



UNDERSTANDING PUBLIC POLICY EXEMPTIONS

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Introduction

The exemptions provisions of any competition regime lie at the intersection of competition law policy and broader economic and social policy objectives. Section 10 of the South African Competition Act² deals with so-called 'public policy' exemptions, and requires the Competition Commission to exempt conduct otherwise prohibited if it is required to achieve identified socio-economic aims.

However, the grounds for exemption set out in the Act are unusually narrow and the drafting of section 10 is peculiar in a number of respects. There are no guidelines as to how the Commission is to approach its assessment of applications for exemption, and the reasons published by the Commission for its decisions on previous exemption applications provide little direction.

In this critical aspect of our competition law, there is a gap. Firms seeking to behave in a manner which promotes essential economic, social and political ideals face an unpredictable onus. It is submitted that greater certainty in this area is crucial, particularly in light of the Act's stark *per se* prohibition of certain potentially efficiency enhancing and objectively desirable conduct.

In this paper we examine:

- The role of exemptions within the Competition Act;
- The provisions of section 10, including the section's likely policy objectives;
- The equivalent rules in some foreign jurisdictions which may guide our interpretation of South Africa's exemption provisions, and
- Recent decisions of the Commission on exemption applications.

From this analysis, we hope to extract a set of principles which may:

- guide potential exemption applicants motivating for exemption under the largely untested provisions of section 10, and
- serve as a basis for guidelines which the Commission may consider adopting.

In summary, our view is that the Act envisages a limited role for the Commission in adjudicating exemption applications. Its enquiry should be restricted to whether the relevant conduct contravenes the Act, and whether it is required to attain any of the policy

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² Act 89 of 1998

objectives listed in section 10(3)(b). No further investigation is required into how potentially conflicting competition and public policy goals should be balanced, and which should prevail. This is the preserve of policy makers within the executive and the legislature, and the Commission should not lightly interfere.

Background to exemptions

Competition between firms in the economy produces a number of objectively desirable outcomes. Rivalry forces firms to innovate, produce, and distribute more efficiently. This results directly in increased product variety and lower prices for consumers. Ultimately, competition fosters conditions conducive to productivity, growth and employment creation. The Act protects competition by prohibiting collaborative and unilateral conduct by firms that may have a restrictive effect on competition, and prohibiting mergers between firms that are likely to give rise to anti-competitive market behaviour or structures.

However, competition may occasionally be at odds with other important social and economic goals. For instance, collaboration between competing firms to develop innovative life saving pharmaceutical products where limited resources would otherwise prevent firms from such developments, would clearly be in the public interest despite the resulting restriction of competition. Competitive pressure may force small firms to go out of business, resulting in job losses. Competition may also drive firms to compromise on important product characteristics such as safety, in order to reduce costs to a minimum³. In appropriate circumstances, it is therefore necessary for competition laws to yield to other, more important policy objectives. The aims of competition policy are important, but should not be pursued blindly.

It is also important to recognise that a number of the reasons for the enactment of a country's competition law may at times conflict with those laws themselves. The South African Act prohibits restrictive collaborative and unilateral conduct by firms that yields market outcomes deemed 'inefficient' when measured against consumer, producer and total welfare standards. However, it also seeks to remedy endemic inequality by explicitly promoting a range of social objectives, including employment and the participation of historically disadvantaged people in the economy.

These goals of competition for efficiency's sake - 'pure competition' objectives - and competition as a means of achieving public policy goals may often conflict. For instance, as explained above, competition creates growth and, importantly in the South African context, jobs. However, competitors in a declining industry, who would normally be forced to retrench workers, could potentially increase prices, and therefore profits, to a viable level and maintain their employees by cooperating, rather than competing.

The exemptions provisions of the Act embody the legislature's expression of the types of government policy objectives which may 'trump' the objectives of 'pure' competition policy in particular circumstances. These provisions are critical to ensure that competition policy is considered in its proper context, and to prevent society losing out as a result of important social objectives giving way in dogmatic pursuance of competition.

Importantly, prioritising potentially conflicting policy objectives is the role of government. The hierarchy of policy aims should be determined by cabinet and expressed in legislation.

³ Whish, 'Competition Law', 6ed at page 12

The role of the Commission in deciding on exemptions should not be one of a 'super-regulator', which determines which policy aspiration should prevail. As explained below, the Act recognises this by proscribing a narrow enquiry which the Commission must undertake in evaluating 'public policy' exemption applications.

We submit that the Commission is a competition policy maker, but this role does not extend to the balancing of competition policy with other socio economic policies.

Different types of exemptions

The Act provides for a number of different categories of exemptions. The nature of the exemption conferred differs fundamentally in each category.

First category – the Act does not apply

The first category comprises those activities or agreements to which the Act simply does not apply, and which are therefore inherently exempt from application of any portion of the Act. We submit that this category entails a necessary overlap between conduct which should be considered 'exempt', and questions typically considered when addressing the ambit of the Act's jurisdictional reach. The Act exempts from its own application:

- Economic activity which takes place outside South Africa, and does not have an effect within South Africa;
- Collective bargaining within the meaning of section 23 of the Constitution and the Labour Relations Act;
- A collective agreement, as defined in section 213 of the Labour Relations Act, and
- Concerted conduct designed to achieve a non-commercial socio-economic objective or similar purpose.

