

**THE FACTORS TO BE CONSIDERED BY THE COMPETITION AUTHORITIES  
WHEN A FINE MAY CAUSE THE FIRM TO EXIT**

by

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## **Abstract**

The Competition Act empowers the Competition Tribunal to levy fines against a firm for certain contraventions of the Act. Such fines are statutorily capped to prevent the fine from causing the firm's exit. This maximum is based on the overarching principle of fairness which precludes a fine, on its own, from destroying a firm's business. However, the Competition Appeal Court acknowledged in 2013 that fines below this cap may still cause a firm to exit. The purpose of this paper is to propose the factors that should be considered when determining a firm's ability to pay such a below-cap fine. These factors are the calculation of the fine, probable exit, causation of exit and the competitive effect of the firm's exit. The fining provisions of the Act are initially explored to provide context for the discussion and are then compared to equivalent provisions in Europe. Liquidation and business rescue proceedings are then described as the most common forms of a firm's exit from the market. Methods for determining the causal relationship between the fine and the firm's exit are explored through delictual law's factual and legal causation. The competitive effects of the firm's exit are premised on the purpose of the Competition Act and are evaluated through the Competition Act's merger provisions, specifically, the failing firm factor. These proposed factors are then tested through hypothetical facts to analyse their possible interactions and efficacy.

## **Key words**

Fine, Ability to Pay, Firm, Causation, Exit, Competition

## Key Concepts Underpinning Research

<b>Ability to Pay</b>	A firm's ability or inability to pay a below-cap fine and still avoid exit
<b>Causation</b>	Where an event is the probable cause of a certain outcome in terms of the factual and legal elements of delictual law
<b>Competition</b>	The competitive process between multiple firms in a market.
<b>Firm</b>	Economic units that engage in economic activities which may take the form of a juristic person or larger economic forms such as a group of companies

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## CHAPTER 1: INTRODUCTION AND OUTLINE

1. This chapter briefly sets out the background to the problem that will form the subject of this paper. The problem for research is then described.
2. An outline of the research scope undertaken for this problem and its limitations are described to provide the structure for the presentation of the paper. The outline of the research indicates the main headings under the chapters that follow.
3. Chapter 2 follows Chapter 1's overview by describing the relevant legal principles in both statute and case law that underpin the discussion. Chapter 2 includes a comparison between these legal principles in South Africa and their equivalent legal principles in the European Union.
4. Chapter 3 proceeds by distilling the proposed factors for determining a firm's ability to pay a fine based on Chapter 2's legal groundwork. Chapter 3 goes further by exploring certain concepts that the proposed factors introduce into the analysis.
5. Chapter 4 takes this understanding of the proposed factors and tests the factors against hypothetical facts to see whether the factors interact with each other and whether they result in intuitive outcomes.
6. Chapter 5 looks at a different period compared with the preceding chapters to explore the applicability of the proposed factors after a fine has been levied. Chapters 2 to 4 examine the application of the proposed factors in anticipation of a fine. Chapter 5 takes the learning from the preceding chapters on the

proposed factors and explores whether the Tribunal can still apply these after it has levied a fine.

7. Finally, Chapter 6 summarises the research and analysis to propose a way forward for further research as well as real-world application for this paper's proposed factors.

## Background to Research

8. On 30 November 1998, the Competition Act<sup>1</sup> came into force. The stated purpose of this Act is to "*promote and maintain competition*" to achieve certain public interest goals such as competitive prices, product choices, and the promotion of employment.<sup>2</sup>
9. To achieve its purpose, the Competition Act created two statutory bodies: The Competition Commission<sup>3</sup> ("**Commission**") as its investigatory body and the Competition Tribunal<sup>4</sup> ("**Tribunal**") as its adjudicative body. The Commission investigates allegations of contraventions of the Competition Act and brings the alleged conduct before the Tribunal for adjudication and remedy.<sup>5</sup> Where the Tribunal finds a contravention,<sup>6</sup> it is empowered to levy a fine against the offending firm.<sup>7</sup>

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<sup>1</sup> 89 of 1998.

<sup>2</sup> Section 2 of the Competition Act.

<sup>3</sup> Part A, Chapter 4 of the Competition Act.

<sup>4</sup> Part B, Chapter 4 of the Competition Act.

<sup>5</sup> Section 21(c) read with section 27(a) of the Competition Act.

<sup>6</sup> For example, price fixing in terms of section 4(1)(b)(i) of the Competition Act. See Chapter 2 of the Competition Act for further prohibited practices.

<sup>7</sup> As defined under section 1 of the Competition Act.

10. These fines are, however, capped by the Competition Act to avoid the fine “[destroying] the business of the offending party...”<sup>8</sup> Unfortunately, this statutory cap is a blunt instrument which does not completely protect an offending party from a fine, below this statutory cap, still destroying its business.<sup>9</sup> The Commission has acknowledged this possibility and indicated its general approach to such situations in its fining guidelines. These guidelines are, however, not comprehensive and do not explore the details of the factors it may consider when evaluating such a situation.

### **Problem for Research**

11. This concept of a firm’s ability to pay such a below-cap fine and still avoid exit (“**Ability to Pay**”) is nascent in South African competition law. Owing to such novelty, the relevant factors for considering Ability to Pay have not yet been considered casuistically over time. This paper seeks to assist the Tribunal, Commission, and practitioners with this problem of how to approach the evaluation of Ability to Pay.

### **Outline of the Research**

12. To assist with this problem, this paper explores the factors to be considered when analysing Ability to Pay. This paper seeks to distil the main factors for considering Ability to Pay under the following headings:
- 12.1. *Relevant provisions of the Competition Act*: These include the fining provisions of the Act as well as the types of prohibited conduct that may attract a fine. The

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<sup>8</sup> Section 59(2) of the Competition Act. *Southern Pipeline Contractors and another v The Competition Commission* (105/CAC/Dec10;106/CAC/Dec10) 6 para 9.

<sup>9</sup> *Macneil Agencies (Pty) Ltd v Competition Commission* (121/CAC/Jul12) 34 para 85.

merger control provisions are also explored to provide context for the competition effects of Ability to Pay.

- 12.2. *The Commission's view on Ability to Pay is compared to the European approach:* The South African Commission's guidelines on Ability to Pay are compared to the equivalent legal principles in the European Union. For context, the European Union's fining principles are also described.
- 12.3. *Causation:* Exploring factual and legal causation from delictual law and whether the "but for" test is applicable to Ability to Pay.
- 12.4. *Exit of firm:* Describing exit through either statutory liquidation or business rescue. The triggers for these processes are also analysed to see if they are also useful indicators of exit for purposes of Ability to Pay.
- 12.5. *Competition effects:* Analysing whether competitive effects of a firm's exit should form part of determining Ability to Pay.
- 12.6. *Employment effects:* Analysing whether employment effects of a firm's exit should form part of determining Ability to Pay.
- 12.7. *Testing the proposed factors:* The proposed factors are applied to thought experiments to test whether outcomes seem reasonable against intuition and how the factors may interact with each other.
- 12.8. *Ability to Pay after fine is levied:* The Competition Act's variation provisions are described together with the Tribunal's view on variation based on change of circumstances. The applicability of Ability to Pay after the Tribunal levies a fine is explored through this framework.

## Limitations of the Research

13. This paper does not explore the following considerations:
  - 13.1. Determining the appropriate payment plan and fine amount after analysing Ability to Pay. Such further research may include exploring the advantages and disadvantages of reducing the fine compared to an extended payment and how best to calculate an appropriate reduction to the fine, possibly to zero; and
14. The possibility of a firm manipulating its corporate structure or finances to benefit from Ability to Pay in an attempt to receive an inappropriately low fine. Such an analysis may require further research into insolvency law, *in fraudem legis* principles and the European concept of economic continuity (where the fine follows the business and not the legal entity).<sup>10</sup>
15. Within this framework, the research is presented from Chapter 2's description of the relevant legal principles underpinning the discussion.

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<sup>10</sup> For the general principles relating to conduct *in fraudem legis* see *Gauteng Gambling Board and another v MEC for Economic Development, Gauteng Provincial Government* 2013 (3) All SA 370 (SCA) 383 paras 46 and 47. See *Hoechst v Commission* (T-161/05) 2009 E.C.R. at para 51 and 52 for an explanation of the liability of an economic successor in competition law proceedings.

## CHAPTER 2: COMPETITION ACT AND EU COMPARISON

16. Chapter 1 sketches the problem for research within a certain factual context and sets out how this paper presents the research undertaken. Chapter 2 sets out the statutory and legal context for the research by exploring the relevant provisions of the Competition Act as well as related guidelines and decisions from the relevant authorities. These principles are then compared to equivalent laws, Court decisions and guidelines in the European Union to inform our approach to Ability to Pay.
17. Based on Chapter 2's groundwork, Chapter 3 follows by distilling the proposed factors for analysing Ability to Pay. Chapter 3 goes further by providing the necessarily detail from other areas of law that fall outside the scope of Chapter 2.

### Purpose of the Competition Act

18. The purpose of the Competition Act is described in section 2 as:

*"The purpose of this Act is to promote and maintain competition in the Republic in order—*

- (a) to promote the efficiency, adaptability and development of the economy;*
- (b) to provide consumers with competitive prices and product choices;*
- (c) to promote employment and advance the social and economic welfare of South Africans;*
- (d) to expand opportunities for South African participation in world markets and recognise the role of foreign competition in the Republic;*
- (e) to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and*

- (f) *to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.*
- (g) *to detect and address conditions in the market for any particular goods or services, or any behaviour within such a market, that tends to impede, restrict or distort competition in connection with the supply or acquisition of those goods or services within the Republic;*<sup>11</sup> (emphasis added)

## **Competition Commission, Competition Tribunal and Competition Appeal Court**

19. To give effect to its purpose, the Competition Act created two statutory bodies. These are the Commission<sup>12</sup> and the Tribunal<sup>13</sup> (collectively “**Competition Authorities**”). Each is discussed in turn.

### Commission

20. The functions of the Commission include:

*“investigate and evaluate alleged contraventions of Chapter 2” (prohibited practices);...*

*authorise, with or without conditions, prohibit or refer mergers of which it receives notice;...*

*negotiate and conclude consent orders in terms of [section 49D<sup>14</sup>]; ...*

*refer matters to the Competition Tribunal, and appear before the Tribunal, as required by this Act.*<sup>15</sup>

### Tribunal

21. The Tribunal is a specialist adjudicative body which performs functions such as:

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<sup>11</sup> As subsequently amended.

<sup>12</sup> Section 19.

<sup>13</sup> Section 26.

<sup>14</sup> The reference in this provision to “section 63” is an error as the current section 63 regulates leave to appeal. Corrective amendment of this provision to reference “section 49D” is pending in terms of Competition Amendment Act 1 of 2009.

<sup>15</sup> Section 21.

*“adjudicate on any conduct prohibited in terms of Chapter 2 [prohibited practices], to determine whether prohibited conduct has occurred, and, if so, to impose any remedy provided for in this Act; ...*

*adjudicate on any other matter that may, in terms of this Act, be considered by it, and make any order provided for in this Act”.*<sup>16</sup>

22. Section 52(2)(b) of the Competition Act provides that the Tribunal “*may conduct its hearings informally or in an inquisitorial manner.*” Such inquisitorial powers allow the Tribunal to explore matters brought before it without being limited to the filed papers.<sup>17</sup>

### Competition Appeal Court

23. The Competition Act also creates the Competition Appeal Court (“**CAC**”) which specialises in hearing competition law matters from the Tribunal on appeal or review.<sup>18</sup> Such appeals may include the Tribunal’s finding on whether a prohibited practice has taken place.

### Prohibited Practices

24. A prohibited practice is defined in the Competition Act as “*a prohibited practice in terms of chapter 2.*” The relevant portions of this chapter in the Competition Act are further divided into parts A, B and C.
25. Part A of chapter 2 in the Competition Act regulates restrictive horizontal conduct through section 4 and vertical conduct through section 5. Both these sections regulate the competitive conduct of firms.

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<sup>16</sup> Section 27.

<sup>17</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 73 and referencing *Competition Commission of South Africa v Senwes Limited* 2012 JDR 0579 (CC).

<sup>18</sup> Section 36.

## Regulating the conduct of “firms”

26. A “firm” in the Competition Act is defined broadly as including a “person, partnership and trust”.<sup>19</sup> The wide ambit of this definition generally encompasses economic units that engage in economic activities. Such economic units may take the form of a juristic person, such as a company, or a larger economic form such as a group of companies (“Firm”).<sup>20</sup>

27. The Tribunal has interpreted this concept and held that:

*“It is clear from what the word ‘firm’ includes that it is not restricted to or limited to liability companies, but is inclusive of natural persons, trusts and partnerships.”<sup>21</sup>*

...

*“our law recognizes that one must focus on the economic activity of the entity concerned.”<sup>22</sup>*

...

*“We accept and understand that the word “firm” can mean different things in different contexts. It could mean an economic entity, or a group where the component parts of it are related to each other in such a way that they constitute a single economic entity...”<sup>23</sup> (emphasis added)*

28. The Tribunal held further with reference to European case law that the Competition Act is aimed at:

*“Economic entities made up of a combination of personal and physical elements which can contribute to the commission of an infringement of the kind referred to in that provision.”<sup>24</sup> (emphasis added)*

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<sup>19</sup> Section 1.

<sup>20</sup> P Sutherland and K Kemp *Competition Law of South Africa* (2017) section 5.5.

<sup>21</sup> *Competition Commission v Delatoy Investments (Pty) Ltd and others* (CR212Feb15) 10 para 39.

<sup>22</sup> *Competition Commission v Delatoy Investments (Pty) Ltd and others* (CR212Feb15) 16 para 53.

<sup>23</sup> *Competition Commission v Delatoy Investments (Pty) Ltd and others* (CR212Feb15) 10 para 40.

<sup>24</sup> *Competition Commission v Delatoy Investments (Pty) Ltd and others* (CR212Feb15) 16 para 54.

29. Firms in both forms of a company or economic unit may contravene the Competition Act by engaging in prohibited horizontal or vertical practices.

#### Prohibited horizontal practices

30. Section 4(1)(a) regulates restrictive horizontal practises between competing Firms. This section prohibits an agreement<sup>25</sup> or a concerted practice<sup>26</sup> between competing Firms or an association of competing Firms if:

*“it has the effect of substantially preventing, or lessening, competition in a market, unless a party to the agreement, concerted practice, or decision can prove that any technological, efficiency or other pro - competitive gain resulting from it outweighs that effect;”<sup>27</sup>*

31. This section’s defence of pro-competitive gains through *“technological, efficiency or other pro - competitive gain”* is not available where the conduct involves the following conduct described in section 4(1)(b):

*“(i) directly or indirectly fixing a purchase or selling price or any other trading condition;*

*(ii) dividing markets by allocating customers, suppliers, territories, or specific types of goods or services; or*

*(iii) collusive tendering.”*

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<sup>25</sup> Meaning in section 1: *“when used in relation to a prohibited practice, includes a contract, arrangement or understanding, whether or not legally enforceable”*.

<sup>26</sup> Defined in section 1 as *“co-operative or co-ordinated conduct between firms, achieved through direct or indirect contact, that replace their independent action, but which does not amount to an agreement”*.

<sup>27</sup> Section 4(1)(a).

32. Section 4(1)(b) lists *per se* contraventions as such conduct is generally considered the most egregious contraventions of the Competition Act without any redeeming features.<sup>28</sup>

#### Prohibited vertical practices

33. Section 5 prohibits agreements<sup>29</sup> between suppliers and customers<sup>30</sup> if they result in a substantial lessening or prevention of competition as contemplated under paragraph 30 above.
34. Like section 4, such anti-competitive conduct may be justified by showing certain pro-competitive effects from the agreement. This pro-competitive defence is not available where the restrictive vertical conduct takes the form of minimum resale price maintenance. Minimum resale price maintenance is considered a *per se* contravention which cannot be justified by any pro-competitive gains.
35. Minimum resale price maintenance is “*any attempt by an upstream supplier to control or maintain the minimum price at which the product is resold by its customers.*”<sup>31</sup> However, section 5(3) does allow suppliers to recommend a non-binding resale price to a downstream customer.

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<sup>28</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 86. However, the author also references “characterization” of conduct into section 4(1)(b) which was introduced by *American Soda Ash Corporation and another v Competition Commission* (121/CAC/Jul12) [2013] ZACAC 63.

<sup>29</sup> See definition in footnote 25 above.

<sup>30</sup> Vertical relationship is defined as “*the relationship between a firm and its suppliers, its customers or both.*”

<sup>31</sup> M Neuhoff *et al A Practical Guide to the South African Competition Act* 2 ed (2017) 114.

36. Both sections 4 and 5 apply regardless of the size of the Firm involved in the prohibited practice. This is different from part B of chapter 2 of the Competition Act which regulates large Firms with market power.

#### Abuse of dominance

37. Part B of chapter 2 of the Competition Act prohibits the abuse of a dominant position. This part only applies to large Firms that are dominant in a market. Section 7 provides that a Firm is presumed to be dominant if it has more than 45% of the share of the relevant market.
38. A Firm is rebuttably presumed dominant if it has 35% market share and rebuttably presumed not to be dominant with less than 35% market share. These presumptions can be rebutted by determining whether the Firm has or does not have market power.
39. Market power is defined in the Competition Act as *“the power of a firm to control prices, to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers”*.<sup>32</sup>
40. After determining whether a Firm is dominant in accordance with section 7, section 8 states that it is prohibited for such a dominant Firm to:
- “(a) charge an excessive price to the detriment of consumers or customers;*
  - (b) refuse to give a competitor access to an essential facility when it is economically feasible to do so;*
  - (c) engage in an exclusionary act, other than an act listed in paragraph (d), if the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive gain;”*

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<sup>32</sup> Section 1 of the Competition Act.

41. Section 8(1)(c) refers to an “*exclusionary act*” which is defined as “*an act that impedes or prevents a firm from entering into, participating in or expanding within a market.*”<sup>33</sup> Section 8(1)(d) extends this concept of an “*exclusionary act*” by listing the types of conduct that is assumed to be an exclusionary act.

These are:

- (i) requiring or inducing a supplier or customer to not deal with a competitor;*
- (ii) refusing to supply scarce goods or services to a competitor or customer when supplying those goods or services is economically feasible;*
- (iii) selling goods or services on condition that the buyer purchases separate goods or services unrelated to the object of a contract, or forcing a buyer to accept a condition unrelated to the object of a contract;*
- (iv) selling goods or services at predatory prices;*
- (v) buying-up a scarce supply of intermediate goods or resources required by a competitor; or*
- (vi) engaging in a margin squeeze.”*

42. Section 8(4) provides a further prohibition relating to small firms stating that:

*“(a) It is prohibited for a dominant firm in a sector designated by the Minister in terms of paragraph (d) to directly or indirectly, require from or impose on a supplier that is a small and medium business or a firm controlled or owned by historically disadvantaged persons, unfair-*

*(i) prices; or*

*(ii) other trading conditions.*

*(b) It is prohibited for a dominant firm in a sector designated by the Minister in terms of paragraph (d) to avoid purchasing, or refuse to purchase, goods or services from a supplier that is a small and medium business*

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<sup>33</sup> Section 1 of the Competition Act.

*or a firm controlled or owned by historically disadvantaged persons in order to circumvent the operation of paragraph (a).”*

43. Section 8 is followed by section 9 which regulates price discrimination by a dominant Firm. Section 9(1) provides that:

*“An action by a dominant firm, as the seller of goods or services, is prohibited price discrimination, if-*

- (a) it is likely to have the effect of-*
  - (i) substantially preventing or lessening competition; or*
  - (ii) impeding the ability of small and medium businesses or firms controlled or owned by historically disadvantaged persons, to participate effectively;*
- (b) it relates to the sale, in equivalent transactions, of goods or services of like grade and quality to different purchasers; and*
- (c) it involves discriminating between those purchasers in terms of-*
  - (i) the price charged for the goods or services;*
  - (ii) any discount, allowance, rebate or credit given or allowed in relation to the supply of goods or services;*
  - (iii) the provision of services in respect of the goods or services; or*
  - (iv) payment for services provided in respect of the goods or services.”*

44. Such price discrimination is not prohibited in terms of section 9(2) if it:

*“(a) makes only reasonable allowance for differences in cost or likely cost of manufacture, distribution, sale, promotion or delivery resulting from-*

- (i) the differing places to which goods or services are supplied to different purchasers;*
- (ii) methods by which goods or services are supplied to different purchasers; or*
- (iii) quantities in which goods or services are supplied to different purchasers.*

- (b) *is constituted by doing acts in good faith to meet a price or benefit offered by a competitor; or*
- (c) *is in response to changing conditions affecting the market for the goods or services concerned...*

45. However, the volume discounts justification contemplated in section 9(2)(a)(iii) falls away when the prohibited practice relates to “*small and medium businesses or firms controlled or owned by historically disadvantaged persons*” under section 9(1)(a)(ii).

46. Section 9(1A) goes further to provide that it is prohibited for:

*“a dominant firm to avoid selling, or refuse to sell, goods or services to a purchaser that is a small and medium business or a firm controlled or owned by historically disadvantaged persons in order to circumvent the operation of subsection (1)(a)(ii).”*

47. The Competition Act does not only regulate the conduct of Firms, such as dominant Firms, but also the merging of Firms where such transactions may have unwelcome competitive effects.

### **Merger Regulation**

48. Under this heading, the concept of a merger is described and when such mergers are required to be notified to the Commission. Once notified, these mergers are analysed according to certain factors listed in the Competition Act. The detail of this analysis, including the factor of a failing firm, is described under this heading.

49. Following an analysis of a merger, the relevant competition authority decides whether to allow the merger to proceed. The possible decisions following such merger analysis are also described under this heading.

#### Notifiable mergers

50. Section 12(1)(a) indicates that a merger occurs “*when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm.*” This acquisition of control may occur through the “*purchase or lease of shares, assets or an interest the other firm*” (“**Merger**”).<sup>34</sup>
51. As contemplated in section 12(1)(a), a Merger can occur with the transfer of control over a part of a business i.e., assets, where such assets have relatively permanent productive capacity. Such assets must, however, provide market share for the acquiring party to constitute a Merger.<sup>35</sup>
52. Examples of such control over another Firm are set out in section 12(2) and include beneficially owning more than half of the issued share capital<sup>36</sup> or being able to appoint or veto the appointment of a majority of the directors of a Firm.<sup>37</sup>
53. Such a Merger must be notified to the Commission if the combined annual turnover<sup>38</sup> and/or asset value<sup>39</sup> of the acquiring Firm(s)<sup>40</sup> together with the

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<sup>34</sup> Section 12(1)(b).

<sup>35</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 181.

<sup>36</sup> Section 12(2)(a).

<sup>37</sup> Section 12(2)(c).

<sup>38</sup> In, into or from South Africa (L Kelly *et al Principles of Competition Law in South Africa* (2016) 182).

<sup>39</sup> Only those in South Africa (L Kelly *et al Principles of Competition Law in South Africa* (2016) 182).

<sup>40</sup> Defined in section 1 of the Competition Act.

target Firm(s)<sup>41</sup> are at least R600 million and the target Firm's assets or turnover is at least R100 million.<sup>42</sup>

54. Once notified, such Mergers may not be implemented until the Commission or Tribunal has approved the Merger, with or without conditions.<sup>43</sup>
55. A Merger that does not meet these thresholds for notification can be implemented without notifying the Commission.<sup>44</sup> However, the Commission may require notification of the Merger within six months of its implementation.
56. The Commission may require notification of the unnotified Merger if it believes that the Merger may substantially lessen competition or cannot be justified on public interest grounds.<sup>45</sup> Once notified in this way, the Merger may not be implemented any further until the Commission approves implementation.<sup>46</sup>
57. After being notified of the Merger, the Competition Authorities consider the Merger in accordance with the section 12A of the Competition Act.

#### Merger analysis

58. Once notified of a Merger, the authorities analyse the potential effects of the Merger through the factors set out in section 12A of the Competition Act. This provision states that:

*“(1) Whenever required to consider a merger, the Competition Commission or Competition Tribunal must initially determine whether or not the merger is*

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<sup>41</sup> Defined in section 1 of the Competition Act and expanded to include a business or assets through the definition of “transferred firm” in the Determination of Merger Thresholds and Method of Calculation, GN 216 *Government Gazette* 31957, 6 March 2009.

<sup>42</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 183 read with Section 11 of the Competition Act and Determination of Merger Thresholds and Method of Calculation, GN 216 *Government Gazette* 31957, 6 March 2009 (updated by GN1003 of 15 September 2017).

<sup>43</sup> Section 13A(3).

<sup>44</sup> Section 13(1).

<sup>45</sup> Section 13(3).

<sup>46</sup> Section 13(4).

likely to substantially prevent or lessen competition, by assessing the factors set out in subsection (2), and if it appears that the merger is likely to substantially prevent or lessen competition, then determine-

(a) whether or not the merger is likely to result in any technological, efficiency or other pro-competitive gain which will be greater than, and offset, the effects of any prevention or lessening of competition, that may result or is likely to result from the merger, and would not likely be obtained if the merger is prevented; and

(b) whether the merger can or cannot be justified on substantial public interest grounds by assessing the factors set out in subsection (3).

(1A) Despite its determination in subsection (1), the Competition Commission or Competition Tribunal must also determine whether the merger can or cannot be justified on substantial public interest grounds by assessing the factors set out in subsection (3)." (emphasis added)

59. The first issue for determination is whether the Merger is likely to substantially prevent or lessen competition. This is generally called the likely "SLC" test ("SLC").<sup>47</sup>

60. The CAC has commented, *obiter*, on what it understands is a "likely" competitive result of a Merger in terms of section 12A(1)'s SLC:

"There is thus much to be said for the view that 'likely' in s 12A(1) means reasonably probable rather than more probable than not. One is concerned with a predictive exercise where future outcomes cannot be measured with fine callipers."<sup>48</sup> (emphasis added)

61. The Tribunal also commented on the nature of this predictive exercise by indicating that:

"Merger evaluation presupposes a certain degree of speculation and conjecture. The adjudicator is called upon to estimate the future impact of a transaction on market structure and behaviour. While this is a nettle to be grasped rather than avoided, the worst effects of this conjecture can be ameliorated by solid research and data."<sup>49</sup> (emphasis added)

<sup>47</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 190.

<sup>48</sup> *Imerys South Africa (Pty) Ltd and another v Competition Commission* (147/CAC/Oct16) para 53.

<sup>49</sup> *Nasionale Pers Ltd v Educational Investment Corp Ltd* [1999-2000] CPLR 89 (CT) para 23.

