

The South African Airways cases: blazing a trail for Europe to follow?

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1 Introduction

In July 2005 the Competition Tribunal fined South African Airways (SAA) R45m—at the time the largest fine under the Competition Act 1998—for an abuse of dominance centred on its use of loyalty rebates with travel agents between 1999 and 2001. In early 2009, SAA was defending a similar loyalty rebates case at the Tribunal relating to a later time period. One feature that makes both cases stand out is the use of an effects-based framework to evaluate SAA's abusive and allegedly abusive conduct. This contrasts with the famous BA/Virgin and Michelin loyalty rebates cases by the European Commission, both of which were dealt with using a form-based approach.²

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² European Commission (1996), 'Commission decision of 14 July 1999 relating to a proceeding under Article 82 of the EC Treaty (IV/D-2/34.780—Virgin/British Airways)'. European Commission (2002) 'Commission Decision of 20 June 2001 relating to a proceeding pursuant to article 82 of the EC Treaty (COMP/E-2/36.041/PO – Michelin)', *Official Journal of the European Communities*, May, L143.

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The most recent SAA case is also very interesting because of the timing of hearings; the economic experts were heard in early 2009, only a few months after the publication of prominent policy papers by the European Commission and US Department of Justice on monopolisation and abuse of dominance.³ As such, this case is one of the first to use these policy papers in practice. Finally, the 2005 case was also the subject of the first antitrust follow-on damages claim in South Africa, in which rival, Nationwide Airlines, sought damages from SAA.

The article begins by setting out the key features of the two SAA abuse cases (given that the second SAA case is still being considered by the Tribunal, the focus is towards the 2005 case). It then places the SAA case in the context of the ongoing international debate about exclusionary conduct.

2 SAA: summary of the two cases

Both abuse cases focus on loyalty rebates, which offer a discount or a rebate payment to a purchaser in return for remaining loyal to a particular supplier; in this case rebates, in the form of increased commission payments, were made to travel agents in return for increasing SAA sales relative to the previous year's sales. This form of rebate is a common feature of intermediate/wholesale product markets. For example, some retail stores make a substantial proportion of their profits from rebates from goods manufacturers, and car dealerships often rely on the rebates offered to them by car manufacturers. However, while there are many benign applications of loyalty rebates, those put in place by dominant firms may raise abuse of dominance concerns. The key issue that needs to be resolved when reviewing such incentives is how to separate aggressive competition from abuse of market power.

2.1 The 2005 case

In July 2005, SAA was found to have contravened Section 8(d)(i) of the Competition Act, since it had engaged in two practices in the period from 1999 to 2001 that the Tribunal found to be prohibited.⁴ These practices were referred to as the 'override incentive scheme' and the 'Explorer scheme'. Both schemes provided strong incentives to travel agents to divert passengers from rivals' domestic flights (primarily those of Nationwide Airlines and BA/Comair)⁵ to SAA. There were also schemes targeted at international flights, however, these were not the focus of the case.

The Tribunal concluded that SAA was dominant in the market for domestic airline travel, and that, the schemes were exclusionary since they induced the travel agents not to deal with SAA's competitors, and that SAA had abused its dominant position in the relevant markets by adopting these practices. Oxera acted as economic expert for the Competition Commission during this case.

2.1.1 Override agreements

The first practice—the override incentive scheme—involved incentive contracts between SAA and a large proportion of South African travel agents.⁶ The contracts were designed such that the agents received a flat basic commission for all SAA sales up to a target (in rand) specified in the contract. When the target was reached, the agents were eligible for two

³ Department of Justice (2008), 'Competition and Monopoly: Single-firm Conduct Under Section 2 of The Sherman Act', September; and European Commission (2008), 'Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings', December 3rd.

⁴ These practices are not prohibited per se, but were considered to be an abuse of a dominant position by SAA.

⁵ Comair was trading as a BA franchisee during the period examined in this case.

