KNOWLES HUSAIN LINDSAY INC ATTORNEYS

# Whether excessive pricing has been clarified and settled in South African Competition law

In South Africa, excessive pricing is regarded as one of the most harmful contraventions of the Competition Act as it has an explicit damaging impact on consumers. It is within the scope of abuse of dominance which directly contradicts the preamble of the Act which aims to "promote the efficiency, adaptability and development of the economy". However, the Act does not define the precise definition of excessive pricing. The ambiguity and extensive debates which have resulted from this were brought to light in the cases of Mittal Steel South Africa Limited and Others v Harmony Gold Mining Company Limited and Another and Sasol Chemical Industries Limited v Competition Commission.

## I. SECTION 8(a) OF THE COMPETITION ACT

Section 8(a) of the Act prohibits a dominant firm from charging an excessive price that is to the detriment of its consumers. The Act defines an excessive price as a price for a good or service which bears no reasonable relation to the economic value of that good or service and is higher than the value referred to in 8(a). This has led to extensive and complicated price cost debate regarding about how one determines the appropriate economic value of the goods or services concerned and subsequently, how the reasonableness of the firm's rate of return is having regard to the price charged by the firm.

The courts in Mittal and Sasol, have attempted to provide clarity to s8(a). In order to determine how the prohibition of excessive pricing can be sufficiently defined to enable firms to determine where a permissible price end, an impermissible price begins and regulates their conduct accordingly.

It is important to note, that intervention by a competition regulator is a controversial matter in itself as the courts need to be careful not to become a price regulator which contravenes the nature of a free market economy. Thus, the courts acknowledge that some measure of latitude has to be given to firms regarding pricing. This controversy is evident in the respective judgments by the Competition Tribunal and the Competition Appeal Court as they have different interpretations of the excessive pricing under s8(a).

## II. HISTORY OF EXCESSIVE PRICING LITIGATION IN SOUTH AFRICA

In the Mittal and Sasol cases, the firms are recognised as being dominant in the economy as they can control prices, or exclude competition or behave to an appreciable extent independently. The

Competition Commission argued that the firms abused their dominance by having excessive prices on their goods.

*a. Mittal Steel South Africa Limited and Others v Harmony Gold Mining Company Limited and Another*

The Appeal Court overruled the tribunal, therefore only the Appeal Court decision will be discussed. Mittal Steel was founded by ISCOR, which was established and run by the South African state until its privatisation and listing on the JSE. Mittal was an effectively entrenched dominant firm which had adopted an import parity price as the basis for its pricing in the local market which it had identified as being naturally protected. Import parity pricing is a practice where local firms charge prices equal to those charged for a similar imported product even though there is a trade surplus and imports are not required. This means that the price includes the notional costs of transporting. Harmony Gold, the complainant submitted that Mittal import parity prices were excessive under s8(a).

The court briefly examined numerous ways to test excessive pricing and held that the most appropriate manner to determine the definition of excessive pricing was to engage in a two-step enquiry, namely the interpretation of economic value and the proper assessment of the reasonableness of the relation between price and economic value.

The court held that in interpreting the economic value of a good or service an objective test is necessary as “the cost savings to the firm resulting from the subsidised loan or the lower than market rental – or indeed any other special advantage, current or historical, that serves to reduce the particular firm’s cost below the notional competitive norm ought to be disregarded.” Subsequently, this results in the “economic value being a notional objective competitive-market standard and not one derived from the circumstances peculiar to the particular firm.” The court held that if the relevant price is not higher than the economic value, there will be no breach of s8(a).

If the price is higher than the economic value it is necessary to apply the second leg of the enquiry which determines whether the difference in price is reasonable. The court noted that it is important to understand that the difference between the economic value and the ‘pure profit’ is implicit in the test. The ‘pure profit’ enquiry requires a subjective test as it examines the circumstances peculiar to the particular dominant firm which would rationally come into reckoning. To do this, it is necessary to take into account “benefits flowing to the firm from the subsidised loan, long-term low rental, or other special advantage which may serve to reduce its own long-run average costs below the notional norm.” After analysis of the facts and applying the tests the court overruled the Tribunal’s decision of excessive pricing.