62. The CAC indicated the scope of such legitimate speculation in Merger analysis for predicting future events:

*“The decision required by section 12A(1) must be made on evidence which is available to the Tribunal. In other words the Tribunal cannot base its decision upon speculation of a kind which cannot be attributed to any evidential foundation placed before the Tribunal. But the prohibition against unjustified speculation should not be confused with the need for a predictive judgment. The section enjoins the Tribunal to forecast a likely possibly, that is, it makes a predictive judgment, based on evidence which has been placed before it”*<sup>50</sup> (emphasis added)

63. The CAC contrasted this SLC test to the Competition Act’s standard of proof by indicating that:

*“The fact that the burden of proof in proceedings is proof on a balance of probability is not inconsistent with interpreting the word ‘likely’ as meaning something less than a balance of probability. That is to confuse the burden of proof with that which must be proved...”*<sup>51</sup>

64. Where this SLC test predicts such likely and substantial anti-competitive harm, the analysis turns to whether the Merger is likely to result in pro-competitive gains such as new technologies.<sup>52</sup>

65. Based on the outcome of the above, the Competition Authorities consider whether the Merger can or cannot be justified on substantial public interest grounds.<sup>53</sup>

66. Finally, regardless of the above competition effects of the Merger in paragraphs 59 and 64, the authorities are still required to determine whether

<sup>50</sup> *Mondi Ltd and Kohler Cores and Tubes* [2003] 1 CPLR 25 (CAC) para 38.

<sup>51</sup> *Imerys South Africa (Pty) Ltd and another v Competition Commission* (147/CAC/Oct16) para 50.

<sup>52</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 190.

<sup>53</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 190.

the Merger can or cannot be justified on substantial public interest grounds. In this way, a Merger that does not result in an SLC can still be prohibited based on public interest grounds.<sup>54</sup>

67. As indicated in section 12A, an analysis of the SLC must consider the factors set out in section 12A(2):

*“(2) When determining whether or not a merger is likely to substantially prevent or lessen competition, the Competition Commission or Competition Tribunal must assess the strength of competition in the relevant market, and the probability that the firms in the market after the merger will behave competitively or co-operatively, taking into account any factor that is relevant to competition in that market, including-*

- (a) the actual and potential level of import competition in the market;*
- (b) the ease of entry into the market, including tariff and regulatory barriers;*
- (c) the level and trends of concentration, and history of collusion, in the market;*
- (d) the degree of countervailing power in the market;*
- (e) the dynamic characteristics of the market, including growth, innovation, and product differentiation;*
- (f) the nature and extent of vertical integration in the market;*
- (g) whether the business or part of the business of a party to the merger or proposed merger has failed or is likely to fail;*
- (h) whether the merger will result in the removal of an effective competitor;*
- (i) the extent of ownership by a party to the merger in another firm or other firms in related markets;*
- (j) the extent to which a party to the merger is related to another firm or other firms in related markets, including through common members or directors; and*
- (k) any other mergers engaged in by a party to a merger for such period as may be stipulated by the Competition Commission.*

*(3) When determining whether a merger can or cannot be justified on public interest grounds, the Competition Commission or the Competition Tribunal must consider the effect that the merger will have on-*

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<sup>54</sup> L Kelly et al *Principles of Competition Law in South Africa* (2016) 191.

(a) *a particular industrial sector or region;*

(b) *employment;*

(c) *the ability of small and medium businesses, or firms controlled or owned by historically disadvantaged persons, to effectively enter into, participate in or expand within the market;*

(d) *the ability of national industries to compete in international markets; and*

(e) *the promotion of a greater spread of ownership, in particular to increase the levels of ownership by historically disadvantaged persons and workers in firms in the market.” (emphasis added)*

68. The following factors from this statutory list are briefly described as they are likely to be considered together with the failing firm factor which is expanded upon below:

68.1. *Market concentration:* A Firm’s exit may attract greater scrutiny where it results in a concentrated market with only a few remaining Firms. Less so when the market remains fragmented with a plethora of Firms holding distributed market shares.<sup>55</sup>

68.2. *Effective competitor:* Competition is unlikely to be affected where the exiting Firm is not a significant constraint on the Firms that acquire its market shares.<sup>56</sup>

68.3. *Barriers to entry:* High barriers to entry into the relevant market, such as high switching costs for customers, may protect the Firm with market power. Alternatively, low barriers mean potential entrants are likely to discipline the remaining Firms’ conduct post-merger.<sup>57</sup>

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<sup>55</sup> P Sutherland and K Kemp *Competition Law of South Africa* (2017) section 10.7.1.2.

<sup>56</sup> P Sutherland and K Kemp *Competition Law of South Africa* (2017) section 10.7.1.4.

<sup>57</sup> P Sutherland and K Kemp *Competition Law of South Africa* (2017) section 10.7.1.5.

- 68.4. *Countervailing power*: Competition is unlikely to be affected where large customers wield considerable power over their suppliers. Such power disciplines the suppliers' conduct regardless of whether they have acquired the exiting Firm's market shares.<sup>58</sup>
69. These factors may inform an analysis of the most relevant factor to Ability to Pay which is the failing firm factor set out in section 12A(2)(g). This factor considers whether the business of a party to the Merger has failed or is likely to fail.

*Failing Firm factor*

70. The Tribunal summarised its approach to this factor in *ISCOR Limited and Saldanha Steel (Pty) Ltd* ("**ISCOR Decision**")<sup>59</sup> after exploring equivalent factors considered by other jurisdictions.
71. The Tribunal noted that the authorities in the United States of America ("**US**") indicate that:

"A merger is *not likely to create or enhance market power or facilitate its exercise if the following circumstances are met:*

- (1) the allegedly failing firm would be *unable to meet its financial obligations in the near future;*
- (2) it would *not be able to reorganize successfully under Chapter II of the Bankruptcy Act;*
- (3) it has made *unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets of the failing firm that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger; and*

<sup>58</sup> P Sutherland and K Kemp *Competition Law of South Africa* (2017) section 10.7.1.7.

<sup>59</sup> *ISCOR Limited and Saldanha Steel (Pty) Ltd* (67/LM/Dec01).

(4) absent the acquisition, the assets of the failing firm would exit the relevant market.<sup>60</sup> (emphasis added)

72. The Tribunal did, however, question the rationale for this position in the US:

*“The rationale expressed here seems to be that if the status quo remains unchanged if the failing firm’s assets exit or are acquired one would favour their acquisition. That still begs the question of the underlying rationale of invoking the defence when the post merger state of the market is less competitive than before because the acquiring firm would enjoy a greater market share on acquisition of the failing firm than it would have if it just exited. Here case law is not that consistent.”<sup>61</sup> (emphasis added)*

73. The Tribunal noted that the requirements in the European Union (“EU”) are slightly different and more stringent than the US as they require that:

*“a) the acquired firm would have withdrawn from the market if not taken over by the other firm;*

*b) the acquirer would gain the market share of the acquired firm if the latter were to exit the market; and*

*c) no alternatives were available that were less anticompetitive.”<sup>62</sup>*

(emphasis added)

74. The Tribunal also found the Australian approach most instructive and quoted its position at length:

*“Briefly, the Commission [the ACCC] will need to be convinced that the firm cannot be successfully re-organised and there is no other viable buyer for the business, and no likelihood of such a buyer emerging, such that the firm’s resources are likely to exit the market absent the merger and so cease to represent an actual or potential constraint on the market.*

*If the target firm is considered to be failing, the Commission will consider the likely effect of the acquisition on competition compared to the effect of the*

<sup>60</sup> *ISCOR Limited and Saldanha Steel (Pty) Ltd* (67/LM/Dec01) 16 para 80.

<sup>61</sup> *ISCOR Limited and Saldanha Steel (Pty) Ltd* (67/LM/Dec01) 19 para 89.

<sup>62</sup> *ISCOR Limited and Saldanha Steel (Pty) Ltd* (67/LM/Dec01) 17 para 82.

target's assets exiting the market. Under the latter circumstances, the distribution of the target's customer base among the remaining market participants would be determined by market forces, whereas an acquisition would tend to deliver those customers to the acquiring firm. If the competitive strength of the remaining participants is evenly matched, the level of competition in the market may be better served by allowing the firm to fail. However, the loss of capacity will tend to reduce competitive pressures in the market. Depending on the effect of the acquisition on the relative strength of remaining participants, retaining the failed firm's capacity in the market may still be pro-competitive.<sup>63</sup> (emphasis added)

75. The Tribunal ultimately summarised its approach as:

"1. A failing firm defence should not be invoked if it amounts in substance to another factor or defence which the Act already provides. In particular we draw attention to the efficiency defence and the public interest criteria.

2. The merger criteria for a failing firm set out in the tests of other jurisdictions will carry serious weight in our assessment. Organising ones evidence on the basis of these criteria would thus be useful and instructive to the Tribunal.

3. A merger would not be regarded as lessening competition if the conditions laid out in the more stringent EU test can be satisfied.

4. A party falling short of the 'market share would have gone to us' requirement, but that could satisfy the other elements of the test or the standard in the US test, would have a reasonable possibility of success depending on the degree of the anti-competitive sting. Thus where the anti-competitive effects of the merger are otherwise slight, then the Tribunal might be less stringent in the application of some of the criteria. Here the party should have regard to evidence that establishes some rationale for the existence of the failing firm doctrine. We have referred to some of these in our discussion although we do not suggest that this is an exhaustive list.

5. Evidence of the extent of failure or its imminence, would be weighed up against the evidence of the anti-competitive effect. The greater the anticompetitive threat the greater the showing that failure is imminent;

6. No leniency would be afforded to the requirement that there be evidence that there is no less anticompetitive alternative.

7. The onus is on the merging firms to establish the evidence necessary to invoke the doctrine of the failing firm"<sup>64</sup> (emphasis added)

<sup>63</sup> ISCOR Limited and Saldanha Steel (Pty) Ltd (67/LM/Dec01) 18 para 84.

<sup>64</sup> ISCOR Limited and Saldanha Steel (Pty) Ltd (67/LM/Dec01) 23 para 110.

76. This summary of its approach to the failing firm factor indicates the Tribunal's focus on the effect of the failing Firm's possible exit on competition compared to the effect of the proposed Merger on competition. This is intuitive as this factor forms part of the competitive effects SLC test in analysing a Merger.

### Decisions on Mergers

77. After investigating a Merger, the Competition Authorities may make one of the following decisions:<sup>65</sup>
- 77.1. Approve the Merger;
- 77.2. Approve the Merger subject to certain conditions which address SLC or public interest concerns;<sup>66</sup> or
- 77.3. Prohibit the implementation of the Merger after finding that it is anti-competitive or should not be allowed based on substantial public interest grounds.<sup>67</sup>

### Consent Orders

78. As mentioned above, one of the Commission's functions is to negotiate and conclude consent orders in accordance with Section 49D(1).<sup>68</sup> This provision states that:

*"[if] the Competition Commission and the respondent agree on the terms of an appropriate order, the Competition Tribunal, without hearing any evidence, may confirm that agreement as a consent order..."*<sup>69</sup>

<sup>65</sup> Sections 14 and 16 of the Competition Act.

<sup>66</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 215.

<sup>67</sup> In terms of the stages of analysis described from paragraph **Error! Reference source not found.** above.

<sup>68</sup> Paragraph 0 above.

<sup>69</sup> See also section 58(1)(b) for the Tribunal's power to give such orders.

79. These agreements, generally, include the payment of a settlement amount to finalise the allegations against the Firm. The Tribunal's function is to evaluate whether such a settlement is appropriate.

#### Appropriateness of settlement

80. When evaluating the appropriateness of the settlement, the Tribunal may not hear evidence but may request relevant information from the Commission's investigation of the matter.<sup>70</sup> The CAC has held that after the Tribunal considers the information before it:

*"the true inquiry before the Tribunal in this context is whether the agreement is a rational one, whether it meets the objectives [of the Competition Act] above and is not so shockingly inappropriate that it will bring the [c]ompetition authorities into disrepute."<sup>71</sup>*

81. Similarly, the Tribunal indicated that an appropriate order in accordance with section 49D:

*"means no more than suitable - it is suitable in the sense that it is an agreement that suits the contending interests of the Commission, as the proxy of the public interest, and the respondent, and in that sense, can be said to be appropriate as between themselves."<sup>72</sup> (emphasis added)*

#### Payment terms

82. Normally, the Tribunal does not issue reasons for consent orders but confirms the obligation to pay the settlement amount. These amounts may be paid in

<sup>70</sup> *Netcare Hospital Group (Pty) Ltd and another v Norman Manoim N.O. and others* (75/CAC/Apr08) 12 para 28.

<sup>71</sup> *Netcare Hospital Group (Pty) Ltd and another v Norman Manoim N.O. and others* (75/CAC/Apr08) 14 para 29.

<sup>72</sup> *Competition Commission v South African Airways (Pty) Ltd and others* (83/CR/Oct04) 15 para 47.

one payment or in instalments over time.<sup>73</sup> Such payment terms can extend for many years.<sup>74</sup>

83. To avoid an erosion of the settlement's real value during the extended payment period, the Commission may require interest to be paid on the amount in accordance with its Guidelines for the Determination of Administrative Penalties for Prohibited Practices ("**Fining Guidelines**").<sup>75</sup> The Fining Guidelines calculate interest in terms of "*section 80(1)(b) of the Public Finance Management Act 1 of 1999 and the Prescribed Rate of Interest Act No. 55 of 1975.*"<sup>76</sup>
84. The contravening Firm is required to pay the settlement amount to the Commission. Such consent orders normally contain a clause confirming that the Commission will transfer the settlement amount to the National Revenue Fund.<sup>77</sup>

### **Tribunal Fines**

85. This section expands on the fining provisions of the Competition Act by describing the contraventions that may attract a fine. When a fine is applicable, the factors for determining a fine are used to calculate an appropriate fine.

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<sup>73</sup> For example, *Competition Commission v Stefanutti Stocks Holdings Ltd* (017038) para 11.1.

<sup>74</sup> *Competition Commission v Hendok (Pty) Ltd* (CR093Jan07/SA082Aug19) where payment would be made over five years.

<sup>75</sup> GN 323, *Government Gazette* 38693, 17 April 2015 (Effective 1 May 2015). Issued in accordance with section 79(b) of the Competition Act.

<sup>76</sup> GN 208, *Government Gazette* 41593, 26 April 2018 read with Treasury's "Standard Interest Rate to be Levied on Debts Owning to the State" (<http://www.treasury.gov.za/legislation/pfma/interest%20rates/20%20Standard%20interest%20rates%20on%20debts%20owing%20to%20the%20State%20-%20effective%201%20May%202018.pdf>) [accessed 16 December 2018]. The Prescribed Rate of Interest Act 55 of 1975 provides guidance on when to calculate such interest.

<sup>77</sup> For example, *Competition Commission v Cape Gate* (CR093Jan07/SA004Apr18) para 7.4.

86. These factors for determining an appropriate fine are explored under this heading by describing the statutory limit, the Tribunal's six-step methodology as well as the guiding principles for determining fines.

#### Finable contraventions

87. Section 58(1)(a) of the Competition Act provides:

*“(1) In addition to its other powers in terms of this Act, the Competition Tribunal may-*

*(a) make an appropriate order in relation to a prohibited practice or an appeal referred to in section 43F,*

*including-*

- (i) interdicting any prohibited practice;*
- (ii) ordering a party to supply or distribute goods or services to another party on terms reasonably required to end a prohibited practice;*
- (iii) imposing an administrative penalty, in terms of section 59, with or without the addition of any other order in terms of this section;*
- (iv) ordering divestiture, subject to section 60;*
- (v) declaring conduct of a firm to be a prohibited practice in terms of this Act, for purposes of section 65;*
- (vi) declaring the whole or any part of an agreement to be void;*
- (vii) ordering access to an essential facility on terms reasonably required;*

*(b) confirm a consent agreement in terms of section 49D as an order of the Tribunal;...”*

*(emphasis added)*

88. Section 58(1)(a)(iii) refers to section 59 which provides the instances where the Tribunal may impose an administrative penalty:

*(1) The Competition Tribunal may impose an administrative penalty only-*

*(a) for a prohibited practice in terms of section 4(1), 5(1) and (2), 8(1), 8(4), 9(1) or 9(1A);*

*(b)...*

(c) for contravention of, or failure to comply with, an interim or final order of the Competition Tribunal or the Competition Appeal Court; or

(d) if the parties to a merger have-

(i) failed to give notice of the merger as required by Chapter 3;

(ii) proceeded to implement the merger in contravention of a decision by the Competition Commission or Competition Tribunal to prohibit that merger;

(iii) proceeded to implement the merger in a manner contrary to a condition for the approval of that merger imposed by the Competition Commission in terms of section 13 or 14, or the Competition Tribunal in terms of section 16; or

(iv) proceeded to implement the merger without the approval of the Competition Commission or Competition Tribunal, as required by this Act.

89. Section 59(1) empowers the Tribunal to impose an administrative penalty, also called a fine,<sup>78</sup> for certain listed contraventions. The use of “*only*” means that this is a closed list of contraventions that may attract a fine.<sup>79</sup> The inclusion of “*may*” affords the Tribunal a discretion on whether to impose such a penalty or not.<sup>80</sup>

90. Section 59(1)(a) then lists the following contraventions that may attract a fine:

90.1. Restrictive horizontal practices under section 4(1) that are described above from paragraph 30. These include both the *per se* contraventions of section 4(1)(b) as well as the collusive conduct in section 4(1)(a) which may also result in some pro-competitive gains.

<sup>78</sup> An administrative penalty in the Competition Act is more appropriately called a fine. *Woodlands Dairy v Milkwood Dairy* (105/2010) [2010] ZASCA 104 (13 September 2010) para 10.

<sup>79</sup> It is interesting to note that the contraventions listed in section 59 do not reference section 43F (appeals against market inquiries). Section 58 refers to such section 43F appeals and raises the possibility that an appropriate order in accordance with section 58 may include a fine in terms of section 59. However, section 59 does not expressly empower the Tribunal to impose a fine for such a section 43F appeal.

<sup>80</sup> M Neuhoff *et al* *A Practical Guide to the South African Competition Act* 2 ed (2017) 438.

- 90.2. Restrictive vertical practices under section 5(1) and (2) described from paragraph 33 above. Fines may be levied for minimum resale price maintenance as a *per se* contravention. Fines may also be levied against agreements between Firms in a vertical relationship where any pro-competitive gains from such agreements do not outweigh their anti-competitive effects.
- 90.3. Abuses of dominance by a large Firm contemplated by sections 8 and 9 may also attract a fine. A dominant Firm may be fined for all the abuses of dominance described from 37 paragraph above. These include the conduct listed under section 8 as well as price discrimination contemplated by section 9.
91. The Tribunal may also impose a fine when a Firm does not comply with its obligations relating to a Merger. The following contraventions relating to Mergers may attract a fine:
- 91.1. Where a Firm fails to notify a Merger that meets the thresholds for notification as described from paragraph 50 above. This includes the situation where the Commission requires notification even though the Merger does not meet the thresholds for notification.<sup>81</sup>
- 91.2. Where a Firm implements a Merger without the required approval of the Competition Authorities or implements the Merger contrary to a prohibition as described from 77 paragraph above.

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<sup>81</sup> Paragraph 55 above.

91.3. As described above from paragraph 77, a Merger may be approved subject to certain conditions. A fine may be levied for implementing a Merger contrary to these imposed conditions.

92. The fine that may be imposed on such contraventions is, however, limited by section 59 to a maximum.

#### Statutory limit

93. Section 59(2) provides that:

*(2) An administrative penalty imposed in terms of subsection (1) may not exceed 10 per cent of the firm's annual turnover in the Republic and its exports from the Republic during the firm's preceding financial year.*

*(2A) An administrative penalty imposed in terms of subsection (1) may not exceed 25 per cent of the firm's annual turnover in the Republic and its exports from the Republic during the firm's preceding financial year if the conduct is substantially a repeat by the same firm of conduct previously found by the Competition Tribunal to be a prohibited practice.* (emphasis added)

94. Section 59(2) creates a statutory cap of 10% for all types of fines. This cap increases to 25% for recidivists in terms of (2A). This increased cap only relates to prohibited practices contemplated by chapter 2 of the Competition Act, such as restrictive horizontal practices, and not for other contraventions, such as implementing a Merger without approval.<sup>82</sup>

95. Whether 10% or 25%, the relevant cap is calculated from the Firm's South African turnover during its "*preceding financial year*". The Tribunal clarified "*preceding financial year*" as the "*last completed year prior to the imposition*

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<sup>82</sup> See paragraph 88 above.

*of the penalty; provided the contravention is enduring and there has been no undue delay in the proceedings.”* The Tribunal may, however, deviate from this approach where a *“respondent has no, or minimal turnover, in the year preceding the imposition of the penalty.”*<sup>83</sup>

96. Section 59(3A) indicates what may be included as turnover in this preceding year. It provides a broadening of the relevant turnover that may form the basis of the calculation in section 59(2) and (2A):

*“(3A) In determining the extent of the administrative penalty to be imposed, the Competition Tribunal may-*

*(a) increase the administrative penalty referred to in subsections (2) and (2A) to include the turnover of any firm or firms that control the respondent, where the controlling firm or firms knew or should reasonably have known that the respondent was engaging in the prohibited conduct; (emphasis added)*

97. This provision, effectively, increases the cap that may be applied by including the turnover of other Firms in the perpetrator’s corporate group. In this way, a group of companies could constitute a Firm for purposes of this section. This increase in turnover inflates the maximum allowable fine without needing to raise the percentage limits in section 59(2) and (2A).

#### Factors for determining a fine

98. When determining a fine, the Tribunal is required to consider a list of statutory factors provided in section 59(3):

*“(3) When determining an appropriate penalty, the Competition Tribunal must consider the following factors:*

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<sup>83</sup> M Neuhoff *et al* *A Practical Guide to the South African Competition Act* 2 ed (2017) 441.

- (a) the nature, duration, gravity and extent of the contravention;
- (b) any loss or damage suffered as a result of the contravention;
- (c) the behaviour of the respondent;
- (d) the market circumstances in which the contravention took place, including whether, and to what extent, the contravention had an impact upon small and medium businesses and firms owned or controlled by historically disadvantaged persons;
- (e) the level of profit derived from the contravention;
- (f) the degree to which the respondent has co-operated with the Competition Commission and the Competition Tribunal;
- (g) whether the respondent has previously been found in contravention of this Act; and
- (h) whether the conduct has previously been found to be a contravention of this Act or is substantially the same as conduct regarding which Guidelines have been issued by the Competition Commission in terms of section 79." (emphasis added)

99. The Tribunal is enjoined by section 59(3) to consider these factors when determining an appropriate fine.<sup>84</sup> Section 59(3) does not close the list of factors or principles that could be considered but lists those that must be considered. To assist with this process, the Tribunal has developed a six-step methodology for applying these factors to determine an appropriate fine.<sup>85</sup>

#### *Six-step methodology*

100. The steps that constitute this methodology are:

100.1. *Step one:* Determine the “*affected turnover*” of the respondent in the “*base year*”. The “*affected turnover*” of the respondent Firm is “*the firm’s turnover that*

<sup>84</sup> *Federal Mogul Aftermarket Southern Africa (Pty) Ltd v Competition Commission* (33/CAC/Sep03) 44.

<sup>85</sup> *Competition Commission v Aveng (Africa) Limited t/a Steeledale and others* (84/CR/Dec09) and confirmed in *Reinforcing Mesh Solutions (Pty) Ltd and others v Competition Commission and others* [2013] 2 CPLR 455 (CAC).

*is attributable to the market for the goods or services affected by the conduct in question.*<sup>86</sup> In other words, it is the Firm's line of business involved in the contravention.<sup>87</sup> The "base year" is the "*most recent financial year in which there is evidence that the firm participated in the contravention.*"<sup>88</sup>

100.2. *Step two:* Calculating the basic amount. This amount is a percentage of the "affected turnover". This percentage can range up to 30% based on the nature, gravity, extent of the contravention as well as its impact on the market and its resultant losses.<sup>89</sup>

100.3. *Step three:* the basic amount is multiplied by the duration of the contravention. Any period before the commencement of the Competition Act is excluded from this calculation and any duration less than a year will be calculated as a proportion of a year. Where the duration of a contravention is less than a year, this short duration will reduce the basic amount. For example, R100 basic amount x 6 months duration / 12 months in a year = R50.<sup>90</sup>

100.4. *Step four:* The resulting amount in step three is then rounded down to the maximum allowable fine in terms of section 59(2) and (2A) read with section 59(3A). For example, an amount of R150 in step three is reduced to a R100 cap as determined in terms of section 59(2)/(2A)/(3A).<sup>91</sup> The Tribunal introduced this rounding down process at step four to give effect to any aggravating or mitigating factors that follow in step five. For example, the

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<sup>86</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 230.

<sup>87</sup> *Competition Commission v Southern Pipeline Contractors Concrete Walls (Pty) Ltd* (23/CR/Feb09) (unreported) para 29.

<sup>88</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 230.

<sup>89</sup> M Neuhoff *et al A Practical Guide to the South African Competition Act* 2 ed (2017) 443.

<sup>90</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 231.

<sup>91</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 231.

Tribunal was concerned that a very high amount from step three would render any mitigating factors nugatory if the final amount would just be rounded down to a lower maximum in step six.<sup>92</sup>

100.5. *Step five*: Aggravating and mitigating factors. These factors include the remaining factors listed in section 59(3) such as the aggravating factor in 59(3)(g) where the Firm is a repeat offender.<sup>93</sup>

100.6. *Step six*: Further rounding down the amount from step five if step five's amount exceeds the maximum allowable fine contemplated in section 59(2) or (2A).

101. The Tribunal is, however, not bound to apply this approach to section 59(3) factors in every matter. The Tribunal indicated that this six-step methodology is "*appropriate in circumstances of a long standing and on-going overarching agreement over an extended period of time.*"<sup>94</sup>

102. The Tribunal ultimately held "*that there is no scientific approach to the determination of an administrative penalty, the overriding principle is fairness and proportionality.*" The CAC has similarly indicated that the guiding principles for determining an appropriate fine are deterrence, proportionality and fairness.

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<sup>92</sup> P Sutherland and K Kemp *Competition Law of South Africa* (2017) 12.4.2. However, the authors criticize this step as they argue that it will result in anomalous results where firms which were involved for different durations (one for a long duration and another significantly shorter) will come out at the same fine.

<sup>93</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 232.

<sup>94</sup> *Competition Commission v Stanley's Removals CC and another* (CR030Jun15) para 28.

