objectives.⁷ This assessment is undertaken in addition to a competition assessment. Importantly, a merger can be blocked or allowed on public interest grounds alone – there is no requirement for a weighing-up of such considerations. Although this can bring challenges, over time practitioners and courts have become accustomed to and adept at dealing with the dual focus on traditional competition concerns as well as public interest considerations as part of a merger review.

Given the consistency with the merger provisions and the fact that South Africa has learnt to navigate these considerations in merger control (arguably with a fair degree of success), there is no real reason to expect that the Guidelines would try to square this circle in the context of buyer power. In any case, it is not clear that the tension is likely to be a common feature of such cases (and would almost certainly be less likely to occur in the current context than in the case of mergers). This is because the provision is limited to small firms that are unlikely to materially influence average prices and consequently the negative impact on downstream prices and final consumers is likely to be limited. Therefore, although potentially in tension with a strict consumer welfare (or even total welfare) approach, in our view the public interest focus is ultimately workable.

6 Competition Commission of South Africa, ‘Buyer Power Enforcement Guidelines’ (2020) paras 2.2.1–2.2.2.

7 Public interest also features in the exemption regime but is rarely used and therefore has not had a material impact.

Bargaining power as an abuse of dominance

Given that the approach and intention of the legislation extends beyond monopsony power to exploitative bargaining power concerns, a second interesting and relatively novel aspect of the provisions is that they have been included in the abuse of dominance section of the Amendment Act. Thus, the provision only applies to buyers that are considered ‘dominant’ within the meaning of the Act. In contrast, other jurisdictions have generally regarded exploitative buyer power as a concern that is best dealt with outside the ambit of the abuse of dominance provisions, and often even outside of competition law itself. For example:

- France, Germany, Greece, Italy, Portugal and, recently, Belgium have separate provisions in their legislation for determining an abuse of economic dependence that is distinct from an abuse of market dominance. Economic dependence is a different concept to dominance with a wider scope of application. An abuse of economic dependence occurs when one economic actor is in a position of strength in relation to another, without necessarily holding a dominant position in a relevant market.⁸
- In Kenya an abuse of buyer power is prohibited under the Competition Act,⁹ but as indicated in the associated Buyer Power Guidelines, the ‘proof of dominance is not a mandatory criteria’.¹⁰
- The European Union and the United Kingdom have typically sought to deal with such concerns outside the scope of competition law. In particular, the EU has proposed addressing concerns around the exploitation of small food product suppliers via its 2018 proposal for a directive on unilateral trading practices (UTPs) in business-to-business relationships in the food supply chain.¹¹ Similarly, the UK introduced a Groceries Supply Code of Practice due to concerns around supplier exploitation through the transfer of excessive risks and unexpected costs.¹²

8 BundesKartellamt, ‘Buyer Power in Competition Law – Status and Perspectives, Background Paper Meeting of the Working Group on Competition Law’ (2008) pp 6–7; Ignacio Herrera Anchustegui, ‘Buyer power in agreements and abuse of market power cases: An overview of EU and national case law’ (19 April 2018): www.concurrences.com/en/bulletin/special-issues/buyer-power-in-agreements-and-abuse-of-market-power-en/buyer-power-in-agreements-and-abuse-of-market-power-cases-an-overview-of-eu-and-en accessed 30 October 2020.

9 Competition Act (Kenya) 2010 (No 12).

10 Competition Authority of Kenya, ‘Buyer Power Guidelines’ (2017) para 22.

11 European Commission, ‘Proposal for a Directive of the European Parliament and of the Council on unfair trading practices in business-to-business relationships in the food supply chain’ COM(2018) 173 final.

12 UK Competition Commission, ‘The Groceries (Supply Chain Practices) Market Investigation Order’ (2009).

Part of the rationale behind these alternative approaches is that it is generally recognised by economists that concerns about exploitative buyer power can arise even when a buyer is not dominant in the relevant market. The existence of buyer power is determined by the relative bargaining position of the buyer and supplier and, as a result, a non-dominant buyer may exert bargaining power over a particular supplier even if it does not hold market power in the purchasing market as a whole. Consequently, the traditional tests of dominance are often seen as setting a much higher bar, which makes it difficult to capture much of the exploitative buyer power that is of concern.

