An assessment of the tests for excessive pricing and amendments to the Competition Act

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Abstract

Excessive pricing occurs when a dominant firm charges a price that is above prices that would prevail in competitive markets or under effectively competitive situations. Economic theory provides explanations for why one might be concerned about excessive pricing in terms of welfare harm to consumers and customers. However, the analytical framework used to assess whether prices are excessive in practice is highly contentious and open to subjectivity. To address this, the South African Competition Act was amended in 2019 to give more direction to the provision. This paper critically reviews the tests for excessive pricing, drawing on local and international case precedent. It further reviews the approaches used to assess excessive pricing under the introduction of the new price gouging provisions in South Africa following the Covid-19 pandemic. The study also demonstrates the complexity of the provision in recent excessive pricing cases and the implications of the amendments to the Competition Act.

The study finds that in the absence of a ubiquitous test, it is crucial that to avoid errors, competition authorities need to try and find the best approach for each particular case. Consequently, competition authorities should strive to examine an excessive pricing case by combining several methods among those which are accepted by standard economic thinking. In addition, the convergence of results of multiple tests can be used as a robust indicator of excessive pricing.

Keywords: excessive price, price gouging, economic value, monopolist pricing, legal uncertainty, abuse of dominance, market power, consumer welfare

1. Introduction

South Africa has undergone a remarkable transformation since its democratic transition in 1994. Since the end of apartheid, the South African economic system became primarily centred on the principles of a free-market economy. However, the transition into liberalised markets did not result in the expected increase in competition and greater participation of historically disadvantaged persons. Like many other developed and developing countries, several markets in the South African economy remain highly concentrated in ownership and control. The distinctive features of the South African economy are ascribed to the discriminatory and interventionist policies of the apartheid government before 1994. During apartheid, there were government subsidies, strict market controls, high tariffs, low foreign direct investments, and high levels of government ownership (Fox, 2000; Lewis, 2008; OECD, 2008; Roberts, 2012). When the new democratic government was elected in 1994, it inherited an economy characterised by inequality, poverty, several State-owned monopolies, large conglomerates and high concentration in many markets (OECD, 2003; Lewis, 2008). Given the level of historical government interventions and the concentrated structure of many industries in South Africa, the probability of markets correcting themselves is low. This has made these markets susceptible to anticompetitive conduct by firms abusing their dominance and market power.

Against this backdrop, South Africa instituted a Competition Act aimed at regulating competition in the economy (the Competition Act No 89 of 1998, hereafter referred to as the Act. One of the many objectives of the Act is to restrain trade practices that may undermine a competitive economy. These anticompetitive practices include restrictive horizontal and vertical practices and abuse of dominance which may have exclusionary or exploitative effects that directly or indirectly negatively affect consumers. This paper focuses explicitly on conduct involving a dominant firm charging a price deemed too high relative to some benchmark. The Act refers to such conduct as excessive pricing under section 8 (a), Referred to hereafter as the 'old Act', the excessive pricing provision states that: "*it is prohibited for a dominant firm to charge an excessive price to the detriment of consumers*". The old Act further defined an excessive price as: "*a price of a good or service that bears not a reasonable relation to the 'economic value' of that product or service: and is higher than this value*".

Per the Act, market shares are considered central to the statutory test for dominance and market power. The Act prescribes, that a firm is irrebuttable dominant if it has at least 45 %, but it may still be considered "rebuttable dominant" when it has 35 to 45 %, provided that the firm can prove that "market power" does not exist. If a firm has "market power," it might be dominant even if its market share is less than 35%. The Act further defines market power as:

"*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".*

The Act did not further define what constitutes "economic value" and did not provide a clear benchmark for assessing excessive prices, this left room for (mis)interpretation (Sylvester, 2013). The lack of a clear benchmark also caused debates on the appropriate test for excessive pricing and the actual calculations involved in conducting these tests (Roberts, 2008). As a result, there is a noticeable differing economic interpretation, legal uncertainty and lack of consistency in how excessive pricing cases have been assessed in the past.

In South Africa, the complexity was brought to light in two critical cases - Harmony Gold Mining and Durban Roodepoort Deep versus Mittal Steel SA (hereafter referred to as the Mittal case) in the steel industry, and Sasol Chemical Industries versus the Competition Commission (hereafter referred to the SCI case) in the chemicals industry. The fundamental challenges and disagreements between parties in both these cases were in the determination of economic value. Given the substantial challenges in successfully prosecuting excessive pricing cases in South Africa and the importance placed on the provision in the South African context, several changes to the Act have since been made. The excessive pricing provisions were amended with effect from 12 July 2019, and the amendments are discussed in section 5. The other recent change was the introduction of price gouging provisions further discussed in section 6.

The issues in the prohibition of excessive pricing conduct relate to the inconsistencies in determining an excessive price. This paper debates these issues and their impact on the broad economic questions surrounding excessive pricing. It critically assesses the tests for excessive pricing. In light of recent excessive pricing cases internationally, the implications of the amendments to the Competition Act and the introduction of the price-gouging provisions in South Africa following the Covid-19 pandemic are included.

2. Methodology

The paper employs a qualitative, retrospective approach to evaluate the economic literature and case law on excessive pricing locally and internationally. The literature review briefly discusses the theoretical framework of monopoly pricing and what might be considered an excessive price from an academic perspective. Then discusses the fundamental differences in the treatment and justification for excessive pricing prohibition in different jurisdictions. Then the paper provides a comprehensive assessment of the conceptual and practical complications of the excessive pricing tests. In so doing makes use of previous excessive

pricing cases. The discussion concentrates on four local (South African) excessive pricing cases: the Mittal case, the SCI case, Dis-Chem Pharmacies Limited ("Dis-Chem case") and the Commission v Babelegi Workwear & Industrial Supplies CC ("Babelegi case"). These are considered pertinent in setting a precedent in the assessment of excessive prices in the South African context. The four cases illustrate the key debates on the tests used to establish excessive pricing contraventions and benchmarks used in the determination of a competitive price.

The tests for excessive pricing and the implications of the amendments to the Act are assessed through: firstly, a critical evaluation of how the tests have been applied in four pertinent excessive pricing cases in South Africa; secondly, an evaluation of the fundamental precedent emanating from judgements of international excessive pricing cases; and. Thirdly, a retrospective critical analysis of the case judgements to establish whether the recent cases offer any development or insight on the approaches to assessing excessive pricing. The study is reliant on desktop research and, as a result, is affected by the extent to which information is publicly available.

The following research questions are assessed:

(i) What are the different tests used to assess whether a price is excessive in the South African context?

(ii) Do the recent international case developments offer any new insights on approaches to testing for excessive pricing?

(iii) Do the amendments to the Competition Act provide more direction in terms of the appropriate tests to be used?

(iv) Is the assessment of excessive pricing in the context of the price-gouging provisions during Covid-19 per competition economics principles?

3. Literature review: The Prohibition of Excessive Pricing

In the abuse of dominance prohibition discussion, size alone does not matter as much as dominance and market power. Dominance and market power are not problematic if they are not abused. An indicator of market power is a sustainable increase in prices of the dominant firm without losing market share (Evans & Padilla, 2004; Evans & Padilla, 2005; Ezrachi & Gilo, 2008). The analysis of market power, especially in the context of excessive pricing investigations, involves assessing whether factors such as legal advantages, licences to intellectual property rights afford unique firm benefits. It further requires an understanding of

whether the firm has special access to inputs or raw materials that others do not, whether dominance is due to economic efficiencies, or whether it was attained by government intervention and support. Significantly, the existence of barriers to entry or the prospect of the entry of an effective rival into the market (Evans & Padilla, 2004).

In an industrial organisation framework, a range of factors contributes to the level at which prices are set. Under situations of perfect or near-perfect competition, the price of any product or service tends to be set close to some measure of cost (Evans & Padilla, 2004). Under the theoretical construct of perfect competition, this measure is marginal cost ($p = mc$). Prices tend to be higher, the further the market conditions deviate from the perfect competition ($p > mc$). Under conditions of perfect competition, allocative, productive and dynamic efficiencies result. Allocative efficiency occurs when goods and services are distributed according to consumer preferences (Ezrachi & Gilo, 2008). Productive efficiency is when the optimal combination of inputs results in the maximum output (Ezrachi & Gilo, 2008). Dynamic efficiency occurs over time, as innovation reduces production costs (Ezrachi & Gilo, 2008). In imperfect competition, productive, allocative and dynamic efficiencies are diminished due to higher prices and reduced outputs.

