



Anti - competitive practices

Corporate Governance Network

position paper 2

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ANTI - COMPETITIVE PRACTICES

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Executive summary

Competition law is a complex area that many a company has recently run foul of. Transactions that may previously have been considered to be rational economic behaviour may, in

the light of current legislation, be anti-competitive and have serious legal implications for the company and its directors. This paper aims to raise awareness of and provide guidance to directors faced with real or perceived anti-competitive practices within their organisations. It specifically excludes from its scope the consideration of merger and acquisition activity. This paper also does not cover exempt practices governed by the Prevention of Organised Crime Act. Directors that find themselves in this difficult situation should take legal advice from a person who is familiar with competition law.

Introduction

A feature of most modern free market economies is the existence of legislation and enforcement mechanisms to guard against, investigate and punish anti-competitive behaviour. This is a significant challenge for global companies as competition law worldwide is diverse in its scope. South Africa has made significant strides in this regard during the past decade and now has arguably one of the most stringent combinations of legislation and enforcement capabilities in the world. Implications for companies found to have abused their monopoly powers, or to have acted in some other manner deemed anti-competitive, include significant fines, exposure to damages claims, being forced to exit certain markets, and serious reputational harm. Draft legislation may bring about consequences for directors and managers who participated or acquiesced in such behaviour. These consequences include criminal liability and personal fines. These sanctions will supplement the current sanctions of reputational damage and potential actions based on reckless trading. However, companies that cooperate with the Competition Authorities may face mitigated fines or penalties.

Directors and senior executives thus have a significant responsibility to ensure compliance with competition law in order to protect both the company and themselves. The difficulty for boards of directors is that anti-competitive practices often occur at levels of the business that directors have no direct knowledge of. It is also often extremely difficult to determine which practices actually are considered to be anti-competitive.

This paper discusses the responsibilities of directors in this regard and outlines potential steps that directors may take to guard both themselves and their company from litigation.

Understanding Competition Law

The basis for establishing whether a practice is considered to be anti-competitive is the Competition Act 1998, the 2008 proposed amendments thereto (once promulgated) and the growing body of local case law and international precedents.

Some breaches of competition law, such as the rigging of tenders, allocation of markets and the manipulation of prices are so obviously anti-competitive that any ethical business person would know that they are wrong. However, competition law contains much that is not obvious: such as the determination of dominance and market power, circumstances

in which price collusion is deemed to have occurred, and the way markets are defined in order to determine whether a firm is dominant in one or more of its markets.

Since even actions that may not at face value appear to be anti-competitive may still fall within the ambit of anti-competitive practices, a good understanding of what constitutes anti-competitive behaviour is fundamental in order to avoid unlawful behaviour. Ignorance of the law is no excuse for non compliance. It is therefore important for directors, as part of their normal evaluation of any new method or line of business that the company is contemplating, to consider whether the transaction results in an anti-competitive practice.

Market Dominance and the Abuse of Dominance

Dominance is defined in terms of market share and market power. Any firm that has market power is deemed to be dominant. The definition of market power follows the EU definition of 'the power of a firm to control prices or to exclude competition or to behave to an appreciable extent independently of its competition, customers or suppliers'. A firm with more than 45% market share is conclusively dominant, a firm with between 35% and 45% is presumed dominant although the firm may rebut this conclusion by showing that it does not have market power. If the firm has less than 35% market share then the enforcer carries the burden of proof of dominance.

Abuse of dominance is dealt with mainly through a list of prohibited practices, including:

- excessive pricing that is harmful to consumers,
- refusal of access to an essential facility to a competitor,
- the committing of an exclusionary act which includes:
 - a requirement or inducement not to deal with a competitor, whilst exclusive supply contracts are not prohibited, they are a high risk area,
 - refusal to supply scarce goods when it would be economically feasible to do so,
 - selling goods on condition that other goods are bought or forcing an unrelated condition on the buyer,
 - selling below marginal or average variable cost, which is often referred to as predatory pricing, which is intended to deter the entrance of competitors into the market or force small competitors out of the market, and
 - buying up scarce supply of intermediate goods needed by a competitor.