## Deterrence

103. The CAC has held that “*deterrence [is] the primary purpose of the imposition of an administrative penalty.*”<sup>95</sup> The CAC provided further guidance on what constitutes a sufficiently deterrent fine by indicating that:

*“The achievement of effective deterrence requires careful consideration. Apart from the possibility of being discovered, successful deterrence depends on the extent to which the expected benefit of the conduct can be significantly reduced by a penalty which is so imposed.”*<sup>96</sup> (emphasis added)

104. The Tribunal indicated that deterrence has two elements, namely, “*deterrence of the respondent and deterrence of others contemplating the same conduct.*”<sup>97</sup> In essence, the fine should be sufficiently high to discourage all Firms from engaging in such prohibited conduct in the future.<sup>98</sup>

105. The upper-bound of a fine would seem to be untrammelled by the purpose of deterrence. The higher the fine, the higher its deterrent effect.

106. This seems especially true where the detection of clandestine prohibited conduct is challenging. In such cases, deterrence may prompt the Commission to seek a very large fine to compensate for the low likelihood of discovering the secretive conduct.<sup>99</sup>

107. The other guiding principles for determining an appropriate administrative penalty provide such a limitation.

<sup>95</sup> *Federal Mogul aftermarket Southern Africa (Pty) Ltd v Competition Commission* (33/CAC/Sep03) 43.

<sup>96</sup> *Southern Pipeline Contractors and another v The Competition Commission* (105/CAC/Dec10;106/CAC/Dec10) 31 para 58.

<sup>97</sup> *Competition Commission v Federal Mogul Aftermarket SA (Pty) Ltd and others* (08/CR/Mar01) para 118.

<sup>98</sup> *Isipani Construction (Pty) Ltd v Competition Commission* (144/CAC/Aug16) 45 para 90.

<sup>99</sup> W Wils “Optimal Antitrust Fines: Theory and Practice” in *World Competition* Vol 29(2) (2006) from 17.

## *Proportionality*

108. In relation to proportionality, the CAC interpreted the Competition Act through the prism of The Constitution of the Republic of South Africa, 1996 and concluded that:

*“it is clear that the doctrine of proportionality constitutes a further applicable factor in the determination of an appropriate constitutional penalty in the circumstances of a dispute such as that before this Court.”<sup>100</sup> (emphasis added)*

109. The CAC explained this principle in relation to a fine as being:

*“proportional in severity to the degree of blameworthiness of the offending party, the nature of the offence and its effect on the South African economy in general and consumers in particular.”<sup>101</sup> (emphasis added)*

110. Such a proportionate fine may be calculated in terms of the above six-step methodology which seeks to fulfil this principle by considering factors relating to the Firm’s involvement, the nature of the offence and its effect. As the CAC noted:

*“By using the base line of affected turnover, the implications of the doctrine of proportionality that is between the nature of the offence and benefit derived therefrom, the interests of the consumer community and the legitimate interests of the offender can be taken more carefully into account and appropriately calibrated.”<sup>102</sup> (emphasis added)*

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<sup>100</sup> *Southern Pipeline Contractors and another v The Competition Commission* (105/CAC/Dec10;106/CAC/Dec10) 5 para 9.

<sup>101</sup> *Southern Pipeline Contractors and another v The Competition Commission* (105/CAC/Dec10;106/CAC/Dec10) 5 para 9.

<sup>102</sup> *Southern Pipeline Contractors and another v The Competition Commission* (105/CAC/Dec10;106/CAC/Dec10) 27 para 51.

111. The CAC confirmed that proportionality is an overarching guiding principle and can be used to test whether the application of the six-step methodology is appropriate:

*“Once the indication is that the penalty is not proportional, it is necessary to consider where the Tribunal erred. The appropriate starting point would be to consider each of the indicated steps... Ultimately the penalty must have a deterrent effect and yet be proportional.”<sup>103</sup> (emphasis added)*

112. In addition to proportionality, the CAC also considers fairness to be an overarching principle for determining an appropriate fine.

### *Fairness*

113. In addition to proportionality, the CAC indicated that:

*“the overriding principle to determining an appropriate penalty [is] fairness and proportionality.”<sup>104</sup> (emphasis added)*

114. The CAC also indicated that fairness should be considered together with deterrence:

*“imposition of an administrative penalty should not only promote the important objective of deterrence but that sight should not be lost of fairness to the offending party. In particular, a penalty should not be imposed in order to destroy the business of the offending party, a point confirmed by s59(2) which places a cap on the amount of a penalty which may be imposed*

...

*This conclusion therefore illuminates the animating idea that the legislature was concerned that the penalty, although severe, should not, on its own,*

<sup>103</sup> *Isipani Construction (Pty) Ltd v Competition Commission* (144/CAC/Aug16) 46 para 92 and 51 para 102.

<sup>104</sup> *Competition Commission v Stanley’s Removals CC* (149/CAC/Jan17) 15 para 47.

be destructive of the offending party's business; hence the restraint of the cap."<sup>105</sup> (emphasis added)

115. The CAC later confirmed this reasoning based on fairness and went further to indicate that:

"Of course, s59(2) is inevitably a blunt instrument to achieve this constraint, and no doubt the Tribunal could receive and take into account evidence that a penalty arrived at along conventional lines would jeopardise the firm's viability (cf para 35 of the EU Guidelines)..."<sup>106</sup> (emphasis added)

116. The Tribunal used similar wording when applying this principle and held that:

"If Amitech does exit the market it will not be consequent on the levelling of a penalty, but because of other commercial reasons...onus is on the firm to establish that the levelling of a penalty would result in its exit."<sup>107</sup> (emphasis added)

117. In that case, the Tribunal found that the respondent had not proved its assertion that the fine would result in its exit. This concept of proof is explored below under the headings of standard of proof and burden of proof.

## **Standard and Burden of Proof**

118. This section highlights the provisions of the Competition Act relating to the concepts of standard of proof and the burden of proof.

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<sup>105</sup> *Southern Pipeline Contractors and another v The Competition Commission* (105/CAC/Dec10;106/CAC/Dec10) 6 para 9 and 33 para 61.

<sup>106</sup> *Macneil Agencies (Pty) Ltd v Competition Commission* (121/CAC/Jul12) 34 para 85.

<sup>107</sup> *Competition Commission v DPI Plastics (Pty) Ltd and others* (15/CR/Feb09) 47 para 191.

## Standard of proof

119. Section 68 of the Competition Act states its standard of proof as:

*“In any proceedings in terms of this Act...[other than interim relief or criminal proceedings] the standard of proof is on a balance of probabilities.” (emphasis added)*

120. This balance of probabilities is understood as:

*“the probabilities favour one party in preference to the other. What is required is that the probabilities in the case be such that, on the preponderance, it is probable that the particular state of affairs existed... but if the probabilities are equal [the burden is not discharged].”<sup>108</sup> (emphasis added)*

## Burden of proof

121. Normally, the nature of the law relied upon determines which party bears the burden of proving a specific allegation.<sup>109</sup> This is true for the Competition Act as well. For instance, the Commission bears the burden to prove that there was an agreement underpinning a prohibited vertical practice and that it had an anti-competitive effect.<sup>110</sup> Where the Competition Act does not indicate who bears the burden of proof, the following guiding principle is normally used to determine with whom the burden lies:

*“the person who makes a positive assertion is generally called upon to prove it, with the effect that the burden of proof lies generally on the person who seeks to alter the status quo.”<sup>111</sup>*

<sup>108</sup> PJ Schwikkard and SE van der Merwe *Principles of Evidence* 4th ed (2016) 627.

<sup>109</sup> PJ Schwikkard and SE van der Merwe *Principles of Evidence* 4th ed (2016) 617.

<sup>110</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 113.

<sup>111</sup> PJ Schwikkard and SE van der Merwe *Principles of Evidence* 4th ed (2016) 619.

122. Applying this principle to Ability to Pay, the Tribunal held that the “*onus is on the firm to establish that the levelling of a penalty would result in its exit.*”<sup>112</sup> In deciding the matter, the Tribunal held that the proposed fine would not cause the firm’s exit as the Firm had access to sufficient funding to continue trading.<sup>113</sup>

### **Payment and Enforcement of Fines**

123. This section explores when a fine may be paid and how the Commission can enforce the payment of a fine if it is not paid on time.

#### Delayed payment

124. Section 59 does not expressly require a fine to be paid immediately when imposed. As mentioned above, a consent order may allow for instalment payments over many years.<sup>114</sup> Similarly, the Tribunal has previously allowed for the delayed payment of a fine.<sup>115</sup> In such situations, the Tribunal’s order may allow the parties to approach it later and seek more time to pay based on a change of circumstances.<sup>116</sup>
125. When the fine falls due, it is paid to the Commission which then forwards the monies to the National Revenue Fund in terms of section 59(4):

*“(4) A fine payable in terms of this section must be paid into the National Revenue Fund referred to in section 213 of the Constitution.”*

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<sup>112</sup> *Competition Commission v DPI Plastics (Pty) Ltd and others* (15/CR/Feb09) 47 para 191.

<sup>113</sup> *Competition Commission v DPI Plastics (Pty) Ltd and others* (15/CR/Feb09) 47 para 190.

<sup>114</sup> Paragraph 79 above.

<sup>115</sup> *Competition Commission v Telkom SA Ltd* (11/CR/Feb04) 46 para 196.

<sup>116</sup> *Competition Commission v ArcelorMittal South Africa Limited* (CR092Jan07/SA090Aug16) 24 paras 12.2 and 12.3.

## Recovery of fine

126. If the fine is not paid in terms of the Tribunal's order, the Commission may enforce the order as if it was a High Court order. This power is provided in section 64:

*“(1) Any decision, judgment or order of the Competition Commission, Competition Tribunal or Competition Appeal Court may be served, executed and enforced as if it were an order of the High Court.”*

## Commission's Fining Guidelines

127. On 17 April 2015, the Commission published its Guidelines for the Determination of Administrative Penalties for Prohibited Practices i.e., its Fining Guidelines.<sup>117</sup> These guidelines describe the Commission's general approach when considering the factors in section 59(3) but also provides further detail outside these factors including *“the ability to pay the administrative penalty”*.<sup>118</sup>
128. However, these Fining Guidelines are not binding on the Commission or the Tribunal but provide the Commission's general methodology when calculating fines.<sup>119</sup>

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<sup>117</sup> GN 323, *Government Gazette* 38693, 17 April 2015 (Effective 1 May 2015). Issued in accordance with section 79(b) of the Competition Act.

<sup>118</sup> Section 7 of the Fining Guidelines.

<sup>119</sup> Preface of the Fining Guidelines.

## Commission's approach to six-step methodology

129. The Fining Guidelines incorporate the Tribunal's above six-step approach and provide further guidance to the following steps:

129.1. *Step one*: Where the contravention takes the form of market allocation, a Firm may not generate any revenue from the affected products as it agreed to stay out of that product market. In such an instance, the Commission will “*have regard to the turnover of those products or services that are ‘protected’ by the anti-competitive conduct (being the market ‘allocated’ to the firm).*”<sup>120</sup>

129.2. *Step one*: Where the contravention is a once-off bid rigging contravention, the Commission distinguishes between the successful and unsuccessful bidders in the arrangement. For the successful bidder, the “affected turnover” is the greater of “*(i) the value of the bid submitted by the successful bidder; (ii) the value of the contract concluded (or to be concluded) with the successful bidder; or (iii) the amount paid to the successful bidder.*” For the unsuccessful bidder, the “affected turnover” is the greater of “*(i) the value of the bid submitted by the unsuccessful bidder; (ii) the value of the contract concluded(or to be concluded) with the successful bidder; or (iii) the amount paid to the successful bidder.*”<sup>121</sup> (emphasis added)

129.3. *Step two*: The Commission may go beyond the factors stated in section 59(3) and consider other factors such as “*the impact of the contravention on small*

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<sup>120</sup> L Kelly et al *Principles of Competition Law in South Africa* (2016) 230.

<sup>121</sup> L Kelly et al *Principles of Competition Law in South Africa* (2016) 230.

*and medium-sized enterprises, and low-income consumers*<sup>122</sup> as well as “*the structure of the market [and] market shares of the firms involved*”.<sup>123</sup>

129.4. *Step five*: The Fining Guidelines group the relevant section 59(3) factors into two groups. The first group includes those factors relating to the behaviour of the respondent Firm in the relevant market. These include whether the Firm was pro-active or passive in the conduct as well as whether the Firm’s senior management was involved. The second group of factors includes the remaining factors that relate to the Firm’s conduct towards to the Competition Authorities. These include whether the Firm is a recidivist, whether the Firm co-operated or obstructed the Commission’s investigation as well as the presumption of profit for hard-core conduct under section 4(1)(b).<sup>124</sup>

#### Discounts for early settlement

130. The Fining Guidelines provide for discounts to incentivise Firms to settle early with the Commission. The Fining Guidelines indicate that the Commission may discount an administrative penalty calculated under the six-step methodology by 10% to 50%.<sup>125</sup>

131. When determining any discount, the Commission may consider how early in the process the Firm is willing to settle. Those Firms that settle early in the investigation will receive a relatively greater discount compared to those that

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<sup>122</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 230.

<sup>123</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 230 footnote 53.

<sup>124</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 232.

<sup>125</sup> Fining Guidelines para 6.1.

settle closer to litigation. The Commission will also consider how the Firm assists the Commission with its prosecution of the other Firms involved.<sup>126</sup>

#### Ability to pay a fine

132. The Fining Guidelines indicate that the Commission may consider Ability to Pay in “*exceptional circumstances*”. Unfortunately, no further guidance is provided on what the Commission considers exceptional circumstances.

133. When considering such exceptional circumstances, the Commission is mindful of the “*firm’s financial position and market circumstances*” to avoid:

*“imposing substantial hardship on a particular firm that may lead to a significant reduction in competition. This does not negate the need for consideration of the principle of proportionality and fairness.”<sup>127</sup> (emphasis added)*

134. The Fining Guidelines indicate that the essential test is whether the:

*“imposition of the administrative penalty as provided for in these guidelines would irretrievably jeopardise the ability of the firm concerned to continue trading and exit.”<sup>128</sup> (emphasis added)*

135. To consider whether the Firm meets this test, the Fining Guidelines require the Firm to provide objective evidence such as “*information relating to business rescue proceedings, insolvency proceedings*”<sup>129</sup> or “*audited financial statements attesting the veracity of the firm’s financial position*.”<sup>130</sup> The Fining

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<sup>126</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 233.

<sup>127</sup> Fining Guidelines para 7.1.

<sup>128</sup> 7.2 of the Fining Guidelines.

<sup>129</sup> Fining Guidelines para 7.2 with footnote 12.

<sup>130</sup> Fining Guidelines para 7.2.

Guidelines do, however, specifically mention that financial loss alone is insufficient to meet this test.<sup>131</sup>

136. Should the Commission find that the fine would result in the Firm's exit, it may accept favourable payment terms, with interest,<sup>132</sup> or a reduction of the proposed fine. A reduction is only competent when the Firm cannot pay the fine over the long term.<sup>133</sup>
137. The Commission's Fining Guidelines seem to borrow certain language such as "*ability to pay*", "*irretrievably jeopardize*" and the economic context of "*market circumstances*" from the European Union's experience on a Firm's Ability to Pay. To understand these concepts in context, the following section briefly describes the EU's approach to fining and Ability to Pay.

### **EU Approach to Ability to Pay**

138. The EU approach to fining and Ability to Pay is described under this heading as an appropriate comparator to South Africa's fining provisions and current view on Ability to Pay.
139. Under this heading, the legal premise for fining and Ability to Pay in the EU is explored through the EU Treaty, EU Regulations, Eu Fining Guidelines, and Information Note on the Ability to Pay.
140. The EU Courts' interpretation of these legal instruments relating to Ability to Pay also falls under this heading.

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<sup>131</sup> Fining Guidelines para 7.3.

<sup>132</sup> Fining Guidelines para 9.3.

<sup>133</sup> Fining Guidelines para 7.4

## EU Treaty

141. The competitive conduct of Firms in the EU is primarily regulated by articles 101 and 102 of the Treaty on the Functioning of the European Union<sup>134</sup> (“**EU Treaty**”). Article 101 provides that:

*“(1) The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:*

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;*
- (b) limit or control production, markets, technical development, or investment;*
- (c) share markets or sources of supply;*
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;*
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.” (emphasis added)*

142. An “*undertaking*” in this context means:

*“any entity engaged in an economic activity, regardless of its legal status and the way in which it is financed. An undertaking may comprise several natural or legal persons, provided that they form a single economic unit.”<sup>135</sup> (“**Undertaking**”) (emphasis added)*

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<sup>134</sup> (2012) OJ C326/47.

<sup>135</sup> Bellamy & Child *European Union Law of Competition* 8 ed (2018) 14.089.

143. The South African Tribunal has held that the concept of “undertaking” is similar to the concept of “*firm*” in the Competition Act.<sup>136</sup>

144. Article 102 of the EU Treaty focuses on Undertakings with a dominant position in the EU market and lists the following abuses:

*“Such abuse may, in particular, consist in:*

*(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;*

*(b) limiting production, markets or technical development to the prejudice of consumers;*

*(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;*

*(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.” (emphasis added)*

145. When compared to the wording of the Competition Act there seems to be some overlap with the articles in the EU Treaty. For instance, article 101(a) seems to be akin to our section 4(1)(b)(i) and article 101(c) is similar to our section 4(1)(b)(ii). Article 102(c) seems to address similar price discrimination conduct that our section 9 regulates and article 101(d) shares similar language to our section 8(1)(d)(iii).

146. The EU Treaty then references fining powers in article 103 which provides that:

*“The appropriate regulations or directives to give effect to the principles set out in Articles 101 and 102 shall be laid down by the Council, on a*

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<sup>136</sup> *Competition Commission v Delatoy Investments (Pty) Ltd and others* (CR212Feb15) para 53.

*proposal from the Commission and after consulting the European Parliament.*

2. *The regulations or directives referred to in paragraph 1 shall be designed in particular:*

(a) *to ensure compliance with the prohibitions laid down in Article 101(1) and in Article 102 by making provision for fines and periodic penalty payments;* (emphasis added)

## EU Regulations

147. The regulation contemplated in article 103 is Council Regulation on the Implementation of the Rules on Competition Laid Down in Article 81 and Article 82 of the Treaty ("**EU Regulation**").<sup>137</sup> Article 23 of the EU Regulation provides that:

*"The Commission may by decision impose fines on undertakings and associations of undertakings where, either intentionally or negligently:*

*(a) they infringe Article 81[now article 101] or Article 82 [now article 102] of the Treaty; or*

*(b) they contravene a decision ordering interim measures under Article 8; or*

*(c) they fail to comply with a commitment made binding by a decision pursuant to Article 9."* (emphasis added)

148. Article 23(2) then limits this possible fine by including:

*"For each undertaking and association of undertakings participating in the infringement, the fine shall not exceed 10% of its total turnover in the preceding business year."* (emphasis added)

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<sup>137</sup> (2003) OJ L1/1

149. This article in the EU Regulation seems analogous with section 59(2) of the Competition Act. The EU Regulation then turns to how such a fine should be determined.
150. Article 23(3) of the EU Regulation requires the EU Commission to consider “*both to the gravity and to the duration of the infringement*” when determining the fine.<sup>138</sup> This factor finds its sibling in section 59(3)(a) of the Competition Act.
151. From this basis, the EU Commission provided further detail on how it determines fines in its Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (“**EU Fining Guidelines**”).<sup>139</sup>

#### EU Fining Guidelines

152. The EU Fining Guidelines’ introductory paragraphs refer to the principle of deterrence by indicating that:

*“Fines should have a sufficiently deterrent effect, not only in order to sanction the undertakings concerned (specific deterrence) but also in order to deter other undertakings from engaging in, or continuing, behaviour that is contrary to Articles 81 and 82 of the EC Treaty (general deterrence).”<sup>140</sup> (emphasis added)*

153. This description of the principle of deterrence is similar to how the Tribunal and CAC have described the principle.<sup>141</sup>

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<sup>138</sup> EU Regulation

<sup>139</sup> (2006) OJ C210/2.

<sup>140</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 4.

<sup>141</sup> From paragraph 103 above.

154. To achieve this deterrence goal, the EU Fining Guidelines describe the EU Commission's general methodology<sup>142</sup> for setting fines through the following steps:

*Step One: Basic Amount*

155. Determine the value of the undertaking's sales of goods or services to which the infringement directly or indirectly relates in the relevant geographic area during the last full business year of its participation in the infringement ("**Basic Amount**").<sup>143</sup>
156. The EU Commission may take a different year than the last year of involvement to ensure the period "*taken into consideration reflects the impact of, and the economic reality during, the infringement, which may require the use of a different year, and that the turnovers of the various participants in the same infringement are objectively as comparable as possible.*"<sup>144</sup> For example, the final year of involvement may not be reflective of the others because of cyclical nature of sales.<sup>145</sup>
157. A proportion of these sales, up to 30%, is then multiplied by the number of years of the infringement. The proportion of sales up to 30% is determined by looking at the gravity of the infringement. For instance, prohibited horizontal

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<sup>142</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 37.

<sup>143</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 13.

<sup>144</sup> Bellamy & Child *European Union Law of Competition* 8 ed (2018) 14.022.

<sup>145</sup> Bellamy & Child *European Union Law of Competition* 8 ed (2018) 14.023.

conduct will be a higher proportion because of its egregious effects on competition.<sup>146</sup>

158. The EU fining Guidelines also indicate that such egregious conduct will attract a minimum of 15% to 25% proportion of sales for the Basic Amount to achieve general deterrence, regardless of the length of the undertaking's involvement. Similar "entry fees" may be added to other types of infringements to avoid insufficient amounts where an undertaking's participation was of short duration.<sup>147</sup>
159. After calculating the relevant percentage, the EU Commission may apply the same percentage to all respondents or reflect the gravity of a particular undertaking's involvement by applying a different percentage. The result of this first step is then adjusted based on numerous factors.<sup>148</sup>

### *Step Two: Adjustments*

160. *Step two ("Adjustments")*: The Basic Amount is then upwardly adjusted after considering aggravating factors and downwardly adjusted for mitigating factors. Aggravating factors include recidivism, refusal to co-operate, and instigating the infringement.<sup>149</sup> An instigator is different from a leader in that it "*persuaded or encouraged others to establish or join*"<sup>150</sup> where a ring-leader "*took specific steps giving a major boost to the implementation of the anti-*

<sup>146</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 19.

<sup>147</sup> Bellamy & Child *European Union Law of Competition* 8 ed (2018) 14.033.

<sup>148</sup> Bellamy & Child *European Union Law of Competition* 8 ed (2018) 14.011.

<sup>149</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 28.

<sup>150</sup> Bellamy & Child *European Union Law of Competition* 8 ed (2018) 14.044.

*competitive conduct, thereby clearly distinguishing itself from the other participants in the infringement.*"<sup>151</sup>

161. Mitigating factors include cheating on the collusive arrangement by acting competitively, infringing negligently or terminating the conduct as soon as the authorities intervened.<sup>152</sup> Termination is not a *per se* mitigating factor as it will not be included where the conduct is secretive. In such situations, there is an incentive to terminate only when the authorities are aware and still receive the benefit.<sup>153</sup> Coercion from others is also not a recognised mitigating factor as the undertaking could have reported the infringement to protect itself.<sup>154</sup>

162. Other relevant factors include:

162.1. the number and size of the undertaking or undertakings involved in the infringement;

162.2. the proportion of the market controlled by the undertaking or undertakings involved in the infringement;

162.3. the situation of the market when the infringement was committed;

162.4. the volume and value of the goods or services in respect of which the infringement was committed;

162.5. the geographic scope of the infringement;

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<sup>151</sup> Bellamy & Child *European Union Law of Competition* 8 ed (2018) 14.045.

<sup>152</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 29.

<sup>153</sup> Bellamy & Child *European Union Law of Competition* 8 ed (2018) 14.049.

<sup>154</sup> Bellamy & Child *European Union Law of Competition* 8 ed (2018) 14.061.

- 162.6. the precautions taken by an undertaking to prevent the infringement from being exposed;
- 162.7. the role played by an undertaking in the establishment of the infringement; and
- 162.8. the profit which an undertaking was able to derive from the infringement.<sup>155</sup>
163. Certain of these factors are similar to those considered by the Tribunal in section 59(3) of the Competition Act which form part of its six-step methodology for determining an appropriate fine.
164. The EU Fining Guidelines contemplate further increases to the fine to ensure that it is sufficiently deterrent.<sup>156</sup> Such an increase may occur when an undertaking has “*a particularly large turnover beyond the sales of goods or services to which the infringement relates*”<sup>157</sup> or to “*exceed the amount of gains improperly made as a result of the infringement.*”<sup>158</sup>

### Cap

165. The ultimate fine may not exceed 10% of the Undertaking’s total turnover in the preceding business year.<sup>159</sup>
166. Notwithstanding the detailed explanation of this methodology in setting fines, the EU Guidelines allow the Commission to deviate depending on “*the*

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<sup>155</sup> Bellamy & Child *European Union Law of Competition* 8 ed (2018) 14.026.

<sup>156</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 30.

<sup>157</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 30.

<sup>158</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 31.

<sup>159</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 32.

*particularities of a given case or the need to achieve deterrence in a particular case may justify departing from such methodology.”<sup>160</sup>*

### *Ability to Pay*

167. The EU Fining Guidelines go further to mention the “*ability to pay*”. Under this heading the EU Fining Guidelines provide that:

*“In exceptional cases, the Commission may, upon request, take account of the undertaking’s inability to pay in a specific social and economic context. It will not base any reduction granted for this reason in the fine on the mere finding of an adverse or loss-making financial situation. A reduction could be granted solely on the basis of objective evidence that imposition of the fine as provided for in these Guidelines would irretrievably jeopardise the economic viability of the undertaking concerned and cause its assets to lose all their value.”<sup>161</sup> (emphasis added)*

168. In applying the EU Fining Guideline’s on Ability to Pay, the EU Commission determines a Firm’s Ability to Pay after all other factors, including further increases for deterrence and the maximum allowable fine, are considered.<sup>162</sup>

169. Fortunately, the EU Commission has provided further guidance on its approach on Ability to Pay in an information note.

### Information note on Ability to Pay

170. In June 2010, the EU Commission published the *Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines*

<sup>160</sup> Para 37 of the EU Guidelines.

<sup>161</sup> Guidelines on the Method of Setting Fines Imposed Pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006) OJ C210/2 para 35.