Indeed, while Article 102(a) of the Treaty of the Functioning of the European Union allows for the prosecution of unfairly low purchase prices or unfair trading terms, such cases are rare. For example, the European Commission recently opted to develop the aforementioned directive on UTPs in the food supply chain due to an acknowledgment that these behaviours were generally outside the scope of EU (and national) competition law. This is because the latter ‘requires the existence of a dominant position in a given market, as well as the identification of an abuse of that position that affects the market overall’.¹³

The South African Guidelines seem to be alive to these difficulties in that, although they refer to the market share thresholds for a presumption of dominance set by the Act,¹⁴ they acknowledge that buyers with market shares below this threshold (ie, less than 35 per cent) may well have buyer power. The Guidelines go on to outline an approach to determining buyer power when a buyer has a market share of less than 35 per cent (the Act requires that market power¹⁵ is established for firms with market share of less than 35 per cent). These include: (1) the supplier dependency on the buyer and outside options; (2) the alternative suppliers available to the buyer; and (3) the nature of supply negotiations.¹⁶ Although this approach seeks to resolve the tension between buyer power and the traditional view of dominance, it creates potential difficulties.

First, such an approach diverges significantly from that traditionally adopted in South Africa when it comes to dominance (albeit supplier dominance). In particular, the typical approach to dominance has been largely structural in nature,

13 See n 11 above, p 3.

14 For firms with a share of between 35 per cent and 45 per cent there is a rebuttable presumption of dominance while for firms with a share of 45 per cent and above there is a non-rebuttable presumption of dominance. Firms with a market share of less than 35 per cent must be shown to possess market power.

15 Market power is: ‘The power of a firm to control prices, or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers’. See Competition Act (South Africa) 1998, s 7.

16 Competition Commission of South Africa, ‘Buyer Power Enforcement Guidelines’ (2020) para 4.4.

focusing on market shares and whether they reach the various thresholds prescribed in section 7 of the Act. Very few cases of abuse of dominance have dealt with firms falling below the market share thresholds for presumed dominance that must then be shown to possess market power.

Second, in addressing the requirement to show market power, the Guidelines appear to conflate the ideas of bargaining power, buyer power and dominance. In fact, the Guidelines seem to use these terms interchangeably and it is not clear that the factors identified by the Guidelines with respect to establishing buyer power are necessarily sufficient to establish dominance. This is not to say that there is no relationship between these various concepts. Indeed, if a firm does have market power (ie, buyer power for the market as a whole), it is most likely also to have bargaining power over individual suppliers. However, the literature is clear that bargaining power and buyer power are not equivalent to the notion of market power or dominance and that bargaining power can be exercised without a firm being dominant. In particular, to have market power it is generally considered that one must have substantial buyer power in the market as a whole.¹⁷ That is, one must be able to dictate industry terms of supply or the conduct must result in a market-wide effect.¹⁸ This could occur if, for example, there is a high level of economic dependency on an average basis across all suppliers.¹⁹

This is why other jurisdictions have either carved out a separate provision for economic dependence or have not sought to prosecute unfair purchasing practices as an infringement of competition rules.²⁰ Interestingly, in Kenya, like the case of South Africa, buyer power is dealt with under the abuse of dominance provisions in the Kenyan Competition Act.²¹ However, unlike the South African Act, it appears that there is nothing in the wording of the Kenyan Act that actually requires dominance to be established in the case of establishing a buyer power abuse. As already indicated, this has been confirmed in the Guidelines issued by the Competition Authority of Kenya.²²

17 Pranvera Këllezhi, 'Abuse of dominance below the Threshold of Dominance? Market Power, Market Dominance and Abuse of Economic Dependence in Mark-Oliver Mackenrodt, Beatriz Conde Gallrgo and Stefan Enchelmaier (eds), *Abuse of Dominant Position: New Interpretation, New Enforcement Mechanisms?* (Springer-Verlag Berlin Heidelberg 2008); see n 8 above, Anchustegui; see n 8 above, BundesKartellamt; see n 3 above OECD.

18 Office of Fair Trade, 'The Competitive Effects of buyer groups' Economic Discussion Paper (2007), paras 1.20, 1.23, ft 5.