The South African Airways (SAA) abuse of dominance case considered an incentive scheme that the airline offered to travel agents. Travel agents were offered an incentive to sell SAA tickets to customers. The case demonstrated that the Commission and the Tribunal have now focused more seriously on restrictive practices. SAA's dominance was not contested, and the scheme effectively meant that other airlines were

severely disadvantaged. A fine of R45 million was imposed, which SAA has paid without appeal.

Other actions that increase the risk of anti-competitive behaviour

Outright or per se prohibitions (in addition to the abuse of a dominant market position described above) are:

- Restricted horizontal practices between competitors to:
 - fix prices or selling conditions,
 - divide markets, (therefore contracts that contain non-compete clauses could potentially contravene the law although the Competition Tribunal has shown its willingness in recent cases to accept certain ordinary commercial restraints as acceptable from a competition law perspective), or
 - collude in tendering.
- minimum resale price maintenance except where a minimum price is merely recommended and not mandatory.

An example of this is where a company imposes minimum resale prices on its products, thereby limiting or even excluding a customer's ability to offer discounts or to sell at lower prices than what the supplier imposes. The Tribunal imposed a fine of R3 million on Federal Mogul Aftermarket for setting a minimum resale price in respect of spare parts. Toyota SA also paid an administrative penalty of R12 million for dictating maximum discounts which their dealers were allowed to give to customers in respect of certain models of cars that Toyota manufactures.



Many restrictive practices are not prohibited outright in the law, but require a rule of reason assessment as to whether they bring about a substantial lessening of competition. These include:

- Restricted horizontal or vertical practices. Vertical and horizontal restrictive practices are treated separately in South African competition law. Horizontal restrictions apply to agreements, concerted practices or decisions between competitors. These are prohibited if they have the effect of substantially lessening or preventing competition in a market. However, the conduct will not constitute a contravention if the company is able to demonstrate that pro-competitive gains arise; which include technology, productive efficiency or other pro-competitive consequences related to such conduct. The Pro-competitive gain must out weigh the anti-competitive effect.
- Price discrimination, which includes the charging of different prices for goods and services of like grade and quality in equivalent transactions to different purchasers, is prohibited if it is likely to substantially prevent or lessen competition. Not only price discrimination is regulated but also discrimination relating to discounts, allowances, rebates, credit given and the provision of services in respect of the goods delivered or the services rendered.

Other actions that increase the risk of anti-competitive behaviour include:

- Other contact between competitors, including at industry forums, may provide opportunities for anti-competitive behaviour. The behaviour of junior employees such as sales agents (who may well be motivated by commission) will generally be attributed to the company.
- Discussing pricing, discounts, costs, market allocation and similar issues with competitors.
- Cartel behaviour. A cartel is a group of two or more companies who are competitors or potential competitors, who are enter into price fixing, bid rigging, collusive tendering or market sharing arrangements. Although, the arrangement often has the effect of lessening competition in the industry or results in one or more of the colluding parties excluding other parties from the market, a significant lessening or prevention of competition does not have to be proven in a cartel case. A recent example of cartel behaviour has been the Competition Commission investigation into the bread cartel which saw Tiger Brands and Foodcorp fined R98 million and R45 million respectively for their roles in the matter. The penalties for cartel behaviour are discussed on page 5.

The indicators above may not necessarily occur in a formalised environment. Even inappropriate, informal discussions may result in companies contravening the law.

Prevention better than cure

An important part of any risk management framework is the assessment of laws and regulations affecting the entity. Assessment of the company's adherence to competition laws is an important and often overlooked aspect of this pillar of risk management. The board should be asking what processes and controls are in place to mitigate the risk of anti-competitive behaviour by the company.

The following guidelines will provide assurance over the company's and board's approach to managing the exposure to competition matters:

A) Setting an ethical tone

An appropriate ethical tone should be established at the top by the board and senior executives and cascaded throughout the organisation. This is necessary as sound moral values and ethics are propagated not by the drafting of policies but by the conduct of individuals. The Institute of Directors code of ethics states that the responsibility of a director is primarily towards the company, then to its shareholders and then to all stakeholders.