<sup>162</sup> EU Commission Decision *Electrical and mechanical carbon and graphite products* (C.38.359) 3 December 2003 page 100.

(“**Information Note**”)<sup>163</sup> to provide further guidance on its approach to Ability to Pay in the EU Guidelines.

171. As with the South African Commission’s Fining Guidelines, the Information Note’s introductory paragraphs sound a warning that:

*“As a general matter, any type of reductions in the fine, either in the nominal amount or through favourable payment conditions, in view of a company’s alleged critical financial situation has to be treated with great caution. Granting such favourable treatment to one company may give rise to concerns of equal treatment with regard to those companies that do not obtain such treatment. In addition, taking into account the distressed financial situation of a company can carry the inherent risk of favouring those companies that are inefficient, badly managed or over-leveraged at the expense of well managed and financially prudent companies.”<sup>164</sup> (emphasis added)*

172. The Information Note indicates that a generous treatment of such requests may also diminish the deterrent effect of the fine, but it does recognise that:

*“the Commission should avoid imposing fines that would drive competitive companies and productive assets out of the market, especially of SMEs and/or mono-product companies.” (emphasis added)*

173. In addition, the Information Note provides that it should be:

*“demonstrated with a sufficient degree of probability that it is the Commission’s fine ...that is likely to cause the company’s bankruptcy.”<sup>165</sup> (emphasis added)*

<sup>163</sup> European Commission, SEC(2010) 737, 10 June 2010 2.

<sup>164</sup> J Almunia, J Lewandowski “Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines”, European Commission, SEC(2010) 737, 10 June 2010 2 para 4.

<sup>165</sup> J Almunia, J Lewandowski “Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines”, European Commission, SEC(2010) 737, 10 June 2010 2 para 17.

174. Based on this understanding, the Information Note provides further detail on the following concepts contained in the EU Guidelines on a Firm's Ability to Pay:

174.1. *"irretrievably jeopardise the economic viability of the undertaking"*: For this analysis, indicators of profitability, capitalisation, solvency and liquidity are considered. Such indicators include bankruptcy prediction models including the Altman Z-score test described below. The Information Note goes further to state that the EU Commission:

*"(i) gives more emphasis to solvency and liquidity relative to capitalisation and profitability of the company, (ii) it assesses whether and how the fine would cause the above financial indicators to deteriorate, and (iii) it relies not only on historical data but also uses projections, in particular regarding cash flows (for the current year and two future years) in its assessment. Thus, if there is sufficiently clear evidence that a company is in immediate danger of bankruptcy, the Commission will try to assess whether it is likely that bankruptcy would indeed be caused by the fine."<sup>166</sup> (emphasis added)*

174.2. *"specific social and economic context"*: The Information Note indicates that these concepts will be interpreted broadly without indicating the limits to such broadness. However, the Information Note does give examples of when these requirements will be easily met. For instance, during a cyclical economic crisis or where undertakings face difficulties in accessing capital or credit owing to general economic conditions. On the social aspect, high or mounting unemployment in a region or wider may be considered under social context.<sup>167</sup>

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<sup>166</sup> J Almunia, J Lewandowski "Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines", European Commission, SEC(2010) 737, 10 June 2010 2 para 7.

<sup>167</sup> J Almunia, J Lewandowski "Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines", European Commission, SEC(2010) 737, 10 June 2010 2 para 8.

174.3. “*assets to lose all their value*”: The Information Note accepts that a literal interpretation of the requirement would be unworkable as:

*“assets practically never lose completely their value, even if the company that participated in the anticompetitive practice goes bankrupt (because the assets normally will retain a certain operational and resale value).”*<sup>168</sup> (emphasis added)

175. The Information Note interprets this requirement as meaning that:

*“the fine would not only be likely to lead to the bankruptcy of an undertaking as such, but also that it would cause its productive assets to lose ‘significantly’ their value.”*<sup>169</sup> (emphasis added)

176. An example of such significant loss would be where a company goes bankrupt and is not continued as a going concern, but its assets are sold separately at a substantial discount. The opposite situation where the company’s business is sold as a going concern would not be captured under this factor.<sup>170</sup> Such a situation would need to be established on the available evidence.

177. The EU Commission’s preferred evidence to support this analysis is described in the EU Commission’s best practice guideline which mentions “*detailed and up-to-date financial information.*”<sup>171</sup> This type of financial information also seems to be favoured in the South African Commission’s Fining Guidelines.<sup>172</sup>

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<sup>168</sup> J Almunia, J Lewandowski “Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines”, European Commission, SEC(2010) 737, 10 June 2010 2 para 9.

<sup>169</sup> J Almunia, J Lewandowski “Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines”, European Commission, SEC(2010) 737, 10 June 2010 2 para 9.

<sup>170</sup> J Almunia, J Lewandowski “Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines”, European Commission, SEC(2010) 737, 10 June 2010 2 para 9.

<sup>171</sup> Commission notice on the best practices for the conduct of proceedings concerning Articles 101 and 102 TFEU (2011) OJ C308/06 para 88.

<sup>172</sup> Paragraph 135 above.

178. Based on this information, the EU Commission may seek further information to clarify the Undertaking's current financial position. This investigation includes the Undertaking's relationships with outside financial partners and shareholders.<sup>173</sup>
179. If an inability to pay is found in accordance with the EU Fining Guidelines, the Information Note indicates two possible responses. The first is a reduction of the fine, even to zero. This is a similar remedy to those included in the South African Commission's Fining Guidelines.<sup>174</sup> A reduction is more beneficial for a financially strained company as:
- "fine reductions definitely remove the claim from the company's balance sheet, clarify the liability and allow for more effective financial planning."*<sup>175</sup>  
(emphasis added)
180. The second option is to grant deferred payment by instalments not exceeding three to five years. Such instalment payments together with a fine reduction would only be considered in "*exceptional cases*."<sup>176</sup> This is a similar remedy to those in the South African Fining Guidelines.<sup>177</sup>
181. Such an analysis on the undertaking's Ability to Pay can even be done after the EU Commission has made the decision to fine. This possibility of

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<sup>173</sup> Commission notice on the best practices for the conduct of proceedings concerning Articles 101 and 102 TFEU (2011) OJ C308/06 para 90.

<sup>174</sup> Paragraph 136 above.

<sup>175</sup> J Almunia, J Lewandowski "*Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines*", European Commission, SEC(2010) 737, 10 June 2010 2 para 12.

<sup>176</sup> J Almunia, J Lewandowski "*Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines*", European Commission, SEC(2010) 737, 10 June 2010 2 para 11.

<sup>177</sup> Paragraph 136 above.

evaluating Ability to Pay after a fine is levied in the South African context is evaluated in Chapter 5.

182. In the EU, considering Ability to Pay after a fine is levied is only done in exceptional circumstances such as when an appeal takes several years.<sup>178</sup>

For this analysis, the Information Note distinguishes three situations:

182.1. Financial distress occurs within three months from the decision: Payment of the fine may be deferred if there are prospects to recover the fine and that the financial interest of the EU and the principle of equal treatment for other Undertakings is considered;<sup>179</sup>

182.2. Financial distress occurs while waiting for appeal proceedings: After repeating the analysis of the Undertaking's Ability to Pay, the Commission may fully or partially waive the fine;<sup>180</sup>

182.3. Financial distress occurs after the fine becomes definitive: Upon a properly reasoned request, the EU Commission may grant a deferred payment plan covered by a bank guarantee.<sup>181</sup>

183. The EU Courts have considered the above and provided helpful guidance on understanding the concept of Ability to Pay in the EU.

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<sup>178</sup> J Almunia, J Lewandowski "Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines", European Commission, SEC(2010) 737, 10 June 2010/2 para 18.

<sup>179</sup> J Almunia, J Lewandowski "Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines", European Commission, SEC(2010) 737, 10 June 2010/2 para 18(a).

<sup>180</sup> J Almunia, J Lewandowski "Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines", European Commission, SEC(2010) 737, 10 June 2010/2 para 18(b).

<sup>181</sup> J Almunia, J Lewandowski "Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines", European Commission, SEC(2010) 737, 10 June 2010/2 para 18(c).

## EU Cases on Ability to Pay

### *Equal treatment and proportionality*

184. The EU Courts have identified equal treatment and proportionality as guiding principles when determining fines. The EU Courts confirmed that the principle of equal treatment means:

*“that comparable situations not be treated differently and different situations not be treated alike unless such treatment is objectively justified.”*<sup>182</sup>

185. Applying the EU Commission’s factors for evaluating Ability to Pay seems to avoid such unjustified unequal treatment of Undertakings arguing Ability to Pay. By extension, this paper’s proposed factors seek to avoid such unequal treatment of Firms based on Ability to Pay as these proposed factors seek to be the objective justification contemplated by this Court for distinguishing between one Firm that succeeds on Ability to Pay and the other that fails.

186. For the principle of proportionality, the EU Courts have held that:

*“principle of proportionality requires that measures adopted by EU institutions do not exceed the limits of what is appropriate and necessary in order to attain the objectives legitimately pursued by the legislation in question; where there is a choice between several appropriate measures, recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued. It follows that fines must not be disproportionate to the aims pursued, that is to say, to compliance with the competition rules, and that the amount of the fine imposed on an undertaking for an infringement of competition law must be proportionate to the infringement, viewed as a whole, account being taken, in particular, of the gravity of the infringement.”*<sup>183</sup> (emphasis added)

<sup>182</sup> *Novácke Chemické Závody v European Commission* (T-352/09) para 135.

<sup>183</sup> *Marine Harvest ASA v European Commission* (T-704/14) page 47.

187. The EU Court’s reference to the fine being “*proportionate to the infringement*” seems equivalent to the CAC’s understanding of proportionality “*in severity to the degree of blameworthiness.*”<sup>184</sup>

188. Based on this understanding of proportionality, the European Courts have considered whether a fine would be disproportionate if it leads to insolvency:

*“in order to conclude that a fine imposed for infringement of the competition rules is disproportionate because it leads to the insolvency of the undertaking concerned, the condition according to which the personal, tangible and intangible elements represented by the undertaking would, in that situation, lose their value must also be satisfied. Accordingly, reliance on the risk that the applicant might be declared insolvent in consequence of the imposition of the fine at issue is not sufficient to establish that that fine is disproportionate.”<sup>185</sup> (emphasis added)*

189. The EU Courts have also commented on the purpose of capping fines which align with the CAC’s explanation of the purpose of section 59(2) in the Competition Act. The EU Court held that:

*“Regulation No 1/2003 provides, inter alia, that for each undertaking participating in an infringement of Article 81 EC, the fine is not to exceed 10% of its total turnover in the preceding business year. According to the case-law, the ceiling in respect of turnover seeks to prevent fines imposed by the Commission from being disproportionate in relation to the size of the undertaking concerned.”<sup>186</sup> (emphasis added)*

### *Interpreting EU Fining Guidelines*

190. When interpreting the EU Fining Guidelines on Ability to Pay, the EU Courts have held that:

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<sup>184</sup> Paragraph 109 above.

<sup>185</sup> *Almamet GmbH Handel mit Spänen und Pulvern aus Metall v European Commission* (T-410/09) para 269.

<sup>186</sup> *Novácke Chemické Závody v European Commission* (T-352/09) para 135.

“the Commission is not, in principle, required when determining the amount of the fine to take account of an undertaking’s financial losses, since recognition of such an obligation would have the effect of conferring an unfair competitive advantage on the undertakings least well adapted to the conditions of the market”<sup>187</sup> (emphasis added)

191. In addition, the European Courts warned that:

“the fact that a measure taken by a European Union authority leads to the insolvency or liquidation of a given undertaking is not prohibited as such by European Union law. Although the liquidation of an undertaking in its existing legal form may adversely affect the financial interests of the owners, investors or shareholders, it does not mean that the personal, tangible and intangible elements represented by the undertaking would also lose their value.”<sup>188</sup> (emphasis added)

192. When interpreting the elements of the EU Fining Guidelines on Ability to Pay, the EU Courts have held in relation to the fine causing “its assets to lose all their value” that:

“as envisaging a situation in which the acquisition of the undertaking, or at least of its assets... appears unlikely or even impossible. If that were the case, the assets of the bankrupt undertaking would be offered for sale individually, and it is likely that many of them would not find a buyer or, at best, would be sold only at a heavily reduced price; accordingly it seems legitimate to refer, as does point 35 of the Guidelines, to the loss of all their value.”<sup>189</sup>

193. The EU Courts have interpreted “specific social and economic context” to mean that the payment of the fine leads:

“to an increase in unemployment or deterioration in the economic sectors upstream and downstream of the undertaking concerned...”<sup>190</sup> (emphasis added)

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<sup>187</sup> *Garantovana a.s v European Commission* (T-392/09) para 118.

<sup>188</sup> *Garantovana a.s v European Commission* (T-392/09) para 119.

<sup>189</sup> *Novácke Chemické Závody v European Commission* (T-352/09) para 190.

<sup>190</sup> *Novácke Chemické Závody v European Commission* (T-352/09) para 192.

194. This legal groundwork on Ability to Pay in the EU is useful in informing the South African approach to Ability to Pay owing to the above similarities and the EU's more extensive experience on Ability to Pay. Based on this groundwork, Chapter 3 distils the factors for the South African context to evaluate Ability to Pay.

### CHAPTER 3: ABILITY TO PAY: PROPOSED FACTORS

195. Chapter 2 laid down the groundwork for Ability to Pay as it described the legal framework for the concept. Chapter 2 also explored European experience with the concept to inform our thinking relating to Ability to Pay.
196. Chapter 3 analyses Chapter 2's legal basis for Ability to Pay and proposes the factors for evaluating Ability to Pay. Certain factors are then expanded upon in this chapter as they require research into other areas of law and research to gain a better understanding of the factors proposed in this chapter.
197. With a fuller understanding of the proposed factors, the factors are then tested in Chapter 4 against hypothetical facts. These tests seek to determine whether an application of the proposed factors produce acceptably intuitive results. A further purpose of Chapter 4's tests is to see if there are any possible interactions between the factors when applied holistically and how such interactions should be assessed.

#### Distilling the Elements

198. As can be seen from the above, the fining provisions of section 59 do not expressly recognise Ability to Pay. Section 59 does, however, provide a maximum cap on the possible fine that may be imposed. The possibility of a fine below this statutory cap causing the Firm's exit is acknowledged by the CAC under the principle of fairness to the Firm.
199. Within the framework of the statutory cap, the CAC indicated that the "*penalty should not be imposed in order to destroy the business of the offending party*" or "*should not, on its own, be destructive of the offending party's business.*"

The CAC noted that these principles were based on fairness which prompted the legislature to cap the possible fines in terms of section 59(2).<sup>191</sup>

200. The CAC later affirmed this approach but acknowledged that the statutory cap is not a complete solution in complying with the fairness principle. It acknowledged that section 59(2) is a “*blunt instrument to achieve this constraint*” and that a fine calculated through the “*conventional*” section 59 factors could still “*jeopardise the firm’s viability*”.<sup>192</sup>
201. Through these cases, the CAC used different language to explain the principle of fairness when determining a fine. Initially, the CAC indicated that the fine “*on its own*” should not “*destroy*” the respondent’s “*business*”. Later the CAC recognised that a fine could “*jeopardise the firm’s viability*”. When applying this principle, the Tribunal explained that the principle related to a situation where “*a penalty would result in its exit*”.
202. The Commission has taken these principles and included them in its Fining Guidelines under the heading “*ability to pay*”. The Commission uses similar language by mentioning that a fine may “*irretrievably jeopardise*” the Firm’s ability to “*continue trading and exit*.” The Fining Guidelines go further by adding that the fine “*may lead to a significant reduction in competition*.”
203. Based on these descriptions of the fairness principle, this paper seeks to distil the factors for the analysis of Ability to Pay. This distillation process necessarily requires an interpretation of such case law without the aid of a

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<sup>191</sup> See paragraph 113 above.

<sup>192</sup> See paragraph 115 above.

statutory substratum on the subject. Owing to the nature of such interpretation, the Constitutional Court's guidance is apt:

"Judgments should not be read as though they are statutes where every word is presumed to have a precise and special meaning. What matters is the reasoning that lies at the heart of the decision and that, as a matter of legal logic, leads to the order made."<sup>193</sup> (emphasis added)

204. Based on this approach, this paper seeks to interpret the above quotes with an open mind as the CAC and Tribunal's context was different to the purpose of this paper. The Court and Tribunal were not squarely analysing Ability to Pay but provided *obiter* guidance on the concept while grappling with other legal issues.
205. This paper relies on the above quotes as the starting point for distilling certain concepts that are germane to Ability to Pay. This is done humbly as I accept that the CAC or Competition Authorities are at large to develop further factors for consideration or reject any or all the factors proposed by the paper based on a different interpretation of the above case law.

The fine

206. Both the CAC and Tribunal refer to a "*penalty*" in the above quotes. In all cases, the CAC and Tribunal were engaging with an administrative penalty in terms of section 59. This "*penalty*" can then be understood as a fine determined through the section 59(3) factors as well as the section 59(2) or (2A) cap.

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<sup>193</sup> *Juleiga Daniels v Robin Grieve Campbell NO and others* (CCT 40/03) 22 para 33.

207. By extension, this includes a fine calculated by the Tribunal's six-step methodology as this methodology incorporates the section 59(3) factors. In other words, this is a fine determined through the conventional statutory lines of section 59.
208. Similar to the EU,<sup>194</sup> the principle of fairness (including the Ability to Pay) applies to such a fine after the fine is fully determined in accordance with section 59. The CAC indicated that fairness is an "*overriding*" principle when determining an appropriate fine.<sup>195</sup> This sequence is followed by the Commission in its Fining Guidelines as it only considers the Firm's Ability to Pay after such a fine is determined in accordance with the Fining Guidelines.<sup>196</sup>
209. The fine in this context is a fine determined in terms of section 59 of the Competition Act.

The exit of the Firm

### *The Firm*

210. Both the Tribunal and the Commission's Fining Guidelines refer to the exit of a "*firm*".<sup>197</sup> The CAC also refers to "*firm*" when mentioning "*viability*" from a fine but also refers to "*party*" when analysing the statutory cap.
211. "*Party*" in this context seems to mean "*Firm*" as section 59(2) only refers to Firm as the relevant party. The statutory cap is calculated with reference to

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<sup>194</sup> Paragraph 168 above.

<sup>195</sup> Paragraph 113 above.

<sup>196</sup> Fining Guidelines paras 7.1 and 7.2.

<sup>197</sup> Paragraph 116 above.

the Firm's relevant turnover and relevant financial year. Similarly, section 59(1) empowers the Tribunal to levy fines for prohibited practices and breaches of Merger provisions which all refer to Firms as the contravening party. The context of the CAC's reference to "*party*" seems to indicate that "*party*" means Firm where Firm was later used by the CAC after referencing its previous analysis.

212. This interpretation seems congruent with the reality of the above cases as in all these cases the Firm under consideration was a legal entity in the form of a company or close corporation.

213. As mentioned above, the concept of "*Firm*" is broadly defined and can take the form of a legal entity, such as a company, or the form of an economic unit, such as a group of companies.<sup>198</sup> Based on this interpretation of "*Firm*", the above reference to Firm can be scaled up to an economic unit that includes multiple companies in a corporate group, where appropriate.

214. The Firm for Ability to Pay is a Firm contemplated by the Competition Act.

### *Exit*

215. The CAC does not use "*exit*" in relation to the Firm but refers to "*destruction*" of the Firm's "*business*". A "*business*" in this normal commercial context can be understood as "*the activity of buying and selling goods and services.*"<sup>199</sup> Aligned with this commercial context, the CAC referred to the Firm's "*viability*" as understood from the EU Fining Guidelines.

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<sup>198</sup> From paragraph 26 above.

<sup>199</sup> Cambridge Dictionary "Meaning of Business" <https://dictionary.cambridge.org/dictionary/english/business> [accessed 1 October 2020]

216. The concept of “*viability*” in the EU Fining Guidelines refers to the “*economic viability of the undertaking*”. In addition to irretrievably jeopardizing such economic viability, the EU Fining Guidelines adds the requirement that the Undertaking’s assets “*lose all their value.*”<sup>200</sup>
217. It is interesting to note that the CAC did not go as far as to include the EU Fining Guideline’s additional requirement of loss of asset value.<sup>201</sup> This asset value requirement is also absent from the Commission’s Fining Guidelines which only speaks of the Firm’s exit.
218. As in the Fining Guidelines, the Tribunal refers to the Firm’s “*exit*”. As mentioned above, the Tribunal analysed whether a Firm would “*exit the market*” following the fine. The Fining Guidelines contextualise such exit by indicating that it is precipitated by the Firm’s inability to “*continue trading*”. Both these references include the concept of economic activity which seems to align with the CAC’s references to “*business*” and “*economic viability*”.
219. Based on these references, the exit of a Firm from a fine seems to relate to its economic inability to continue trading in the market. Based on this understanding, we can apply this concept of “*exit*” to the above understanding of a Firm.
220. Where the Firm takes the form of a company, such economic inability to continue trading would ultimately render it unable to pay outstanding debts,

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<sup>200</sup> Paragraph 167 above.

<sup>201</sup> Paragraph 115 above.

including the fine. Such commercial insolvency would render it susceptible to being wound-up in accordance with the 1973 Companies Act.

221. This winding-up could then be considered as the “*exit*” of the company from the market as contemplated by the CAC and Competition Authorities for purposes of Ability to Pay.
222. This winding-up through an inability to trade and pay debts seems to be the most intuitive form of “*exit*” from a fine. This paper’s focus on winding-up does not, however, exclude the possibility of other forms of “*exit*” that may fall short of possible winding-up proceedings.
223. Notwithstanding the above openness to other forms of exit, such possible forms seem to be unlikely outliers. The Firm would struggle to show that the fine renders it economical unable to continue trading even though it will be commercially solvent and can pay its debts in the normal course of business going forward.
224. For purposes of this paper, the exit of a Firm is its winding-up owing to its economic inability to continue trading.

#### Causation

225. The factor of causation links the fine to the Firm’s exit. This element is required by the CAC as it indicates that the fine “*should not, on its own*” destroy the Firm or that the fine “*would*” jeopardise the Firm’s viability. Similarly, the Tribunal required the Firm to show that the fine “*would*” result in its exit.

226. The use of “*would*” seems to indicate a predictive exercise as the fine has not yet been levied. This predictive analysis is explored below together with the standard and burden of proof in the Competition Act for predicting future events.
227. In this way, the factor of causation seeks to determine whether the fine causes the Firm to exit.

#### Effect on competition

228. Neither the CAC nor the Tribunal mentioned competition effects when considering Ability to Pay under the fairness principle. The Commission’s Fining Guidelines do, however, indicate that the Commission will be mindful of “*market circumstances*” where the imposition of the fine may lead to a “*significant reduction in competition*.”<sup>202</sup> The EU Commission also mentions competitive effects of Ability to Pay in its Information Note.
229. Like the Commission’s Fining Guidelines, the Information Note refers to a specific “*economic context*” when evaluating Ability to Pay. This includes cyclical economic downturns and general economic conditions.<sup>174.2</sup>
230. The Information Note also describes the purpose of considering Ability to Pay as to avoid driving “*competitive companies out of the market*”.<sup>203</sup> However, it warns that such benefits risk favouring inefficient companies which would provide an “*unfair competitive advantage on the undertakings least well adapted to the conditions of the market*.”<sup>204</sup>

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<sup>202</sup> Paragraph 133 above.

<sup>203</sup> Paragraph 172 above.

<sup>204</sup> Paragraph 190 above.

231. An investigation into the competitive effects of Ability to Pay aligns with the purpose of the Competition Act. As described above, the purpose of the Competition Act is to “*promote and maintain competition in the Republic*”. This purpose under section 2 together with the concept of competition is explored below to determine whether it can function as a useful factor when considering Ability to Pay.

#### Effect on employment

232. Employment effects are not completely foreign to the Competition Act. The promotion of employment is mentioned in section 2 as a goal flowing from promoting and maintaining competition. Employment effects also form part of Merger analysis under section 12A(3).<sup>205</sup>

233. Unlike the Commission’s Fining Guidelines, the EU Fining Guidelines specifically refer to “*social context*” as a factor for determining Ability to Pay. This factor includes investigating high or mounting unemployment in a region or wider.<sup>206</sup> If this EU approach is applied to South Africa, the South African social context of high and mounting unemployment would need to be considered.<sup>207</sup>

234. Within this current South African social context, employment effects are explored below to determine whether it can function as a useful factor when considering Ability to Pay. Employment is used as the best public interest candidate for this analysis. Similar arguments can be made for other public

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<sup>205</sup> Further references are exemptions in terms of section 10(3)(b) and market inquiries under section 43A.

<sup>206</sup> Paragraphs 174.2 and 193 above.

<sup>207</sup> Approximately 30% per report dated 23 June 2020 (StatsSA “Mbalu Brief – June 2020”) <http://www.statssa.gov.za/?p=13411> [accessed 1 October 2020].

interest goals such as the upliftment of small businesses and historically disadvantaged individuals.

## Causation

### Factual causation

#### *“But for” test*

235. The generally accepted legal test for determining whether an event factually caused a certain result is the “but for” test in delictual law.<sup>208</sup> This “but for” test is explained as follows:

*“In order to apply this test one must make a hypothetical enquiry as to what probably would have happened but for the wrongful conduct of the defendant. This enquiry may involve the mental elimination of the wrongful conduct and the substitution of a hypothetical course of lawful conduct and the posing of the question as to whether upon such an hypothesis plaintiff’s loss would have ensued or not. If it would in any event have ensued, then the wrongful conduct was not a cause of the plaintiff’s loss...”<sup>209</sup> (emphasis added)*

236. When applying this test, the Courts have indicated that a party:

*“is not required to establish the causal link with certainty, but only to establish that the wrongful conduct was probably a cause of the loss, which calls for a sensible retrospective analysis of what would probably have occurred, based upon the evidence and what can be expected to occur in the ordinary course of human affairs rather than an exercise in metaphysics.”<sup>210</sup> (emphasis added)*

237. In other words, an act is the cause of a result if the act cannot be thought away without the result disappearing as well. Another expression for this test is the

<sup>208</sup> *Mukheiber v Raath and another* 1999 (3) SA 1065 (SCA) 1077 para 34.

<sup>209</sup> *International Shipping Co (Pty) Ltd v Bentley* 1990 (1) SA 680 (A) 700E-I.

<sup>210</sup> *Minister of Safety and Security v van Duivenboden* 2002 (6) SA 431 (SCA) 449.

*conditio sine qua non* as the act must be the *conditio sine qua non* of the result.<sup>211</sup> The test results in a binary outcome where an event is either a cause or not.