The 'carve-outs' relating to extra-territorial conduct which does not have an effect in South Africa and collective bargaining are beyond the scope of this paper. The final exclusion, of concerted conduct designed to achieve non-commercial socio-economic objectives or similar purposes, is intentionally broad. The inclusion of the words 'or similar purpose' opens up the scope of this exclusion considerably. It is not clear how this provision is intended to operate, or the extent of any overlap with the other 'public interest' exemption provisions of the Act. A detailed discussion of this issue is beyond the scope of this paper.

Second category – Concurrency agreements

Where a particular industry or sector is subject to a specialised regulatory authority, the Act envisages a system of concurrent jurisdiction between that regulator and the competition authorities. It requires that the Commission and the relevant sector regulator should conclude an agreement setting out the manner in which concurrent jurisdiction is to be exercised and managed⁴.

⁴ The Act in section 21(1)(h) as read with sections 3(1A)(b) and 82(1), (2) and (3) authorizes the Commission to enter into a Memorandum of Agreement. Thus far the Commission has entered into Agreements with the Independent Communications Authority of South Africa (GG No. 23857 of 20 September 2002); the Postal

Conduct which may otherwise contravene the Act may be permissible if it is authorised by sector-specific rules and regulations. Certain pricing behaviour in particular may be exempt. For example, by charging a fee or tariff which is prescribed in sector regulations, a firm could never be found to be charging an excessive price to the detriment of consumers, in contravention of section 8(a) of the Act.

The result is a peculiar situation – the Act would apply to the relevant conduct, but the competition authorities' jurisdiction to regulate the conduct may be ousted by the provisions of a 'concurrency agreement'. Our view is that such conduct could be considered 'exempt', although the nature of the exemption differs fundamentally from the other types of exemptions which may be granted under the Act.

Third category – Intellectual property exemptions

Intellectual property rights are by their nature at odds with competition – they place their holder in a monopoly position in respect of their exercise. In line with competition policy worldwide and on the basis that intellectual property protections play a crucial role in incentivising innovation in the economy, the legislature has therefore deemed it appropriate to provide for exemption of agreements or practices which relate to the exercise of intellectual property rights from the application of Chapter 2 of the Act.

There has only been one case of an exemption for purposes of exercising intellectual property restrictions to date⁵. The interaction of intellectual property protections with competition law is a self-standing and broad topic which we do not consider further in this paper.

Fourth category – Professional rules

Schedule 1 to the Act allows a professional association to apply to the Commission for an exemption from application of Chapter 2 for any restriction contained in its rules which substantially lessens or prevents competition, but which is required to maintain professional standards or the ordinary functioning of the profession. The rationale for this Schedule is that competition between members of a profession in certain aspects of work may incentivise firms to compromise on quality and ethics in an effort to undercut rivals and where permitting, a professional association's rules should be exempt from application of the Act⁶.

Regulator (GG 26712 of 24 August 2004) and the National Electricity Regulator (GG 24108 of 29 November 2002).

⁵ Visa SA, a branch of Visa International Service Association Incorporated, Case number 2001JUL4 (GG 27006 of 26 November 2004)

⁶ See decision of Commission in the Law Society of South Africa exemption application, Case number 2004Jul1127 (GG 34051 of 4 March 2011); and pending exemption application in Health Professions Council of South Africa, Case number 2008Jan3456 (GG 30828 of 7 March 2008) and amendment (GG 32253 of 29 May 2009)

Fifth category – the specific ‘public policy’ factors

Finally, section 10 of the Act provides that a firm may apply to the Commission to exempt from application of Chapter 2 agreements and practices which are necessary to achieve any of the following objectives:

- Maintenance or promotion of exports;
- promotion of the ability of small businesses or firms controlled or owned by historically disadvantaged persons to become competitive;
- change in productive capacity necessary to stop decline in an industry, or
- the economic stability of any industry designated by the Minister.

This paper is primarily concerned with this category of exemptions, which we analyse in detail below.

The position of public policy exemptions within the structure of the Act

Before commencing an analysis of the ‘public policy’ exemption provisions of section 10, it is important to consider the place of these exemptions within the broader statutory scheme established by the Act.

A firm may apply to the Commission for an exemption from application of Chapter 2 of the Act to specified agreements or practices. Chapter 2 sets out the conduct which is considered a ‘prohibited practice’. We begin with some cursory discussion of how exemptions may apply to each type of behaviour which is expressly prohibited in Chapter 2.

Abuse of dominance included?

There is some debate as to whether the reference to ‘practice’ in section 10 is sufficiently broad to contemplate exemption for abuses of dominance⁷. ‘Agreements and practices’ could conveniently be equated to prohibited agreements and concerted practices under sections 4 and 5 of the Act. However, abuses of dominance, which are prohibited by sections 8 and 9, fall within the Act’s definition of ‘prohibited practices’.

It is submitted that this debate is largely academic, and that in practice the Commission is unlikely to refuse to accept an exemption application solely on the basis that it relates to an abuse of dominance. However, practices in contravention of section 8 and 9 which are required to achieve the public policy goals set out in section 10 are likely to be few and far between. Section 10 applies more naturally to agreements and concerted practices under sections 4 and 5, and we have restricted our discussion of the section on this basis.

