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Tsunami of a Penalty as "Lucky Monopolist" gets Unlucky

18 November 2022 *12 min read*

by Rudolph Raath, Director and Nokwanda Zondi, Candidate Attorney

In a rare display of its utmost displeasure, the Competition Tribunal ("**Tribunal**") this year imposed the maximum penalty for first time offenders of the Competition Act[1] on Tsutsumani Business Enterprise CC ("**Tsutsumani**"), being 10% of its total annual turnover.

Tsunami of a Penalty as "Lucky Monopolist" gets Unlucky: ***Competition Commission v Tsutsumani****[2]*

This is a story of extreme levels of uncertainty and pressure and, in consequence, opportunity. Set in unprecedented circumstances, it is a complaint about opportunism which, on paper, evokes moral condemnation. However, for the legal advisor seeking to distill legal principles for compliance purposes, the matter has chilling implications.

As a thought experiment, consider being an in-house legal adviser tasked with signing off on the competition law compliance of a new business opportunity in circumstances where –

- the business will offer a product for the first time and therefore has no historic market share;
- the firm is one of 18 bidders for a government tender;
- the market is for the national supply of the product (albeit on an urgent basis);
- the bidder is a trader and has to source the product from manufacturers and/or other suppliers (something other successful bidders were unable to do);
- the firm can supply less than 6% of the buyer's total requirements[3];
- due to its scarcity the product is priced at almost twice its cost;
- the tender issuer elects not to negotiate on the bid price before placing its order;
- only two orders will be placed on the firm, for delivery during a single month, with no repeat business after that; and
- the business as a whole has to navigate great economic uncertainties, creating an increased risk of unexpected expenses and loss of work, potentially threatening its sustainability.

The question to ask is if these facts should prompt legal advisors and compliance officers to raise the alarm bell about potential dominance? Knowing that once dominance is raised, one enters into the quagmire of assessing the risk of abusing such dominance in contravention of the Competition Act.

For Tsutsumani the answer was yes. And, once its dominance had been established, it was convicted and punished for abusing its dominance by charging excessive prices.

Background

Given that "***context always matters in legal disputes***" and that excessive pricing cases is no exception*[4]*, it is necessary to flesh-out the above skeletal facts with the following –

- Tsutsumani was a general trader supplying a range of products via tenders for government contracts;
- during the early days of the Covid-19 pandemic the South African Police Services ("**SAPS**") issued tenders on a daily basis for the supply of bulk 3-ply surgical masks ("**masks**"), following National Treasury's emergency procurement process;

- the SAPS needed 9 million masks per month and no one supplier was able to meet this demand;
- due to the unforeseen urgency caused by the pandemic, the SAPS did not have the luxury to shop around and thus accepted all bids, almost all of them at the tendered prices;
- the SAPS bought 500 000 masks from Tsutsumani through two orders for supply placed during April 2020;
- in the Tribunal proceedings Tsutsumani admitted that "*the pandemic brought about unprecedented consequences and that there was a demand spike [for masks]*" and "*disruptions in supply*";
- Tsutsumani applied an average gross margin of between 42.9% and 46% to the prices at which it sourced its masks. In contrast, the evidence from the Commission's experts were that an acceptable range of gross margins for traders and resellers is between 10% and 15%[5]. Also, the Tribunal observed from past consent orders that margins of 20% or less has been approved[6].
- Lastly, Tsutsumani's conduct before the Tribunal was uncooperative, if not disrespectful. More than once it ignored the timelines and directives set by the Tribunal. When it did eventually state its case, it put forward an unrealistic and unsubstantiated cost structure.

The complaint against Tsutsumani was that it had contravened section 8(1)(a) of the Competition Act, read with the COVID-19 related regulations issued by the Minister of Trade and Industry on 19 March 2020[7] ("**the COVID-19 Regulations**") by charging the SAPS excessive prices for masks.

Given Tsutsumani's large gross margin, this article accepts that once Tsutsumani was classified as "dominant" and therefore found itself within the realm of section 8(1)(a), it was likely to be in for a hiding. All the more so given the narrow cost-based focus of the COVID-19 Regulations in respect of excessive pricing.