#### *Multiple independent causes of result*

238. A feature of the test is that multiple independent acts may be seen as individual causes of a result. For example, two different actors in a hypothetical firing squad each fire a fatal bullet through the victim's heart.<sup>212</sup> When the "but for" test is applied, each actor's bullet is not the cause of the victim's death as the other actor's bullet would have still killed the victim. A more commercial example is where a Firm is ordered to pay high fines at the same time by the South African Revenue Service and the Tribunal. These penalties are analogous to two fatal bullets fired at a person if each fine would force the Firm to exit.
239. A common sense approach is proposed to address this anomalous result. In terms of this approach, both fatal bullets are the cause of death as the victim would still be alive if these two bullets are thought away.<sup>213</sup>

#### *Multiple actions causing result*

240. The "but for" test is not calibrated to the degree of an event's significance in causing the result. The test's binary conclusions may lead to counter-intuitive results where an event significantly increased the risk of a result but did not cause it. For example, a heavy smoker increases her risk of cancer by

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<sup>211</sup> Neethling *et al* *Law of Delict* 4<sup>th</sup> ed (2001) 175.

<sup>212</sup> *Minister of Police v Skosana* 1977 (1) SA 31 (A) 43F to 44A.

<sup>213</sup> Neethling *et al* *Law of Delict* 4<sup>th</sup> ed (2001) 178.

smoking but the smoke at work finally causes her to fall ill.<sup>214</sup> In other words, actions that precipitate the result are not necessarily the cause of the result.<sup>215</sup>

241. The CAC has faced such a situation where two separate actions were necessary to result in an anti-competitive outcome. The CAC held that:

*“what is required by this provision is that the primary or substantial cause of the prevention or lessening of competition must be identified. Where an agreement and some other separate action by a different party are identified as both having been necessary conditions for the prevention or lessening of competition it is only where the agreement or concerted practice plays the dominant role that it falls within the section. In other words it is necessary to consider whether the lessening or prevention of competition is so closely connected to the agreement or concerted practice that it can properly be said that the former was the effect of the latter and any other action was merely ancillary... This is similar to, but not the same, as the question of legal causation that arises in the delictual context. In the context of competition law and the requirements of the Act it is only where the substantial prevention or lessening of competition is the direct and predominant consequence of the agreement or concerted practice that s 4(1)(a) is contravened,”<sup>216</sup> (emphasis added)*

242. The Court’s description of “*primary or substantial cause*” relates to section 4(1)(a) which prohibits certain cooperation between competitors.<sup>217</sup> Based on this provision, the Court focused on the anti-competitive “*effects*” of the agreement and whether the agreement is the direct or predominant cause of such effects. As indicated by the Court, this is not homologous to factual causation in delict but more akin to legal causation.

<sup>214</sup> JR Midgley “Revisiting Factual Causation” (2006) *Essays in Honour of AJ Kerr* 277 at 297-300.

<sup>215</sup> M Loubser *et al* *The Law of Delict in South Africa* 2<sup>nd</sup> ed (2012) 74.

<sup>216</sup> *Netstar (Pty) Limited and others v Competition Commission* (97.98.99/CAC/May10) paras 32 and 33.

<sup>217</sup> See paragraph 30 above.

## Legal causation

243. Apart from factual causation, the law of delict includes legal causation. Legal causation seeks to determine which harmful consequences can be imputed on the wrongdoer and which consequences are too remote.<sup>218</sup> Included in an analysis of legal causation is determining whether an event is a *novus actus interveniens*.

### *Subsequent intervening event*

244. A *novus actus interveniens* is a new independent intervening event which occurred after the impugned conduct. This new event either caused or contributed to the consequences concerned.<sup>219</sup>

245. Where this new event causes the result, this event completely extinguishes the causal connection between the previous conduct of the wrongdoer and the consequence. In such an instance, the wrongdoer's act can no longer be considered as a factual cause of the consequence.<sup>220</sup>

## Application to Ability to Pay

### *Multiple causes of exit*

246. As explored above, Ability to Pay requires the fine, on its own, to cause the Firm to exit. The above "but for" test may assist in determining whether the Firm's exit would occur in any event notwithstanding the fine.

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<sup>218</sup> Neethling *et al* *Law of Delict* 4<sup>th</sup> ed (2001) 184.

<sup>219</sup> Neethling *et al* *Law of Delict* 4<sup>th</sup> ed (2001) 204.

<sup>220</sup> Neethling *et al* *Law of Delict* 4<sup>th</sup> ed (2001) 205.

247. The “but-for” test would entail mentally eliminating the fine from the present facts and evaluating whether the Firm would still exit. As with a delict, this process requires an analysis of hypothetical events that may be expected to occur based on the evidence.<sup>221</sup> The goal of this analysis is to determine whether an event, other than the fine, is a probable cause of the Firm’s exit.
248. Such a non-fine cause could also be a simultaneous cause of exit together with the fine. Fortunately, the above anomaly of neither event being the factual cause under the “but for” test does not arise.
249. The purpose of the “but for” test in Ability to Pay is to determine whether the fine is the only probable cause of exit. The presence of any other cause, including simultaneous causes, excludes the fine “*on its own*” from causing exit.<sup>222</sup>
250. This approach also eschews having to grapple with determining whether the event, other than the fine, is the dominant action that ultimately causes the exit.<sup>223</sup> Where an event other than the fine is the probable cause of exit, the exit would have occurred in any event regardless of whether the fine or the other event played the dominant role. For example, a financially moribund Firm’s exit is merely accelerated by the fine where its exit is caused by other events.
251. Other factual causes of exit could also be predicted in the future. Such future intervening events could still extinguish the factual causation of the fine to exit

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<sup>221</sup> Paragraphs 235 and 236 above.

<sup>222</sup> Paragraph 114 above.

<sup>223</sup> Paragraph 241 above.

owing to a *novus actus interveniens*. Where such an intervening event is predicted, this event and not the fine is the probable cause of the exit.

*Fine as sole cause*

252. Where no other causes of exit are identified by the “but for” test, the test may identify the fine as the sole probable cause of the Firm’s exit. In this analysis, the proposed Fine is thought into the Firm’s current situation to see if the Firm would exit or continue trading. This analysis requires a measure of prediction as the fine has not yet been imposed and the Firm has not yet exited as a result. Such a predictive exercise is, by its nature, uncertain.
253. To resolve such uncertainty, the Tribunal may rely on the standard and burden of proof. As explored above, the standard of proof in the Competition Act for all proceedings is the balance of probabilities.<sup>224</sup> The generality of this standard suggests that it will also apply to Ability to Pay where the fine is found to be the probable cause of the Firm’s probable exit.
254. The Tribunal may find that the probabilities are balanced for Ability to Pay. This impasse can be resolved by finding against the party that bears the onus. The Tribunal previously confirmed that the Firm alleging Ability to Pay bears such an onus. Based on this approach, the Firm raising Ability to Pay would fail to establish Ability to Pay where the probabilities are balanced relating to the fine causing exit.<sup>225</sup>

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<sup>224</sup> Paragraph 119 above.

<sup>225</sup> Paragraph 122 above.

255. An alternative to relying on onus is for the Tribunal to postpone its proceedings and gain more certainty on whether a cause other than the fine would probably lead to exit. Such postponements to gain greater certainty are unavailable in Merger analysis where decisions are required to approve the consummation of the Merger or where prohibited practices come to the Tribunal after they occur.
256. The Tribunal may postpone its proceedings until a certain expected event has occurred to gain greater clarity on whether the Firm would exit even without the fine. The Tribunal's order may allow the parties to return to the Tribunal on the occurrence of a future event.<sup>226</sup> This future event may be the exit of the Firm. This element of exit is expanded upon under the next heading.

### **Exit Through Winding-Up**

257. As indicated above in paragraph 212, the CAC and Tribunal contemplated Ability to Pay in relation to juristic persons such as companies. This company form of a Firm is derived from the Companies Act ("**2008 Companies Act**").<sup>227</sup>
258. The "*exit*" of such a company is where the fine renders it unable to continue trading which leaves it susceptible to being wound-up. A company can be wound up either through liquidation or through business rescue proceedings. Both processes are described below to better understand their requirements

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<sup>226</sup> For example, the order could be similar to the variation clause in *Competition Commission v ArcelorMittal South Africa Limited* (CR092Jan07/SA090Aug16) 24 paras 12.1 to 12.3. where the respondent can seek a variation or removal of the order where there is a "*change in laws, or significant change in economic, financial and market circumstances affecting AMSA's ongoing viability...*"

<sup>227</sup> 71 of 2008. As defined in section 1. *Millers and others v Nafcoc Investment Holdings Company and others* 2010 (4) All SA 44 (SCA) 49 para 11.

as these requirements may be helpful indicators of the Firm's probable exit based on Ability to Pay.

#### Winding-up of companies

259. A company ceases to exist when it is removed from the companies register by the Companies and Intellectual Property Commission in terms of section 82 of the 2008 Companies Act.<sup>228</sup> The end of a company may be preceded by its affairs being formally wound-up. This winding-up process is commonly referred to as liquidation as winding-up involves selling the company's assets for cash to pay creditors.<sup>229</sup> The 2008 Companies Act regulates when a company can be wound-up and distinguishes between companies that are solvent and those that are insolvent.<sup>230</sup>

#### *Commercially solvent companies*

260. Section 79 of the 2008 Companies Act provides that a solvent company may be wound-up voluntarily through a resolution of the company. Section 80 of the 2008 Companies Act regulates this voluntary process and contemplates the company paying off all its debts, if any, within twelve months from the start of the winding-up process. In terms of section 80, this voluntary process is managed by the company or its creditors.

261. Section 79 of the 2008 Companies Act also contemplates a voluntary winding-up of a solvent company by Court order. This process is regulated by section 81 and includes various grounds for approaching the Court, including

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<sup>228</sup> *Millers and others v Nafcoc Investment Holdings Company and others* 2010 (4) All SA 44 (SCA) 49 para 11.

<sup>229</sup> Section 386(4)(h) of the Companies Act 61 of 1973, read with section 9 of Schedule 5 of the 2008 Companies Act.

<sup>230</sup> Similar considerations relate to Close Corporations.

a resolution by the company that it should be wound up in terms of a Court order.

262. These provisions only apply to the winding-up of solvent companies. The Supreme Court of Appeal (“**SCA**”) recognises two types of solvency or its mirror, insolvency:

“factual insolvency (where a company’s liabilities exceed its assets) and commercial insolvency (a position in which a company is in such a state of illiquidity that it is unable to pay its debts, even though its assets may exceed its liabilities).”<sup>231</sup> (emphasis added)

263. Ultimately, the SCA held that a company must be commercially solvent to be wound-up voluntarily in terms of section 79 of the 2008 Companies Act.<sup>232</sup> In other words, a commercially solvent company should be able to pay its debts when they fall due. This is the opposite to a commercially insolvent company.

#### *Commercially insolvent companies*

264. Unlike a solvent company, a commercially insolvent company is wound-up in terms of the 1973 Companies Act (“**1973 Companies Act**”).<sup>233</sup> In terms of the 1973 Companies Act, the insolvent company can voluntarily wind-up its affairs through a resolution.<sup>234</sup> However, the Act requires the insolvent company to furnish security to pay all its debts within twelve months from the start of the winding-up process.<sup>235</sup>

<sup>231</sup> *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 (1) All SA 507 (SCA) 513 para 16.

<sup>232</sup> *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 (1) All SA 507 (SCA) 514 para 22.

<sup>233</sup> 61 of 1973. Section 9 of Schedule 5 of the 2008 Companies Act. See also *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 (1) All SA 507 (SCA) 514 para 22.

<sup>234</sup> Sections 343 and 349 of the 1973 Companies Act.

<sup>235</sup> Section 350 of the 1973 Companies Act.

265. The alternative for the company, or other party such as a creditor, is to apply to Court for an order that the company be wound-up. Section 344 of the 1973 Companies Act includes various grounds for winding-up a company including where the company cannot pay its debts. The company's inability to pay its debts or, stated differently, its commercial insolvency is a well-recognised ground for winding-up a company.<sup>236</sup>

266. The Court's decision whether to wind-up a company based on its inability to pay its debts entails the following determination:

*“The primary question which a Court is called upon to answer in deciding whether or not a company carrying on business should be wound up as commercially insolvent is whether or not it has liquid assets or readily realisable assets available to meet its liabilities as they fall due to be met in the ordinary course of business and thereafter to be in a position to carry on normal trading – in other words, can the company meet current demands on it and remain buoyant?”<sup>237</sup> (emphasis added)*

267. Assets that can be sold without negatively affecting the company's ability to continue trading may include investment property<sup>238</sup> or non-current production assets held for sale.<sup>239</sup>

268. The 1973 Companies Act goes further to list certain situations where the company is deemed to be unable to pay its debts.<sup>240</sup> The company is deemed to be unable to pay its debts where, essentially, it has failed to satisfy a debt

<sup>236</sup> *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 (1) All SA 507 (SCA) 513 para 17.

<sup>237</sup> *ABSA Bank Ltd v Rhebokskloof (Pty) Ltd and others* 1993 (4) SA 436 (C) 440F-J.

<sup>238</sup> Investment property is disclosed in the company's financial statements together with the methods and significant assumptions in determining its value (H van Greuning *International Financial Reporting Standards A practical guide* Revised edition (2005) 216 para 26.5.1.).

<sup>239</sup> Such assets held for sale are disclosed in the financial statements together with the circumstances of the highly probable expected sale (H van Greuning *International Financial Reporting Standards A practical guide* Revised edition (2005) 231 para 28.3.2 and 233 para 28.5.5).

<sup>240</sup> Including to the satisfaction of the Court that it is unable to pay its debts in terms of section 345(1)(c) of the 1973 Companies Act.

within three weeks from proper demand or where the Sheriff cannot find sufficient disposable property to satisfy a judgment debt.<sup>241</sup>

269. Future possible liabilities are also considered when determining whether the company can pay its debts. Section 344 of the 1973 Companies Act provides that the company's contingent and prospective liabilities should be considered when determining whether the company can pay its debts.

270. The Courts have defined these terms as follows:

*“a prospective liability in the sense that it is enforceable on some future date or on a date determinable by reference to some future date or event. Such obligation may be a contingent liability in that it is enforceable upon the occurrence of some future event. Equally clear is that...[the] obligation ... may be validly enforced in a court of law.”<sup>242</sup> (emphasis added)*

271. Evidence of such contingent or prospective liabilities may be found in the company's financial statements. These financial statements are, normally, prepared in accordance with International Financial Reporting Standards (“**IFRS**”).<sup>243</sup> In terms of IFRS, a contingent liability arises when there is a possible obligation that may be confirmed by an uncontrollable future event or where a present obligation is unlikely to require an outflow of resources.<sup>244</sup>

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<sup>241</sup> Section 345(1)(a) and (b) of the 1973 Companies Act.

<sup>242</sup> *Kyle and others v Maritz & Pieterse Inc.* 2002 (3) All SA 223 (T) 226 para 11.

<sup>243</sup> Section 29(1)(a) of the 2008 Companies Act read with its regulations 26 and 27 in Companies Regulations, GNR 351, *Government Gazette* 34239, 26 April 2011.

<sup>244</sup> Deloitte “*IFRS in your pocket 2017*” <https://www2.deloitte.com/ro/en/pages/audit/articles/IFRS-in-you-pocket-2017.html#:~:text=Deloitte's%20Global%20IFRS%20Office%20has,on%20the%20IASB%20work%20plan.> (20 October 2017) [accessed 11 December 2018] 86.

272. When a contingent liability is recognised it is disclosed in the financial statements by indicating the nature of the liability, its estimated financial effect and any uncertainties relating to its timing or amount.<sup>245</sup>
273. In addition to contingent liabilities, IFRS recognises the concept of a “*provision*”. A provision is a legal or constructive<sup>246</sup> obligation created by a past event which is likely to result in an outflow of resources which can be reliably estimated.<sup>247</sup> In other words, there is some uncertainty relating to the timing or amount of the obligation that is the subject of the provision.<sup>248</sup>
274. When recognised, a provision is disclosed in the financial statements by indicating the nature of the obligation, the expected timing of the financial effect as well as the uncertainties relating to the timing or amount of such an effect.<sup>249</sup>
275. After accounting for such contingent liabilities and provisions, IFRS requires the company’s financial statements to disclose whether the company will continue as a going concern. Where there are significant doubts about the company’s ability to continue as a going concern, the financial statements should disclose the reasons for such concerns.<sup>250</sup>

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<sup>245</sup> H van Greuning *International Financial Reporting Standards A practical guide* Revised edition (2005) 193 para 23.5.2.

<sup>246</sup> A constructive obligation arises where the company has indicated through its past practices, policies or statements that it will accept certain responsibilities and by these representations has created an expectation that the liability will be discharged (H van Greuning *International Financial Reporting Standards A practical guide* Revised edition (2005) 191 para 23.4.3.).

<sup>247</sup> Deloitte “*IFRS in your pocket 2017*” <https://www2.deloitte.com/ro/en/pages/audit/articles/IFRS-in-you-pocket-2017.html#:~:text=Deloitte's%20Global%20IFRS%20Office%20has,on%20the%20IASB%20work%20plan.> (20 October 2017) (accessed 11 December 2018) 86.

<sup>248</sup> H van Greuning *International Financial Reporting Standards A practical guide* Revised edition (2005) 190 para 23.3.

<sup>249</sup> H van Greuning *International Financial Reporting Standards A practical guide* Revised edition (2005) 193 para 23.5.

<sup>250</sup> H van Greuning *International Financial Reporting Standards A practical guide* Revised edition (2005) 16 para 3.4.3. See also section 30(3)(b) of the 2008 Companies Act for disclosure requirements in annual financial

276. Such concerns on whether the company will continue as a going concern may assist the Court in determining whether to wind up the company based on its commercial insolvency.
277. The Court may look at other financial indicators, such as factual insolvency. The company's factual solvency, where its assets exceed its liabilities, is not an automatic bar against winding-up the company.<sup>251</sup> In such a situation, the company may have excess assets, but they are not "*liquid assets or readily realisable assets available to meet its liabilities*" to avoid commercial insolvency.<sup>252</sup>
278. The converse, where a company is factually insolvent is only a factor in showing that a company is unable to pay its debts.<sup>253</sup> The Courts have been cautious when using factual insolvency to determine whether to wind up a company as "*the valuation of assets, other than cash, is a notoriously elastic and often highly subjective one*"<sup>254</sup> and that "*there are undoubtedly very many companies operating exceedingly successfully in the real business world*" while factually insolvent.<sup>255</sup>
279. Where a company is wound-up according to the 1973 Companies Act, the Tribunal's fine ranks together with the claims of other general creditors. This

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statements on the company's affairs. For an example see *Iscor Ltd and Saldanha Steel (Pty) Ltd* (67/LM/Dec01) 5 para 25.

<sup>251</sup> *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 (1) All SA 507 (SCA) 515 para 24.

<sup>252</sup> See paragraph 266 above.

<sup>253</sup> *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 (1) All SA 507 (SCA) 515 para 24.

<sup>254</sup> *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 (1) All SA 507 (SCA) 513 para 17. See also Deloitte "*IFRS in your pocket 2017*" <https://www2.deloitte.com/ro/en/pages/audit/articles/IFRS-in-you-pocket-2017.html#:~:text=Deloitte's%20Global%20IFRS%20Office%20has,on%20the%20IASB%20work%20plan.> (20 October 2017) (accessed 11 December 2018) 42 and BE Needles, M Powers *International Financial Reporting Standards: An Introduction* 3<sup>rd</sup> ed (2013) 23 for an indication of such subjectivity when evaluating the fair value of certain types of assets.

<sup>255</sup> *Ex parte Strydom No: In re central Plumbing Works (Natal) (Pty) Ltd and others* 1988 (1) SA 616 (D) 623D-E.

means that the Tribunal's fine has no priority in the order of payment from the company's liquidated funds and holds no security over the assets of the company being wound up.<sup>256</sup> In such a case, the Commission may only recover a portion of the fine from the liquidated assets of the Firm.

#### Application to Ability to Pay

280. A Firm may persuade the Tribunal that the proposed fine is the cause of its probable exit where the fine will probably place it in a commercially insolvent position as contemplated by the 1973 Companies Act. Such commercial insolvency includes current as well as foreseeable future debts such as the fine. While commercially insolvent, the company is exposed to being wound up. In this way, commercial insolvency contemplated by the 1973 Companies Act seems to be a reliable harbinger of the Firm's probable exit through winding-up.
281. A Firm's current or impending commercial insolvency without the fine is also a useful indicator that the fine is not the probable cause of the Firm's exit.
282. Unlike commercial insolvency, factually insolvency is not a robust indicator of probable exit. Factual insolvency does not necessarily render the company unable to continue trading following the fine. As the Courts held above, evaluation of assets is "*highly subjective*", and a factually insolvent Firm can still be "*highly successful*".<sup>257</sup> Factual insolvency from a fine is not a reliable

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<sup>256</sup> Section 339 of the 1973 Companies Act read with sections 99 and 103 of the Insolvency Act.

<sup>257</sup> Paragraph 278 above.

indicator that exit is probable but can corroborate other indicators of probable commercial insolvency.

283. The above guidance relating to commercial insolvency in winding-up proceedings also gives a useful indication of the type of information that should be provided to the Commission when responding to a request in terms of the Fining Guidelines for “*information relating to ... insolvency proceedings*”.<sup>258</sup> This seems akin to the EU Information Note’s reference to information on “*insolvency and liquidity*”.<sup>259</sup>

#### Business rescue proceedings

284. Before being wound-up, a company may foresee its impending liquidation and anticipate it by placing itself in business rescue. In terms of the 2008 Companies Act, business rescue proceedings are:

*“proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for-*

- (i) the temporary supervision of the company, and of the management of its affairs, business and property;*
- (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and*
- (iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.”*<sup>260</sup> (emphasis added)

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<sup>258</sup> Paragraph 135 above.

<sup>259</sup> Paragraph 174.1 above.

<sup>260</sup> Section 128(b) of the Companies Act.

### *Grounds for business rescue*

285. In terms of section 129 of the 2008 Companies Act, the company may voluntarily place itself under business rescue where its directors reasonably believe that the company is financially distressed and there is a reasonable prospect of rescuing the company.<sup>261</sup> Such financial distress may also be used by third parties, such as a creditor,<sup>262</sup> to apply to Court to place the company under business rescue in terms of section 131.<sup>263</sup>
286. The 2008 Companies Act considers a company to be financially distressed when it appears “*to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months*” or when it is “*reasonably likely that the company will become insolvent within the immediately ensuing six months.*”<sup>264</sup>
287. The company’s inability to pay its debts within six months seems to be equivalent to the company falling into commercial insolvency within that time.<sup>265</sup> A company’s commercial insolvency is also contemplated in the

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<sup>261</sup> *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and others* 2015 (5) SA 192 (SCA) 204 para 30 confirming that it is a subjective decision of the directors based on a concrete factual foundation.

<sup>262</sup> Section 128(1)(a).

<sup>263</sup> Section 131 of the 2008 Companies Act which provides further grounds such as “*just and equitable to do so for financial reasons*” and if the company has not paid an obligation in terms of a public regulation, contract or employment related matter.

<sup>264</sup> Section 128(f) of the 2008 Companies Act. See also *Imerys South Africa (Pty) Ltd and another v Competition Commission* (147/CAC/Oct16) 15 para 49 to 17 para 53 for the Court’s general comments on the interpretation of “*likely*” depending on the statutory context.

<sup>265</sup> See paras 262 and 266 above on commercial insolvency. See also *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 (3) All SA 303 (SCA) 308 para 7 where the SCA held that the company was commercially insolvent and, consequently, financially distressed.

second test that the “*company will become insolvent within the immediately ensuing six months*”.<sup>266</sup>

288. The SCA has confirmed that business rescue is still possible were the company is currently commercially insolvent in terms of the 1973 companies Act. The Court found that current commercial insolvency can also mean financial distress contemplated in the 2008 Companies Act.<sup>267</sup>

### *Prospect of rescuing company*

289. In addition to financial distress, there should be a “*reasonable prospect of rescuing the company*.”<sup>268</sup> The SCA has held that a reasonable prospect in this context:

*“is a lesser requirement than the ‘reasonable probability’...On the other hand, I believe it requires more than a mere prima facie case or an arguable possibility. Of even greater significance, I think, is that it must be a reasonable prospect - with the emphasis on ‘reasonable’ - which means that it must be a prospect based on reasonable grounds. A mere speculative suggestion is not enough.”<sup>269</sup> (emphasis added)*

290. In interpreting the above definition of business rescue, the SCA has held that:

*“business rescue means to facilitate ‘rehabilitation’, which in turn means the achievement of one of two goals: (a) to return the company to solvency, or (b) to provide a better deal for creditors and shareholders than what they would receive through liquidation. It follows, as I see it, that the achievement of any one of the two goals referred to in section 128(1)(b)*

<sup>266</sup> However, see P Delpont *et al Henochsberg on the Companies Act 71 of 2008* (2018) 455,456 which argues that such insolvency should be different from commercially insolvency to avoid an overlap between the tests.

<sup>267</sup> *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 (3) All SA 303 (SCA) 308 para 7.

<sup>268</sup> Sections 129(1)(b) and 131(4)(a) of the 2008 Companies Act. It is argued in P Delpont *et al Henochsberg on the Companies Act 71 of 2008* (2018) 449 that business rescue means returning the company to both factual and commercial insolvency.

<sup>269</sup> *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 (3) All SA 303 (SCA) 316 para 29.

would qualify as ‘business rescue’ in terms of section 131(4).” (emphasis added)<sup>270</sup>

291. Based on this understanding, a company may be placed under business rescue where there are no reasonable prospects of rescuing the company. In this instance, business rescue is used to provide greater benefit to creditors and shareholders when compared to winding-up the company under the 1973 Companies Act.
292. Such business rescue proceedings may also interrupt 1973 Companies Act winding-up proceedings to realise this benefit. Section 131(6) of the 2008 Companies Act provides that:

*“If liquidation proceedings have already been commenced by or against the company at the time an application is made in terms of subsection (1), the application will suspend those liquidation proceedings until-*

*(a) the court has adjudicated upon the application; or*

*(b) the business rescue proceedings end, if the court makes the order applied for.” (emphasis added)*

293. The Courts have held that business rescue proceedings can even interrupt an advanced winding-up process where *“business rescue proceedings will yield a better return for shareholders and creditors and jobs will be retained, there could be no reason to deny business rescue only because a company is in final liquidation.”*<sup>271</sup>

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<sup>270</sup> *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 (3) All SA 303 (SCA) 316 para 26.