Exemption for ‘per se’ and ‘rule of reason’ prohibitions

The Act clearly distinguishes conduct which is automatically prohibited from that which may be justified by reference to technological, efficiency or other pro-competitive gains arising

⁷ See Sutherland and Kemp, *Competition Law of South Africa*, Issue 13, Page 11 - 9

from the conduct. It is submitted that the operation of section 10 may differ in relation to each of these two broad categories of prohibited conduct.

Sections 4(1)(b) and 5(2) prohibit certain types of agreements and concerted practices on an absolute or *per se* basis. Section 4(1)(b) prohibits agreements and concerted practices between competitors which involve price fixing, market allocation or collusive tendering. Section 5(2) prohibits resale price maintenance, which is effectively a form of price fixing between firms in a vertical relationship. Once the relevant prohibited conduct is established, no opportunity is provided to the respondent firms to justify the conduct. Any justifications would only be relevant to mitigation of an applicable administrative penalty, which may be imposed following a 'first time' offence.

Firms whose conduct risks contravening section 4(1)(b) or 5(2) therefore have a relatively clear standard or 'bright line' against which to assess whether the Act is contravened, and whether an exemption may therefore be required. If the agreement or practice involves price fixing, market allocation, collusive tendering or resale price maintenance, then it would contravene the Act and an exemption would be required if the firm wished to continue with the conduct.

Sections 4(1)(a) and 5(1) on the other hand are different. They prohibit agreements and concerted practices which have the effect of substantially lessening or preventing competition in a particular market, unless the parties to the agreement or practice can prove that any technological, efficiency or other procompetitive gains arising from the agreement or concerted practice outweigh that anti-competitive effect.

In order to determine whether section 4(1)(a) or 5(1) have been contravened, an often complex balancing exercise must be undertaken. A significant amount of economic and factual evidence must be weighed up regarding the effect of the conduct on the relevant market before a contravention of the Act is established.

It is very difficult for a firm which is party to such an agreement or practice to know whether it is acting in contravention of the Act, and therefore whether an exemption may be required in order to continue with or embark upon the behaviour concerned. Although no penalty may be imposed for a first offence, a repeat offence may carry a fine of up to 10% of the annual turnover of the firms involved.

The fundamental difference between the standards required to determine whether a *per se* or 'rule of reason' contravention has taken place (and often the significant risk of penalty) materially affects the motive of a firm which seeks exemption for such conduct. For firms at risk of contravening the *per se* provisions of section 4(1)(b) or 5(2), obtaining exemption is the only way to lawfully embark upon or continue with the conduct which would otherwise contravene the Act.

For firms at risk of contravening section 4(1)(a) or 5(1), however, exemption may in appropriate circumstances provide the only mechanism through which certainty can be obtained, without being subjected to unwanted and costly litigation before the Tribunal. If an agreement or practice meets the public policy requirements of section 10(3)(b), then the Commission must either confirm that the agreement or practice does not contravene the Act, or exempt the practice. Either way, certainty is obtained and the firm may continue with the conduct, free from the risk of being investigated by the Commission and prosecuted before the Tribunal.

We point out that there may be some overlap between the ‘public policy’ goals which may give rise to grounds for an exemption and the ‘efficiency defence’ which may be raised in defending a ‘rule of reason’ enquiry under section 4(1)(a) or 5(1). For instance, the economic stability of an industry should, it is submitted, be considered an efficiency gain which may justify an otherwise anti-competitive agreement or practice. However, the extent of this overlap would appear to be largely academic as it does not affect the enquiry which the Commission is required to undertake in considering an exemption application.

For a respondent firm that wishes to engage in an agreement or practice which may be prohibited by section 4(1)(a) or 5(1), the middle ground between seeking exemption and defending itself before the Tribunal would be to request the Commission to provide a non-binding advisory opinion on the lawfulness of the relevant agreement or practice. It is in the Commission’s interests, however, to prepare these opinions on a conservative basis, and in any event they are non-binding in nature. We submit that advisory opinions are therefore unlikely to provide sufficient certainty to a firm which risks contravening the Act.

Against this background we proceed to examine the provisions of section 10.

Section 10 of the Act

The substance of the ‘public policy’ exemption provisions is contained in section 10(1), (2) and (3). We consider each in turn. Section 10(1) provides:

- (1) A *firm* may apply to the Competition Commission to exempt from the application of this Chapter –
 - (a) an *agreement* or practice, if that *agreement* or practice meets the requirements of subsection (3); or
 - (b) a category of *agreements* or practices, if that category of *agreements* or practices meets the requirements of subsection (3).

Who is the applicant?

First, it is important that a *firm* may apply to the Commission. There is no reference to an applicant for exemption having to be a *party to* or *participant* in an agreement or practice. A firm therefore need not apply on its own behalf, and may apply for an exemption in respect of an agreement or practice to which it is not a party. For example an association may apply in respect of an agreement between its members, to which the association is not a party.

Agreement or practice exempt, not the applicant(s)

An application is made to exempt from the application of Chapter 2 an *agreement or practice* or a *category of agreements or practices*. Ultimately, it must therefore be the agreement(s) or practice(s) which are ultimately exempted, rather than the applicant firm itself. Of course, agreements and practices do not exist in a vacuum. The firms which participate in the agreement or practice are necessary and central elements. An agreement or practice can not exist apart from its participants.