3.1. Monopoly pricing

In any discussions related to excessive pricing, the fundamental understanding of monopoly pricing is important. At the extreme is a monopoly - there is a single supplier and no potential entry of other companies into the market (Mohr, 2015). Monopolies maximise their profits by producing at a level of output where the marginal revenue equals the marginal costs because the individual firm’s demand curve is downward sloping, reflecting market power. As a result, the prices these firms tend to charge are likely to exceed their marginal costs. Monopolies do not have a supply curve as there is no function of price that determines what quantity a given price is offered (Mohr, 2015).

Monopolies tend to use their position to reap trading benefits they would not have if there had been normal and sufficiently effective competition (Case C-27/76, 1978). Monopoly pricing tends to compromise the ability of a consumer to access goods or services, and thus consumer welfare is adversely impacted. Resulting in adverse effects or a situation where the social cost is higher (Lee, 2006). In some instances, monopoly pricing leads to the misallocation of resources and the redistribution of consumer surplus from consumers to producers (Lee, 2006).

Another critical feature that distinguishes monopolies from competitive markets is the price elasticity of demand facing the firm (Kauper, 1990). The price elasticity of demand measures the responsiveness of demand to a change in a product's price. The availability of alternatives affects the demand elasticity of the product or service. In a perfectly competitive market, demand is highly elastic. Hence, companies tend to charge prices equal to marginal cost and earn an economic profit of zero because consumers tend to be more reactionary to a price change (OECD, 2011). The limited availability of alternatives allows a monopolist firm to set a price above the marginal cost and earn positive economic profits because consumers are relatively insensitive to price changes. Due to product pricing in this market, consumer surplus decreases below the Pareto optimal levels found in perfectly competitive markets, at least in the short run. As a result, the market suffers deadweight loss. Standard welfare economics condemns high prices, at least on the grounds of deadweight welfare loss. These higher prices require consumers to use up more resources than necessary to achieve a given level of utility satisfaction. Consequently, a more considerable deadweight, and as a result, there is a loss of consumer welfare (Ahlborn et al., 2001; Roberts, 2017). Nevertheless, market structure alone does not suggest that the market is competitive or non-competitive (Vickers, 1995).

3.2. The concept of competition

The concept of competition can be thought of or described as a form of rivalry that arises whenever two or more companies selling equivalent products and services compete to gain more revenue, profit and market share growth (Vickers, 1995). Thus, the operative aspect of competition is the firm's conduct as a result of a process of rivalry, and, in practice, this does not have to be under textbook conditions of perfect competition. In other words, effective competition is sufficient, when there is enough rivalry to ensure that prices are not raised significantly above a measure of cost. The market could have effective competition if it is characterised by low barriers to entry, it is contestable, and it faces sufficient rivalry to undermine supra-competitive prices over time (Walker, 2010; Roberts, 2017). Thus, the level of competition depends on the outcomes rather than the form of competition (Bishop & Walker, 2010; das Nair & Mondliwa, 2017).

It is essential to note that, from a firm perspective and experience, virtually all firms charge prices that exceed short-run marginal costs (Evans & Padilla, 2004). The reason is that firms innovate and act as entrepreneurs, allowing them to increase their profits by creating new products or differentiating their products. The charging of prices that exceed short-run marginal costs is also necessary, both for economic growth and the welfare of consumers. If

firms are not allowed to profit from these activities, they refrain from them. Furthermore, the charging of prices above short-run marginal costs does not suggest that all companies are monopolies.

3.3. Monopoly pricing vs Excessive pricing

In theory, monopoly pricing might constitute an abuse of dominance (Gal, 2004). However, this would be controversial, as it would suggest that all monopolies charge excessive prices in breach of competition laws. Furthermore, this would also postulate that a sufficient reason to prove that a firm has abused its dominance by charging excessive prices is that it is a monopoly. By implication, competition authorities should prosecute all, monopolies. Noting that profit-maximising prices tend to fall somewhere between perfectly competitive and monopoly pricing and, there is no well-defined threshold for an excessively high price in between (Calcagno et al., 2019). Alternatively, if prices between the competitive and monopoly levels were prohibited under excessive price prohibition, this would lead to the paradox that monopoly prices would be allowed and lower prices to monopoly prices are prohibited. In this regard, the prohibition against excessive prices would seem redundant from a purely economic standpoint. It would mean that the ban on excessive pricing amounts to a prohibition against monopoly pricing, thus suggesting that competition law penalises dominance instead of abuse. This would be inconsistent with the common knowledge that competition law, worldwide, does not prohibit dominant positions; but rather the abuse thereof (Ahlborn et al., 2001).

In cognisance of the above discussion, monopoly prices are not excessive *per se* and more is needed to determine whether a dominant firm has charged an excessive price in contravention of the law. Emphasis should be given to the fact that the operative feature of the excessive pricing prohibition is that the price charged must have detrimental effects on consumer welfare (Mncube & Ngobese, 2018). The suggested approaches and assessment methods include evaluating market conditions and determining whether they are favourable for a dominant firm to abuse its position through excessive pricing and determining whether there are detrimental effects on consumer welfare.

3.4. Arguments For and Against the prohibition of excessive pricing

The main concern in terms of excessive pricing is the direct detrimental effect on the consumer or customer (Hordijk, 2002; Evans & Padilla, 2005; Kovacic, 2006; O’Donoghue & Padilla,

2006; Roller, 2007; Fletcher & Jardine, 2007; Williams, 2007). An excessive price is exploitative because a critical consequence is a direct loss of consumer welfare (Evans & Padilla, 2005). A firm charging excessive prices would be taking advantage of its dominance and market power to extract fees from consumers that it could otherwise not have if there was effective competition (Evans & Padilla, 2005). Competition authorities, scholars, economists and legislators agree that the main objective of competition law is to protect and promote consumer welfare (Evans & Padilla, 2005; Ezrachi & Gilo, 2008; Ezrachi & Gilo, 2010; Jenny, 2018).

In cognisance of the nature of consumer harm resulting from excessive pricing conduct, jurisdictions such as EU member countries have the legal means in their respective competition laws to intervene against firms charging excessive prices. In the EU, an excessive price is deemed an unfair price. Similarly, the South African Competition Act prohibits a dominant firm from charging an excessive price. As highlighted in the introduction, there are fundamental differences in treating excessive pricing in different jurisdictions. For example, in the USA, competition authorities have categorically excluded the possibility that charging high or monopolistic prices could qualify as a contravention under their competition law (Jenny, 2018). The rationale behind this is the belief in

(i) the self-correcting properties of the market,
(ii) the chilling effect of an intervention on investment, and
(iii) the practical difficulties of intervention.

However, in jurisdictions where excessive prices are prohibited by competition law, such as some EU member states and South Africa, there are stringent screens to ensure that enforcement action can only be brought to address high prices directly (O'Donoghue & Padilla, 2006; Roller, 2007; Fletcher & Jardine, 2007). These screens include several conditions:

(i) the existence of significantly substantial and persisting barriers to entry;
(ii) companies enjoying a near-monopoly position or considerable market power;
(iii) markets where innovation and investment play a relatively minor role;
(iv) the existence of a sector regulator; and
(v) markets that are unlikely to self-correct (O'Donoghue & Padilla, 2006; Roller, 2007; Fletcher & Jardine, 2007).

In the context of South Africa, there are compelling reasons for intervention. These reasons largely stem from the country's unique history and development path. The South African market is characterised by several monopolies or dominant firms that attained and entrenched their positions through current or past government interventions using support and legal rights and operated in incontestable markets with little or no effective rivalry (Vickers, 1995; das Nair,

2008; Roberts, 2008; Roberts, 2017; das Nair & Mondliwa, 2017). In these instances, the market may not self-correct within a reasonable period hence the justifications for intervention.

Another argument for intervention may be that the alleged harm to consumers from excessive pricing is direct to the extent that consumers pay more for a product than they would have under normal conditions of competition. South Africa is characterised by a high level of unemployment, a high level of poverty and a high number of people living below the poverty line. Since excessive pricing conduct exerts a direct negative impact on consumers, there may be a need for regulatory intervention, especially if the affected are historically disadvantaged individuals.