19 See n 8 above, BundesKartellamt, pp 6–7.

20 See, eg, the European Commission directive on unfair trading practices in business-to-business relationships in the food supply chain.

21 Competition Act (Kenya), s 24.

22 See n 10 above.

The implication is that South Africa is in a relatively unique position. The Guidelines certainly present a best-effort attempt at reconciling the concept of buyer power with dominance in order to capture the bargaining power concerns that the provisions were probably intended to address. However, there is still a question as to whether determining buyer power as outlined by the Guidelines will withstand legal scrutiny and sustain a finding of market power and dominance. Only time will tell whether this is the case.

Unfairly low prices as an abuse

Another unusual element of the buyer power provisions is that they cover unfair prices in addition to unfair trading terms. Although it is not unusual for authorities to seek to protect against unreasonable or unfair terms of trade that result in the transfer of unforeseen or undue costs and risks to suppliers, it is less common for them to target unfairly low prices as an exploitative abuse.

This is in part because of the benefits associated with the exercise of buyer power from a consumer welfare perspective, but also because, even in circumstances where authorities may suspect that the exercise of buyer power by a dominant firm results in valid abuse concerns, it is in fact very difficult to establish that purchase prices are indeed too low. This is the case for a number of reasons.

First, the costs of production will differ among firms, with some more efficient than others. In this context, a purchase price test would need to distinguish between situations where the supplier is simply inefficient and where the purchase price is genuinely too low. If other firms could supply profitably at that price (even if it is because they are large and have scale economies), it is unreasonable to expect a buyer to source from inefficient suppliers at higher prices simply because they are less efficient. This would have the undesirable consequences of either rewarding inefficiency in the supply chain, or resulting in buyers not purchasing from smaller firms.

Second, if the supplier is already active with a buyer then the courts are likely to be faced with the context where any price would be above at least variable costs because otherwise the supplier would not continue to supply. From an economic perspective, any price that is at least recovering variable costs is not normally considered too low in the context of a benchmark for predation. As such, the courts would need to engage in some form of assessment of the fairness of the division of margin between the supplier and the buyer. This too has no easy solution and would be subject to considerable disputes. This is especially the case if one takes into account the context of what is reasonable from the buyer's perspective and a consideration of the dynamic effects. For instance, a lower price may provide

the incentive for a buyer to take on a new supplier that poses a degree of risk not associated with incumbent suppliers. Similarly, a lower price may enhance the ability of the supplier to participate in the market through greater sales even if margins are initially low.

Third, there are a wide variety of additional reasons, not necessarily related to the exploitation of buyer power, as to why the price paid to suppliers may differ. These include differences in product quality and characteristics, including associated brand or risk (eg, reliability or experience of performance). These may constitute a sound basis for a buyer demanding a lower price relative to its other suppliers (based on lower economic value). Again, in most cases, the court is unlikely to have the ability to quantify such factors legitimately and without dispute.

The Regulations and Guidelines are alive to these difficulties and have sought to address them by limiting the application of unfair pricing largely to a comparative exercise. In particular, the Guidelines identify and focus on two benchmarks for unfair pricing to SMEs and HDP firms: (1) unjustifiably paying a lower price relative to other suppliers of like goods or services; and (2) an unjustified reduction in prices or imposition of costs on to the supplier.

Under the first benchmark category the Commission must first identify like goods or services based on a consideration of factors including product characteristics and demand side substitutability. In the case where there are no like goods, the Commission will seek to compare goods or services that are differentiated on factors that may be quantifiable through differences in costs.²³ When determining if a price difference relative to the like good will be deemed unfair, the Guidelines indicate that the Commission will take into account the consistency, duration and prevalence among other small suppliers of the price difference and, in particular, indicates an initial screening price difference of three per cent.²⁴

Under the second category, the Commission will compare the effective price paid to the complainant or suppliers in the designated class before and after the price reduction or the imposition of costs. The Commission's assessment will account for the magnitude of the price reduction or costs, the circumstances for the reducing the effective price and whether they may be unfair.²⁵ The Guidelines suggest that unilateral, non-transparent and non-reciprocal reductions in the effective price are likely to be unfair and indicative of a buyer exercising its buyer power.²⁶

The Guidelines indicate that such an inquiry does not require that a specific materiality threshold is passed in terms of the quantum of harm to the supplier in order to establish a contravention. However, in both instances, the respondent

23 Competition Commission, 'Buyer Power Enforcement Guidelines' (2020) para 6.8.2.

24 *Ibid*, paras 6.11.1–6.11.5.