However, it is not necessary for a firm to be an exemption applicant in order to benefit from or be covered by the exemption. If a new participant were to join an exempt agreement or

practice, it would automatically be covered by the exemption. This would simply amount to a change in the nature and functioning of the agreement or practice, which would continue to be exempt.

Categories of agreements or practices

Significantly, the Act specifically creates the possibility for exemption to be sought for a *category* of agreements or practices. This opens up the possibility for 'block' exemptions similar to those which can be granted in Europe for:

- particular types of agreements, such as vertical agreements which are exempted in terms of the Regulations on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices⁸;
- agreements in a particular industry or subsector of an industry, for example in the insurance sector which are exempted in terms of Regulation on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of agreements, decisions and concerted practices in the insurance sector⁹, or
- agreements which are intended to achieve a specific objective. An example of what is in effect a 'category exemption' is the exemption granted to the liquid fuels industry shortly prior to the 2010 FIFA World Cup. The Commission granted exemption for those agreements and practices which were required to ensure a continuous, stable and secure liquid fuels supply for the duration of the tournament¹⁰.

The obvious advantage of category or block exemptions is the elimination of the need for duplicated applications and reduction of the associated administrative burden on the Commission.

Section 10(2) sets out the Commission's options when presented with a valid exemption application:

- (2) Upon receiving an application in terms of subsection (1), the Competition Commission must –
 - (a) grant a conditional or unconditional exemption for a specified term, if the *agreement* or practice concerned, or category of *agreements* or practices concerned, meets the requirements of subsection (3); or
 - (b) refuse to grant an exemption, if –
 - (i) the *agreement* or practice concerned, or category of *agreements* or practices concerned, does not meet the requirements of subsection (3); or

⁸ Commission Regulation (EU) No 330/2010 of 20 April 2010

⁹ Commission Regulation (EU) No 267/2010 of 24 March 2010

¹⁰ See decision of Commission in the South African Petroleum Industry Association exemption application, Case number 2009Dec4813 (GG 33126 of 23 April 2010)

- (ii) the *agreement* or practice, or category of *agreements* or practices does not constitute a *prohibited practice* in terms of this Chapter.

Mandatory language

The first, and it is submitted, fundamental point to note is that the section is framed in mandatory language – the Commission *must* grant or refuse to grant the exemption as the case may be. Factors such as previous contraventions by the applicants, historical competition concerns regarding the relevant industry and the degree to which the objectives in subsection (3) are promoted are irrelevant. The Commission does not have a discretion to consider these factors.

Time limits

There is no time limit on the Commission's consideration of an exemption application and final decision. There is also no provision for an urgent or 'fast track' process in particular circumstances. Therefore, the expediency of the exemptions process rests exclusively in the hands of the Commission. However, it is submitted that where the Commission fails to decide upon an exemption application within a reasonable time period, may be reviewable by the applicants, or potentially any person who is adversely affected by the delay, such as a participants in an agreement or practice which is sought to be exempt. Review jurisdiction in such cases would probably vest in the Tribunal.

Conditions

The Commission is authorised to approve an exemption application on a conditional basis. The Act does not provide any guidance regarding the limits of such conditions. Although it is preferable that conditions should be specific to the exemption itself, the Commission may use the opportunity to address other issues in the relevant industry (whether competition related or not) through applicable conditions.

Specified term

An exemption must be granted for a specified term. This provision may seem self-evident, but important consequences flow from it. There is also no provision for a temporary exemption. An exemption is not automatically renewable, and the Act does not provide for the extension of an exemption. Therefore, upon expiry of an exemption, the practices which are exempt must either be terminated, or a new exemption must be applied for and obtained.

Scope of the enquiry

Critically, the Commission must refuse to grant an exemption if the agreement or practice concerned does not constitute a prohibited practice. It is submitted that this gives rise to a mandatory first step in the Commission's evaluation of an exemption application. Before proceeding to determine whether the agreement or practice is required to achieve the relevant public policy aims in section 10(3)(b), it must decide whether it considers the agreement or practice to contravene the Act. Without conducting this step of the analysis, it would be possible for the Commission to exempt a practice which does not contravene the Act – an untenable situation both from a logical point of view and based on the provisions of section 10(2)(b)(ii).

Prior to the Act being amended, there was previously a requirement that the Commission inform an exemption applicant in writing if it determined that the agreement or practice sought to be exempt did not contravene the Act¹¹. This was removed by legislative amendment based on concerns about the Commission being required to provide a binding determination without necessarily having complete information about the agreements or practices available.

It is submitted that the removal of this language is of no real consequence. In order to comply with the section, the Commission must, in any event, make a binding determination as to whether the agreement or practice contravenes the Act. If the agreement or practice does not contravene the Act, the Commission must refuse to grant the exemption.