⁶ Competition Tribunal (2005), 'Reasons and Order: The Competition Commission and South African Airways (Pty) Ltd', Case Number 18/CR/Mar01, para. 223.

further types of commission in addition to the basic payment. The 'override commission' was paid if the agent exceeded the target. This commission was paid not only on the amount above the target, but on the whole amount below and above the target—referred to as the 'back to rand one' principle. The second type of commission was paid only on the amount in excess of the target (the incremental sales)—referred to as the 'back to rand base' principle. For example, were the override target equal to 100, and the base commission were 7%, the override incentive might be to increase the commission on all units sold to 7.5% once 100 units are sold. So the commission received by the travel agent for 99 units would be $99 \times 7\% = 6.93$, while the price paid for 100 would be $100 \times 7.5\% = 7.50$. Clearly by selling 100 units the average commission paid has risen substantially.⁷

The Tribunal evaluated both the form and the effects of these agreements.

- Form of the agreements—the Tribunal identified that although SAA's override scheme had been in operation since the 1980s, its effects on SAA's competitors were insignificant until September 1999, when SAA adopted a more aggressive approach to the management of the scheme. This involved a reduction in the flat basic commission and an increase in the override commission/or increasing the targets annually over and above the rate of inflation. The Tribunal concluded that these changes provided stronger incentives to the travel agents to sell SAA tickets instead of those of other airlines.

The Tribunal noted that the incentives under these agreements were particularly strong because the additional commission was granted not only on the additional sales achieved (ie, on a marginal basis), but either on all tickets sold by that travel agent during the year (in the case of override incentives), or on all tickets sold in excess of a certain threshold (in the case of incremental payments). Furthermore, the sales targets in the agreements were set individually for each travel agent; thus, the growth targets were tailored to the specific circumstances of each agent (eg, their size). These factors combined to make the marginal incentive rates faced by travel agents for sales of SAA tickets very high.

The Tribunal also highlighted the important relationship between marginal and average commission rates. Despite SAA paying the travel agents very high marginal commission rates, its overall average commission rates remained relatively low (eg, often only just above the standard 7% commission rate) since the override incentives were effectively spread across all sales. In contrast, a smaller rival replicating the same cash value of the marginal commission to the travel agent would require much higher average commission rate (eg, often 15% or more).⁸

- Effects of the agreements—in addition to these form-based conclusions, a substantial volume of behavioural evidence was presented to the Tribunal. This suggested that travel agents responded to SAA's incentives, and that they actively 'off-sold' SAA's competitors in order to meet the SAA targets. Three examples are as follows.
 - **Rennies**—Vernon Bricknell, CEO of Nationwide Airlines, stated that: 'SAA was [Rennies'] preferred carrier and Lillian Boyle [CEO of Rennies] had instructed her entire group to only deal with South African Airways and not to sell Nationwide [tickets]' to consumers.⁹

⁷ In this example an increase of sales of approximately 1% (1 extra unit on a base of 99 units) has increased the commission received by the agent by more than 8% ($7.50 - 6.93 = 0.57$, and $0.57 / 6.93 = 8.2\%$).

⁸ Competition Tribunal (2005), 'Reasons and Order: The Competition Commission and South African Airways (Pty) Ltd', 18/CR/Mar01, para. 151.

⁹ Competition Tribunal (2005), 'Reasons and Order: The Competition Commission and South African Airways (Pty) Ltd', 18/CR/Mar01, para. 172.

- **Sure Travel**—when faced with the question, ‘which one is really paramount to the Managing Director of a firm, a consumer or the incentive, reaching the incentive threshold? Mr Puk from your point of view, what is most important?’, Mr Puk, of Sure Travel, replied: ‘From my personal point of view, if you are asking for the paramount, I am employed to make sure that the group achieves its preferred agreements.’¹⁰
- **Tourvest**—similarly, testimony from a representative of Tourvest, one of South Africa’s largest travel agents, stated that: ‘wherever we have the opportunity we promote our preferred supplier and that can and has been at times highly lucrative and it is on that basis that we are able to achieve our volume incentives and generate profitability in our business’.¹¹