3.5. The Concept of Economic Value

As discussed in the introduction, the 'old Act', did not define what constitutes "economic value". The lack of interpretation of economic value left room for (mis)interpretation and did not provide a clear benchmark for assessing excessive prices (Sylvester, 2013). Literature suggests that the concept of economic value in the assessment of excessive pricing was introduced in the General Motors case (Case C-26/75, 1975), which said that "such an abuse might lie, among other things, in the imposition of a price which is excessive in relation to the economic value of the service provided" (Case C-26/75, 1975). Still, this ruling did not elaborate on what constitutes economic value and its application in excessive pricing cases. The United Brands case provided directions for economists to compare the actual costs incurred and the price charged for the products or services in the assessment of economic value (Case C-27/76, 1978).

In 2006, the Competition Tribunal of South Africa (Tribunal) heard its first excessive pricing complaint brought in the Mittal case. The Tribunal did not use the cost-based and comparative methods proposed by the EU Court of Justice (United Brands case). Instead, the tribunal constructed its test to assess the excessive pricing case (13/CR/Feb04). The Tribunal test involved two stages: the first was a structural test that considered the market structure imposed by the alleged conduct. The second stage of the test is related to the assessment of the conduct that resulted from the structure. This test assumes that where a firm is constrained neither by potential entry nor by a regulator, exploitation in excessive prices or gross inefficiency is a reasonable profit maximising strategy (Case 13/CR/Feb04). The Tribunal concluded that, where the price has no explanation other than the pure exercise of monopoly power, as evidenced by the structure of the market and any relevant ancillary conduct on the part of the dominant firm, then the price is not reasonable in relation to economic value.

Consequently, the tribunal established that, because of the cumulative impact of the market structure and the ancillary conduct, Mittal SA charged an excessive price in contravention of Section 8(a).

Mittal SA appealed the tribunal's decision to the CAC. The point of contention was whether it was unnecessary to examine in detail (cost-based and comparatively) and whether a reasonable relationship exists between the price charged and the economic value of the goods or service. The CAC disapproved of the method used by the tribunal in its assessment of excessive price. In its reasons, the CAC specified four steps of enquiry required in an excessive pricing assessment:

(i) The determination of the actual price of the good or service that is alleged to be excessive.
(ii) The determination, assessment, or both of the economic value of the goods or service.
(iii) An assessment of whether the actual price is higher than the economic value and whether the difference is reasonable.
(iv) An evaluation of whether charging the excessive price is to the detriment of consumers.

The CAC further recommended the use of several tests when assessing excessive pricing. These included:

(i) the price-cost test: comparing the prices of the dominant firm to cost;
(ii) the price comparator test: comparing the prices charged by the dominant firm with those in markets where there is a high level of competition (competitive markets); and
(iii) the profitability test: an analysis of the profitability of the firm.

The first two tests served to find proxies for economic value (the actual tests and practical difficulties discussed in section 4 below). The third (discussed in more detail in section 4) attempts to infer excessiveness directly from the magnitude of profitability of the firm. The CAC emphasised the need to determine the actual economic value of an item or service (as a quantified amount).

For the first time, the concept of economic value was defined in South Africa. The CAC defined economic value as the price that would prevail under long-run competitive equilibrium, with free entry and exit (Case 70/CAC/Apr07). According to this definition, economic value is a national objective, a competitive market standard derived from circumstances peculiar to a particular firm. However, the definition provided by the CAC seems to also be inadequate as it spiked further debates as evidenced in the SCI case. In the SCI case, the tribunal applied

the tests recommended by the CAC in the Mittal case decision. The SCI case debate was primarily on interpretations of the CAC decision of the Mittal case, resulting in several contentions. Among others:

(i) the interpretation and determination of economic value;
(ii) determination of actual price;
(iii) the appropriate methodology for the valuation of assets;
(iv) the appropriate treatment of the cost of capital; and
(v) the appropriate treatment of special cost advantages, group costs, taxation and common costs.

The tribunal applied the price-cost test using the costs of the dominant firm to derive economic value and then considered the reasonableness of the price-cost mark-ups. After consideration, the tribunal ruled that the mark-up charged by SCI was considered excessive (Case 48/CR/Aug10). SCI appealed the tribunal decision at the CAC. The CAC provided further clarity on the discussion on economic value.

The CAC clarified that the assumption of free entry and exit does not imply perfect competition in the short run but rather competition that would be effective enough in the long run to eliminate pure profit (Case 131/CAC/Jun14). The CAC further emphasised that economic value is a notional objective competitive market standard, not one derived from circumstances peculiar to the particular firm. This is aligned with the notion that effective competition depends on the outcomes rather than the form of competition (Bishop & Walker, 2010). Whilst the UK CAT, in the *Pfizer/Flynn* case, considers economic value as the real price of an item or service (Killick & Komninos, 2018). The definition postulated by the UK CAT suggests that economic value assessment includes the cost of production and other elements of value to the customer. By implication, the economic value of a product is fact-specific and so relies on judgement. The notion that decision-makers must exercise judgement may exacerbate the economic and legal uncertainty.

The lack of a clear definition of economic value has resulted in scholars and authorities having divergent views regarding what constitutes the economic value of a product or service (Ezrachi & Gilo, 2008; Ezrachi & Gilo, 2010). These divergent views have led to economic and legal uncertainties. Effectively, this has created significant obstacles to the effective implementation of the excessive price prohibition provisions and the appropriate tests to ascertain whether the price charged is excessive (Evans & Padilla, 2005a; Calcagno & Walker, 2010; Gilo & Spiegel, 2018).

4. The practical complexities and legal uncertainties in the use of Excessive pricing tests

Competition authorities face significant conceptual and practical problems when assessing excessive pricing cases (Robles, 2015). As discussed above, the determination and assessment, of the economic value of the good or service are required to assess whether the actual price charged by a dominant firm is higher than the economic value. Competition authorities have adopted and used different approaches to determine economic value in the assessment of excessive prices. The tests are clustered based on how the benchmark or proxy of economic value is constructed, what type of information is required for the calculation and what is measured. Over the years, a substantial body of knowledge has been developed concerning these excessive pricing tests (Evans & Padilla, 2005; das Nair, 2008; Roberts, 2008; Gilo & Spiegel, 2018). The tests have inherent challenges. There are broadly four categories, each having both conceptual and practical complications (Röller, 2007). These are:

(i) The quantification of the gap between the price of the product and the cost of production (price-cost test).

(ii) The comparison of the product's price to its price in the other market or competing products (the price-comparator test).

(iii) The profitability of the sale of a product relative to the general prevailing level of profitability in the relevant market (the profitability test).

(iv) Although not explicitly considered not foremost in determining economic value, there are also structural methods that have been considered. These focus on the determination of the overall structure in a market. The main structural methods determine whether the prevailing characteristics are conducive for anticompetitive conduct to occur. Thus, these structural methods assist in the reasonable testing of the alleged excessive price.

To demonstrate practical complexities and legal uncertainties in the use of Excessive pricing tests the paper focuses on the price-cost test, the price-comparator test and the profitability test.

4.1. Price-Cost Test

The price-cost test assumes costs to be a proxy for the economic value because they include a capital reward and provide for expenditure necessary to maintain the capital stock. Thus,

the premise is that, if the price charged is higher than that of the appropriate measure of production costs, it may be suggestive of the price being excessive (Whish & David, 2018). Using the price-cost test allows setting aside matters of structure and conduct to focus exclusively on ascertaining the magnitude of the difference between the price charged and the related cost. This means that competition authorities compare the prices that a firm charges with the cost incurred to derive the price-cost markup. The economic literature has a concurrent view that marginal cost is the most accurate benchmark in determining economic value (Mackenzie, 2012).

Economic theory states that economic value is best captured under conditions of perfect competition. The price is equal to the marginal cost of manufacturing the product, where the marginal cost is equated to the economic value. Any price above marginal cost may then potentially reflect a price that could be excessive. However, in some markets, a price greater than the marginal cost does not imply an unreasonable price. As previously stated, the equating of competitive pricing and marginal cost is a long-run connection. This indicates that once firms' actions have been adjusted to the market environment and the process of entrance and exit has run its course, a competitive price equals marginal cost. A price that is greater than the marginal cost may indicate that there are either competition failures or that companies are in the process of adapting to the long-run competitive equilibrium. Therefore, there may be no definitive conclusion from comparing the price charged and the marginal costs on whether the price is excessive. For example, the United Brand excessive pricing case judgement notes the mere fact that revenues (price) exceed the actual cost incurred is not sufficient to conclude that the firm is engaged in excessive pricing conduct (*Case C-27/76, 1978*). It is also widely recognised that marginal cost is difficult to estimate (Mackenzie, 2012).