Although it may be somewhat unpalatable for the Commission, this binding determination would preclude any subsequent immediate investigation of the relevant conduct by the Commission. Section 10(9), read with Rule 20 of the Competition Commission Rules, provides that where the Commission finds that the agreement or practice which is the subject of exemption does not contravene the Act, it must issue a notice of Refusal to Grant Exemption¹². This notice may be withdrawn upon 60 days notice to the exemption applicant(s)¹³. In the interim, the Commission may not initiate a complaint in respect of the conduct which is the subject of the exemption application. The applicant may then either withdraw the exemption application, or require the Commission to reconsider the exemption application together with any further information. The Commission must then commence its enquiry afresh in accordance with section 10.

The practical consequence of this mandatory assessment is that it is not necessary for an exemption applicant to admit to a contravention of the Act when making the application. It is quite legitimate for an exemption applicant to describe the conduct for which exemption is sought, and leave it for the Commission to determine whether the conduct constitutes a contravention. Any other interpretation would render section 10(2)(b)(ii) meaningless.

The Commission cannot, we submit, fence sit and avoid the issue by dealing with the application on the basis that the agreement or practice concerned is 'potentially problematic'. It must determine whether the conduct is, or is not, a contravention.

Once the Commission has determined whether the conduct that is the subject of the exemption application contravenes the Act, two potential outcomes follow. If the conduct does not amount to a contravention, then the Commission must refuse the exemption on that basis. No further analysis is required. If, in the Commission's view, the conduct does contravene the Act, then it must proceed to the next step of the enquiry – determining whether the conduct meets the requirements of section 10(3).

If the answer to this question is 'yes', then the Commission has no option but to grant the exemption. If the answer is 'no', then the Commission must refuse to grant the exemption.

¹¹ This reference was removed from section 10(2)(a) by the Competition Second Amendment Act, 39 of 2000.

¹² In Form CC11(1)

¹³ By issuing to the applicant(s) a notice in Form CC11(3)

If the Commission has determined that the conduct in question does contravene the Act, it must then turn to section 10(3) which sets out the standard that the contravening conduct must meet in order to qualify for exemption.

Section 10(3) provides:

- (3) The Competition Commission may grant an exemption in terms of subsection (2)(a) only if –
- (a) any restriction imposed on the *firms* concerned by the *agreement* or practice concerned, or category of either *agreements* or practices concerned, is required to attain an objective mentioned in paragraph (b); and
 - (b) the *agreement* or practice concerned, or category of *agreements* or practices concerned, contributes to any of the following objectives:
 - (i) maintenance or promotion of exports;
 - (ii) promotion of the ability of *small businesses*, or *firms* controlled or owned by historically disadvantaged persons, to become competitive;
 - (iii) change in productive capacity necessary to stop decline in an industry; or
 - (iv) the economic stability of any industry designated by the *Minister*, after consulting the Minister responsible for that industry.

The first interesting aspect of section 10(3) is that it provides that the Commission ‘may’ grant exemption only if certain circumstances exist. This differs from section 10(2), which states that the Commission ‘*must*’ grant exemption if the requirements of section 10(3) are met. It is submitted that use of the word ‘may’ in this instance does not endow the Commission with any further discretion, but indicates a mandatory duty where those circumstances prevail. This interpretation makes it consistent with section 10(2).

The wording of section 10(3)(a) is peculiar. Rather than referring to the ‘anti-competitive effect’ which would result from the relevant conduct or ‘restrictive practice’ – all of which language is commonly used in the Act, the legislature refers to any ‘restriction’. It would appear that this part of the section has been adapted from Article 81(3) of the Treaty on the Functioning of the European Union (which has since been amended) which provides that the provisions of Article 81(1) may be declared inapplicable to an agreement or practice which *inter alia*,

contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

...

(own emphasis)

The use of the word 'restriction' in the Article 81(3) is consistent with the European terminology of *prevention, restriction or distortion of competition*. However there is no other reference to the word 'restriction' in the Act. Presumably in the context of the South African Act, 'restriction' should simply be read as synonymous with a restriction on competition – referred to elsewhere as a substantial lessening or prevention of competition.

It is also not clear why the legislature has chosen to use the words 'on the firms concerned'. This is also consistent with the wording of Article 81(3) which provides that to be eligible for an exemption, an agreement must not *impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives*. This language appears to have simply been ignored in the European Commission's Guidelines on Application of Article 81(3) of the Treaty¹⁴. Paragraph 73 of the Guidelines interprets the Article 81(3)(a) as referring to restrictions of competition that flow from the agreement.

In the context of the section, this should probably rather be understood as referring to the subjects of or participants in the 'restriction' – those who are restricted by the agreement or practice that is the subject of the exemption application. Expressed more clearly, we submit that section 10(3)(a) could be reworded, and, if submitted, should be understood as follows:

any substantial lessening or prevention of competition arising from the agreement or practice, or category of agreements or practices, is required to attain an objective mentioned in paragraph (b)

'Required to attain'

More importantly perhaps than the poor drafting of the introduction to the sub-section, section 10(3)(a) establishes the overriding standard against which an exemption application should be evaluated. The conduct for which exemption is sought must be *required* to attain one of the objectives listed in section 10(3)(b). This should be read with the first part of section 10(3)(b) which provides that the conduct must 'contribute' to the relevant public policy objectives. Accordingly, the appropriate standard established by the Act is that the conduct must be 'required for and contribute to' any of the relevant objectives. It is submitted that, the second requirement, that the conduct 'contributes to' the objectives of 10(3)(b) is redundant. It goes without saying that any conduct which is required to achieve the particular objectives must necessarily contribute to those objectives.