The Tribunal also pointed to the performance of Nationwide Airlines and BA/Comair, concluding that they ‘experienced a period of decline after strong periods of growth that coincided with the periods in which the override agreements became more challenging’.¹² Furthermore, the Tribunal focused on the thinking of SAA’s competitors at the time the agreements came into effect, pointing to the ‘evidence of BA/Comair and Nationwide not only during this hearing but more importantly their thinking at the time and before litigation had commenced’, as one of its main reasons to conclude that anti-competitive effects were likely.¹³

2.1.2 Explorer scheme

The Explorer scheme aimed at rewarding individual travel agency staff with free travel on SAA flights in return for reaching sales targets for SAA tickets. It operated in a similar way to a frequent-flyer scheme. Thus, rather than targeting travel agencies as a whole, the scheme provided the individual travel agents with a strong personal incentive to sell SAA tickets. In contrast to the override scheme, which continued for a significant period of time after the 1999 to 2001 period of analysis (see the discussion below regarding the second case), the Explorer scheme came to an end in June 2002.

2.1.3 The Tribunal’s decision

The Tribunal found SAA’s conduct to be exclusionary, and that SAA had abused its dominant position by adopting these exclusionary agreements.¹⁴ The company was required to cease these incentive schemes and to pay a fine of R45m (€5.7m, \$6.8m).

The 2005 case was particularly notable because it was one of the first successful prosecutions that relied, at least to some extent, on showing the effects of the loyalty rebates. In contrast, the successful cases brought by the European Commission have been proven on the form of the behaviour—eg, the BA/Virgin case did not consider evidence on actual travel agents’ behaviour, while the SAA case did.

¹⁰ Competition Tribunal (2005), ‘Reasons and Order: The Competition Commission and South African Airways (Pty) Ltd’, 18/CR/Mar01, para. 195.

¹¹ Competition Tribunal, South Africa (2005), ‘Reasons and Order: In the Matter between the Competition Commission (complainant) and South African Airways (Pty) Ltd (respondent)’, Case Number: 18/CR/Mar01, July, p. 46.

¹² Competition Tribunal (2005), ‘Reasons and Order: The Competition Commission and South African Airways (Pty) Ltd’, 18/CR/Mar01, para. 240.

¹³ The BA/Comair board minutes highlighted ‘the SAA override scheme and the incentive bonuses paid to travel agents’ as a possible cause of that airline’s poor performance. See Competition Tribunal (2005), ‘Reasons and Order: The Competition Commission and South African Airways (Pty) Ltd’, 18/CR/Mar01, para. 233.

¹⁴ However, it is worth noting that the Tribunal concluded: ‘We find further that use of the Explorer scheme has contributed to the anticompetitive effects of the scheme. We find that, although the override incentive scheme on its own would constitute a prohibited practice in terms of the Act, the same cannot be said with the same certainty of the Explorer scheme.’ Competition Tribunal (2005), ‘Reasons and Order: The Competition Commission and South African Airways (Pty) Ltd’, Case Number 18/CR/Mar01, para. 258.

Therefore, while the 2005 SAA case does not go as far as might be required in the USA, which generally requires evidence of direct harm to competition and hence consumer detriment (eg, via higher prices), the Tribunal was convinced that SAA's rebates were having some effect on consumers:

consumers are likely to have made wrong choices of airlines, chosen the wrong prices and essentially, it has led to the wrong set of outputs.¹⁵

Two other features of the 2005 case are worthy of note: that the Tribunal set out what can be considered a set of 'fining guidelines' in its decision (see Box 2.1), and that the case spawned the first follow-on damages claim in South Africa (see Box 2.2).

Box 2.1 The 'fining guidelines' in the 2005 case

The South African legal system does not have clearly developed or widely used sentencing guidelines. Thus, the Tribunal had to consider in some detail how to set an appropriate penalty for an infringement of Section 8 of the Competition Act. In doing so it set out an approach that was 'intended to act as a guideline for the future'. The approach it adopted—which is set out in the table below—allocates the 10% maximum fine to a variety of headings.¹⁶ A decision was then taken assessing the nature of the infringement against each of them.

