

COMPETITION

Do you have temporary market power? The Competition Commission's first finding of excessive pricing under the COVID-19 emergency regulations

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The Competition Commission has, by way of a settlement agreement, concluded its first investigation into excessive pricing related to the national disaster that has been declared in relation to the COVID-19 pandemic ("**COVID-19 Disaster**"). Such settlements do not constitute legal precedent^[1] but provide insight into the Commission's approach to particular matters and can reveal its views regarding the interpretation and application of statutory and/or regulatory provisions.

This settlement agreement, approved by the Competition Tribunal on 20 April 2020, involved the pricing of facial masks by the Centrum Pharmacy, situated in Boksburg, which price the Commission found to be excessive. The consent order reveals that the Commission was willing to conclude that an individual pharmacy selling low volumes of facial masks before March 2020 could, by the end of March 2020, be considered to be a dominant firm holding market power as a result of changed market circumstances arising from the COVID-19 Disaster. This appears primarily to be based on a finding that the geographic scope of the market became narrower during the COVID-19 Disaster than it may have been before the COVID-19 Disaster. Interestingly, the consent order makes no reference to market shares, indicating that the Commission may not have taken actual market shares into account in concluding that Centrum Pharmacy was dominant. Instead, in addition to its conclusion that the geographic market was narrower than before the COVID-19 Disaster, the Commission considered that the respondent's "economic behaviour" – in particular "its ability to raise prices" of the product in question – indicated that it held market power and was therefore dominant.

This indicates that companies supplying essential products that may consider themselves to operate in competitive markets in ordinary market conditions should not assume that pre-COVID-19 Disaster market shares will carry weight when the Commission is assessing COVID-19 related excessive pricing. Such companies also need to be aware that their pricing and behaviour in relation to essential products during the COVID-19 Disaster may be relied on by the Commission as an indication that they are, at least temporarily, free of normal competitive constraints. However, as we note below, if the Commission seeks to establish dominance in a manner similar to the way it seems to have done in the Centrum Pharmacy case, there may be a number of counter-arguments and defences to such allegations.

Excessive pricing under the emergency regulations

Excessive pricing is prohibited in terms of section 8(1)(b) of the Competition Act. A price is excessive if (a) it is higher than a "competitive price" and (b) the difference between the actual price and the competitive price is "unreasonable". Only dominant firms are subject to the prohibition against excessive pricing.^[2]

Whether a firm has engaged in excessive pricing is a highly complex issue, both factually and economically. Ordinarily, such investigations take years to conclude. However, as we noted in our earlier brief ([Use of Competition Law in response to COVID-19: emergency government actions taken](#)), by way of an emergency regulation ("**Consumer and Customer Protection Regulation**")^[3] the Minister of Trade and Industry has sought to bolster the Commission's powers to prosecute excessive pricing cases during the COVID-19 Disaster where those cases involve certain specified critical products, which include basic foods, emergency products, and medical and hygiene supplies ("**Affected Products**").^[4] The Minister has done this by seeking to trigger provisions of the Competition Act that permit for burden-shifting from the Commission to the

respondent in relation to excessive pricing allegations. The Consumer and Customer Protection Regulation specifies that a material increase in the price of an Affected Product may be considered to be excessive if the price increase –

- does not correspond to, or is not equivalent to, the increase in the cost of providing those goods or services; or
- results in an increase in the net margin, or mark-up above the average margin or mark-up, for those goods or services in the three month period prior to March 2020.

Under the Consumer and Customer Protection Regulation, these factors are “*relevant and critical*” factors. It should be noted that the Competition Act specifies a number of other factors that are relevant to assessing whether a price is excessive. While, ordinarily, the Commission bears the burden of proving a prohibited practice, in excessive pricing cases, if a *prima facie* case of an abuse of dominance by way of excessive pricing is demonstrated, the evidentiary burden will shift to the respondent to prove reasonableness of the price. However, unlike the Consumer and Customer Protection Regulation, the Competition Act does not specify that certain factors would give rise to a *prima facie* case, nor that certain factors play a more significant role than others in whether a price is *prima facie* considered to be excessive. There may therefore be some legal questions about whether the Minister can, by regulation, determine that certain factors are on their own sufficient to establish a *prima facie* case (thus weighing those factors more heavily than others), in particular where the new factors now specified are not contained in the Competition Act. However, since the Centrum Pharmacy consent order is not binding precedent and is noted in this brief for what it says about the Commission’s views and approach to dominance, we do not consider these legal considerations further in this brief. Nevertheless, this would be an important legal consideration that any company under investigation should consider if the Commission sought to establish a *prima facie* case on the basis only of the two factors specified in the Consumer and Customer Protection Regulation.