The conduct which the applicants wish to have exempted must therefore on a balance of probabilities be 'required to attain' any of the relevant public policy objectives. The Act provides no guidance as to how an applicant must discharge this onus – whether the application itself must be comprehensive, or whether an applicant may have an opportunity of engaging with the Commission in order to prove its case, by providing further explanations or evidence.

Our authorities have not yet enunciated on the interpretation of what 'required' means in this context. In an imperative sense and interpretation, 'required' will mean necessary for the fulfilment or achievement of the objective concerned. Simply put, there must be no other method of achieving the same objective. If there is another method, the required condition is not fulfilled and the application must be refused.

¹⁴ Notice 2004/C 101/08, Official Journal of the European Union

A lesser standard would be that adopted by the European Commission, from whence the exemption language appears to be derived¹⁵. Adapting the test used there, the question would be whether the prohibited conduct is reasonably necessary for the attainment of the identified objectives. The reasonableness qualification permits an enquiry and determination whether there are any economically practicable and less restrictive means of achieving the identified objectives. If there are none, the requirement condition is satisfied.

It is submitted that this is the most logical and reasonable interpretation of the language of the section and captures the intention of the legislature. Adopting an absolute or imperative test would be unnecessarily restrictive and exclude exemption applications on the basis of unreasonable, impractical, but possible alternative methods of achieving the objectives.

If this more purposive interpretation is accepted, then in this enquiry, the Commission will be required to consider, on a practical and commercial basis, what alternative methods there may be of achieving the identified objectives. But there is no guidance as to the application and interpretation. There is no reference for instance to the usual standard of a balancing of interests based upon whether the restrictions on competition which are anticipated to arise from the prohibited conduct are outweighed by identified pro-competitive or efficiency gains.

The first enquiry which the Commission is obliged to conduct, namely whether the Act has been contravened, draws appropriately on the Commission's economic and legal expertise in how the Act should be applied. The Commission will either have to consider if there is a *per se* restrictive practice or whether the conduct is prohibited following a rule of reason analysis, for example under the section 4(1)(a) test.

However, it is important to note that there is nothing about this second enquiry – the 'requirement test' - which necessitates particular competition expertise. Upon a plain reading of the language, and even on a purposive approach as recommended above, it is primarily an enquiry of causation, possibly tempered by a standard of commercial and practical reasonableness and the Commission is not especially well placed to make this determination. Therefore, it is submitted that the Commission's evaluation of this aspect should not be overly expansive. This would be unnecessary and outside the scope of the Commission's field of regulatory authority and expertise.

We now turn to consider each of the relevant 'public policy factors'.

Maintenance or promotion of exports

Export sales result in a net injection of income into an economy. By expanding the base of potential customers beyond national borders, production and income can be increased and additional jobs may be created. In certain circumstances export levels can be increased by local firms coordinating, rather than competing with each other in international markets.

This is in keeping with the preamble of the Act itself, which states that one of the goals of the Act is to create an environment for South Africans to compete effectively in international markets. Section 2(d) recognises the importance of expanding opportunities for South African participation in world markets.

¹⁵ See part 3.3 of Guidelines on Application of Article 81(3) of the Treaty, paragraph 74 onwards.

Competition laws in a number of jurisdictions internationally make provision for exemption for export associations, export cartels and conduct required to improve international competitiveness¹⁶. The Organisation for Economic Development sets out the following rationale for competition law exemptions for export cartels in its official definition of the term:

The rationale for permitting export cartels is that it may facilitate cooperative penetration of foreign markets, transfer income from foreign consumers to domestic producers and result in a favourable balance of trade.¹⁷

It is therefore unsurprising that the legislature has deemed it appropriate to include the promotion of exports as one of the policy objectives to which competition regulation must defer. However, interestingly, the Act goes even further by requiring the Commission to exempt conduct which is required to attain the *maintenance* of exports.

South Africa has experienced an oversupply of maize in recent times. Maize consumers pay low prices while bankruptcy threatens many farmers¹⁸. Silos are full and poor export infrastructure, together with the strong currency, limits the volume of maize that can be sold into the international market. Many producers have been forced to exit the market and financial institutions are also alleged to be refusing to grant financing for upcoming production seasons, as a result of the surplus.

In attempting to solve the industry's difficulties, Grain SA, an industry association of maize producers in South Africa, applied to the Competition Commission for exemption from the application of Chapter 2 of the Competition Act¹⁹. It sought permission to establish an 'export pool' through which the producers could collectively set prices for the sale of maize into international markets and allocate export markets amongst themselves.

The purpose and intended effect would have been to increase the volume of maize exported and to achieve higher prices in international markets. This in turn would have reduced the surplus volumes in the South African market and thereby increased prices which could be achieved domestically.

The Commission refused to grant exemption²⁰ on the basis that:

- It was not clear that the pooling arrangement would in fact have increased the volume of maize exported from South Africa.