25 *Ibid*, paras 6.16.1–6.16.3.

26 *Ibid*, paras 6.18.1–6.18.3.

may provide an objective justification for the lower price paid to the complainants. Factors that the Commission would consider include similar relative margins earned by the buyer, contractual volume commitments, additional costs incurred or differences in supply relationships.²⁷

The comparator-focused approach of the Guidelines is helpful in that it seeks to circumvent some of the most problematic areas of dealing with an unfairly low price – namely the need to deal with cost and efficiency considerations when assessing whether a price is unfairly low. In addition, the Guidelines also clarify important elements of this approach, including when goods are likely to be comparable and potential objective justifications.²⁸ In doing so, the Guidelines provide important clarity on a number of the key issues that are likely to arise.

However, there are still a number of unanswered questions and challenges as to how the comparator test will be applied. For example, the initial screening threshold of a price difference of three per cent combined with a lack of materiality threshold in terms of the quantum of harm to the supplier sets a relatively low bar for a *prima facie* finding of abuse. This is exacerbated by the fact that the buyer power regulations also bear a reverse onus requirement.

The practical consequence of this is that a dominant buyer (which could be set at a lower standard than normal market dominance as previously discussed) would need to be able to justify the existence and magnitude of any price differences relating to small firms in order to comply with the buyer power provisions. This is particularly the case for ‘like products’, but also products that are not directly comparable yet could be subject to cost adjustments.

However, this is not always practical as many justifications are not easily quantifiable. For example, even in the case of like goods, prices can differ because of differences in risk or reliability associated with a supplier. Such a justification is not directly quantifiable and it is also unclear if the Commission would even accept this as a justification. Further, in the case of goods where differences are quantifiable and can be adjusted for (eg, if one good is fortified and the other is not), it is not clear that the buyer will have access to the required information on its suppliers’ costs to appropriately estimate what the difference should be.

Given the aforementioned, it is also conceivable that the risks associated with taking on SME or HDP firms as suppliers may ultimately discourage at least some buyers from contracting with such firms in the first place. This may be particularly pronounced for new entrants where the risks (due to a lack of a track record of performance) are higher and buyers may not be able to compensate for such risks by requiring lower prices from these suppliers. This seems especially relevant in a

²⁷ *Ibid*, paras 8.1–8.2.4.

²⁸ *Ibid*, paras 6.7, 8.

retail or on-selling environment where goods are typically subject to some form of differentiation and where there are valid costs and risks associated with taking on new small suppliers but which are difficult to quantify.

Although it must be noted that section 8 of the Act includes an avoidance provision²⁹ that prohibits dominant buyers from circumventing the buyer power provisions by avoiding or refusing to purchase from a supplier that is an SME or HDP firm, such a provision is for extreme cases where there is clear evidence of avoidance. It is not clear that more marginal instances of refusals resulting from an overall decreased preference to deal with SME and HDP firms are intended to be caught by this provision, and in any case, would be extremely difficult to prove.

Where South Africa will ultimately land on this will depend on the types of cases that the Commission chooses to pursue, how strictly or aggressively it applies the criteria outlined in the Guidelines and the objective justifications that it is willing to accept.

Conclusion

South Africa is not the first jurisdiction to consider abuse of buyer power as a concern or to incorporate it into some form of legislation. However, the combination of the three elements discussed in this paper sets it apart from approaches adopted in other jurisdictions. This is in part because the Amendment Act and the buyer power provisions contained therein are aimed at targeting very specific public interest concerns that are driven by the fairly unique history and context of South Africa.

In our view, the Guidelines are a brave and honest attempt by the Competition Authority to meet the mandate laid out by the legislature and go a long way in clarifying how the provisions will be approached given their novel and untested nature. However, there are a number of questions relating to the application of this provision and consequently its ultimate effect on SME and HDP firms and the economy as a whole that remain. These issues will only be settled through the development of case precedent. This is going to be a fascinating space for competition lawyers and economists alike to watch over the next few years.

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29 Competition Act (South Africa) 1998, s 8(4)(b).

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