The Centrum Pharmacy consent order

Centrum Pharmacy was found to have increased the price for facial masks by approximately 150% on average for the month of March 2020. The Commission compared this to Centrum Pharmacy’s mark-up for “*all non-essential products including facial masks*” over a sustained period of time, which was lower than 150%, and found that the price was therefore excessive. Because excessiveness was determined by reference to this mark-up comparison, and Centrum Pharmacy’s average mark-up is not publicly available,^[5] the finding that a 150% mark-up results in an excessive price does not seem to reveal a possible benchmark that companies can take note of as a relevant benchmark at which the Commission would consider prices to be excessive in other cases. In any event, however, under the Consumer and Customer Protection Regulation the benchmark for a *prima facie* excessive price is a low one: if the price has increased above cost increases, or in a manner that results in an increase in net margins or average mark-ups relative to net margins or average mark-ups before 1 March 2020, the Consumer and Customer Protection Regulation indicates that this would *prima facie* be excessive.^[6]

What is of perhaps greater interest is the Commission’s approach to dominance.

Dominance in a state of national disaster

Dominance is a particularly interesting issue in relation to retail markets, as there are a numerous retail competitors, ranging from large national chains to independent retail outlets. Centrum Pharmacy is an individual pharmacy not part of any national chain. Additionally, generic facial masks do not appear to be regulated pharmaceutical products (nor medical devices), meaning that Centrum Pharmacy would likely compete with a range of non-pharmacy retail suppliers of such products.

Dominance is also interesting in the Centrum Pharmacy case because the Commission states that Centrum Pharmacy “did not sell many facial masks before March 2020”. In ordinary competition law cases, it would be unusual for a firm to go from being an apparently low-volume supplier of a product to a dominant supplier of that product in a matter of weeks.

The Commission’s finding of dominance appears to be based on two primary issues:

- First, the Commission concluded that dominance (through market power) can be inferred from the economic behaviour of a firm. In the Commission’s view, “*the mere ability to raise prices is indicative of market power*”.
- Second, the Commission averred that states of disaster provide conditions for temporary market power to be held by market participants that might not have had market power outside of the disaster period. The Commission noted that such market power “may occur for several reasons many of which are conceptually related to a narrowing of the geographic market... as a result of disruptions”. In other words, the Commission primarily identified narrower geographic markets as the basis for market power. The Commission went on to link

this to the national lockdown, stating that the scope of the geographic market is narrower in national lockdown as citizens' movements are heavily restricted.

Companies supplying essential products – whether at the retail level or a higher level in the value chain – should take note of the Commission's conclusion that market power may exist because geographic markets are narrower in a state of disaster and, in particular, during lockdown. While companies may have existing evidence or market shares indicating that their markets are competitive and that they do not have market power, the Commission may not be persuaded by this information when dealing with a COVID-19 related excessive pricing case. Furthermore, from the terms of the consent order it does not appear that the Commission considered market shares in its assessment of dominance.^[7] Instead, as indicated above, the ability to raise the price of facial masks and the notion that geographic markets are narrower due to the COVID-19 National Disaster appear to be the two prongs in the Commission's finding of dominance.

On the facts of the Centrum Pharmacy case, this was an apparently sufficient basis for the Commission to conclude that Centrum Pharmacy abused its dominance by charging an excessive price for a product that the Commission accepted Centrum Pharmacy did not sell in any material volumes before March 2020. Accordingly, in the Commission's view, the COVID-19 Disaster resulted in Centrum Pharmacy, a one-outlet pharmacy, becoming dominant.

Companies supplying any products that are specified in Annexure A to the Consumer and Customer Protection Regulation should take heed of the Commission's approach whether or not they consider themselves to be dominant. Nevertheless, there are a number of conceptual and factual questions about the Commission's finding of excessive pricing. Should the Commission adopt a similar approach in subsequent cases, these issues may very well be subject to legal challenges.

Questions arising from the Commission's findings recorded in the consent order

The conclusion that market power exists merely because a firm has the "*ability to raise prices*" appears to be superficial. The Commission recognises that national disasters change the structure and normal functioning of a market. The Commission also recognises that there was a shortage of facial masks and that Centrum Pharmacy needed to source facial masks from various suppliers. These and other factors may affect what is considered to be a "*competitive price*" for a product, as what constitutes a competitive price may change from time to time depending on market circumstances. Since a price is only excessive under the Competition Act if that price is unreasonably higher than the competitive price, it stands to reason that if the competitive price were to increase, then the sale price could similarly increase (at least to a degree) without necessarily reflecting market power or constituting an excessive price.