¹⁶ Shyam Khemani, 'Application of Competition Law: Exemptions and Exceptions', United Nations Conference on Trade and Development, 2002

¹⁷ Glossary of Industrial Organisation Economics and Competition Law, compiled by R. S. Khemani and D. M. Shapiro, commissioned by the Directorate for Financial, Fiscal and Enterprise Affairs, OECD, 1993

¹⁸ Wyndham Hartley, "10 000 Farmers Face Bankruptcy", Business Day, 8 November 2010 [Available online at www.businessday.co.za]

¹⁹ Case 2010Jul5262.

²⁰ GG 33900 of 31 December 2010. Note that a further ground on which the exemption was denied was that the industry had not been designated as required by section 10(3)(b)(iv). The applicants were therefore not allowed to rely on this section as a basis for exemption.

- The arrangement would have resulted in (artificially) increased food prices, increased the risk to food security and reduced the incentives of maize producers to innovate. There was insufficient evidence of how the exemption would yield benefits which would outweigh the proposed restriction in competition.
- A number of alternatives existed, such as crop substitution, converting maize to bio-diesel, producing value added products, hedging on futures markets, storage for future use and the entry into the market of specialised export traders.

In short, the Commission's approach was to allow the market to dictate the acceptable levels of supply, demand and price. While there is an oversupply of maize domestically, consumers should benefit from lower prices. Producers should benefit in future periods of increased demand and reduced supply.

It is submitted that this provides a useful example of the Commission going beyond its mandate set out in the Act. The applicants' failure to provide sufficient evidence that the pooling arrangement would increase exports would be relevant to determining whether the arrangement is 'required to attain' the promotion of exports. However, the effect of the proposed arrangement on prices, food security risks, alternatives to deal with the surplus and how the restriction should be balanced against the potential benefits, are all irrelevant to the enquiry which the Commission is mandated to undertake under section 10. There is an important distinction here – the 'required to attain' requirement relates to the objective (in this case, promotion of exports) not the rationale for the proposed arrangement.

Promotion of the ability of small businesses or firms controlled or owned by historically disadvantaged persons to become competitive

Whether or not a firm is controlled or owned by historically disadvantaged people can be objectively determined by reference to the definition in section 3(2) of the Act. A 'small business' is also defined by reference to the National Small Enterprise Act, which sets out objective criteria for a firm to qualify as a small enterprise (previously referred to as a small business).

The policy rationale behind this factor is self-explanatory. When viewed in the context of South Africa's history of divisive economic and social policies, and entrenched high levels of market concentration, the importance of promoting the ability of small businesses and firms controlled by historically disadvantaged persons to become competitive is clear.

However, it will probably be difficult for eligible firms to satisfy the requirement that a restrictive agreement which they seek to exempt is required to promote their ability to become competitive. In almost all circumstances, there will likely be a variety of other, less restrictive and compliant means to promote the firms' ability to become competitive.

Change in productive capacity necessary to stop decline in an industry

In times of depressed demand, firms' revenues fall, resulting in lower profits and, if the downturn is sustained over a substantial period, firms may have no option but to retrench employees and sometimes abandon their business entirely. In certain circumstances, firms may avoid these adverse consequences by collaborating to maintain viable profit margins and stay in business.

In such circumstances, we submit that it would be legitimate for policy-makers to sanction such collaboration in order to preserve jobs and the long term sustainability of the particular industry. This same basic policy is reflected in the failing firm arguments in merger control.

However, the language of section 10(3)(b)(iii) specifies something different. Firms may not apply for exemption to collaborate simply to retain profit margins. They must show that the collaboration is required to change the productive capacity of the industry, which will in turn stop or reverse the decline in the industry.

This is somewhat difficult to understand, as in conditions of depressed demand, firms' production capacity is not usually affected. Their problem is not a lack of production capacity, but rather reduced demand leading to reduced income and prices. Therefore, it is difficult to conceive of situations where an agreement or practice could potentially stop decline in an industry through collaboration to change participants' production capacity in the sense of an increase in such capacity. A more restricted interpretation would be that the subsection is intended to deal with collaboration between firms with the objective of removing capacity from the market in order to stabilize prices so as to more closely match fallen demand.

The economic stability of any industry designated by the Minister

This objective acts as a 'catch all' provision for policy concerns relating to a particular industry to be introduced as grounds for practices within an industry to be exempt from application of Chapter 2 of the Act.

To obtain an exemption under this ground, the first step is for the Minister of Trade and Industry²¹ to designate the relevant industry for purposes of section 10(3)(b)(iv). In other words, the Minister must declare that in his / her view agreements or practices which promote the stability of the relevant industry should be eligible for an exemption.

In practice, it is likely that the process of obtaining a designation will be driven by industry participants themselves through the minister responsible for the relevant industry. This would entail industry players or participants in the agreements or practices making submissions to the relevant minister on the importance of exemption for the stability of the industry. The relevant minister may then engage with the Minister of Trade and Industry with a view to persuading him / her to designate the industry as suggested.

Designation for purposes of section 10(3)(b)(iv) may therefore be said to be a product of political engagement, pressure and decision making. This allows a wide variety of socially or economically expedient activities to be brought within the purview of section 10. Once an industry practice which may contravene the Act is identified, it can be legitimately recognised as eligible for exemption if it is important for the industry or society more broadly. The exemption application by the South African Petroleum Industry Association for exemption for the joint operation of a range of supply chain infrastructure leading up to and during the 2010 FIFA World Cup provides a useful example²².