Due to the difficulty of estimating the marginal cost, the average variable cost (AVC) and long-run average cost (LRAC) have been cited as proxies for the marginal cost (Case 70/CAC/Apr07). The LRAC is the relevant cost given its properties of long-term entry and exit. However, a limitation of LRAC is the allocation of common or joint costs (Whish & David, 2018). The identification and consensus on what constitutes these costs have proven to be complex and a source of debate among economists (Whish & David, 2018). This requires allocating common costs (including fixed costs) to the various products and apportioning those relevant to the market in question. The difficulty arises when the firm produces multiple products, as some may share some or all costs (Whish & David, 2018). Moreover, a profit maximising pricing decision for firms that offer several products or services involves setting prices to cover the overall cost of production, including all common or joint costs. This implies that price-cost margins tend to differ for different products considering the different demand

elasticities. As a result, it has been suggested that the pricing policy of a multiproduct firm should be analysed in its entirety (Whish & David, 2018).

In these circumstances, long-run average incremental cost (LRAIC) may be considered. According to the OECD (2011), the LRAIC are the total costs associated with entering a market and supplying a product or service, as an average over total output. These measures exclude common costs as only the actual costs related to the product or service in question are included in LRAIC (OECD, 2011). The LRAIC is the total value of the costs needed to enter a market or supply the product, as an average over total output (O'Donoghue & Padilla, 2006). Because the LRAIC includes only costs associated with supplying the product, the LRAIC is thus equal to the long-run average avoidable cost (LRAAC) plus the sunk costs incurred on entry (Whish & David, 2018). Thus, the LRAAC is the total value of costs that are avoided in the long run if the firm decides to stop supplying the product, as an average over the firm's total output (O'Donoghue & Padilla, 2006).

In the SCI case, the debates on the price-cost test were related to the assessment of SCI's capital assets, level of return on the capital, the allocation of the group and fixed costs between domestic and export sales to determine economic value. In essence, these debates related to allocating common costs, identifying reasonable capital reward in determining the equity risk premium and whether the benchmark is a pre-or after-tax measure, and assessing reasonableness. This indicates the complexity related to the allocation and calculation of costs.

The Italian commission initiated formal antitrust proceedings against Aspen Pharmacare Holdings Limited (Aspen). The alleged conduct was that Aspen had imposed unfair and excessive prices in the form of significant price increases for medicinal products containing the Active Pharmaceutical Ingredients chlorambucil, melphalan, mercaptopurine, busulfan and tioguanine. The Italian Competition Authority found that Aspen had contravened their excessive pricing prohibition.

The Italian Commission, in its assessment, used a gross margin test- calculated the difference between prices - before the increases - and direct costs. The resulting gross margin - in the percentage of sales - as compared to the total indirect costs - in the percentage of sales - to conclude that prices before the increase already granted a margin in line with Aspen's average gross margin. Therefore, percentage price increases ranging between 300% and 1,500% of initial prices led to an unreasonable price compared to economic value. The Italian Commission further calculated the difference between prices and a comprehensive measure of costs, including direct costs plus a portion of indirect costs plus a reasonable rate of Return On Sales. The analysis allowed for the conclusion that new prices applied by Aspen generated

an excess in the percentage of cost-plus, ranging from 100% to almost 400%. On the other hand, the EU Competition in assessment compared the costs of production to the revenues earned by Aspen with the Products and then assessed the excessiveness of the resulting profits (Case AT.40394 – ASPEN).

The EU Commission considered the cost of goods sold method appropriate in the assessment of Aspen's costs. The Commission argues that attributing indirect costs based on the cost of goods sold method can partially account for the heterogeneity across different products and is not affected by the specific circumstances of the suspected infringement contrary to a revenue-based allocation. The choice to combine several methods is, in fact, the approach that several antitrust authorities have followed worldwide: for example, the UK Office of Fair Trading (OFT) has done so in the Napp case. An authority ought to consider direct and indirect production costs for the product or service in question and the cost of capital and all types of overheads (including, for example, advertisement, research and development). Certain types of costs that a given firm may have incurred may not be immediately evident or easily imputable to the supply of a given product or service (for example, abortive research and development)

4.2. Price Comparator Test

This test involves comparing the price charged by a dominant firm to a measure of competitive prices (Gilo & Spiegel, 2018). The economic reasoning here is that market power results in prices above competitive levels (Vickers, 2005; Gunner et al., 2011). This is prefaced on a similar principle to the price-cost test discussed in Section 4.1 above. The price charged in a more competitive market could be a useful benchmark to proxy conditions of effective competition. Competitive prices may include prices charged by competitors in the same or different geographic markets and prices charged by the dominant firm in other markets. The assumption is that these may be indicative of competitive markets. However, there have been difficulties concerning the use of a comparator test. These include *inter alia* finding comparable markets (Furse, 2008). This is because markets are characterised by differences in tax and exchange rates, the general income level of customers and the elasticity of demand (Furse, 2008).

The price comparator test has been used in several international cases. In the United Brands case and the Scandlines case, the port of Helsingborg. The common difficulty in these cases was that the comparators were not directly comparable, and thus meaningful comparisons between prices charged could not be made (Whish & David, 2018). The lesson from these

cases was that assessing the fairness of a price could not come from a simple comparison of the price-cost margin of two similar services in different markets.

Therefore, the fundamental challenge in using a price comparator test is the selection of the appropriate comparator. The selection of the appropriate comparator is apparent in the newer excessive pricing case in the pharmaceutical sector. For example, British CMA v Flynn and Pfizer (Pfizer/Flynn). The UK Competition and Markets Authority (CMA) used a price comparison of Flynn and Pfizer over time and concluded that they were charging an excessive price compared to before the sale of distribution rights. However, on appeal, the Competition Appeals Tribunal (CAT) concluded that the CMA's analysis of the comparator evidence was insufficient (supra note 6, para 86). The CAT argued that the CMA should have carried out a more intense evaluation of comparable products. Factors to consider in the assessment include the price increase, the selective change of prices in the UK but not elsewhere, the impact on the buyer, the lack of any independent or objective justification, and alternative product prices. Therefore, the CMA failed to ascertain a hypothetical benchmark price in "normal and sufficiently effective competition" conditions.

The CMA in the assessment considered its cost price analysis under which a return on sales of no more than 6% would be considered a reasonable and permissible return. The CAT noted that the CMA was wrong in law to adopt a methodology that produced a result relevant in circumstances of perfect or more accurately idealised competition rather than the real world (supra note 6, para 86). The CAT held that the CMA was wrong in law to confine its methodology for determining whether the drug prices were excessive by reference only to its "cost-plus" test. The ruling indicates the fundamental challenge in using a price comparator test and in selecting the appropriate comparator.

Another challenge with employing a price comparator test is the lack of a common threshold or benchmark over which a price must be judged exorbitant. The AKKA/LAA excessive price instance is an example of this problem. The Competition Council fined AKKA/LAA on December 1, 2008, for abusing its dominant position by charging unreasonably high prices/rates for music licensing to Latvian shops and service providers. Following that, the AKKA/LAA implemented revised tariffs that were effective in 2011. The underlying concern of the Latvian Competition Authority (LCA) was that Latvia's only authorised entity for issuing licences for the public performance of copyrighted music works had abused its legal monopoly. Following a comparison of the AKKA/LAA rates against those prevailing in Lithuania and Estonia and 20 other member states, the LCA decided that AKKA/LAA imposed excessive fees for music licensing to Latvian retailers and service providers. The ECJ's statement in AKKA/LAA says that there is, in fact, no minimum threshold above which a rate must be

regarded as “appreciably higher”, given that the circumstances specific to each case are decisive in that regard (supra note 6, para 85). Although the ECJ emphasises that the difference must be significant for the rates concerned to be regarded as abusive, the question of what difference is to be considered significant is open to interpretation.

The ECJ also addressed the question of comparing various user segments or within the same specific segment, noting that the competition authority has a "margin of manoeuvre and no one sufficient procedure." The AKKA/LA ruling clearly shows no significant novelties in the EU Courts' approach to excessive pricing. The AKKA/LA case does not establish new tests, only a detailed guide for future case law. This judgement essentially reaffirms previous case law, but it is helpful because it provides some helpful guidance for comparing prices to determine whether the price in question is excessive. It sets out suitable price benchmarks and what factors the authorities should consider when selecting suitable benchmarks.