<sup>271</sup> B van Niekerk "Launching business rescue applications in liquidation proceedings - (successfully) flogging a dead horse?" 2015 *De Rebus* 164.

### *Business rescue process*

294. Once a company is placed under business rescue, a business rescue practitioner is appointed to confirm that the firm is financially distressed and to prepare a business rescue plan.<sup>272</sup> During this process, the company is given breathing room through a moratorium against any legal proceedings, including enforcement of orders.<sup>273</sup>
295. Certain proceedings are, however, excluded from this moratorium including *“proceedings by a regulatory authority in the execution of its duties after written notification to the business rescue practitioner.”*<sup>274</sup> The 2008 Companies Act defines a regulatory authority as *“an entity established in terms of national or provincial legislation responsible for regulating an industry, or sector of an industry.”*<sup>275</sup>
296. While under the protection of the moratorium, the appointed business rescue practitioner investigates the affairs of the company. This practitioner may find that the company is not financially distressed and then terminate business rescue proceedings, including the moratorium against legal proceedings.<sup>276</sup> If the practitioner finds that there are no reasonable prospects of rescuing the company, she may recommend that the company be wound up in terms of the business rescue plan to realise a greater benefit to creditors compared to liquidation.

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<sup>272</sup> Sections 128(d), 129(3)(b), 131(5), 141(2) of the 2008 Companies Act.

<sup>273</sup> Section 133(1) of the 2008 Companies Act. See also *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd and Another* (13/12406) Unreported (2013) SGHC para 51.

<sup>274</sup> Section 133(f) of the 2008 Companies Act.

<sup>275</sup> Section 1 of the 2008 Companies Act.

<sup>276</sup> Section 141(2)(b) of the 2008 Companies Act.

297. This business rescue plan will indicate the ongoing role of the company, the order of preference in which creditors (including preferred creditors such as employees)<sup>277</sup> will be paid and the benefits of the plan as opposed to immediately winding-up the company in terms of the 1973 Companies Act.<sup>278</sup> Once adopted by creditors, this business rescue plan becomes binding on the company and its creditors and is then implemented.<sup>279</sup>

#### Application to Ability to Pay

##### *Commission as “regulatory authority”*

298. In terms of the definition of “*regulatory authority*” in the 2008 Companies Act, the Commission would seem to be a regulatory authority. In terms of section 3(1) of the Competition Act, “*all economic activity within, or having an effect within, the Republic*” is regulated under the Competition Act.<sup>280</sup>

299. For this purpose, the Commission has jurisdiction throughout the Republic to perform its functions under the Competition Act.<sup>281</sup> In addition, section 3(1A)(a) of the Competition Act establishes concurrent jurisdiction between the Commission and any other regulatory authority<sup>282</sup> responsible for a specific industry or sector of an industry.

300. Based on the Commission’s jurisdiction over all national economic activity, including all industries, the Commission would seem to constitute a “*regulatory*

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<sup>277</sup> Section 135(1) and (3) of the 2008 Companies Act.

<sup>278</sup> Section 150(2)(b) of the 2008 Companies Act.

<sup>279</sup> Section 152(4) of the 2008 Companies Act.

<sup>280</sup> Section 3(1) of the Competition Act, which lists certain exceptions to the Act’s application such as collective bargaining.

<sup>281</sup> Section 19(1)(a) of the Competition Act.

<sup>282</sup> Defined in section 1 of the Competition Act as “*an entity established in terms of national, provincial or local government legislation or subordinate legislation responsible for regulating an industry, or sector of an industry*”

*authority*” contemplated by the 2008 Companies Act as it is “*an entity established in terms of national ... responsible for regulating an industry, or sector of an industry.*”<sup>283</sup> If classified as such a regulatory authority, the Commission would not be bound by the business rescue’s moratorium against recovering the fine in terms of section 64.<sup>284</sup>

301. In this way, business rescue proceedings do not protect the Firm from the impact of a fine. Business rescue does not afford the Firm breathing space to absorb the fine by possibly compromising the debt with the Commission together with other creditors.
302. The fine may be imposed and enforced regardless of the business rescue process. This shifts the focus to the purpose of the business rescue proceedings and whether the Firm can recover from business rescue proceedings, with or without the fine.

*Business rescue to avoid exit*

303. The essential trigger for business rescue is current or expected commercial insolvency. The reasons for business rescue may indicate that the company’s commercial insolvency resulted from events other than a possible fine. These reasons for business rescue may assist the above “but for” test in determining whether events, outside the proposed fine, are the factual cause of the company’s commercial insolvency.

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<sup>283</sup> Paragraph 295 above.

<sup>284</sup> Paragraph 126 above.

304. A company under business rescue does not necessarily mean that the company will exit. To the contrary, the business rescue plan may seek to rehabilitate the company and allow it to continue trading. Where the business rescue plan contemplates the company's recovery and continued economic activity, this would indicate that exit for purposes of Ability to Pay is absent.
305. This ability to recover from commercial insolvency through business rescue also influences the above proposition that commercial insolvency is a good indicator of probable exit through winding-up. Commercial insolvency would normally be a good indicator of probable exit where business rescue proceedings would not allow the company to continue trading. In this situation, the business rescue plan would not contemplate reasonable prospects of recovery but propose winding-up through business rescue to achieve better returns for creditors compared to liquidation.
306. The possibility of business rescue proceedings rehabilitating the Firm places a qualification on the utility of commercial insolvency as a reliable indicator of exit. Commercial insolvency would be a helpful indicator of probable exit only where recovery is not probable through business rescue. For instance, where creditors with the largest claims give evidence that they would not support a business rescue plan that contemplates the recovery of the Firm.
307. The above guidance relating to business rescue proceedings should be kept in mind when providing information on the purpose of such business rescue

proceedings when the Commission requests “*information relating to ... business rescue proceedings*” based on its Fining Guidelines.<sup>285</sup>

### Other Indicators of Exit

308. The CAC previously mentioned that a Firm could give evidence on whether the fine would jeopardise the Firm’s “*viability*”. For this purpose, the CAC referenced the EU Fining Guidelines which refers to the “*economic viability*” of that Firm.<sup>286</sup> The EU Information Note provides further guidance on what evidence is helpful in establishing such economic viability.
309. The Information Note provides that indicators of solvency, liquidity and future cashflow as well as bankruptcy indicators such as the Altman Z-score test are useful.<sup>287</sup> The Altman Z-Score test indicates the likelihood of bankruptcy in the form of commercial insolvency.<sup>288</sup> The utility of these indicators when determining a Firm’s exit is explored below.

### Financial indicators

310. Financial ratios are recognised as important indicators of bankruptcy.<sup>289</sup> The liquidity, insolvency and profitability ratios are considered the most useful ratios for this purpose.<sup>290</sup> These ratios include the current liquidity ratio  $\frac{\text{Current assets}}{\text{Current liabilities}}$ , the debt-equity solvency ratio  $\frac{\text{Total long-term debt}}{\text{Total Equity}}$ , and the

<sup>285</sup> Paragraph 135 above.

<sup>286</sup> Paragraph 147 above.

<sup>287</sup> Paragraph 174.1 above.

<sup>288</sup> Lumen Business Law “Introduction to Bankruptcy”

(<https://courses.lumenlearning.com/masterybusinesslaw/chapter/introduction-to-bankruptcy/>) [accessed 3 October 2020]

<sup>289</sup> D Liang *et al* “Financial ratios and corporate governance indicators in bankruptcy prediction: A comprehensive study” (2016) 252 *European Journal of Operational Research* 561 at 561.

<sup>290</sup> El Altman “Revisiting credit scoring models in a Basel 2 Environment” in M Ong, *Credit Rating: Methodologies, Rationale and Default Risk* (2002) 8. D Liang *et al* “Financial ratios and corporate governance indicators in bankruptcy prediction: A comprehensive study” (2016) 252 *European Journal of Operational Research* 561 at 569.

return on total equity profitability ratio  $\frac{\text{Net income}}{\text{Average total equity}}$ .<sup>291</sup> These financial ratios do, however, have their blind-spots.

311. Financial ratios are normally based on backwards-looking financial statements which are constructed from historical data.<sup>292</sup> Relying on only one ratio provides a myopic view of the company's previous financial position and may result in faulty interpretations.<sup>293</sup> For example, a single ratio showing poor profitability at a time may be countervailed by strongly positive liquidity.
312. Similarly, ratios may conflict and provide ambiguous results. For instance, a favourable  $\frac{\text{Profit}}{\text{Turnover}}$  ratio may hide an underlying instability indicated by a negative current liquidity ratio together with over-indebtedness and slow inventory turnover.<sup>294</sup>

### Bankruptcy indicators

313. To address such weaknesses in financial indicators, weighted financial ratios have been combined to provide a more robust indication of a Firm's financial position and ability to pay its future debts. A widely used combination of financial ratios is the company's Z-score:<sup>295</sup>

$$Z = .012X_1 + .014X_2 + .033X_3 + .006X_4 + .999X_5$$

<sup>291</sup> H van Greuning *International Financial Reporting Standards A practical guide* Revised edition (2005) 24 table 3.2 for a list of various financial ratios classified under liquidity, solvency, operational efficiency, growth and profitability categories.

<sup>292</sup> H van Greuning *International Financial Reporting Standards A practical guide* Revised edition (2005) 21 para 3.6.8.

<sup>293</sup> El Altman "Financial Ratios, discriminant analysis and the prediction of corporate bankruptcy" (1968) Vol 23(4) *The Journal of Finance* 589 at 591.

<sup>294</sup> M Tamari "Financial Ratios as a means of forecasting bankruptcy" (1966) Vol 6(4) *Management International Review* 15 at 18.

<sup>295</sup> El Altman *et al* "Distressed Firm and Bankruptcy prediction in an international context: a review and empirical analysis of Altman's Z-Score Model" [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2536340](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2536340) [accessed 14 December 2018]. See also J Almunia, J Lewandowski "Information Note: Inability to pay under paragraph 35 of the 2006 Fining Guidelines and payment conditions pre- and post-decision finding an infringement and imposing fines", *European Commission, SEC(2010) 737, 10 June 2010, 4 para 7.*

where

$X_1 = \text{Working capital/Total assets}$

$X_2 = \text{Retained Earnings/Total assets}$

$X_3 = \text{Earnings before interest and taxes/Total assets}$

$X_4 = \text{Market value equity/Book value of total debt}$

$X_5 = \text{Sales/Total assets}$

$Z = \text{Overall Index}$ <sup>296</sup>

314. Firms with a Z-score over 2.99 are unlikely to go bankrupt but a score below 1.81 portends to possible bankruptcy.<sup>297</sup>
315. The Z-score model has evolved to increase its utility beyond large manufacturing Firms listed on a stock exchange.<sup>298</sup> This led to the revised Z'-score model, which is tailored for private, non-listed, Firms. In the revised model, the element of market value, based on a stock exchange, was removed in favour of the book value of the Firm's equity. The revised Z'-score is reflected as:

$$Z' = 0.717 \cdot X_1 + 0.847 \cdot X_2 + 3.107X_3 + 0.420X_4 + 0.998X_5$$

where

$X_1 = \text{Working capital/Total assets}$

$X_2 = \text{Retained Earnings/Total assets}$

$X_3 = \text{Earnings before interest and taxes/Total assets}$

$X_4 = \text{Book value of equity/Book value of total liabilities}$

$X_5 = \text{Sales/Total assets}$

$Z' = \text{Overall Index}$

316. Firms with a Z'-score of above 2.90 are unlikely to go bankrupt but a score below 1.23 foreshadows possible bankruptcy.<sup>299</sup>

<sup>296</sup> El Altman "Financial Ratios, discriminant analysis and the prediction of corporate bankruptcy" (1968) Vol 23(4) *The Journal of Finance* 589 at 594 for a description of the elements.

<sup>297</sup> El Altman "Financial Ratios, discriminant analysis and the prediction of corporate bankruptcy" (1968) Vol 23(4) *The Journal of Finance* 589 at 606.

<sup>298</sup> El Altman "Financial Ratios, discriminant analysis and the prediction of corporate bankruptcy" (1968) Vol 23(4) *The Journal of Finance* 589 at 609.

<sup>299</sup> El Altman "The use of credit scoring models and the importance of a credit culture" <http://pages.stern.nyu.edu/~ealtman/3-%20CopCrScoringModels.pdf> [accessed 14 December 2018]

317. A further evolution of the Z-score was developed for non-manufacturing Firms and firms in emerging markets. The model was adapted by removing the ratio  $\frac{\text{Sales}}{\text{Total assets}}$  which was seen as too specific to the manufacturing industry which requires large investments in production assets.<sup>300</sup> The further revised Z''- score now states:

$$Z'' = 3.25 + 6.56 \cdot X_1 + 3.26 \cdot X_2 + 6.72 \cdot X_3 + 1.05 \cdot X_4$$

where

$X_1$  = Working capital/Total assets

$X_2$  = Retained Earnings/Total assets

$X_3$  = Earnings before interest and taxes/Total assets

$X_4$  = Book value of equity/Book value of total liabilities

Z'' = Overall Index

318. Firms with a Z''-score of above 2.60 are unlikely to go bankrupt but Firms with a score below 1.1 risk bankruptcy.<sup>301</sup>

#### Application to Ability to Pay

319. Financial ratios and the above Z-scores may be useful in predicting commercial insolvency. However, they should not be over-stated and should be supplementary to the above-mentioned evidence relating to commercial insolvency contemplated by the 1973 Companies Act.<sup>302</sup> For instance, Z-scores indicate the likelihood of a Firm's bankruptcy but not necessarily its exit as contemplated by Ability to Pay.

<sup>300</sup> El Altman "Revisiting credit scoring models in a Basel 2 Environment" in M Ong, *Credit Rating: Methodologies, Rationale and Default Risk* (2002) 21.

<sup>301</sup> El Altman "The use of credit scoring models and the importance of a credit culture" <http://pages.stern.nyu.edu/~ealtman/3-%20CopCrScoringModels.pdf> [accessed 14 December 2018]

<sup>302</sup> M Tamari "Financial Ratios as a means of forecasting bankruptcy" (1966) Vol 6(4) *Management International Review* 15 at 16.

320. Z-Scores indicate the likelihood of bankruptcy in terms of the bankruptcy laws of the US.<sup>303</sup> These laws contemplate a Firm's possible recovery out of such bankruptcy in certain circumstances. Bankruptcy in terms of chapter 11 of the US bankruptcy laws is similar to our business rescue proceedings as it allows for creditors to compromise in terms of an agreed plan and allow the Firm to continue trading.<sup>304</sup>
321. In this way, a Z-score indicator of likely bankruptcy does not seem to be a sufficiently robust indicator on its own of exit contemplated by Ability to Pay. A further question whether bankruptcy will end in liquidation still needs to be answered. An expert in this field may assist with this question.
322. Experts on financial ratios and/or business rescue may assist the Tribunal evaluation of these questions on a Firm's commercial insolvency, possible recovery through business rescue and probability of exit. Fortunately, the CAC has usefully explained the responsibilities and duties of such experts.

### *Expert testimony*

323. The CAC explained that an expert witness has the following duties and responsibilities:

*"1. Expert evidence presented to the Court should be, and should be seen to be, the independent product of the expert uninfluenced as to form or content by the exigencies of litigation..."*

*2. An expert witness should provide independent assistance to the court by way of objective unbiased opinion in relation to matters within his*

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<sup>303</sup> National Banks Act 1989 as amended. See Lumen Business Law "Introduction to Bankruptcy" (<https://courses.lumenlearning.com/mastery/businesslaw/chapter/introduction-to-bankruptcy/>) [accessed 3 October 2020]

<sup>304</sup> Vox "Why businesses that declare bankruptcy don't always die" (<https://www.vox.com/the-goods/2019/3/11/18259894/bankruptcy-business-chapter-11-close-stores>) [accessed 3 October 2020]

*expertise ... An expert witness in the High Court should never assume the role of an advocate.*

*3. An expert witness should state the facts or assumption upon which his opinion is based. He should not omit to consider material facts which could detract from his concluded opinion ...*

*4. An expert witness should make it clear when a particular quotation or issue falls outside his expertise.*

*5. If an expert's opinion is not properly researched because he considers that insufficient data is available, then this must be stated with an indication that the opinion is no more than a provisional one... In cases where an expert witness who has prepared a report could not assert that the report contained the truth, the whole truth and nothing but the truth without some qualification, that qualification should be stated in the report ..."<sup>305</sup> (emphasis added)*

324. Based on these principles, experts on business rescue or financial indicators may be able to provide “*appreciable help*” to the Tribunal on its evaluation of probable exit.<sup>306</sup> The mere opinion of the expert, however, is not decisive but her reasons for her opinion based on her experience may persuade the Tribunal to accept her opinion.<sup>307</sup>
325. The opinion of such an expert does not, however, relieve the Tribunal of evaluating the evidence on a company's probable commercial insolvency and winding-up as contemplated by the 1973 Companies Act. Expert evidence would not add significant probative value where the Court is in as good a position as the expert to consider such an issue in dispute.<sup>308</sup>
326. With such expert assistance, the Tribunal may find that the Firm's exit is probable. The next question to grapple with is whether this exit is expected to have a significant effect on competition.

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<sup>305</sup> *Sasol Chemical Industries Limited v Competition Commission* (131/CAC/Jun14) 89 para 181.

<sup>306</sup> PJ Schwikkard and SE van der Merwe *Principles of Evidence* 4th ed (2016) 99.

<sup>307</sup> PJ Schwikkard and SE van der Merwe *Principles of Evidence* 4th ed (2016) 102.

<sup>308</sup> PJ Schwikkard and SE van der Merwe *Principles of Evidence* 4th ed (2016) 89 to 90.

## Effect on Competition

327. The above statements by the CAC and Tribunal on Ability to Pay do not expressly contemplate an effect on competition in the relevant market. However, the Commission’s Fining Guidelines mention a fine “*leading to a significant reduction in competition.*”<sup>309</sup> Similarly, the EU’s Fining Guidelines indicate that fines should not “*drive competitive companies and productive assets out of the market.*”<sup>310</sup> Section 2 of the Competition Act also describes competition as the guiding purpose of the Competition Act.

### Competition as purpose of Competition Act

328. Section 2 of the Competition Act describes the purpose of the Act as being “*to promote and maintain competition in the Republic.*”<sup>311</sup> This promotion and maintenance of competition is then followed by “*in order*” together with a list of objectives. These listed objectives include “*the traditionally accepted competition law goals of lower prices and greater choices for customers*” as well as “*wider public interest goals*”<sup>312</sup> such as to “*promote employment and advance the social and economic welfare of South Africans*”.<sup>313</sup> These multiple goals raise the question whether section 2 indicates a single competition purpose or multiple public interest purposes of the Competition Act.

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<sup>309</sup> Paragraph 133 above.

<sup>310</sup> Paragraph 172 above.

<sup>311</sup> Paragraph 18 above.

<sup>312</sup> M Neuhoff *et al* *A Practical Guide to the South African Competition Act 2* ed (2017) 8.

<sup>313</sup> Paragraph 18 above.

*Single purpose vs multiple purposes*

329. It has been argued before the Tribunal that the listed objectives in section 2 should also be viewed as purposes of the Competition Act. Unfortunately, the Tribunal left the question open and did not provide guidance on whether the single purpose of the Competition Act is the promotion and maintenance of competition or whether we should interpret the Competition Act to achieve the public interest goals listed in section 2.

330. In support of a single purpose, it was argued that these listed objectives “*speak broadly of the overall impact of the legislation on society, including the indirect benefits that the legislation may bring, they are not meant to be given effect to in interpreting an operational section.*”<sup>314</sup> In its decision, the Tribunal held that it did not need to decide whether it should use the social objectives in section 2 to interpret the Competition Act. However, the Tribunal referred to previous cases where it held that:

*“in many respects our jurisdiction in these areas is secondary, as these other statutes and the institutions that they create, are better placed and resourced to deal directly and effectively with these issues than are we.”*<sup>315</sup> (emphasis added)

331. In a similar vein, the Tribunal previously held that:

*“The role played by the competition authorities in defending even those aspects of the public interest listed in the Act is, at most, secondary to other statutory and regulatory instruments ... The competition authorities, however well intentioned, are well advised not to pursue their public interest mandate”*

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<sup>314</sup> *Anglo American Holdings Ltd and Kumba Resources Ltd with the Industrial Development Corporation intervening* (46/LM/Jun02) 30 para 156.

<sup>315</sup> *Distillers Corporation (SA) Ltd and Stellenbosch Farmers Winery Group Ltd* (08/LM/Feb02) 53 para 232.

*in an overzealous manner lest they damage precisely those interests that they ostensibly seek to protect.*<sup>316</sup>

332. Although not definitive, the CAC indicated in passing when considering Merger regulation that “[s]ection 2 of the Act provides that the purpose of the Act is to promote competition in the Republic.”<sup>317</sup> To date, the CAC has not been called upon to conclude whether the Competition Act should be interpreted through the frame of the listed public interest goals in section 2.
333. This question necessarily involves the statutory interpretation of section 2 of the Competition Act. Such process of statutory interpretation is generally guided by the following approach:

*“Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production...The ‘inevitable point of departure is the language of the provision itself’, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.”*<sup>318</sup> (emphasis added)

334. As contemplated by this approach, a contextual reading of the actual text in section 2 initiates the analysis. Section 2 begins with “*the purpose of this Act is*” which seems to contemplate a single purpose. What follows is “*to promote and maintain competition in the Republic*”. This statement seems to contain

<sup>316</sup> *Shell SA (Pty) Ltd / Tepco Petroleum (Pty) Ltd* (66/LM/Oct01) 15 para 58.

<sup>317</sup> *Distillers Corporation (SA) Ltd and Another v Bulmer (SA) (Pty) Ltd and Another* [2001-2002] CPLR 36 (CAC) 45.

<sup>318</sup> *Natal Joint Municipal Pension Fund v Endumeni Municipality* (920/2010) [2012] ZASCA 13 (15 March 2012) para 18.

two elements i.e., “*promotion and maintenance*”, which could be notionally separated into two separate concepts. However, “*to promote and maintain competition*” is capable of being read as one single concept when read with “*purpose*” in the singular form.

335. The introduction of “*in order to*” seems to signal a departure from the “*purpose*” towards its consequences. This context seems to indicate that the single purpose of promoting and maintaining competition seeks to achieve other consequential goals. This textual reading seems to favour the interpretation of a single purpose which seeks to achieve other consequential goals which are not themselves the purpose of the Competition Act.

336. We gain further guidance on the purpose of section 2’s text from the memorandum to the Competition Bill<sup>319</sup> (“**Memorandum**”). This Memorandum indicates that “*[c]ompetition policy and its associated legislation and institutions are concerned with promoting and maintaining high levels of competition.*”<sup>320</sup> In relation to the purpose of the Competition Act, the Memorandum indicates that:

*“The competition laws of most countries share certain common objectives, principally to maintain healthy rivalry among firms in markets for goods and services. However, as the World Trade Organisation notes in its 1998 report most countries link the goal of maintaining inter-firm rivalry with broader economic and social objectives including the protection of consumers from the undue exercise of market power, the promotion of trade, the promotion of democratic values such as economic pluralism and the dispersion of socio-economic power and the protection of the public interest including consideration leading to industrial competitiveness and employment and the promotion of small and medium sized business.”<sup>321</sup> (emphasis added)*

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<sup>319</sup> B-98 of 1998.

<sup>320</sup> Memorandum section 1.

<sup>321</sup> Memorandum section 1.

337. When viewing section 2 within the context of the rest of the Competition Act, Professor Eleanor Fox distinguishes between the purpose of maintaining and promoting competition and aspirant public interest goals:

*“In spite of these multiple, and sometimes incompatible, aspirations, ninety-five percent or so of the body of the statute reflects relatively well-tested principles of competition law.”*<sup>322</sup> (emphasis added)

338. She then explores certain provisions of the Competition Act that go beyond the normal principles of competition law such as a Merger’s effect on historically disadvantaged individuals.<sup>323</sup> She concludes with:

*“If expectations are high that the new competition law will visibly change the terms of economic participation in favour of the historically repressed black majority in South Africa, they are likely to be unfulfilled; the stated purposes of the competition law could give false hope. In view of the clarity and limits of the law, however, it is doubtful that expectations will be high for benefits other than the right to compete on the merits, which itself is empowering.”*<sup>324</sup> (emphasis added)

339. Based on the above, the maintenance and promotion of competition seems to be the primary purpose of the Competition Act and should guide an evaluation of Ability to Pay. From this interpretation, the concept of “*competition*” is germane to applying this purpose to the Ability to Pay.

340. Notwithstanding this submission, this paper’s proposal of a separate factor of “*effect on competition*” is not contingent on a single competition purpose for the Competition Act. The proposal of including the factor of “*effect on*

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<sup>322</sup> EM Fox “Equality, Discrimination, and Competition Law: Lessons from and for South Africa and Indonesia” (2000) 41 *Harvard International Law Journal* 579 at 585

<sup>323</sup> Section 12A(3)(d) of the Competition Act.

<sup>324</sup> EM Fox “Equality, Discrimination, and Competition Law: Lessons from and for South Africa and Indonesia” (2000) 41 *Harvard International Law Journal* 579 at 588 read with P Sutherland and K Kemp *Competition Law of South Africa* (2017) 1-54.

*competition*” is still possible where other public interest purposes exist alongside the promotion and maintenance of competition as purposes of the Competition Act.

### *Concept of “competition”*

341. The concept of “*competition*” is not defined in the Competition Act. The dictionary definition of “*an activity done by a number of people or organizations, each of which is trying to do better than all of the others*”<sup>325</sup> seems intuitive but may be facile in understanding competition in the context of the Competition Act. Fortunately, the Tribunal has given guidance on its understanding of this concept.

342. In relation to the general purpose of competition laws, the Tribunal confirmed the following from the American case of *Fishman v. Estate of Wirtz*:<sup>326</sup>

*“The antitrust laws are concerned with the competitive process, and their application does not depend in each particular case upon the ultimate demonstrable consumer effect. A healthy and unimpaired competitive process is presumed to be in the consumer interest.”<sup>327</sup> (emphasis added)*

343. This is similar to the EU where “*competition laws protect the competitive structure and dynamic of the market. They protect openness of and access to markets...*”<sup>328</sup>

344. The Tribunal has also held in relation to Merger control that:

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<sup>325</sup> Cambridge Dictionary “Meaning of Competition” <https://dictionary.cambridge.org/dictionary/english/competition> [accessed 23 October 2020]

<sup>326</sup> 807 F.2d 530 (7th Cir. 1986).