²¹ Since the competition authorities now fall within the auspices of the Department of Economic Development, the intention may now be that the Minister of Economic Development should be the one to make the designation contemplated. However, no amendment to this effect has been made to the Act as yet.

²² Case number 2009DEC4813 (GG 33126 of 23 April 2010)

Although this section adds a dimension of flexibility to the recognised grounds for exemption, the involvement in the process of a number of different stakeholders inevitably results in unpredictable and potentially frustrating delays. In the context of the purposes of the section – to attain the stability of an industry – such delays are often not acceptable, and can make the section impractical. For instance, we understand that the dairy industry has made extensive submissions to both the Department of Trade and Industry and the Department of Economic Development regarding the desirability of designating the industry for exemption purposes. As at December 2010, more than one year after making the submissions, Clover had not received any reply from either department, and no designation was forthcoming²³.

Once an industry has been designated, the Commission's role is like that in an application for exemption under any of the other grounds. It must determine whether the conduct constitutes a contravention, and then determine whether it is required to attain the stability of the relevant industry. By designating the industry, the Minister of Trade and Industry would have already confirmed that his / her view is that the industry broadly is in need of exemption. Otherwise there would be no need for designation. The Commission's enquiry would be whether the specific agreements and practices themselves are required for the stability of the industry.

For the Commission to determine, based upon its economic and legal expertise, whether economic stability will be attained through identified practices in an industry is not an easy task. The Commission is required to determine that the practices or agreements will not cause any unusual or harmful economic change in the designated industry. The Commission applies economic policy considerations to the anti-competitive conduct which have already been approved on socio-political policy grounds.

Uncertainty and proposals

In this paper we have set out how we believe the 'public policy' exemptions provisions of section 10 of the Act should be interpreted, and how they fit in with the Act's broader scheme and government's balancing of competition policy objectives with other social and economic policies. In summary, our proposal is simple – the Commission's role in deciding upon exemption applications should be limited to determining whether (a) the relevant agreement or practice contravenes the Act and, if so, (b) whether it is required to attain any of the policy objectives listed in section 10(3)(b). The Commission does not need to conduct the 'weighing up' exercise of balancing the degree of any anti-competitive effect with the importance of the relevant policy objective²⁴. This balancing exercise should rather be conducted by the appropriate government ministries responsible for the relevant industry or sector.

However, it is not at all clear that the Commission shares this view. Past decisions of the Commission on exemption applications show that the Commission does not necessarily conduct the mandatory first exercise of determining whether the agreement or practice

²³ 'No reply to Clover's appeal for exemption', Business Report, 8 December 2010 [Available online at <http://www.iol.co.za/business/business-news/no-reply-to-clover-s-appeal-for-exemption-1.998869>]

²⁴ For example in the Board of Healthcare Funders Case number 2007Sep31761 decision the Commission appears refers to a rule of reason evaluation, which we submit is not the appropriate test

contravenes the Act²⁵. This is particularly in cases where agreements or practices potentially in contravention of section 4(1)(a) are sought to be exempt. The Commission also appears to embark on an assessment of the effect of a particular contravention on the relevant market, which in the case of *per se* restrictions is not required.

There has not yet been a decision on a public policy exemption decision which has been appealed or reviewed to the Tribunal. Given potential applicants' desire to obtain commercial certainty as soon as possible, and to cooperate with the Commission in obtaining exemption, such appeals and reviews will probably continue to be uncommon.

Therefore, we submit that in this critical area of our competition law there is a need for guidelines from the Commission to cure the current uncertainty. We would propose that such guidelines could be relatively straightforward, and should set out:

- How the Commission interprets its role in adjudicating upon exemption applications based on 'public policy' exemption applications under section 10.
- That the Commission will, as a necessary first step, determine whether the agreement or practice constitutes a contravention of the Act in all cases.
- How the Commission interprets the prerequisite that the relevant agreement or practice must be 'required to attain' one of the objectives in section 10(3)(b).
- What steps and internal process the Commission goes through in conducting its assessment of such applications.
- Importantly, the likely timing of the Commission's internal processes. Although there is no statutory deadline on the Commission's decision, it is highly undesirable for parties to embark upon the application process with no idea of when they may expect a decision. The Commission has previously taken over one and a half years to adjudicate on exemptions applications²⁶.
- How each of the objectives in section 10(3)(b) should be interpreted and what standard would be expected of an exemption applicant seeking to show that a particular agreement or practice is required to attain each particular objective.

We submit that guidelines published along these lines would go some way to remedy the prevailing vagueness in this area of our competition law. Importantly the role of the competition authority would be clarified in the policy sphere outside of competition law. Certainty would in turn allow the Act's diverse objectives to be met, and other important social, economic and political goals to be realised in a more effective and efficient manner.

²⁵ It is only in the National Hospital Network application (2003Nov717) where the Commission specifies in its decision that it has found the behaviour to be a contravention of the Act. The bulk of the decisions are based upon behavior which 'may' or 'could' constitute contravention.

²⁶ Health Professions Council of South Africa Case number 2008 Jan 3456 and Spring Light Gas (Pty) Ltd, Case number 2009Dec4805. There is inconsistency regarding when an applicant may expect a decision from the Commission. On average it seems the time from submission of an application to publication of a decision is between six to twelve months.

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