The effectiveness of free enterprise and the market economy demand responsibility and it is important that business activity is directed by people of integrity, fairness and vision. Fair competition is fundamental to the free enterprise system. Directors should support laws regulating restraints of trade, unfair practices, abuse or the unscrupulous use of economic power and collusive practices.



B) Developing and reviewing policies to deal with anti-competitive practices

Risk management processes and policies

The board should determine the extent to which the company is affected by competition law. A company of size or complexity would be unwise not to use experts in the field of competition law because the enquiry needs to be a detailed one at all levels (perhaps even to the salesperson level) and aspects of the business. This would usually involve an in-depth assessment of contracts that the entity has entered into. Specific focus should be placed on those of its business practices that may appear to be improper or could attract scrutiny. The board should also assess which parts of the business may be considered to be dominant in the market. This would involve an assessment both of what the market is considered to be as well as the market share (and potential dominance) of the company in such market.

The risk management process should include identification and evaluation of key risks related to anti-competitive practices, their potential impact on the company, and how best to manage and mitigate those risks. The establishment of internal controls to prevent and detect non-compliance is a critical part of this process. Directors should be particularly aware that anti-competitive behaviour may inherently involve manipulation of the information presented to them.

Development of internal policies relating to anti-competitive behaviour

Internal policies should be developed which define and prohibit anti-competitive behaviour, and define appropriate responses in the event that such behaviour is encountered. These policies should include internal penalties.

Periodic compliance assessment

The board should review compliance with the Competition Act on a periodic basis. This periodic assessment may include the use of internal functions like internal audit or external advisors or a combination of the two. In long established companies anti-competitive behaviour may be ingrained into the fabric of the operations of the company or division. In these instances the use of an external party with a fresh perspective may provide additional insight.

Trade and industry forums

Consideration should be given as to who will represent the company at industry forums. The representative should understand the issues from a competition law perspective and should be at an appropriate level within the organisation. A written, fixed agenda should be adopted beforehand. The agenda should not contain potentially anti-competitive items, for example price, quantity, market allocation or costs. Accurate minutes should be kept in the event that sensitive information is discussed, the company representative should distance himself from the discussion and ask for the discussion on the matter to stop. Should the discussion continue, the company

representative should leave and request that this be recorded in the minutes of the meeting. To the extent that this is not recorded in the minutes, the representative should send a letter communicating this to all who were present at the meeting.

C) Creating awareness and educating staff within all levels of the organisation

Creating awareness of what constitutes anti-competitive behaviour

Directors and employees should be aware of the actions that result in contraventions of the Competition Act. An education programme should be developed, consisting of *inter alia* regular training sessions and other communication methods. The directors, senior executives, sales and other staff should receive training in relation to competition law and its application.

Creating avenues for anti-competitive behaviour to be reported

Mechanisms should be established to facilitate the confidential reporting of any inappropriate conduct. Monitoring of the reporting mechanisms should be at an appropriately senior level. When of a serious nature, these reports should flow to the chairmen of the board and audit committee. Traditional methods currently in use are whistle blowing mechanisms like confidential hotlines.

Previously legitimate practices have become illegal

Because the Competition Act and many of its concepts are relatively new to South African business people, many businesses will find that customs and practices that have been in place for years, and in many cases may previously have been legitimised by government regulation, may now be illegal. This applies not only to business practices at board and executive level, but also to customs that have developed at lower levels in organisations – for instance between sales representatives. It is for this reason that a thorough review of the entire business needs to be carried out to determine whether there are potential problems.



D) Obtaining and sharing information*Develop a protocol to provide information to authorities*

The company should establish a protocol detailing the manner in which company officials should react to requests for information or raids on the corporate offices by the Competition Authorities. This may include a checklist of procedures including, for example, requesting the warrant to search the premises and notification of the appropriate persons.

Demonstrating a commitment to compliance

Management and employees may be requested to sign declarations at appropriate intervals indicating that they have not participated in, nor are they aware of or suspect any anti-competitive behaviour. Any exceptions reported should be thoroughly investigated.

E) Obtaining appropriate advice

If necessary, directors should obtain independent professional advice in order to ensure that their conduct, and that of the company, is appropriate. The guidelines for use of such advice may be incorporated into the internal policy discussed above.