The more challenging question, however, is the qualifying question of whether or not a firm such as Tsutsumani was dominant to start with. The approach of the Tribunal in this regard is also likely to be of enduring value, given that the test for dominance was not affected by the temporary COVID-19 Regulations.

Dominant Firm?

Dominance is an important issue in competition law. Ordinarily only a small number of firms fall into this category. As a consequence, very few firms have any reason to take the slightest cognizance of section 8's list of prohibited abuses of dominance.

Sections 6[8] and 7 of the Competition Act set out the rules for determining dominance. At its core dominance is about having "market power", defined as the ability to control prices, exclude competition and behave to an appreciable extent independently of competitors, customers, and suppliers[9].

As market power is an economic concept which can be difficult to prove, section 7 introduced market share based assumptions of dominance for firms with a 35% or higher market share. Firms with smaller market shares are, however, not out of the woods entirely as the door is left open in section 7(1)(c) of the Competition Act to prove that they have market power and therefore dominance. Tsutsumani had to be assessed under the latter section, with the Commission bearing the *onus*.

In assessing Tsutsumani's dominance the Tribunal applied the same principles it previously set out in the excessive pricing case brought against Babelegi Workwear and Industrial Supplies CC[10] (later upheld in the *Babelegi* appeal), where it cautioned that a distinction should be made between market power in ordinary times and market power under non-ordinary market circumstances in the context of COVID-19.

The Tribunal held that there are important elements in the relevant period of COVID-19 that must be taken into consideration, including the following, *inter alia* –

- COVID-19 was an ongoing health related crisis with both economic and social consequences for South Africa and the globe;
- one such consequence was a global increase in demand for masks; and
- such a spike in demand could result in import channels becoming unavailable, or even lead to the exportation of masks from the country that would otherwise have been available local use.

With the above considerations in mind the Tribunal dismissed Tsutsumani's reliance on being a **first-time supplier** of masks, pointing out that the transaction in question was in and of itself significant in terms of the number of masks supplied. Citing the *Babelegi* appeal's confirmation that context matters, the Tribunal relied on the context of excess demand and short supply of masks to find Tsutsumani to be a "lucky monopolist"[11].

The Tribunal also rejected Tsutsumani's reliance on the fact that it was **one out of 18 competitors** bidding for the tender. Quoting from the *Babelegi* appeal[12], the Tribunal pointed out that the *"lucky monopolist might not be a single firm in the relevant market. Given prevailing exogenous factors, multiple firms can be found to be dominant during the crisis. Customers can be completely dependent on a firm for the supply of scarce products during a crisis. In such a case, more than one supplier can be in a dominant position in respect of its normal customers"*.

It also relied on the observation in the *Babelegi* appeal that "*[n]otionally other suppliers could have exploited the same state of affairs.*"[13] In the context of the pandemic-induced spike in the demand for masks, no firm that supplied masks, regardless of their size[14], was exempt from the abuse of dominance provisions of section 8 of the Competition Act. The Tribunal relied for its determination on various exogenous factors that had applied at the time, including, *inter alia*, that no single supplier had the capacity to satisfy the requirements of the SAPS for masks; that the qualifying bidders (like Tsutsumani) were aware of the immediacy of the need to respond to the tender; and of the lack of scope for the SAPS to shop around.

The Tribunal also rejected Tsutsumani's argument that market power cannot be **inferred from pricing conduct**. It relied on the statement in the *Babelegi* appeal[15] that *"…[i]n a crisis situation such as that induced by the COVID-19 pandemic, one needs to use a somewhat different conceptual framework from what ordinarily would be employed in an excessive pricing case…"*, adding that this was *inter alia* because market forces may have been disrupted during the pandemic so as to increase demand for and create shortage in supply of masks.

The Tribunal accepted that the reason why the SAPS purchased masks from Tsutsumani at soaring prices was because it did not have a choice: the difficulties caused by the supply shortage were amplified by the large volumes of masks the SAPS required and by the utmost urgency of the need. The Tribunal concluded that there is no conceivable explanation which might account for Tsutsumani's pricing other than the existence of market power. In the relevant period Tsutsumani had the power to act independently of its competitors on the supply side and independently of the SAPS as a customer on the demand side, which is the very definition of market power.