A further issue related to the Commission's willingness to find that market power exists based on the "*ability to raise prices*" is that the Commission did not define a market for facial masks. Instead, the Commission defined a broader market for pharmaceutical products in the Boksburg central business district. That is the market in which the Commission concluded that Centrum Pharmacy had dominance. It is not clear that generic facial masks are classified as pharmaceutical products (or as medical devices). However, even if they are, it would be a significant shortcut to conclude that a firm has market power in a broad market for pharmaceutical products based on the fact that it is able to raise prices for one particular product only, namely facial masks. On the other hand, had the Commission defined a separate market for facial masks, as we note above, it seems likely that these products may have been sold by other retailers that are not pharmacies, which would dilute Centrum Pharmacy's market share in the supply of facial masks.

A final concern with the finding of dominance is a factual issue peculiar to this case. COVID-19 was declared a national disaster on 15 March 2020 while the lockdown was announced on 22 March 2020, with effect from 27 March 2020. However, according to the consent order, the Commission received information about Centrum Pharmacy's inflated pricing of facial masks on 20 March 2020 and the investigation of pricing considered average pricing over the month of March 2020. Accordingly, the inflated prices in question occurred prior to the declaration of a state of disaster, prior to the implementation of the lockdown and even prior to the announcement of the lockdown. Yet the Commission concluded that Centrum Pharmacy was dominant because citizens' movements were restricted during lockdown, thus narrowing the scope of the geographic market, based on circumstances that occurred after the price increase had already occurred. Accordingly, the Commission appears to have taken into account circumstances that occurred after the price increases in question, to define a narrower geographic market and determine that Centrum Pharmacy had market power at the time of raising its prices. This may constitute not only a retrospective application of the Consumer and Customer Protection Regulation, but factually and economically attributes market power to a firm in relation to market conditions that occurred after the price increase.

Need for care

A consent order arises from settlement and is therefore poor precedent. Similarly, since such matters are settled rather than litigated, it is difficult to ascertain the totality of the Commission's evidence and findings relative to the totality of the defences or admissions of the respondent. Nevertheless, by all indications the Commission has received hundreds of complaints and these are being dealt with on an urgent basis. The Centrum Pharmacy consent order is the first and only definitive pronouncement by the Commission to date of its approach to such cases under the COVID-19 Disaster, and practitioners and companies can only assess that approach by the text of the consent order itself. This raises a number of questions about how rigorousness and robust the Commission's findings were.

Both the Government's intentions with the Consumer and Customer Protection Regulations and the Commission's efforts to address and prioritise excessive pricing cases in relation to essential products are laudable. However, excessive pricing cases are complex at the best of times. Rushed prosecution of such cases in times of national disaster, when market conditions have been disrupted, can make these cases even more complex. Additionally, overly-aggressive prosecution in times of national disaster can lead to adverse consequences. A careful balance is required between ensuring that firms are incentivised to engage in the effort of emergency sourcing, distribution and supply of essential products, on the one hand, while dis-incentivising them from exploiting consumers through excessive pricing cases, on the other hand. For example, if the prohibition against excessive pricing is enforced too aggressively, firms may not wish to invest the resources, time and expense in locating emergency supplies to begin with, which could result in less availability of the products in question. While there is no doubt an urgent need to consider price gouging, hopefully the Commission will not take short-cuts and will conduct its investigations and prosecutions in a robust, rigorous and responsible manner.

[1] Settlement agreements between the Commission and respondents to its investigations require confirmation by the Competition Tribunal as consent orders.

[2] Dominance is rebuttably presumed if a firm has 35% or more of a relevant market, but less than 45% of the market. The presumption can be rebutted through proof that the firm does not have "market power". Market power can be summarised as the ability of a firm to behave and/or set prices independently of customers, competitors and suppliers. Dominance is (irrebutably) deemed to exist if a firm has 45% or more of a market.

[3] Consumer and Customer Protection and National Disaster Management Regulations and Directions, 2020 (Government Gazette Notice 43116, No R. 350)

[4] The full list of products appears in Annexure A to the Consumer and Customer Protection Protections. The manner in which the Commission's powers have been bolstered applies only for as long as COVID-19 remains a declared national disaster.

[5] The average mark-up of non-essential products was claimed as confidential and is not available in the public version of the consent order.

[6] Whether this is a sound approach is not a matter which we deal with in this brief, but we note that the Consumer and Customer Protection Regulation seems to focus on a mere change (increase) in the differential between (a) price and cost or (b) pre-March 2020 margin/mark-up and margin/mark-up from March 2020 onwards whereas the Competition Act focuses on whether a price differential is reasonable. There may be circumstances in which it is reasonable for the price to rise at a rate greater than the cost or margins to increase relative to those pre-March 2020.

[7] Given the speed with which the matter was investigated and settled (apparently approximately one month) it would not be surprising if the Commission did not have reliable information on market shares.



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