<sup>327</sup> *Competition Commission v South African Airways (Pty) Ltd and others* (83/CR/Oct04) 29 para 123.

<sup>328</sup> EM Fox “What is harm to competition? Exclusionary practices and anticompetitive effect” (2002) Volume 70 Number 2 *Antitrust Law Journal* 371 at 392.

*“[h]ostile mergers - red of tooth and claw though they may be - are an important part of the very competitive process that we are mandated to defend and to promote.”<sup>329</sup> [emphasis added]*

345. This focus on the competitive process and not a particular firm is described by the Tribunal where:

*“competition law is premised on the exclusion of competition as an objective fact, not the exclusion of a particular competitor...”*

*[86] Competition law does not look at effects subjectively from the vantage point of a particular firm, but objectively from the vantage point of a hypothetical competitor.”<sup>330</sup> (emphasis added)*

346. The Courts have similarly held that *“it is fundamental to healthy market-based economies that companies which cannot be competitive will fail”*.<sup>331</sup>

347. These views seem to contemplate competition as the competitive process between multiple firms in a market. The fortunes or exit of a single Firm would only be a factor in the analysis of a broader competitive process involving many Firms. Depending on the mechanisms of this competitive process, a single Firm may be a minor or significant influence on the working of competition in a market.

348. For example, the exit of a Firm may result in a worryingly high concentration of Firms in the relevant market.<sup>332</sup> Such high concentration from a Firm’s exit may also be counter-balanced by a decreasing number of customers which

<sup>329</sup> *Gold Fields Limited and Harmony Gold Mining Company Limited and others* (86/FN/Oct04) 23 para 4.

<sup>330</sup> *Shoprite Checkers (Pty) Ltd and others v Massmart Holdings Ltd in re Massmart Holdings Ltd v Shoprite Checkers (Pty) Ltd and others* (CRP034Jun15/EXC239Mar17; CRP034Jun15/EXC240Mar17; CRP034Jun15/EXC241Mar17) 19 paras 85 and 86.

<sup>331</sup> *Booyesen v Jonkheer Boerewynmakery(Pty) Ltd (in business rescue) and another* 2017 (1) All SA 862 (WCC) para 17.

<sup>332</sup> A Stephan “Price Fixing in Crisis: Implications of an Economic Downturn for Cartels and Enforcement” (2012) Volume 35 Issue 3 *World Competition Law and Economics Review* 511 at 515-516.

results in the remaining Firms ferociously competing for the diminished demand.<sup>333</sup>

349. Such an analysis of probable effects on competition is currently performed by the Competition Authorities when considering Mergers. The principles from such analysis in Merger regulation seem to provide a useful framework for determining the competitive effects of Ability to Pay. Specifically, the failing Firm factor.

#### Application to Ability to Pay

350. The Commission's Fining Guidelines contemplate an analysis of the competitive effects of a Firm's exit through Ability to Pay. Considering competitive effects of Ability to Pay also seems aligned with the "*promotion and maintenance of competition*" purpose of the Competition Act. Fortunately, Merger analysis provides useful factors to consider when determining the competitive effects of a Firm's exit.
351. Section 12A enjoins the Competition Authorities to determine the SLC from a Merger which includes analysing "*the strength of competition in the relevant market, and the probability that the firms in the market after the merger will behave competitively...*"<sup>334</sup>

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<sup>333</sup> A Stephan "Price Fixing in Crisis: Implications of an Economic Downturn for Cartels and Enforcement" (2012) Volume 35 Issue 3 *World Competition Law and Economics Review* 511 at 515.

<sup>334</sup> Paragraph 67 above.

352. One of the factors that is considered in this SLC analysis is the failing Firm factor.<sup>335</sup> As described above, this factor contemplates the exit of a firm and how such exit may influence the competitive process.
353. The principles from the failing Firm factor may provide useful guidance when analysing the competitive effects of Ability to Pay as they seem sufficiently analogous.

*Competition factors of failing Firm applicable to Ability to Pay*

354. As described above, the focus of the Tribunal's analysis of the failing Firm factor is not the Firm's exit *per se* but its probable effect on competition. This requires a determination of the current state of competition including the relevant Firm's involvement in the market's competitive process.
355. Determining the current state of competition is case specific and fact intensive. The factors listed under section 12A(2) provide a good starting point for understanding the current workings of the competitive process and the Firm's role in the market.<sup>336</sup> This current state is then compared to the hypothetical counterfactual of the market without the Firm.
356. The standard of proof in this analysis relating to a Firm's exit is the Competition Act's general section 68's balance of probabilities. This paper's reliance on section 12A for guidance in analysing the competitive effects of Ability to Pay does not extend to the "*likely*" standard in the SLC test. As indicated above, the CAC interpreted "*likely*" in section 12A as being separate from the balance

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<sup>335</sup> Paragraph 70 above.

<sup>336</sup> Paragraph 67 above.

of probabilities in section 68. This statutory “*likely*” standard is specific to Mergers as future events cannot be predicted with fine callipers.<sup>337</sup>

357. The legislature may find it necessary to extend this “*likely*” standard to Ability Pay as they both contemplate prediction of future events. Before then, this paper’s Ability to Pay analysis is primarily derived from case law and not statute so it defaults to the balance of probability in section 68.

358. A comparison of current competition to a probable counterfactual of competition is familiar to the Tribunal when considering Mergers as:

*“Central to substantive merger analysis is therefore the comparison between the state of competition in a market absent the merger to the likely state of competition post-merger.”<sup>338</sup> (emphasis added)*

359. Such a comparison seems equally applicable when considering the competitive effects of Ability to Pay. The difference is that Merger regulation thinks the Merger into being while Ability to Pay removes the Firm in the counterfactual. The Tribunal’s approach for evaluating the failing Firm factor in Mergers provides a useful framework for such a comparison.

360. For instance, the Tribunal’s factor of “[n]o leniency would be afforded to the requirement that there be evidence that there is no less anticompetitive alternative”<sup>339</sup> aligns with the Australian approach where the authorities seek to determine whether the Firm’s exit would remove an “*an actual or potential constraint on the market.*”<sup>340</sup>

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<sup>337</sup> Paragraph 60 above.

<sup>338</sup> L Kelly *et al Principles of Competition Law in South Africa* (2016) 186.

<sup>339</sup> Paragraph 75 above.

<sup>340</sup> Paragraph 74 above.

361. Once compared in terms of the Tribunal's approach, the ultimate net competitive effects may favour allowing the Firm to fail when the "*competitive strength of the remaining participants is evenly matched, the level of competition in the market may be better served by allowing the firm to fail.*" Alternatively, the balance of competitive effects may favour keeping the Firm in the market as "*loss of capacity will tend to reduce competitive pressures in the market. Depending on the effect of the acquisition on the relative strength of remaining participants, retaining the failed firm's capacity in the market may still be pro-competitive.*"<sup>341</sup>
362. This comparison to the counterfactual without the Firm seems to include the possible situation contemplated by the EU Fining Guidelines where the Firm's exit also causes the Firm's "*assets to lose all their value*" as interpreted by the EU Courts.<sup>342</sup> This situation seems similar to the US element referred to by the Tribunal for failing Firms where "*assets of the failing firm would exit the relevant market*".<sup>343</sup>
363. Under this paper's proposed "*competition effects*" factor, the EU's requirement of total loss of asset value is only a factual issue subsumed into the failing Firm counterfactual. Unlike in the EU approach to Ability to Pay, this paper does not propose "*assets to lose all their value*" as a self-standing factor but only as an element in understanding the competitive effects of Ability to Pay.

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<sup>341</sup> Paragraph 74 above.

<sup>342</sup> Paragraph 167 above.

<sup>343</sup> Paragraph 71 above.

*Possible outcomes of failing Firm factor*

364. At best for the Firm in an Ability to Pay analysis, its presence is a significant constraint on other competitors and its exit would create an undesirable competitive process to the detriment of consumers.
365. At worst for the Firm, the Firm would contribute very little to the competitive process and its competitive constraint could be minor or neutral. However, its current presence *per se* in the market would not be anti-competitive without specific conduct amounting to a prohibited practice.
366. The two outcomes of this juxtaposition of the current state of competition to competition in the hypothetical counterfactual are:
- 366.1. *It is probable that the Firm's exit would negatively affect the competitive process.* As mentioned in the Australian approach to the Failing firm factor, the Firm's exit may reduce productive capacity in the market which reduces the Firm's competitive constraint on competitors. The Firm's exit may also result in a significant shift in market share to one Firm which may result in that Firm gaining market power.<sup>344</sup>
- 366.2. *It is probable that the Firm's exit would be competitively neutral and not negatively affect competition.* The worst case for the Firm would be that its exit does not materially disturb the competitive process in the market. This could occur when exit results in an equal distribution of market share to

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<sup>344</sup> See paragraph 39 above for the definition of market power.

many small competitors or the exit of productive capacity balances with a decrease in demand.

*Feedback to other factors*

367. The above outcomes of the “*competition effect*” factor may impact the other proposed factors, such as causation, by influencing how much uncertainty is acceptable in the light of such competitive consequences. Where significant anti-competitive effects are predicted from the Firm’s exit, the preceding factors play the crucial role of deciding whether those negative effects are allowed. This increased reliance on preceding factors places the focus on how uncertainty was resolved for these factors where anti-competitive effects are at stake.
368. As explored above, the “but for” test and probable commercial insolvency contemplate the prediction of future events. This predicted world becomes the hypothetical counterfactual that is compared to the established facts. Establishing these facts and predicting the future involves resolving any uncertainty surrounding these events.
369. Methods for resolving such uncertainty include the balance of probabilities standard or the burden of proof when the probabilities balance.<sup>345</sup> Unique to Ability to Pay, the Tribunal may postpone its proceedings to gain greater certainty on a future event.<sup>346</sup> The Tribunal may also exercise its inquisitorial powers to call for further evidence to reduce uncertainty on Ability to Pay.<sup>347</sup>

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<sup>345</sup> From paragraph 119 above.

<sup>346</sup> Paragraph 255 above.

<sup>347</sup> Paragraph 22 above.

370. The Tribunal's choice of how it resolves uncertainty may be informed by the competition effects of the Firm's exit. Where the competitive effects of Ability to Pay are negative and substantial, the Tribunal may react by postponing its proceedings and/or exercising its inquisitorial powers to gain as much certainty as possible. This seems aligned with the EU requiring "*sufficient proof*" in relation to causation without setting a definitive standard for proof.<sup>348</sup>
371. In this way, the competition effects of Ability to Pay heightens the importance of preceding factors. The Tribunal may be moved by such competitive consequences to seek greater certainty, where needed, through its inquisitorial powers and/or through postponement until after an uncertain future event. Such powers go beyond resolving uncertainty through the normal standard of proof and onus as previously mentioned by the Tribunal for Ability to Pay.<sup>349</sup>
372. The legislature may formalise this approach to uncertainty by applying the "*likely*" standard of the SLC test to Ability to Pay as both involve predictions of the future.
373. Similar to competition effects, employment effects are evaluated as a possible factor for Ability to Pay.

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<sup>348</sup> Paragraph 173 above.

<sup>349</sup> Paragraph 122 above.

## Employment Effect of Exit

### Contextualizing employment effects

374. As with competition effects, the Tribunal and CAC's references to Ability to Pay do not contemplate an effect on public interest factors such as employment. The Commission's Fining Guidelines also do not include public interest factors when evaluating Ability to Pay. This seems to run contrary to the EU position which specifically references a "*social context*" including employment.<sup>350</sup>

375. The Commission's ostensibly callous approach initially seems repugnant considering South Africa's current level of unemployment.<sup>351</sup> However, the Tribunal has previously held that the Competition Authorities play a secondary role to other statutes and institutions when applying the public interest provisions of the Competition Act.<sup>352</sup> The Tribunal indicated that other institutions are better placed and resourced to achieve such policy interests.<sup>353</sup>

### Current employee protection

376. When winding-up a company, the company's employees have a statutory claim against the available liquidated funds of the company.<sup>354</sup> This statutory priority is provided by the relevant sections of the Insolvency Act,<sup>355</sup> which are

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<sup>350</sup> Paragraph 174.2 above.

<sup>351</sup> Approximately 27% or 6.14 million at the end of 2018 (Trading Economics "South Africa Unemployment Rate" <https://tradingeconomics.com/south-africa/unemployment-rate> [accessed 22 February 2019]).

<sup>352</sup> Employment is also not sacrosanct in merger control under the Competition Act. Employment loss may be justified by the merging parties or allowed but ameliorated through conditions (*Metropolitan Holdings Limited and Momentum Group Limited* (41/LM/Jul10) paras 70 and 117).

<sup>353</sup> Paragraphs 330 and 331 above.

<sup>354</sup> Section 339 of the Companies Act 61 of 1973, read with section 9 of Schedule 5 of the 2008 Companies Act. These provisions refer to the Insolvency Act 24 of 1936 which are not covered by the 1973 Companies Act.

<sup>355</sup> 24 of 1936.

incorporated into the 1973 Companies Act, to regulate the order of payments when winding-up a company. The company's employees are paid from any remaining funds after paying secured creditors and the costs of winding-up the company.<sup>356</sup>

377. In terms of section 98A of the Insolvency Act, an employee of an insolvent company may claim three months' salary or wages to a maximum of R12 000.<sup>357</sup> The employee's claim to salaries and wages ranks higher than other statutory claims available to the employee under this provision.<sup>358</sup>
378. The other claims that employees have are for any leave accrued during the year of winding-up and the preceding year to a maximum of R4 000.<sup>359</sup> In addition, the company is obliged to pay any contributions that are due to any applicable scheme or fund such as pension funds or medical aid, up to R12 000.<sup>360</sup> The employee may also claim three months paid absence up to R4 000 and any severance pay up to R12 000.<sup>361</sup>
379. Such severance benefits arise where unemployment results from the employer being wound-up in terms of the 1973 Companies Act. An employee

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<sup>356</sup> Sections 95, 97 and 98 of the Insolvency Act 24 of 1936. See also *Diener NO v Minister of Justice and others* 2008 (1) All SA 317 (SCA) para 46 where "free residue" is described as the "portion of the estate which is not subject to any right of preference by reason of any special mortgage, legal hypothec, pledge or right of retention".

<sup>357</sup> Section 98A(1)(a)(i) of the Insolvency Act read with Determination of Amounts and Exclusion of Employees for the Purposes of Section 98A of the Insolvency Act, 1936, GN R865, *Government Gazette* 21519, 1 September 2000.

<sup>358</sup> Section 98A(4) of the Insolvency Act.

<sup>359</sup> Section 98A(1)(a)(ii) of the Insolvency Act read with Determination of Amounts and Exclusion of Employees for the Purposes of Section 98A of the Insolvency Act, 1936, GN R865, *Government Gazette* 21519, 1 September 2000.

<sup>360</sup> Section 98A(1)(b) of the Insolvency Act read with Determination of Amounts and Exclusion of Employees for the Purposes of Section 98A of the Insolvency Act, 1936, GN R865, *Government Gazette* 21519, 1 September 2000.

<sup>361</sup> Section 98A(1)(a)(iii) and (iv) of the Insolvency Act read with Determination of Amounts and Exclusion of Employees for the Purposes of Section 98A of the Insolvency Act, 1936, GN R865, *Government Gazette* 21519, 1 September 2000.

may claim severance benefits of one week's remuneration for each year of continuous employment with the company.<sup>362</sup>

380. When compared to winding-up proceedings, business rescue provides more extensive protection to employees' claims. In terms of section 144(2) of the 2008 Companies Act, any money related to employment that was payable before business rescue proceedings is paid before paying unsecured creditors.<sup>363</sup> This section includes payments to medical and pension schemes that were payable before business rescue proceedings.<sup>364</sup>
381. The business rescue provisions of the 2008 Companies Act do not limit the maximum amount that an employee can claim and goes further to include other types of remuneration such as commission on sales.<sup>365</sup>
382. Section 35 of the 2008 Companies Act also secures the benefits payable to employees during business rescue proceedings. During business rescue, remuneration or any other money related to employment is secured for the company's employees. Such amounts payable to employees during business rescue have a high priority and are paid before the above benefits accrued before business rescue.<sup>366</sup>

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<sup>362</sup> Section 38(11) of the Insolvency Act read with section 41 of the Basic Conditions of Employment Act 75 of 1997.

<sup>363</sup> Section 144(2) refers to such employee as "*preferred unsecured creditor*" but the 2008 Companies Act does not define this term or provide the order of pay-outs. In terms of section 150(2)(b)(v) of the 2008 Companies Act, the business rescue plan will indicate the order of preference of pay-outs.

<sup>364</sup> Section 144(4) of the 2008 Companies Act. Although this section views such claims as merely "*unsecured*", P Delpont *et al Henochsberg on the Companies Act 71 of 2008* (2018) 504-504 argue that it should be a preferred claim otherwise the section would not serve a purpose. See also L du Plessis *Re-interpretation of Statutes* (2002) 243-244 for the statutory presumption that statutes do not contain invalid or purposeless provisions.

<sup>365</sup> *Booyesen v Jonkheer Boerewynmakery(Pty) Ltd (in business rescue) and another* 2017 (1) All SA 862 (WCC) para 65.

<sup>366</sup> Section 135(1) read with 135(3) of the 2008 Companies Act.

383. Employees are also involved in the business rescue process as employees stand to gain the above benefits from such proceedings. These benefits stem from the philosophy that the negative social effects of unnecessary employment losses should be prevented.<sup>367</sup> Based on this approach, employees are incentivised to support appropriate business rescue proceedings instead of unnecessary liquidations which results in employment losses.
384. In addition to the above, employees may qualify for benefits under the Unemployment Insurance Act (“**UIA**”).<sup>368</sup> In terms of the UIA, a qualifying employee<sup>369</sup> may claim an unemployment benefit when her employer terminates the employment contract or where unemployment results from the employer’s insolvency.<sup>370</sup>
385. Where unemployment results from insolvency, the employee may claim unemployment benefits in terms of the UIA even before the employment contract is terminated.<sup>371</sup> When the company begins winding-up its affairs, all its employment contracts are suspended.<sup>372</sup> An employee may claim such

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<sup>367</sup> *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2012 (2) All SA 433 (GSJ) para 15.

<sup>368</sup> 63 of 2001.

<sup>369</sup> In terms of section 3 of the Unemployment Insurance Act, only employees that work for more than 24 hours a month for a specific employer may claim. To qualify, the employee must have contributed to the unemployment insurance fund (defined in section 1 of the Unemployment Insurance Act) in accordance with section 5 of the Unemployment Insurance Contributions Act 4 of 2002. Qualifying employees may only claim after being unemployed for 14 days.

<sup>370</sup> Section 16(a) of the Unemployment Insurance Act.

<sup>371</sup> Section 38(3) of the Insolvency Act. This provision refers to benefits under the Unemployment Insurance Act 30 of 1966 which has been replaced by the Unemployment Insurance Act 63 of 2001. See E Bertelsmann *et al Mars: The Law of Insolvency* 9<sup>th</sup> Edition (2008) 240 para 12.11 where the authors confirm that unemployment benefits can be claimed from suspension of the employment contract.

<sup>372</sup> Section 38(1) of the Insolvency Act.

unemployment benefits in terms of the UIA during this suspension period<sup>373</sup> to a maximum of 238 days.<sup>374</sup>

386. All the above statutory provisions seek to ameliorate the pernicious effects of unemployment after an employer exits. Unfortunately, such statutory assistance to the employees can only soften the harm for a time but cannot secure or create an employment opportunity.

### Employment creation

387. As mentioned above, fines imposed by the Tribunal are paid into the National Revenue Fund (“**NRF**”).<sup>375</sup> This fund was established in terms of section 213 of the Constitution of the Republic of South Africa, 1996 which provides that, generally, all money received by national government should be paid into the NRF.
388. The NRF is managed by National Treasury<sup>376</sup> and is used to fund services such as health care,<sup>377</sup> education<sup>378</sup> and policing.<sup>379</sup> In addition, the NRF may be used to create employment opportunities. In 2018, NRF funds were allocated to stimulate employment in various economic sectors, such as:

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<sup>373</sup> Section 38(3) of the Insolvency Act. Such suspended employment contracts, generally, terminate after 45 days from the appointment of the liquidator tasked with winding-up the company.

<sup>374</sup> Schedule 2 of the Unemployment Insurance Act.

<sup>375</sup> Paragraph 84 and 125 above.

<sup>376</sup> Section 5 of the Public Finance Management Act 1 of 1999.

<sup>377</sup> Vote 16, Schedule 1 of the Appropriation Act 4 of 2018.

<sup>378</sup> Vote 14, Schedule 1 of the Appropriation Act 4 of 2018.

<sup>379</sup> Vote 23, Schedule 1 of the Appropriation Act 4 of 2018.

- 388.1. Public Enterprises by using NRF funds to drive *“investment, productivity and transformation in the department's portfolio of state-owned companies to unlock growth, drive industrialisation, create jobs and develop skills.”*<sup>380</sup>
- 388.2. Public Works: *“Promote growth, job creation and transformation in the construction and property industries.”*<sup>381</sup>
- 388.3. Agriculture, Forestry and Fisheries: *“Lead, support and promote agricultural, forestry and fisheries resources management through policies, strategies and programmes to enhance sustainable use, and achieve economic growth, job creation, food security, rural development and transformation.”*<sup>382</sup>
- 388.4. Labour: *“Play a significant role in reducing unemployment, poverty and inequality by pursuing the objectives of decent work for all through: employment creation and enterprise development...”*<sup>383</sup>
- 388.5. Small Business Development: *“Promote the development of small businesses and cooperatives that contribute to inclusive economic growth and job creation.”*<sup>384</sup>
- 388.6. Trade and Industry: *“Contribute to achieving government's vision of an adaptive and restructured economy, characterised by accelerated economic growth, employment creation and greater equity.”*<sup>385</sup>

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<sup>380</sup> Vote 9, Schedule 1 of the Appropriation Act 4 of 2018.

<sup>381</sup> Vote 11, Schedule 1 of the Appropriation Act 4 of 2018.

<sup>382</sup> Vote 24, Schedule 1 of the Appropriation Act 4 of 2018.

<sup>383</sup> Vote 28, Schedule 1 of the Appropriation Act 4 of 2018.

<sup>384</sup> Vote 31, Schedule 1 of the Appropriation Act 4 of 2018.

<sup>385</sup> Vote 34, Schedule 1 of the Appropriation Act 4 of 2018.

388.7. Arts and Culture: “*Contribute to sustainable economic development and enhance job creation by preserving, protecting and developing South African arts, culture and heritage to sustain a socially cohesive and democratic nation.*”<sup>386</sup>

#### Application to Ability to Pay

389. The CAC and Tribunal have contemplated Ability to Pay but have not been called upon to decide whether such an analysis includes effects on employment as in section 12A(3)(b) relating to Mergers. Similarly, the Commission’s Fining Guidelines do not include public interest considerations such as employment when considering Ability to Pay.

390. It may be argued that employment effects should be a factor in Ability to Pay based on section 2’s goal to “*promote employment*” and the EU’s inclusion of “*social context*” in the EU Fining Guidelines. However, the Tribunal has indicated that the Competition Authorities play a secondary role to other, better placed, institutions and legal instruments when considering those public interest concerns expressly included in the Competition Act, such as employment effects from a Merger.<sup>387</sup>

391. In relation to Ability to Pay, other legal instruments currently seek to protect the interests of employees when a Firm exits. Such protections exist for employees of Firms that are exiting through either business rescue or

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<sup>386</sup> Vote 37, Schedule 1 of the Appropriation Act 4 of 2018.

<sup>387</sup> As done in merger regulation in terms of section 12A(3)(b) of the Competition Act. See also *Duan et Cie AG and Kolosus Holdings Limited* (10/LM/Mar03) para 126 where the Tribunal held that “*because of the powerful link between direct employment loss and a restructuring initiative like a merger, it is undoubtedly in this area that the legislature intended a role for the competition authorities.*”

liquidation proceedings. In addition to such protections, there are also instruments that seek to promote employment.

392. The National Treasury applies the NRF funds to, *inter alia*, stimulate job creation. A competition law fine is ultimately paid to the NRF which can then be applied to such job creation projects. This creates a tension between the possible policy instruments that may be applied for employment i.e., employment protection through Ability to Pay versus job creation through the fine. The legislature seems to be best placed to make such policy decisions on whether Ability to Pay should include a consideration of employment effects.
393. In any event, “employment effects” as a separate factor is not material to the ultimate outcome based on the other factors. Chapter 4 applies the proposed factors to hypothetical Ability to Pay scenarios. Applying these factors to such facts results in outcomes that are aligned with protecting employment. Adding an “employment effects” factor would not change the outcome when applying the other proposed factors.

## CHAPTER 4: TESTING THE FACTORS

394. Chapter 3 distilled the proposed factors for Ability to Pay from Chapter 2's regulatory and case law groundwork. Chapter 3 provided further details from other areas of law and research to gain a better understand of what the proposed factors entail.
395. Chapter 4 uses hypothetical facts to test for possible interactions between the proposed factors. An additional purpose of these tests is to gauge the proposed factors' likely efficacy in extreme and complex scenarios.
396. As a summary of the above chapters, this paper proposes the following factors when considering Ability to Pay:
- 396.1. *A Fine*: That the Tribunal may impose in accordance with section 59 based on the six-step methodology or Fining Guidelines.
- 396.2. *Causes*: Through the application of the "but for" test to determine whether an event, other than the fine, is the probable cause of the Firm's exit or whether the fine is the sole cause.
- 396.3. *Firm's exit*: Probable exit may be indicated by showing that the fine would lead to commercial insolvency where the ultimate outcome is exit (liquidation or business rescue winding-up) and not rehabilitation through creditors implementing a business rescue plan.
- 396.4. *The effects of the Firm's exit on competition*: Determining the Firm's current competitive constraint on competitors and comparing this position to a competitive process in a counterfactual without the Firm.

397. This chapter seeks to pressure test these proposed factors through thought-experiments to determine whether applying these factors results in anomalous outcomes. In addition, these hypothetical facts include possible employment losses to test the above proposal that employment effects should not be a self-standing factor.
398. These thought experiments start with hyperbole to establish the two extremes of the spectrum where the factors should perform well. The thought experiments then progress to more controversial situations that may result in ambiguous results. Applying the proposed factors to less obvious facts should show how the factors interact with each other when the facts pull in different directions.
399. Chapter 5 follows with an investigation into the period after a fine has been levied. Chapter 5 analyses whether the proposed factors, tested in Chapter 4, are still applicable after a fine has been levied.