*b. Sasol Chemical Industries Limited v Competition Commission*

The subsequent case which dealt with s8(a) of the Act, was the Sasol case. The Competition Commission argued that Sasol's prices for certain plastics were excessive and that Sasol had a peculiar cost advantage because it procured its feedstock propylene from Sasol Synfuel, a subsidiary of Sasol that produces feedstock propylene as a by-product in the fuel production process at a low internal transfer price. To determine whether the prices were excessive, the court re-examined the two step enquiry it found appropriate in the Mittal case.

*1. The Mittal interpretation of economic value*

To determine the economic value, the court had to determine whether Sasol's cost of their 'goods', should include this special cost advantage for the feedstock propylene in the approximation of the economic value of propylene and polypropylene. The court applied the Mittal case in holding that the economic value was understood to be an objective enquiry which determines the notional value. Thus, in calculating economic value, Sasol's actual lower feedstock costs had to be ignored and the higher feedstock costs that would be available to hypothetical producers under notional conditions of long run competitive equilibrium.

*2. The Mittal assessment of the reasonableness of the relation between the price and the economic value*

The Appeal court confirmed the Mittal judgment's interpretation of this leg of the enquiry as and also applied a subjective test to determine whether the notional economic value was reasonable in relation to Sasol's 'pure profit'. In so doing, the court examined the circumstances peculiar to Sasol. This allowed the court to evaluate Sasol's capital assets, the appropriate rate of return on capital and revised cost assumption. The court calculated the actual monetary costs incurred by Sasol which found that that the average mark up above economic costs was 12 – 14%. That was significantly different to the Tribunals calculation which was 25 – 51%. Moreover, the court held that proceeds above economic value were not per se unreasonable as a price. The court further held that mark-ups significantly less than 20% above the objective figure used to determine the economic value fell short of justifying interference in this complex area. It can therefore be argued that this judgment implied a rule for firms to use a 20% margin over economic cost to determine whether their prices are excessive. However, despite clarity on this particular issue, ambiguity still remains.

## III. IN LIGHT OF THE JUDGMENT, CAN WE NOW CONSIDER THAT SA LAW ON EXCESSIVE PRICING HAS BEEN SETTLED ONCE AND FOR ALL?

As it stands, the Sasol judgment confirmed the criteria developed in the Mittal case for determining whether the dominant's firm prices are excessive. In doing so, the Sasol case has set a precedent on how to interpret and apply s8(a). It might be argued that the law is settled in regard to application of this provision. The court agreed upon the particular rules which were set down in the judgment such as the 'rule of thumb' for firms to use a 20% margin over economic cost to determine whether their prices are excessive. A careful analysis it reveals that ambiguity is still present in the application of s8(a). This is evident in the second leg of the enquiry which determines the "proper assessment of the reasonableness of the relation between price and economic value. The problem arises in the application of the reasonableness test as a court will never define what constitutes as reasonableness as it is dependent on the facts of a particular case. This creates a great degree of ambiguity in its application as whose reasonableness is referred too or what standard is the reasonableness referring to. This can be immensely problematic to dominant firms when they are evaluating their prices and the margin in which they can set their prices in as their reasonableness may not be another firms. Therefore, the interpretation of what constitutes as reasonable is dependent upon regarding excessive pricing and whether the court attempts to provide an understanding.

**IV. CONCLUSION**

South Africa's competition law continues to develop to provide clarity to s8(a) as unresolved ambiguities remain. However, despite there being a degree of clarity regarding excessive pricing, this discussion has highlighted particular criticisms which have the consequence of creating ambiguity. The Sasol judgment has laid a framework in which the understanding of excessive pricing can evolve and in future cases where the facts may be different, the outcome may well differ.

*Written by Sarah Roberts, Candidate Attorney (Litigation), Knowles Husain Lindsay*