Detection of anti-competitive behaviour

When possible anti-competitive behaviour is detected, the following guidelines should be considered:

1. Obtain legal advice

Understand if the behaviour is indeed anti-competitive. In some instances the behaviour may clearly be anti-competitive. In other instances the behaviour may not be clear cut and legal advice may be required.

2. Terminate the offensive behaviour immediately

It is worthwhile to note that if anti-competitive behaviour is found in one area of the business, an assessment of the risk of anti-competitive behaviour in other areas should be performed as well.

3. Establish a protocol to ensure efficient resolution of the matter

Whilst a claim of anti-competitive behaviour is serious, it cannot distract the entire management team from day to day decision making. The company should ensure that there are processes in place to deal with the anti-competitive behaviour. This may include the establishment of a working committee or the assigning of the responsibility to a single individual as appropriate to the circumstances of the company. The processes should ensure that the required investigations are performed and that the directors are regularly updated.

4. Disclosure to the competition authorities

In certain circumstances, the Competition Commission is

prepared to enter into leniency arrangements with companies that have made full disclosure and have been willing to co-operate. However, the company also has a duty to protect commercially sensitive information. The company must therefore develop a protocol dealing with how the company responds to requests for information (including requests for information immediately or at very short notice) and what information may be shared.

Maintaining confidentiality is of vital importance whilst disclosing information to the Competition authorities. To this end the use of lawyers who will maintain legal privilege and keep a tight rein over the information is important.

5. Appoint a spokesperson to deal with the media and stakeholders.

The reputation of a company is often damaged by claims of anti-competitive behaviour. In the current media intensive environment the need for a person that can clearly articulate the company's position and its response to claims of anti-competitive behaviour in the most transparent manner is essential.

6. Review risk assessment procedures

The detection of anti-competitive behaviour despite formalised processes for its prevention may indicate that a company's current anti-competition measures are insufficient. The current processes should be reviewed and the gaps that allowed the infringement to occur should be closed.



Mitigation of fines and penalties

In terms of the Corporate Leniency Policy applicants who make disclosures and agree to cooperate with the Commission in its investigation, may be granted immunity from prosecution, provided the requirements for leniency have been met. Firms participating in a cartel therefore have an incentive to provide information to the Commission to assist with the investigation of cartel activities. Legal advice must be obtained in this regard as formal leniency may only be applied for by the cartel member that is "first to the door" of the Competition Commission and then only in respect of cartel conduct. Investigations into the bread cartel resulted in Premier foods receiving full immunity under the Corporate Leniency Policy.

Significant actions such as the ones proposed above that are undertaken by the company in order to reduce the possibility of entering into anti-competitive practices will be taken into account as mitigation in the event that such behaviour is detected. The quantum of any fine imposed is likely to be significantly affected by the action plans that the company has put in place to prevent and detect such behaviour.



Penalties for anti-competitive behaviour

In terms of the Competition Amendment Bill [B31D-2008] (still to be promulgated), directors can in certain circumstances be criminally liable and incur personal fines. In terms of section 78 of the Companies Act, 2008 (still to become effective), a company may not directly or indirectly pay any fine that may be imposed on the director of the company, or of a related company, who has been convicted of an offence in terms of any national legislation. Therefore fines incurred by the directors personally as opposed to fines levied against the company as a result of anti-competitive behaviour will in future result in increased personal risk of liability for the directors in their personal capacity, without the prospect of assistance from the company.

Cartel behaviour (as discussed on page 3) can attract a fine even for the first contravention. Fines may be as high as 10% of annual turnover. Other breaches of competition law generally attract a warning for the first contravention, coupled with a requirement to cease the offensive behaviour, often via a modification of business practices.