Factor	Allocation of 10% maximum	SAA allocation
Nature, duration and extent of contravention	3.0	0.75
Loss or damage as a result of contravention	1.0	0.25
Behaviour of respondent	1.0	0.5
Market circumstances	1.0	0.75
Level of profit derived from conduct	0.5	0
Degree of co-operation with Competition Commission and Tribunal	1.5	0
Found in previous contravention (ie, repeat offence)	2.0	0
Total	10	2.25

Source for quotes and the table: Competition Tribunal, South Africa (2005), 'Reasons and Order: In the Matter between the Competition Commission (complainant) and South African Airways (Pty) Ltd (respondent)', Case Number: 18/CR/Mar01, July, pp. 75–78.

¹⁵ Competition Tribunal, South Africa (2005), 'Reasons and Order: In the Matter between the Competition Commission (complainant) and South African Airways (Pty) Ltd (respondent)', Case Number: 18/CR/Mar01, July, p. 55.

¹⁶ The 10% maximum is of the contravening firm's turnover in the previous financial year. See Section 59(2) of the Competition Act.

Box 2.2 The follow-on damages claim

As well as being a notable case under the Competition Act, the action against SAA spawned the first follow-on civil claim for damages in South Africa. The action was brought by Nationwide Airlines in the Pretoria High Court for the harm it claimed that it had suffered as a result of the abuse of dominance. Oxera acted as economic expert for Nationwide Airlines.

While this was the first claim of its kind, it did not result in a ruling. An article summarising the case in *Global Competition Litigation Review* described it in the following terms:

Rather disappointingly for those hoping to see the trial culminate in a long-awaited precedent regarding civil claims for competition-related damages, the parties reached a confidential out-of-court settlement on the second day of the hearings, which were expected to run for several weeks.

Source for quote: Carter, C. (2008), 'South Africa's First Private Competition Damages Claim Settled Out of Court', *Global Competition Litigation Review*, Issue 1, R-14.

2.2 The second case¹⁷

The 2005 case related to agreements that SAA had in place from 1999 to 2001. However, various similar agreements remained in place beyond 2001. Comair lodged a complaint with the Competition Commission about these post-2001 agreements in October 2003, and the Competition Commission referred the matter to the Tribunal in October 2004.

The allegation was broadly the same as in the 2005 case: that SAA's agreements with agents acted to exclude rivals. However, the nature of agreements had changed slightly. Override commission agreements, of a similar kind to those in the 2005 case, were alleged to still be in existence. A second new set of agreements, termed 'trust payments' were alleged to be in place. These were described as 'lump sum payments made to travel agents at the end of a financial year if they attain certain prescribed targets in selling SAA tickets'.¹⁸ As noted above, the Explorer scheme ended in 2002, so this was not a focus of the allegations.

In 2006, SAA reached a settlement with the Competition Commission about these allegations. Both Comair and Nationwide Airlines objected to elements of the settlement, and therefore contested the Competition Commission's consent order. They did so because the agreement did not include an admission of liability or wrongdoing on the part of SAA, and because they considered the agreed fine to be too small (R15m, compared with R45m in the 2005 case). In December 2006, the Tribunal approved the consent order.

As this settlement did not include an admission of liability, it does not allow the two rivals to launch follow-on damages claims. Thus, both Comair and Nationwide Airlines continued with their complaints against SAA. As these complaints are still the subject of Tribunal deliberations, little is said on the substance of the matter (Oxera acted for Nationwide Airlines in this matter). However, as noted in the introduction, the timing of hearings was notable, as

¹⁷ This is sometimes referred to as the 'Comair complaint'. See Competition Tribunal (2006), 'Reasons and Order: In the Consent Order proceedings between the Competition Commission (applicant) and South African Airways (Pty) Ltd (first respondents) Comair Ltd (second respondent) Nationwide Airlines (Pty) Ltd (third respondent)', Case number 83/CR/Oct04, December, p. 3.