4.3. Profitability Test

The profitability test involves comparing the profitability of the sale of a product relative to the general level of profitability in the relevant market (Maier-Rigaud, 2012). Similar to the price-cost and comparator tests, the premise is that, if the profit earned by the dominant firm is higher than that of the prevailing level of profitability in the relevant market, this may suggest that the price charged is excessive. The relevance of the profitability test in the context of excessive pricing is that it is typically linked to excessive profits (Swanson, 2003). In cognisance of the fact that a firm operating under conditions of effective competition and charging non-excessive prices makes zero economic profits or no pure profits (Swanson, 2003). In addition, the fact that economic profits attract new entries into the market (Wagner, 2015). In a scenario where a firm consistently earns an economic profit and with no new entry, and where that firm has perceptible inefficiencies, it can be found to be pricing excessively (Sylvester, 2013).

Profitability analysis may also be used in competition law, including, among other things, in the assessment of market power, degree of competitiveness and market definition (Oxera, 2003). The theoretical grounds for considering profitability in competition analyses is that the analysis may be relatively direct and straightforward to assess structure and conduct in a relevant market (Bishop & Walker, 2010). Despite the ease of application of the profitability assessment, the technique is not without criticism. Bishop and Walker (2010) explain reasons why a firm would make economic profits, and these reasons have formed the base of arguments made against the use of profitability analysis. Critics of this approach quote the

possibility of many factors contributing to or explaining a consistently observed firm's positive profits. The base of the critique is that economic theory does not hold that prices are driven to costs for all firms in the industry. However, economic theory holds that the marginal firms in an industry should earn zero economic profits so that a more efficient one would tend to earn positive economic profits (Bishop & Walker, 2010).

The profitability assessment method is problematic for competition economists as there is no reliable economic standard for determining what could constitute a competitive profit margin in most industries (Evans & Padilla, 2004). Furthermore, even though evaluating whether prices are excessive equates to considering whether profits are excessive, substantial pitfalls have been identified in using the profitability test (Walker, 2003). Profitability assessment also raises problems related to the appropriate accounting measures. As a result, the use of it as the primary test in assessing excessive pricing is discouraged. The profitability test involves a significant value judgement. As a result, it is highly ambiguous and entirely subjective and problematic for competition economists (Evans & Padilla, 2004). For instance, for profitability to indicate anticompetitive conduct, there must be an assumption that the dominant firm operates efficiently, and the profits are not due to returns for innovative activities (das Nair, 2008). A firm can be highly inefficient and have meagre profitability, but this does not mean it does not charge an excessive price.

Sylvester (2013) contends that, despite its critique and restricted results based only on profitability analysis, it is still valuable in competition analysis. According to Oxera (2003), users of profitability analysis should utilize it as one of numerous complimentary economic indicators and approaches that may be employed together in competitiveness analysis. These may involve, among other things, applying profitability approaches in addition to price-cost tests and comparator pricing, examining market structure based on market shares, and analysing entry obstacles (Sylvester, 2013).

Two approaches can be used to assess profitability, the accounting approach and the finance approach (Graham & Harvey, 2001; OFT, 2003). The accounting method of calculating profitability computes a return on capital employed (ROCE) (Graham & Harvey, 2001). The finance approach revolves around the concept of net present value (NPV) and internal rate of return (IRR) to measure profitability (Graham & Harvey, 2001). The calculation requires the determination of capital costs and ascertaining the replacement cost of capital. According to its current worth, replacement cost relates to the amount to pay to replace an asset at present (Graham & Harvey, 2001). In this calculation, actual costs must be considered, and in this context, they include the costs of using a unit of a resource that could be used elsewhere to earn profits (Sylvester, 2013; Sidak & Bork, 2013; CRA, 2003). As the value of capital changes

over time, the replacement cost can diverge significantly from the historical cost (Sidak & Bork, 2013). Some companies have benefitted historically from government interventions which also affect capital costs and thus complicate the calculation of the replacement costs (Sylvester, 2013).

Furthermore, government interventions or subsidies are likely to assist firms in having special cost advantages that may incentivise them to operate in a particular manner. The historical government interventions' impact on cost structure has led to a considerable debate around the treatment of costs. The CAC recommended that any government interventions that reduced costs below the notional competitive norm be disregarded and costs adjusted accordingly (CAC decision in 70/CAC). However, the recommendation is vague in terms of an explicit description disregarding these special cost advantages. There is also a lack of clarity on what should be considered a special cost advantage.

Profitability analysis is heavily criticised on theoretical grounds and is fraught with practical problems. These include how to reward a firm for taking risks and being innovative, and how to account for competitive advantages such as superior efficiency or better management among others (Sylvester, 2013). Profitability analysis is a valuable tool in understanding the workings of a market or dominant firm but is not definitive in answering the question of excessive pricing. Thus, it is suggested that profitability analysis would be more useful when used to complement other analyses in ascertaining unreasonable pricing conduct. The lesson from a profitability assessment is that several profitability indicators may in principle be suitable for assessing suspicious price abuse. Appropriate measures depend on the actual situation of the individual case. In the absence of ubiquitous testing and the inherent limitations of all existing methods, to minimize the risk of error.

4.4. Reasonableness Test

The reasonableness test is not an explicit test, but an assessment that needs to be conducted to ascertain whether a price is excessive relative to the economic value. In assessing the reasonableness of the price, economists need to establish and agree on a reasonable cost margin, profit margin or competitive price. Applying price-cost margins may also be difficult in practice because of the need to identify a reasonable profit margin. Reasonable essentially involves a rule of reason. The Act does not explicitly define what may be considered reasonable, as reasonable profit margins differ across industries (O'Donoghue & Padilla, 2006). In some industries, profit margins may be significantly high, indicative of the

compensation required for risk associated with significant upfront investment and research and development costs (O'Donoghue & Padilla, 2006; Whish & David, 2018).

Despite stating in the Mittal case that a reasonableness assessment would always have to be undertaken on a case-by-case basis (Case 131/CAC/Jun14), the CAC decision in the Mittal indicated that the prices charged have to be substantially higher than the defined economic value before an adverse finding on excessive pricing is made. This is indicative of the subjectivity in the evaluation of reasonableness. For instance, in the reasonableness inquiry, the CAC recommended including the origins of dominance and referred to the historical state support enjoyed by the dominant firm. In its decision, the CAC gives leeway for raising arguments that the dominant position in the relevant market was not the result of any innovation or risk-taking on its part to be included in the reasonableness assessment. This makes the reasonableness test complex, particularly if the analysis consists of the intangible value of assets and relevant opportunity costs (Whish & David, 2018).

5. Evaluation of the Amendments

The President of South Africa signed the Competition Amendment Act into law on 14 February 2019. In general, the amendments aim to empower the competition authorities to address the issue of economic concentration and strengthen the provisions of the Competition Act concerning prohibited practices. However, from a pragmatic point of view, the question remains whether the amendments provided clarity concerning the difficulties faced by competition authorities and economists in assessing excessive pricing. For this paper, the focus is on amendments related to the provision of excessive pricing. The new provisions for excessive pricing in Section 8(1)(a) of the Act has a few critical components. The changes are discussed in the section below.