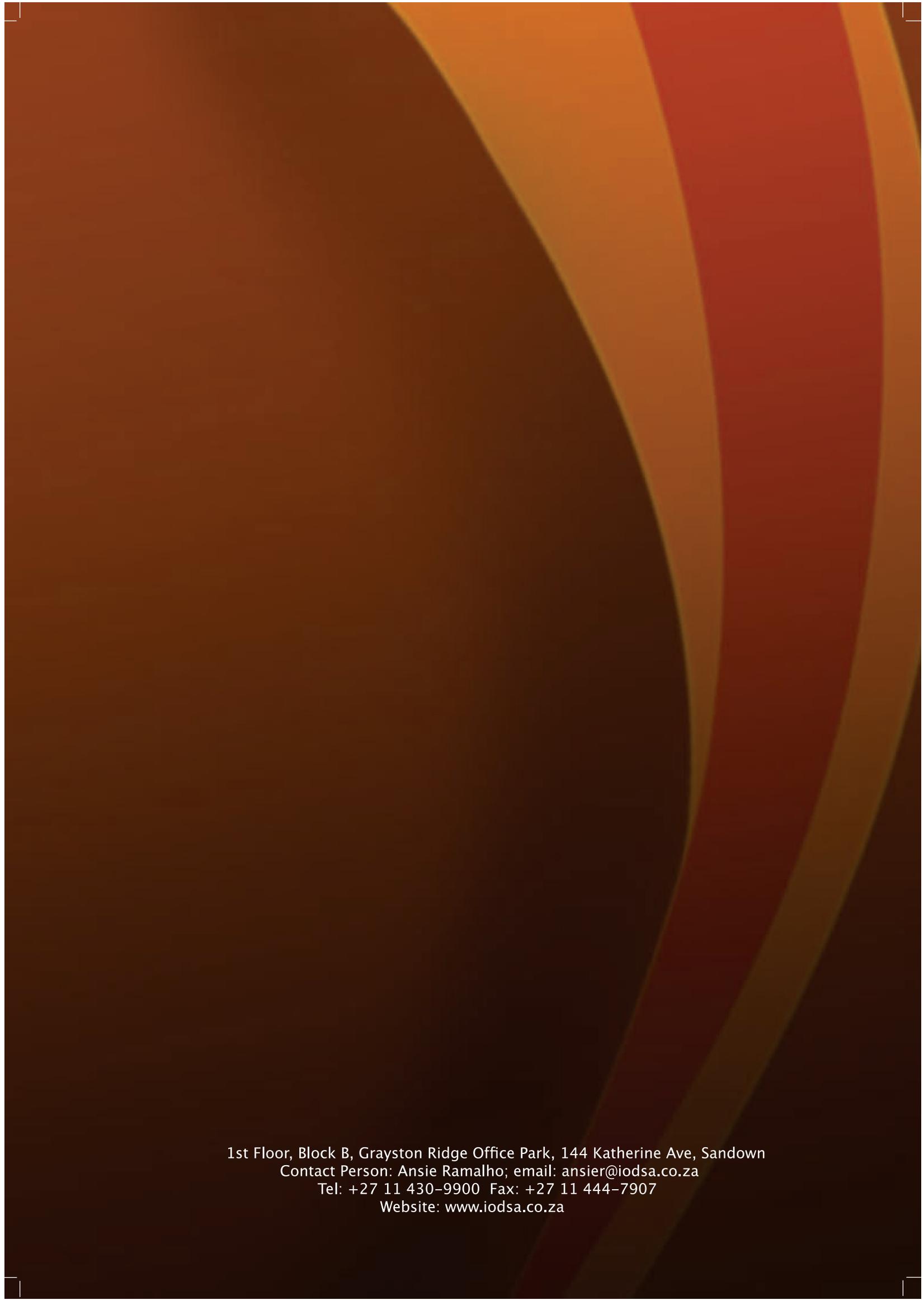
Prescription applies if the company's participation in any offensive behaviour ceased more than three years before a competition investigation is commenced.

Conclusion

The board is responsible for the total process of risk management, as well as for forming its own opinion on the effectiveness of the process. The board is therefore duty bound to ensure that anti-competitive practices, which are often more complex than commonly understood, are on its agenda. Non-compliance with competition law could expose the company and its officers and managers to significant adverse consequences. Where anti-competitive practices are detected or suspected, boards should seek detailed advice from a competition lawyer. As a result, this is a corporate governance matter which should enjoy leadership by, and the attention of, the board.

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