¹⁸ Competition Tribunal (2006), 'Reasons and Order: In the Consent Order Proceedings between the Competition Commission (applicant) and South African Airways (Pty) Ltd (first respondents) Comair Ltd (second respondent) Nationwide Airlines (Pty) Ltd (third respondent)', Case number 83/CR/Oct04, December, p. 2.

the economic experts were heard in early 2009, only a few months after the publication of two prominent policy papers. The debate that these raise is considered further in section 3.

3 The SAA cases in context: the international debate on exclusionary conduct

In recent years there has been extensive debate in the USA and Europe on how competition policy should deal with exclusionary conduct. In the latter part of 2008, the US Department of Justice (DOJ) and the European Commission (DG Competition) each published a prominent policy document on monopolisation and abuse of dominance, following extensive consultation with their respective competition law 'communities'.¹⁹

The debates have covered the tests to be applied both to exclusionary conduct in general and to specific exclusionary practices. One of those specific practices covered is of relevance to the SAA cases. SAA's override agreements—in particular their back-to-rand-one feature—can be broadly classified as a variant of what the European Commission describes as 'retroactive rebates' and the DOJ labels 'single-product loyalty discounts'.²⁰

Much of the debate has centred on whether policy towards abuse of dominance should be form-based or effects-based. European case law on abuse of dominance (under Article 82 EC Treaty) has, at least until recently, largely been form-based, which means that certain types of practice, including back-to-euro-one-type pricing arrangements, were outlawed virtually per se once a firm was considered to have a dominant position.²¹ The following quote, from the European Commission in its BA/Virgin decision, provides an example of the form-based approach.²²

Such commission schemes carried out by a firm enjoying a dominant position as a purchaser of services from travel agents are illegal, regardless of any possibility for the travel agents or competing airlines to minimise or avoid their effects.

The European Commission has sought to move Article 82 policy towards an effects-based approach, which means that practices by dominant firms are prohibited only if they actually, or are very likely to, produce significant adverse effects on competition or consumers.²³ In line with this guidance, many legal and economic commentators, including Oxera, had argued that an effects-based approach to abuse of dominance is more appropriate than a form-based approach.²⁴

Indeed, the Tribunal's decision in the first SAA case of 2005 has been cited in these debates as a good example of how an authority or court can assess both form and effects of

¹⁹ Department of Justice (2008), 'Competition and Monopoly: Single-firm Conduct Under Section 2 of The Sherman Act', September; and European Commission (2008), 'Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings', December 3rd.

²⁰ See, respectively, Section IV.A of European Commission (2008), op. cit., and Chapter 6.II of Department of Justice (2008), op. cit. These documents refer to discounts and rebates, while the SAA override arrangements refer to payments to travel agents, but in essence they have the same effects. It should be noted that there can be several different variants of back-to-rand-one schemes which do not necessarily warrant a uniform approach.

²¹ For example, European Court of Justice (2007), 'British Airways plc v Commission', Judgment Case C-95/04 P, March 15th.

²² European Commission (1996), 'Commission decision of 14 July 1999 relating to a proceeding under Article 82 of the EC Treaty (IV/D-2/34.780—Virgin/British Airways)', para. 102.

²³ See European Commission (2008), op. cit., Section III.B.

²⁴ See, for example, Niels, G. (2006), 'Article 82: Effect Not Form?', *Competition Law Insight*, 5:6, pp. 6–8; and Niels, G. and Jenkins, H. (2005), 'Reform of Article 82: Where the Link between Dominance and Effects Breaks Down', *European Competition Law Review*, 26:11, November.

retroactive rebates in finding an abuse of dominance.²⁵ In that case the Tribunal set out that if the conduct (act) is exclusionary in nature:

We then enquire whether the *exclusionary act* has an anti-competitive effect. This question will be answered in the affirmative if there is (i) evidence of actual harm to consumer welfare or (ii) if the exclusionary act is substantial or significant in terms of its effects in foreclosing the market to rivals. This latter is partly factual and partly based on reasonable inferences drawn from proven facts. [emphasis in original]²⁶

The Tribunal concluded that SAA's override agreements in the period from 1999 to 2001 were indeed likely to have anti-competitive effects. It found that the effect on the structure of the market was:

to inhibit rivals from expanding in the market whilst at the same time reinforcing the dominant position of SAA. Therefore the exclusionary act is substantial or significant in terms of its effect in foreclosing the market to rivals.²⁷

In addition, the Tribunal found there to be effects on consumers, in terms of having been led to make the wrong choices of airlines and the wrong prices (see quote in section 2.1.3).

It is important to note that an effects-based approach does not require there to be definitive proof that competition or consumers have actually been harmed. The available information is not always sufficient, and in abuse of dominance cases it may sometimes be too late to intervene by the time the actual harm has materialised. What matters is that a solid case can be made that the alleged negative effect on competition is both likely and significant.

It is also important to note that advocating an effects-based test for back-to-rand-one-type arrangements is not the same as saying that such arrangements can never be anti-competitive. Even the DOJ, which is known (and has been criticised by many, including the US Federal Trade Commission) for its laissez-faire approach to unilateral conduct by dominant firms, recognises the possibility that back-to-rand-one-type arrangements can be anti-competitive in certain circumstances.²⁸

4 Conclusion

Adopting an effects-based approach does not mean fully quantifying and weighing all the costs and benefits of the alleged abusive behaviour. It may simply involve the consideration of a range of economic indicators of actual and likely competitive effects that go beyond the assessment of dominance, such as the degree of foreclosure of the market to competitors, and the possible efficiency benefits of the behaviour.

The criteria applied by the Tribunal in the 2005 SAA case are in line with the effects-based approach. For example, the Tribunal considered factors such as the degree of foreclosure, and the possible efficiency gains from the agreements (indeed, this latter point is embedded

²⁵ See Oxera (2005), 'Buying Loyalty: South African Airways and the Ongoing Saga of Rebate Cases', *Agenda*, August; and OECD (2008), 'Policy Roundtables: Fidelity and Bundled Rebates and Discounts', December 2nd.

²⁶ Competition Tribunal (2005), 'Reasons and Order: The Competition Commission and South African Airways (Pty) Ltd', 18/CR/Mar01, para. 132.

²⁷ Competition Tribunal (2005), 'Reasons and Order: The Competition Commission and South African Airways (Pty) Ltd', 18/CR/Mar01, para. 241.

²⁸ Department of Justice (2008), *op. cit.*, pp. 114–15. Three commissioners at the FTC have criticised the DOJ's laissez-faire enforcement approach as erecting a 'multi-layered protective screen for firms with monopoly or near-monopoly power', enabling these firms to engage in anti-competitive unilateral conduct 'with impunity'. See Federal Trade Commission (2008), 'Statement of Commissioners Harbour, Leibowitz and Rosch on the issuance of the Section 2 report by the Department of Justice', September.

in the text of Section 8 of the Competition Act). It is likely to evaluate the second SAA in a similar manner.

Indeed, the Tribunal's effects-based approach to examining abuse of dominance was re-affirmed in its June 2009 decision regarding allegedly exclusionary agreements put in place by British American Tobacco South Africa. In that it stated that:²⁹

Ultimately the impact on competition of any form of exclusive arrangement must be measured by the extent of foreclosure that results from the agreement. As noted, we have exhaustively examined the evidence and we find that there is no significant foreclosure and hence no anticompetitive effect.

Therefore, it seems that the Tribunal may well be blazing an interesting effects-based trail for Europe and other jurisdictions to consider following.

²⁹ Competition Tribunal (2009), 'Reasons and Order: In the Matter between the Competition Commission (first applicant) JT International (Pty) Ltd (second applicant) and British American Tobacco South Africa (respondent)', Case Number: 05/CR/Feb05, June, p. 98.