5.1. The deletion of the "excessive price" definition – Section 1

In the amendment Act, the definition of an excessive price has been deleted. The Amended Act instead, requires a consideration of whether the price is higher than the competitive price. In the forgone sections of this paper, the discussions have been related to "economic value". The amended Act by removing the definition of an excessive price has removed the concept of "economic value" and introduced a new concept of "competitive price". The tests for excessive pricing under the amended act ought to determine whether a price charged is

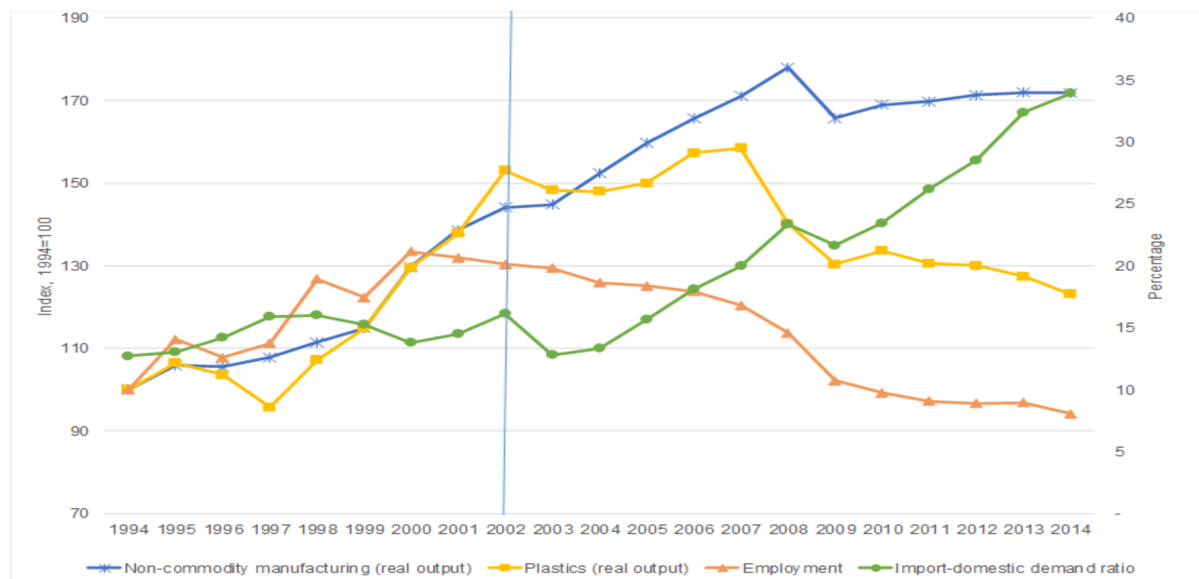
unreasonable compared to the new benchmark which is a competitive price. A competitive price is considered to be a price that could have been charged in a competitive market. One may argue that the concept of a “competitive price” appears to be more flexible than that of “economic value”. The flexibility of the competitive price becomes apparent in the debates that emanated from the enforcement of excessive pricing (price-gouging) prohibition in the context of the COVID-19 pandemic, further discussed in section 6.

In my view, there is little difference between economic value and competitive price. The reason is that the determination of competitive price still involves all the factors considered when determining the economic value of a product. These factors include price-cost margins, internal rate of return, return on capital invested or profit history, prices and relevant comparators. If one considers the “economic value” and “competitive price” the two concepts are determined by considering the same factors and thus are fundamentally related. Thus, one can conclude that the difficulty and the debates concerning what constitutes or determines the benchmark remain unresolved by the replacing concept of economic value with the concept of competitive price. However, as indicated in section 6, when using the price-gouging regulation, there has been an emphasis on using comparators (in terms of ‘before and after’ prices).

5.2. The detrimental effect assessment - Section 8 (1) (a)

The change to Section 8(a) was the inclusion of the word customers. This insertion adjusted the requirement to show that an excessive price is detrimental to final consumers and incorporates customers such as intermediate firms. In the SCI case, the interpretation of consumers was among the points of debate. SCI argued that the consumer included only the product’s end-user and subsequently did not consider the harm caused to downstream manufacturing. For instance, in the Sasol case, the proportion of polypropylene in the final product to consumers was relatively small, so the harm of excessive pricing to end consumers might not seem significant. However, for downstream manufacturers of polypropylene from SCI, the price may make them uncompetitive and drive them out of the firm. Moreover, since plastic products are often components of more complex products, the detrimental effects of SCI excessive pricing were more apparent in the downstream plastics industry, as presented in the figure below.

Figure 1: Performance of the plastics sector



Source: Beare et al. (2014)

When polymers, including polypropylene, were priced at export parity (that is, competitive prices) to local customers, the industry grew significantly, at an average of 6% per annum from 1994 to 2002. However, from 2002 to 2014, the polymers, including polypropylene, were priced higher relative to export parity, the plastics industry contracted by 1% on average, and 15 000 direct jobs were lost over this period (Beare et al., 2014). Among the identified challenges facing the downstream plastics industry is the input polymer cost (Beare et al., 2014).

In my view, the inclusion of customers incorporates intermediate firms, which means that the assessment of consumer harm will focus on both the final consumer and intermediate firms. This is linked to consumer welfare standards and the total welfare standard debate. As discussed in Chapter 3, competition authorities in many jurisdictions are more concerned with consumer welfare than total welfare. The wording of the Act's preamble clarifies that the South African competition policy is concerned with total welfare. The inclusion of customers emphasises the protection of customers, including small, medium and micro enterprises (SMMEs). This inclusion also means that the assessment of the detrimental effect of future excessive prices will focus on both the final consumer and intermediate firms.

5.3. The reverse onus of evidence - Section 8(2)

The addition of Section 8(2) in the amendment introduces a reverse onus concerning excessive pricing prosecutions, requiring the allegedly dominant firm to refute the *prima facie*

case against it by showing that prices charged are reasonable. A question that immediately comes to mind is what evidence the commission needs to establish a *prima facie* case. As a matter of legal onus, it does make a difference to have certainty about what is required to be shown by the commission to establish its *prima facie* case. The addition of Section 8(2) appears to be in line with the CAC's decision in SCI that a price is *prima facie* excessive where a dominant firm raises its prices substantially without a corresponding increase in costs. It is clear from the stance taken in the amendments that a difference in price alone is insufficient to conclude that a higher price is excessive. Therefore, there is still a requirement to establish the reasonableness of this difference. However, the measure of what is reasonable remains open to interpretation. The reliance on the benchmark of 20%, as suggested in the SCI CAC judgement, above economic value may not be the appropriate benchmark for the test of reasonableness. Emphasis should be given to the fact that the operative feature of the excessive pricing prohibition is that the price charged must have detrimental effects on consumer welfare (Mncube & Ngobese, 2018). By implication, the price to economic value or competitive price deferential may be lower than the 20% benchmark and yet have a detrimental effect on consumers or customers.

The amendment retains the reasonableness test on the price charged by the dominant firm after a *prima facie* case has been presented. The concept of reasonableness, in general, is prone to a high level of subjectivity, which may increase the rate of erroneous judgements made by competition authorities. In cognisance of this, a follow-on question would be what evidence a respondent firm would need, to show that the price charged was unreasonable.

On the other hand, the reverse onus provision is likely to minimise the probability of erroneous judgements and increase the efficiency of the competition authorities. The provision requires the Commission to meet the first stage where only *prima facie* evidence of excessive pricing conduct is required. For instance, the Commission can currently use its investigative powers to obtain the necessary data from the dominant firm to analyse whether any complaint has merits. The implication of the new Section 8 (2) is that the Commission can do relatively limited analysis (because it is unclear what a *prima facie* case entails) and refer the matter to the Tribunal for adjudication. The onus would be on the Commission to show a *prima facie* case of an excessive price in the first leg. If successful, the evidential burden shifts to the respondent firm to show that the price was reasonable. The dominant firm will now bear the burden of proving the contrary. The evidential onus shift may shorten the time of investigations, the reason being that the dominant firm owns all the relevant information required to prove that the price charged is reasonable in relation to the competitive price.

5.4. Factors to be considered in the assessment of excessive price - Section 8(3)

The new incorporated Section 8(3) lays out a non-exhaustive list of factors that need to be considered in the tests to determine whether a price is excessive. The listed elements to consider in the enquiry of whether a price is higher than a competitive price and whether that difference is reasonable are without any ranking of importance. We assume the reason for this is that not all factors listed in 8(3) would be present in every case. In other words, the relevant factors to be considered depending on the facts of each case. The provision requires the determination of a competitive price by considering all relevant factors, including price-cost margins, respondent's prices elsewhere and comparator prices. Subsequently, the assessment of whether the "price is higher than a competitive price and whether such difference is unreasonable". Thus, the legal test in Section 8(3) is that the price must be higher than a competitive price. Although the use of the "competitive price" benchmark appears to be much more flexible and broadly in line with case precedence. Similar challenges and complexities that are observed in the determination of economic value may manifest in the determination of a competitive price. These may include challenges concerning the selection of an appropriate comparator and identification of an appropriate measure of costs in determining price-cost margins among other challenges that have been discussed in the study.

On the other hand, the mention of the factors, including price-cost margins, internal rate of return, return on capital invested or profit history and comparator prices, bring greater legal certainty regarding the tests and components of the tests to be used to assess the excessive price. In the principal act, this was not explicit but, the introduction of subsections 8(3) (a), (b) and (c) is likely to provide legal certainty concerning the practical approach to a competitive price. The amended Act now explicitly allows for the use of a price-cost test to determine a potentially competitive price and the use of comparators to make inferences about the competitive level of pricing. Furthermore, comparators can also be used to establish a *prima facie* case, as they may not always be determinative in themselves. Therefore, including these factors in the assessment will likely provide more certainty on the tests conducted. Noticeably the amendment has omitted the use of 'profitability' and instead refers to the internal rate of return, return on capital invested or profit history. This gives certainty as to what to consider when conducting this test.