Lastly, the Tribunal disagreed with Tsutsumani's contention that the "market power" contemplated in the Competition Act is one that must be **substantial and durable**. The Tribunal relied on the CAC's response to a similar argument on durability of market power raised in the *Babelegi* appeal, which was that *"[i]n the complaint period, it (Babelegi) acted as a monopolist, no matter that other firms may have done the same. It extracted a surplus that could only be achieved by virtue of the independence it enjoyed as a result of being "lucky" … Thanks only to the outbreak of the pandemic, it possessed market power which allowed it for at least six weeks to mimic the conduct of a monopolist."*[16]

The Tribunal found that Tsutsumani acted in a similar way to Babelegi, in that due to the outbreak of COVID-19 pandemic, Tsutsumani could mimic the conduct of a monopolist and sell a substantial volume of masks to the SAPS at a high price. It therefore found Tsutsumani to have been a lucky monopolist enjoying market power in the relevant period.

Having classified Tsutsumani as a dominant firm, the Tribunal proceeded with an assessment of its mask prices and concluded that they were excessive. For this conduct (and Tsutsumani's conduct before the Tribunal) the Tribunal meted out the maximum penalty.

Conclusion

As the saying goes, "*drastic times call for drastic measures*", and the COVID-19 pandemic certainly did present the world with unprecedented challenges. However, one should be careful not to write off the *Tsutsumani* decision as a COVID-19 only phenomenon. It serves as a cautionary example that market share serves only as a rule of thumb when determining dominance. Even absent any prior market presence, firms are not immune against being regarded dominant upon commencing trade in a new market. Evidently, abnormally high margins might be taken as indicative of market power and therefore dominance, even for small firms and new market entrants.

The bottom line is that otherwise non-dominant firms who stumble serendipitously across marvellously profitable opportunities seemingly too good to be true, should take note. Exploiting such opportunities, even only once, may render them "lucky monopolists" at risk of abusing their (temporary) dominance, for which they will pay dearly. Such firms would be well served by taking competition law advice before trying their luck.

The views expressed by the authors are their own and do not purport to reflect the views and opinions of Werksmans Inc.

Footnotes

[1] Act no. 89 of 1998

[2] Tribunal case no. COVCR113Sep20

[3] 500 000 units out of a requirement for 9 000 000 units per month

[4] As the Competition Appeal Court emphasised in the excessive pricing case of *Babelegi Workwear and Industrial Supplies CC v Competition Commission* 186/CAC/JUN2020 ("**the *Babelegi* appeal**") at paras 42 and 55

[5] Para 105

[6] Para 141

[7] Consumer and Customer Protection and National Disaster Management Regulations and Directions in Government, published in Notice No. 35 of *Government Gazette* no. 43116. These Regulations ceased to apply when the National State of Disaster came to an end.

[8] Section 6 of the Competition Act requires the Minister of the Department of Trade, Industry and Competition and the Competition Commission to determine a threshold of annual turnover or assets below which the "abuse of dominance" provisions in the Competition Act do not apply. This is currently set at R5 000 000.

[9] Section 1(1) of the Competition Act.

[10] *Competition Commission v Babelegi Workwear and Industrial Supplies CC* [2020] JOL 47572 (CT), para 67 – 70.

[11] In para 65 the Tribunal accepted the definition of a "lucky monopolist" as "*a firm whose power comes not from the state or from natural efficiencies, unparalleled investment efforts, superior management ability or as a result of anticompetitive conduct, but rather from luck, being events that fall outside of the knowledge of the economic actor or its ability to determine the timing thereof. They do not require the firm to incur any cost in order to secure its market position in that the relevant factors are exogenous to the cost functions of the firm but are significantly meaningful to propel a firm to a position of dominance among existing firms.*"

[12] The *Babelegi* appeal, para 49.

[13] *Babelegi* appeal, para 57

[14] Provided it met the R5 000 000 financial threshold set in terms of section 6 of the Competition Act

[15] The *Babelegi* appeal 186/CAC/JUN2020 para 50.

[16] Para 55



Rudolph Raath

Director

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