One of the issues identified relates to the conceptual approach of treating cost advantages, not due to the dominant firm's commercial efficiencies. The amendments attempt to provide clarity by including the Section 8(3)(e) clause. This clause stipulates that anyone determining whether a price is excessive must consider the structural characteristics of the relevant

market. This includes the extent of the respondent's market share, the degree of contestability of the market, barriers to entry and past or current advantages that are not due to the respondent's commercial efficiency or investment, such as direct or indirect state support. Including Section 8(3)(e) is likely to provide legal certainty in considering and treating special cost advantages and overall structural characteristics. They also have the potential to narrow the excessive pricing enforcement focus on markets where high prices are durable and result from prior state support or advantage. In addition, this section encourages using the structural assessment methods to provide additional evidence to determine an excessive price. There have been no cases, in a normal context, to see whether these amendments have provided clarity in the assessment of excessive pricing. However, we can still draw some guidance from how the amendments have been applied in the Covid-19 context with price-gouging regulations.

6. Overview of Regulation 4 on Price Gouging and the Link with Excessive Pricing.

After enacting the amended Act, the world experienced the Covid-19 pandemic, which resulted in market disruption and required restructuring of economic policies. Soon after the first South African case of Covid-19 was reported, the country declared the Covid-19 pandemic a national disaster in terms of the Disaster Management Act No 57 of 2002 on 15 March 2020. Extreme exogenous shocks such as the Covid-19 pandemic tend to result in surges in demand for various goods and services, disruption to supply and create sharp acceleration in prices (Boshoff, 2020). On 19 March 2020, as part of a policy response, the Minister of Trade and Industry published Consumer and Customer Protection Regulations and National Disaster Management Regulations and Directions (price-gouging regulations).

One of the changes that came with the Covid-19 pandemic was an increase in the need for additional precautions such as hand sanitisers and face masks, creating a strong imbalance between demand and supply. As a result, there was a sudden escalation of prices due to the dislocation of supply chains occasioned by the pandemic. The price-gouging regulations were designed to address the pricing in four broad groups of products and services:

- (i) basic food and consumer items;
- (ii) emergency products and services;
- (iii) medical and hygiene supplies; and
- (iv) emergency clean-up products and services during the disaster period.

The price-gouging regulations had specific implications on the assessment of excessive pricing. One of the regulatory requirements is a retrospective comparison of prices charged during and pre-disaster, which is in line with the assessment of an excessive price proposed by the competitive price comparator concept. Competition authorities were subsequently faced with complaints concerning the price increases brought about by the pandemic. The two significant cases brought to the Competition Tribunal for prosecution in South Africa were the Dis-Chem case and Babalegi case. Both the cases were reported during the state of national disaster in South Africa due to the Covid-19 pandemic.

On 9 April 2020, the commission referred a price-gouging case complaint to the tribunal. The complaint was that Babelegi charged an excessive price for the supply of facial masks. Babelegi significantly increased prices for FFP1 masks by a series of price increases from R50.60 per box of 20 to R500 per box excluding VAT (888%). During this time the price increases in the costs of procuring the face masks, even though a future increase in procurement prices was anticipated. The circumstances are prevalent in the period of the pandemic allowed for such increases.

On 23 April 2020, the commission referred another excessive pricing case to the tribunal after the amendment to the Act. The complaint was against Dis-Chem Pharmacies Limited (Dis-Chem). The complaint alleged that Dis-Chem had contravened Section 8(1)(a) of the Act, read with regulation 4 of the price-gouging regulations. Dis-Chem charged excessive prices on three products, including surgical face masks blue 50pc (SFM50), surgical face masks blue 5pc (SFM5), and surgical face masks foliodress blue 50pc (Folio50). The commission alleged that Dis-Chem increased its prices of SFM50 by 261%, SFM5 by 43% and Folio50 by 25%.

6.1. Demand considerations

The standard assessment of excessive pricing traditionally allows for both demand and cost considerations. Obtaining a comparable competitive price from the benchmark period requires accounting for both cost and demand differences between the periods. By implication, even cost-based benchmarks for excessive pricing must account for demand factors (Boshoff, 2020). Calcagno et al. (2019) explicitly recommend assessing economic value rather than simply the relationship between price and the product or service costs. Industries are dynamic and often have high fixed and low incremental costs. As a result, it tends to be efficient for firms to set prices according to customers' willingness to pay (Ahlborn et al., 2001). In such instances, it is inadequate to assess excessive pricing using only information on costs as stipulated in the price-gouging regulations.

The price-gouging regulation disregards the concept of consumer demand and willingness to pay by dampening demand-based price increases. The price gouging regulation explicitly seeks to dampen demand-based price increases by only allowing for cost considerations in the assessment (Boshoff, 2020). The price-gouging regulations use an intertemporal benchmark to overcome the challenge of accounting for demand shifts and consumer benefit while disallowing full exploitation of demand and willingness-to-pay. This rationale is justifiable because the Covid-19 pandemic triggered a surge in demand for hand sanitisers and face masks. The surge in customers and consumer demand is unusual and desperate due to a crisis. Thus, the demand and willingness to pay in a crisis are artificial. This surge in artificial demand and willingness to pay implies the economic value or competitive price will be inflated. The tribunal also does not see the excessive price provision as needing to consider willingness to pay in the context of a crisis. It notes that customers and consumers are desperate in a crisis and are forced to pay inflated or exorbitant prices given a limited choice.

Nevertheless, demand remains a relevant factor in determining economic value and, consequently, assessing excessive pricing (Ratshisusu & Mncube, 2020). The noticeable change in the demand and willingness-to-pay during Covid-19 that ultimately changed the economic value and the price difference of the products is indicative of the link between consumer willingness to pay and economic value. For instance, in the Mittal case, the global steel cycle considerations were relevant for price-cost and profitability tests for excessive pricing, as peaks and troughs of the cycle reflected different demand conditions, among other factors. Therefore, unlike price-gouging assessments, future excessive pricing investigations must consider demand, willingness to pay and cost considerations. The context therefore matters.

6.2. The evaluation of price-gouging assessment

The price-gouging regulations also introduce deviation concerning the assessment of dominance and market power. Following an increase in prices, economic literature suggests that markets self-correct, at least in the long run, because the high prices would attract new entrants to the market. However, in the short term, a positive change in willingness to pay for an incumbent's firm offering may reinforce dominance or market power and the abuse thereof.

Therefore, in assessing excessive pricing and the structural feature of the market competition, authorities may need to consider changes in consumer willingness to pay. For instance, during the Covid-19 pandemic, attempts by other firms to re-position or prospective entrants to the new markets were constrained by the government's action to restrict movement. The

constrictions also implied that conventional tools to assess the abuse of market power were not applicable (Ratshisusu & Mncube, 2020). This indicates the importance of context in determining excessive pricing, especially in determining market power or dominance. In the earlier cases of Mittal and SCI, the firm history and the role of state support and industrial policy in entrenching their quasi-monopoly positions were debated extensively. In Babelegi, the tribunal emphasised that context could not be ignored.

The new Section 8(1)(a), as amended, introduces the concept of a competitive price as a benchmark. Like the pre-amended excessive pricing provision, the notion of a competitive price is not defined. However, the concept of a competitive price appears to be much more flexible than that of economic value. Its flexibility is apparent in the determination of excessive pricing in the context of the Covid-19 pandemic. Therefore, the assessment of excessive pricing in the context of a pandemic is aligned to the determination of a competitive price and the price gouging regulation provisions.

In the Babelegi case, the tribunal held that the competitive price to determine the benchmark should be the pre-COVID-19 prices. The CAC appears to have endorsed this suggestion of using the "pre-crisis price as a benchmark on the basis that the demand and supply conditions at that time were presumably normal". The tribunal held the CAC's decision in SCI that a price is *prima facie* excessive when a dominant firm raises its prices substantially without a corresponding increase in costs. This substantiality requirement is essential, and it should be preferred rather than the approach adopted by the tribunal in Dis-Chem, which suggested that any price increase, regardless of size, above the competitive price, is *prima facie* excessive.

The focus was not on the price *per se* but on price increases induced by the pandemic. Accordingly, the commission used prices before the pandemic as a competitive price benchmark. In its order, the tribunal laid out the legal framework for the assessment of excessive pricing. The tribunal in Dis-Chem indicated that a two-step enquiry needs to be undertaken to evaluate a contravention under Section 8(1)(a):

(i) a determination of whether the price charged is higher than a competitive price; and
(ii) whether such a difference is unreasonable.

This approach is consistent with guidance provided by the CAC in the SCI and Mittal cases. The difference is that, in the Babalegi case, the notion of a competitive price was considered instead of economic value as per the Sasol case. Concerning determining whether a price is *prima facie* excessive, the tribunal suggested that any price increase, regardless of size, above the competitive price, is prima facie excessive in its decision in the Dis-Chem case. The tribunal judgement on Babelegi was appealed to the CAC, which released its Babelegi

decision on 18 November 2020. In its ruling, the CAC held that, where the actual price is shown to exceed the normal price for similar products to a degree which is, on the face of it, excessive, then the need to quantify economic value more precisely before concluding that the actual price bears no reasonable relation to it may fall away. In this way, a *prima facie* case would have been made out, leaving it to the respondent firm to produce evidence to the contrary to avoid the case against it becoming conclusive. As per the amended Act, the shift in onus to the respondent is likely to play a vital role in the case's outcome to favour the commission by stripping away unnecessary complexities prevalent in traditional excessive pricing investigations (such as the Mittal and SCI cases). In addition, it is likely to assist the competition authorities in dealing with these matters efficiently.

The Tribunal published written reasons concerning its decision to penalise Dis-Chem for contravening Section 8(1)(a) of the Act. The Tribunal's judgement provided interpretational guidance on the Amendment Act. The tribunal held that Section 8(3) only requires the "price is higher than a competitive price and whether such difference is unreasonable". Thus, the legal test in Section 8(3) is that the price must be higher than a competitive price without qualifying the size of that difference.

In the Babelegi case, the tribunal held that excessive pricing must be determined in terms of Section 8(3) by considering all relevant factors, which may include a list of factors in Section 8(3) from (a) to (f). The tribunal points out that only these factors from the list must be considered in assessing excessive prices. The tribunal further indicated that factors are considered relevant, and weight is attached to each element depending on each case and facts on a case-by-case basis. To ascertain whether Babelegi charged excessive prices, the tribunal evaluated the prices charged to determine if they bore a reasonable relation to the prices charged before the complaint period.

6.3. Dominance and Market Power concerns

The necessity for dominance or market power in the relevant market is a prerequisite for any excessive pricing behaviour. A relevant market is defined by product and geographic considerations, as well as various other characteristics, such as supply and demand-side substitutability. According to Motta (2020), there may be instances where a corporation is dominant or has market power that is not necessarily dominant in typical times. For example, during a confined time, such as a crisis period. The Babelegi and Dis-Chem cases are similar because both parties disputed their dominance or market power. Babelegi argued that it had a market share of approximately 5% pre-COVID-19. On the other hand, Dis-Chem argued that

although it had a national footprint, it was not dominant in any accurately defined relevant market.

In the Dis-Chem case, the Commission argued that defining the relevant market was unnecessary. The Commission saw Dis-Chem's capacity to raise prices as evidence of significant market power and consequently dominance (Case No: CR008Apr20). The Tribunal determined that market power evaluation might take into account current market conditions without specifically specifying the relevant market (Case No: CR008Apr20). In its reasoning, the Tribunal concluded that the public was required to wear surgical masks. As a result, the Tribunal confined its analysis to the surgical facemask industry. The Tribunal further held that the geographic market is narrow since confinement was imposed by the pandemic(Case No: CR008Apr20).

The Commission stated in the Babelegi case that Babelegi could impose huge price hikes that would otherwise be impossible under normal conditions during the crisis period. Thus, despite having a 5% market share, the price hikes demonstrated Babelegi's capacity to exercise market power and dominance during the complaint period. While Babelegi contended that market power should be defined as "the capacity to raise prices regularly and profitably above competitive levels," This argument is consistent with the view that competition policy should be concerned with a firm's capacity to maintain a price above marginal cost (Motta 2008). This is also in line with the CAC idea of LRCE, as discussed in preceding sections. In normal situation, temporarily market power is not indicative of a firm's ability to sustain prices above marginal cost in the long run.

The Tribunal's examination of dominance in Babelegi was particularly focused on whether the Act imposed timeline constraints on a firm's dominance. The Tribunal ruled that the Act provided no such restrictions, and Babelegi failed to account for the crisis's exceptional supply and demand. As a result, the Tribunal confined its evaluation of market strength and dominance to the complaint period (just over a month). While I agree that fluctuations in supply and demand during a crisis time might result in a temporary gain in market power. In South Africa and across the world, conventional excessive pricing precedent is concerned with market dominance as a long-run structural element.

Given the Tribunal's evaluation of market power and dominance in both the Dis-Chem and Babelegi cases, it is reasonable to conclude that a firm's market power and dominance can be conferred by specific circumstances. As a result, the idea of "temporary market power and dominance" was established. Furthermore, it appears that transitory market price rises are a cause for worry rather than market developments that result in greater long-run price cost deferential. Given the Tribunal's evaluation of market power and dominance in both the Dis-

Chem and Babelegi cases, it may be deduced that market power and dominance can be conferred on a corporation by specific circumstances. Thus, the idea of "temporary market strength and dominance" becomes relevant. The Tribunal's analysis also shows that transient market dominance is permissible in competition law.

7. Conclusion

This paper presents a literature review on monopoly pricing and its impact on consumer welfare, as these are crucial in understanding excessive pricing. The paper presented arguments that have been raised for and against the prohibition of excessive pricing. The paper further provided an overview of the amendments to the Competition Act and discussed how each of these amendments is likely to provide clarity in the assessment of excessive pricing. In addition, an example of price-gouging cases where the amendments have been applied was evaluated.

The main finding is that competition regulators are grappling with the fundamental question of what constitutes an excessive price. A competitive price cannot be determined without making assumptions about the market structure, the nature of competition, and the form of the demand curve. This suggest that different price levels may be competitive in a particular market based on these assumptions. Therefore, an excessive price is determined by the hypothesis used to define the competitive price rather than an objective definition. Consequently, competition authorities must differentiate between two scenarios - where prices are high due to market failure (where intervention may be needed); and where prices are high purely because of competition (where intervention is not required because of the self-correcting nature of the market).

Before the amendments, the excessive pricing clause in the old Act was interpreted differently by the commission, Tribunal, CAC, and the respondents, implying that it was not precisely crafted and specified or that the interpretation thereof was left too wide open. The study emphasizes the inherent complexities of using any one criterion to establish if pricing is unfair and abusive, and it demonstrates that there are several evidentiary or analytical paths to such a result. The amended Act removes “economic value” and introduces a new proxy “competitive price”. Supplementary, stipulates factors that need to be considered regarding the excessive pricing assessment. The explicit mention of the factors was aimed at changing the face of South African competition law to bring some clarity and guidance on the enforcement of the excessive pricing provision.

From a pragmatic point of view, the question was how likely these amendments will assist in bringing clarity in the determination of an excessive price. The preliminary finding is that the amendments are rather likely to bring economic and legal certainty on what needs to be considered in the assessment of excessive pricing conduct. Thus, likely to increase the probability of successful prosecution for excessive pricing. However, there are concerns related to the critical assessment of reasonableness as it is coupled with high levels of subjectivity and may lead to erroneous decisions being made. Although it is commonly acknowledged that price gouging is a kind of excessive pricing, there is a significant difference between legislation focused expressly on preventing price gouging during a crisis and excessive pricing cases examined under standard competition rules. The debates evident in the price gouging cases may be standard for future excessive pricing cases.

Competition authorities should strive to examine excessive pricing cases by combining several methods among those which are accepted by standard economic thinking. In the absence of a ubiquitous test, it is crucial that to avoid errors, competition authorities strive to try and find the best approach for each particular case. This strategy has been criticized because, even with consistent results, the combination of many inaccurate approaches may not lead to more credible conclusions. Of course, the shortcomings of one approach are not permanently fixed in another similarly flawed way. However, when using the methods individually, the restrictions specific to one method do not affect the results obtained by the other methods. As long as the method used is error-free and everything is applied rigorously and objectively, the convergence of results can be used as a possible reference price indicator in some instances.

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