### **Extreme Facts**

Firm can pay fine and continue

400. In this scenario, a large successful Firm contravenes the Competition Act and agrees to pay a fine of 8% of its relevant annual turnover. The consent order is confirmed by the Tribunal and the Firm pays the fine.
401. By paying the fine, the Firm does not place itself in a commercially insolvent position and is able to pay all its debts when they fall due. The Firm continues to trade and employ all its employees going forward. The Firm is also in a very

competitive market containing many innovative Firms with other potential competitors that can easily enter and compete.

402. In this case, the “but for” test does not have to be applied as the company will not exit. In other words, the fine cannot be the factual cause of an imminent exit. Similarly, there is no effect on the competitive process as the structure of the market will not change.
403. Application of the above factors to these facts indicates that Ability to Pay should not be considered by the Tribunal and is unlikely to be raised by the Firm.

Fine will cause exit of competitive Firm

404. In this case, a Firm engaged in prohibited conduct and the Commission seeks a 3% fine of its relevant annual turnover. The Firm raises Ability to Pay during the hearing.
405. The Firm submits that the fine will put it into a commercially insolvent position which would force it to be wound-up by creditors. This submission is based on its constrained cash-flow after it pays the fine and evidence from its creditors that they would not support recovery through business rescue proceedings. The Firm submits that paying a fine larger than 0.5% of its relevant turnover in instalments would result in it defaulting on its debts.
406. The proffered reason for its constrained cash-flow is that it recently suffered a factory fire and requires a year to replace machinery and start running them efficiently again. In the meantime, the Firm is struggling to produce stock to

meet increasing demand for its products but expects to be operating at full capacity within a year.

407. The Firm is a recent start-up and incurred significant debt to invest in the necessary equipment. It does not have access to any other funding from external financiers or affiliated companies. The Firm's major creditors are not willing to support it through business rescue proceedings and have indicated that they would prefer to have the firm wound up to recover their money.
408. The Firm is a maverick in a market with only one other competitor. The established Firm has had a monopoly for several years owing to regulatory and other barriers to entry. The new entrant seeks to aggressively compete with the established Firm and disrupt the *status quo* through innovative technology. The entrant's technology provides a superior and cheaper product that also avoids onerous and costly regulatory approval through technological differentiation.
409. As a start-up, the Firm has many employment opportunities and currently employs 600 employees with plans to expand to thousands.
410. When applying the "but for" test to these facts, the Tribunal is likely to find that the fine is the probable factual cause of the Firm's expected exit. The evidence shows that without the fine the Firm would continue to operate, albeit hobbled for about a year, but levying the fine now would place it in a commercially insolvent position.
411. The evidence indicates that the market currently contains two competitors. If the new entrant exits the market, a monopolist will remain and enjoy the

protection of high barriers to potential entrants. This outcome would change the structure of the market and remove any competitive constraints from the established Firm. This result would negatively impact the competitive process by removing the only competitor in the market.

412. The application of these factors indicates that a softening of a fine is required as the fine is the factual cause of the Firm's exit and its exit would negatively affect the competitive process. In addition, a softening of the fine is expected to have a positive effect on employment where the new entrant intends expanding employment opportunities.
413. As a result, the Tribunal may use the above factors to come to the decision to impose an appropriate payment plan so the Firm's cash-flow can accommodate the payment of the fine. Interest may also be applied so the real value of the fine is not eroded over time.

#### Fine does not cause exit in competitive market

414. In this matter, the Commission seeks a fine of 8% of the Firm's relevant annual turnover for its active participation in a long-running prohibited practice. During the hearing, the Firm submits that the fine will cause it to exit as it is currently financially constrained.
415. During the hearing, the Tribunal hears that the Firm's management recently decided to re-brand its products and increase prices. Management decided to increase its marketing budget and invest in a new ostentatious office building to attract high-value customers.

416. Funding for the re-brand was acquired from loans and from money budgeted for upgrading and maintaining its machinery. The Firm also decided to outsource all its personnel requirements so it could reduce or increase staff when needed.
417. The evidence shows that the Firm's many competitors chose to innovate and improve their production efficiency and output. These other Firms vigorously compete for customers who are generally sophisticated and frequently switch suppliers.
418. Customers reacted to the Firm's rebranding and increased prices by moving away to its more innovative competitors. Customers also moved to the more efficient competitors after the Firm's aging machinery caused a significant decrease in the Firm's quality.
419. In response, the Firm's advisors recommended that the Firm be placed in business rescue as the Firm's cash-flow was declining and the Firm may not be able to pay its debts in the next six months. Most concerning for the advisors was the financing for the new building which was not being paid and had accumulated to millions.
420. The creditor that financed the building has given the Firm six months to pay the outstanding amount or it will apply to have the Firm wound-up. Notwithstanding these concerns, the Firm's management obstinately refused to initiate business rescue proceedings as management thought it would negatively affect its prestigious brand. The Firm sought to trade out of these financial difficulties by increasing the marketing budget to include lavish roadshows.

421. During the hearing, the Tribunal heard testimony from a business rescue practitioner that the Firm's business could not be saved through business rescue. Her opinion was that it had fallen behind its more innovative competitors and should be wound-up by selling the Firm's obsolete machinery for scrap.
422. Applying the "but for" test to the above scenario indicates that the proposed fine is not the cause of the Firm's impending exit. The evidence indicates that the Firm's profligacy and strategic blunders will lead to it being wound-up from commercial insolvency within the next six months. Business rescue will also not allow the Firm to recover. Imposing the fine before this time may accelerate the Firm's exit but removing the fine would not prevent exit.
423. From the evidence, the Firm is inefficient and has lost market share to competitors. Competitors were able to out compete the Firm based on price and product quality within a proper functioning competitive process. This indicates that the market is competitive and that the competitive process will remain competitive if the Firm exits.
424. Based on these factors, Ability to Pay submissions should be rejected and the full fine imposed. However, the Commission may not recover the full fine as there may be insufficient funds remaining after winding-up the Firm to satisfy all unsecured non-preferent creditors.<sup>388</sup>
425. In this unusual example, the employment effect of Ability to Pay does not feature as the Firm does not have any employees. The next example explores

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<sup>388</sup> Paragraph 279 above.

significant employment effects in a competitive environment where the fine does not cause exit.

#### Significant job losses

426. To explore the effect of job losses on such extreme facts, we first apply the facts from paragraph 404 above headed "*fine will cause exit of competitive firm*". In this illustration, both factors call for a softening of a fine to avoid the exit of a competitive Firm in a highly concentrated market where the competitive process is constrained. For purposes of exploring the impact of possible job losses, we add the prospective loss of all 2000 jobs at the Firm.
427. In this case, the employment effect of Ability to Pay does not disturb the conclusion from the other factors that the fine should be softened. The fine is softened to avoid a competitive Firm exiting a concentrated market which means that the Firm continues to employ its staff. Based on these facts, there is no conflict between the proposed factors and the effect on employment.
428. However, a conflict does arise when we apply the facts from paragraph 414 above headed "*fine doesn't cause exit in competitive market*". In that case the Firm's own blunders will cause its exit as it is being out competed in a proper functioning competitive process. To explore the employment effects of Ability to Pay on these facts, we change the facts to the Firm having 5 000 employees.
429. As above, the fine is not the factual cause of the Firm's exit. In addition, the competitive process is robust and rewards the Firm's more efficient and innovative competitors while also allowing customers to leave the Firm for

better quality and lower prices. The Firm's exit will, however, now lead to a jarring 5 000 job losses.

430. In this example, softening the fine will not save or create employment opportunities. The "but for" test indicates that the Firm's commercial decisions are the probable cause of its exit, not the fine. The competitive process has rendered the Firm obsolete and will force it to exit the market. The Firm's exit and resultant job losses are inevitable.
431. In addition, the softening of the fine directs resources, destined for the NRF, into an inefficient and floundering Firm. Such funds may be more productively used by National Treasury to possibly stimulate job creation if the Commission can recover some portion of the fine.

### **Complex Facts**

Fine is not cause of exit, but competition is constrained

432. For this thought experiment, the Commission seeks a fine amounting to 6% of the Firm's relevant annual turnover for its involvement in an international prohibited practice. During the Tribunal's hearing, the Firm raises Ability to Pay.
433. The Firm indicates that it recently bid for a large government contract. The Firm states that it may have to close if it is not awarded this contract and still pay the fine. In addition, the Firm indicates that it is also exploring possible further business to decrease its exposure to such tenders.

434. In its submission, the Firm indicates that it recently bid to construct a new presidential statue. The outcome of its bid will be communicated in three months from the hearing. The Firm submits that if it is not awarded this project, it will become commercially insolvent as it will have to pay fines for its anti-competitive conduct in other jurisdictions as well. Its recent bid is significant for the Firm as demand for statues is infrequent and normally put out to tender by the State.
435. The Firm is, however, exploring other possible business opportunities from large corporates in South Africa. With enough private sector business, the Firm may be able to continue trading for the foreseeable future.
436. Currently, the Firm is the second specialised statue supplier in the country. The incumbent statue supplier enjoyed State protection a few years as the only State-appointed supplier. It is now open to market forces but still enjoys a level of protection from competitors as constructing a statue requires large amounts of capital including safety equipment and training.
437. A new entrant requires some time to establish itself and gain the required safety accreditation. The contravening Firm is the first Firm to successfully enter and compete with the incumbent supplier.
438. Constructing a statue is labour intensive and the Firm currently employs 1 000 employees which will increase should the Firm be awarded the tender.
439. After considering the evidence, the Tribunal finds that the “but for” test does not indicate that the fine is the factual cause of the Firm’s possible exit. Should the Firm exit, it would result from the Firm not being awarded the tender and

not securing enough private sector business to continue trading. However, there is uncertainty whether the Firm will secure enough business to continue trading for the foreseeable future. The Tribunal may resolve this uncertainty by finding against the Firm as the bearer of the onus to prove Ability to Pay.

440. Based on the available evidence, the Tribunal also finds that the competitive process would be adversely affected by the Firm's exit as the remaining supplier would then be unconstrained by any competition.

441. In this matter, the factors pull in opposite directions. However, the causation factor acts as a gateway factor to competitive effects as the CAC indicated that the fine "*should not, on its own, be destructive of the offending party's business.*"<sup>389</sup> This seems intuitive as competitive effects are inevitable where the "but for" test finds that the fine is not the cause of the Firm's exit. In such situations, a softened fine would, unfortunately, not save the Firm from exiting which results in the undesirable competitive outcomes.

442. These facts also create the result that the "but for" test could return opposite conclusions depending on the occurrence or non-occurrence of a future event. If convenient, the Tribunal's may postpone the hearing until the bid is awarded or private sector business is secured to provide greater certainty to its "but for" finding that the fine is not the sole cause of exit. This avoids reliance on onus to resolve such uncertainty where significant anti-competitive effects are predicted.

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<sup>389</sup> From paragraph 113 above.

443. Similarly, where there is little doubt that the Firm will exit for reasons other than the fine, job losses cannot be avoided by softening the fine. In such situations, employment effects do not conflict with the application of the other factors.

#### Fine is cause of exit in competitive market

444. For this thought experiment, the facts from 404 to 407 above are repeated. As with the above example, the contravening Firm suffered a fire but will be able to pay its debts if the fine is softened. For purposes of this example, the market is competitive with a plethora of efficient competitors all vying for the Firm's customers.
445. When applying the "but for" test, the Tribunal finds that imposing the fine would be the sole cause of the Firm's exit. The evidence in this case points to a well-functioning competitive environment with many competitors that would force inefficient Firms out of the market.
446. On the facts of this example, the competitive process is robust and would be mainly unaffected whether the fine is softened, or the Firm exits. However, enforcing the fine solely based on a healthy competitive process would mean that the Commission and not the competitive process is removing the Firm. The Commission would be deciding to remove the Firm before the competitive process is able to do so organically through competition.
447. As submitted above, the health of the competitive process in the market would become relevant where the competitive process is not functioning well. Where the competitive process is functioning properly, enforcing a fine that is the sole

cause of exit to remove a Firm which the Commission views as inefficient would undermine the competitive process.

448. On such facts, factual causation pulls towards the fine being softened and the effect on competition is neutral.
449. On these facts, potential job losses resulting from the fine would not affect the outcome. In situations where the fine is the cause of the Firm's exit and the competitive process is healthy, jobs are likely to be saved from softening the fine.

## CHAPTER 5: ABILITY TO PAY AFTER FINE IS LEVIED

450. As mentioned above in Chapter 2, consent orders may include payment terms that contemplate instalments over many years.<sup>390</sup> Similarly, the Tribunal has previously delayed the payment of a fine it imposed.<sup>391</sup> This raises the possibility of a change in circumstances prompting the Firm to raise Ability to Pay.
451. The Commission's Fining Guidelines do not expressly contemplate this situation of Ability to Pay after a fine is levied. This contrasts with the EU Information Note on Ability to Pay which expressly opens the possibility when, for instance, the fine is under appeal.<sup>392</sup>
452. The factors for evaluating Ability to Pay are distilled in Chapter 3 and then tested in Chapter 4. However, these chapters contemplate the factors being applied by the Tribunal when calculating a fine against a Firm.
453. Chapter 5 explores the situation after a fine has been levied and whether the proposed factors in Chapter 3 are still applicable in such a situation.

### Statutory Variation

454. As described above, delayed payment of a fine creates the possibility that the Firm's Ability to Pay may change after a fine has been levied. The Tribunal may pre-empt this and indicate in its order that the parties may approach it in the future based on changed circumstances.<sup>393</sup> Without this ability, the Firm

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<sup>390</sup> Paragraph 124 above.

<sup>391</sup> *Competition Commission v South African Airways (Pty) Ltd and others* (83/CR/Oct04) 31 para 88.

<sup>392</sup> Paragraph 181 above.

<sup>393</sup> Paragraph 124 above.

would need to approach the Tribunal to vary its order in terms of the Competition Act.

455. Section 66 of the Competition Act provides that:

*“The Competition Tribunal, or the Competition Appeal Court, acting of its own accord or on application of a person affected by a decision or order, may vary or rescind its decision or order—*

- (a) erroneously sought or granted in the absence of a party affected by it;*
- (b) in which there is ambiguity, or an obvious error or omission, but only to the extent of correcting that ambiguity, error or omission; or*
- (c) made or granted as a result of a mistake common to all of the parties to the proceedings.”*

456. The CAC observed that section 66 is modelled on Rule 42 of the Uniform Rules of Court, Superior Courts Act 10 of 2013 (“**High Court Rules**”).<sup>394</sup> Owing to this connection, the principles developed for High Court Rule 42 are helpful in interpreting section 66 of the Competition Act.<sup>395</sup> The CAC also reiterated the principle that once the Tribunal issues a final order, it has exercised its jurisdiction and has no authority to subsequently alter its order. In other words, the Tribunal is *functus officio*.<sup>396</sup>

457. The exceptions to this finality principle are contained in section 66 and include “*obvious error*” in terms of section 66(b) or “*common mistake*” under section 66(c), which are explored below.<sup>397</sup>

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<sup>394</sup> High Court Rules were issued in terms of the Supreme Court Act 59 of 1959 which was repealed by the Superior Courts Act.

<sup>395</sup> *Mike’s Chicken (Pty) Ltd and others v Astral Foods Limited* (32/CAC/Sept03) 17 para 13.

<sup>396</sup> *Mike’s Chicken (Pty) Ltd and others v Astral Foods Limited* (32/CAC/Sept03) 18 para 13

<sup>397</sup> *Boart Longyear (a division of Anglo Operations Limited) and Huddy (Pty) Ltd and another* (41/LM/Aug03) 19 April 2004, 4 para 18.

## Obvious error

458. In relation to section 66(b) of the Competition Act, the Tribunal held that:

*“A patent error has been described as ‘an error as a result of which the judgment granted does not reflect the intention of the judicial officer pronouncing it.’ ... the patent error must be attributable to the Court itself... where the terms of the judgment do not reflect the true intention of the presiding judge.*

...

*Thus, to succeed with this line of argument, the parties must show that a patent error in the order was engendered by the Tribunal.”<sup>398</sup> (emphasis added)*

459. A Firm would be hard-pressed to show that a previously imposed fine was an obvious error by the Tribunal that is inconsistent with the Tribunal’s true intentions to not impose such a fine. The Tribunal’s intentions regarding the imposition of a fine at the time of the order are reflected in its order. A change of circumstances after the order is granted is irrelevant to the Tribunal’s intention at time of the order.

460. The ostensible error is also not obvious from the order itself. The Firm can only raise the alleged error when its circumstances change. The Firm accepts the order as a true reflection of the Tribunal’s intention to impose such a fine when the order is granted. However, the Firm then questions the Tribunal’s intention to levy such a fine after circumstances change.

461. The Firm is not questioning the Tribunal’s intentions about the fine but is impugning the Tribunal’s conclusions of fact relating to possible changes in

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<sup>398</sup> *Boart Longyear (a division of Anglo Operations Limited) and Huddy (Pty) Ltd and another* (41/LM/Aug03), 19 April 2004, para 21.

circumstances that impact the Firm's ability to pay the fine. The soundness of the Tribunal's reasoning on factual evidence is irrelevant to whether the order reflects the Tribunal's true intention.<sup>399</sup> Any dissatisfaction with the Tribunal's factual conclusions would need to be appealed.<sup>400</sup>

462. It seems that a subsequent change of circumstances does not change the Tribunal's intention to impose a certain fine when issuing the order. The ostensible error is not an obvious error contemplated by section 66(b) of the Competition Act. The error is more with predicting future circumstances that may impair the Firm's Ability to Pay the fine.

#### Common mistake

463. In relation to the section 66(c) of the Competition Act, the Tribunal has held that the mistake must be common to all parties, including the Tribunal.<sup>401</sup> In addition, the Tribunal held that:

*"there must be a causative link between the mistake and the grant of the order or judgment... that the mistake relate to and be based on something relevant to the question to be decided by the Court at the time. The principle is that fresh evidence, not relevant to any issue that had to be determined when the order was made, cannot subsequently be used to create a retrospective mistake."*<sup>402</sup> (emphasis added)

464. Put differently, the "fresh evidence" on a change of circumstances was not before the Tribunal when it decided the matter and does not show that any

<sup>399</sup> *Saetle v Protea Assurance Co Ltd* 1984 (2) SA 537 (C) 541C-E.

<sup>400</sup> Section 37(1)(b) excludes consent orders from the CAC's appeal jurisdiction and the CAC has a limited discretion to interfere with section 59 fines on appeal. See *Federal Mogul Aftermarket Southern Africa (Pty) Ltd v Competition Commission* (33/CAC/Sep03) 45.

<sup>401</sup> *Boart Longyear (a division of Anglo Operations Limited) and Huddy (Pty) Ltd and another* (41/LM/Aug03), 19 April 2004, 7 para 33.

<sup>402</sup> *Boart Longyear (a division of Anglo Operations Limited) and Huddy (Pty) Ltd and another* (41/LM/Aug03), 19 April 2004, 7 para 34.

evidence that was previously before the Tribunal is unreliable.<sup>403</sup> It does not necessarily follow from newly submitted evidence that a common mistake resulted from trustworthy evidence previously before the Tribunal.<sup>404</sup>

465. There is no mistake at the time of the order and the Firm did not raise the possibility of the change of circumstances during the hearing.<sup>405</sup> It can only allege such mistake when circumstances change and then bring its unilateral<sup>406</sup> mistake to the attention of all other parties.<sup>407</sup>
466. These flaws become glaring when the fine is ordered in terms of a consent order. In terms of the consent order, the Firm agrees to pay a certain fine but then subsequently argues common mistake between all parties based on the vagaries of its own fortunes.
467. Based on the above, the Firm's inability to pay owing to a subsequent change of circumstances is not a common mistake contemplated by section 66(b) of the Competition Act. Should the Firm take issue with the Tribunal's finding of fact regarding a possible change in circumstances, its next step is to appeal the Tribunal's factual finding.<sup>408</sup>

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<sup>403</sup> *Tshivhase Royal Council and another v Tshivhase and another; Tshivhase and another v Tshivhase and another* 1992 (2) All SA 511 (A) 522 where the Court contrasted fresh evidence with evidence aimed at showing that the evidence underpinning the order is incorrect.

<sup>404</sup> *Ex parte Barclays Bank* 1936 AD 481 484-486 where the Court held that the need to lead new evidence was fatal to the application based on common mistake.

<sup>405</sup> *Seedat v Arai and another* 1984 (1) All SA 127 (T) 129 where the Court held that an issue was irrelevant to the question of common mistake because it was not raised during the hearing.

<sup>406</sup> *Roelof Ernst Botha v Road Accident Fund* (463/2015) [2016] ZASCA 97 (2 June 2016) 4 para 9.

<sup>407</sup> *Seedat v Arai and another* 1984 (1) All SA 127 (T) 130 where the Court held that discovering fresh facts or conceiving of a new defence after judgment was not contemplated by the legislature for common mistake.

<sup>408</sup> See footnote 400 above.

## Change of circumstances

468. Notwithstanding the above, the Tribunal recently indicated that it would consider a further ground for variation of a consent order. In *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) (“**Foskor Case**”) held that it could vary a consent order in terms of section 27(1)(d) of the Competition Act based on changed circumstances.

469. Section 27(1) provides that

*“(1) The Competition Tribunal may-*

*...*

*(d) make any ruling or order necessary or incidental to the performance of its functions in terms of this Act.”*

470. In this matter, the Commission found that Foskor (Pty) Ltd (“**Foskor**”) had contravened section 8(a) by charging an excessive price by:

*“charging local (domestic) customers a Free-on-Board Richards Bay price (‘the FOB price’) plus a 75% notional (not actual) freight cost of shipping the product to India.”<sup>409</sup>*

471. In 2011, the Tribunal confirmed a consent agreement in which Foskor admitted to contravening section 8(a) by charging an excessive price to local consumers which included a notional freight-cost to India. To assuage the Commission’s concerns relating to such conduct, Foskor agreed:

*“not to revert to its past pricing policy for the sale of phosphoric acid, phosphate rock, MAP and DAP. This policy comprised of an import parity benchmark for phosphoric acid which included notional freight charges to*

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<sup>409</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 3 para 9.

*India. Henceforth, Foskor will charge a price based on the [free-on-board] Richards Bay Port in respect of phosphoric acid.*<sup>410</sup> (emphasis added)

472. In 2014, however, Foskor started charging local customers above the agreed free-on-board Richards Bay Port price for phosphoric acid (“**FOB Price**”). One of Foskor’s local customers, Omnia Group (Pty) Ltd (“**Omnia**”), approached the Commission to investigate Foskor’s pricing and successfully applied to the High Court to compel Foskor to sell its phosphoric acid at the agreed FOB Price in the consent order.

473. Foskor then applied to the Tribunal for variation of the consent order. Foskor sought variation of the pricing provision in the consent order on the grounds of changed circumstances/hardship.

474. In the meantime, the Commission had investigated Omnia’s complaint of non-compliance against Foskor and had found *“that Foskor’s pricing for phosphoric acid during the investigated periods was below cost, indicating that the excessive pricing concern had fallen away.”*<sup>411</sup> Based on its findings, the Commission supported Foskor’s application that the consent order should be amended to remove the restriction that Foskor had to charge the FOB Price from Richards Bay by replacing it with:

*“Foskor undertakes not to revert to its pricing policy for the sale of phosphoric acid, phosphate rock, MAP and DAP. This policy comprised of an import parity benchmark for phosphoric acid which included notional freight charges to India.”*<sup>412</sup>

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<sup>410</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 4 para 12.

<sup>411</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 7 para 32.

<sup>412</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 3 para 12.

475. The Tribunal granted the variation based on its powers in section 27(1)(d) finding that:

*“section 27(1)(d) interpreted in accordance with the Constitution and having regard to foreign law must include the Tribunal's power to amend/vary a consent order on the grounds of changed circumstances or hardship. Our discretion under section 27(1)(d) would be exercised here as a necessary function of our regulatory mandate under the Act, which is to regulate the conduct of firms in markets.”*<sup>413</sup> (emphasis added)

476. The Tribunal reasoned that consent orders are different from settlement in private disputes as the *“Commission represents a public interest namely the promotion of competition and the prevention of abusive conduct by dominant firms in markets.”*<sup>414</sup> Unlike civil settlements which concludes the dispute between the parties, consent orders may include behavioural remedies which:

*“often require the respondents to show ongoing compliance with the agreed behavioural remedy, including reporting obligations and the Commission customarily continues to exercise its monitoring function as a regulator with general oversight functions over a particular market.”*<sup>415</sup>

477. The Tribunal recognised that such behavioural remedies are susceptible to changes in circumstances:

*“The pricing of a firm is however a dynamic process because inter alia the costs of the firm to produce or sell the specific product or service may change over time. It is impossible at the time of imposing a pricing remedy to foresee all future changes in a market, which could lead to detrimental consequences to the firm.”*<sup>416</sup>

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<sup>413</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 21 para 83.

<sup>414</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 13 para 49.

<sup>415</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 13 para 50.

<sup>416</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 14 paras 56 and 57.

478. The Tribunal held that, at the level of principle, *“respondents cannot be denied relief from the Tribunal in changed circumstances or hardship because to do so would not be accordance with the mandate and functions of the Tribunal.”*<sup>417</sup> The Tribunal found support for this principle from the Constitutional Court’s view *“that the Tribunal should not adopt an over-technical approach to parties seeking relief when the subject matter of the dispute falls within the mandate of the Tribunal.”*<sup>418</sup>
479. The Tribunal found further support from American jurisprudence when it held that:
- “It is clear from the above decisions of the US Courts, that the modification of a consent decree is permitted under certain appropriate circumstances including when the enforcement of the decree without modification will be detrimental to the public interest.”*<sup>419</sup>
480. The Tribunal grounded its powers in section 27(1)(d) and its general mandate to promote *“competition and economic growth”*<sup>420</sup> and specifically on its function *“to regulate the conduct of dominant firms such as Foskor.”*<sup>421</sup>
481. The Tribunal ultimately held that *“when read in [the] context of the Act, and the Constitution, the Tribunal’s powers under section 27(1)(d), must necessarily include the power to vary for changed circumstances or hardship.”*<sup>422</sup>

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<sup>417</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 15 para 58.

<sup>418</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 16 para 64. referencing *Competition Commission of South Africa v Hosken Consolidated Investments Limited and Another* [2019] ZACC 2.

<sup>419</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 81 para 20.

<sup>420</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 14 para 54.

<sup>421</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 17 para 68

<sup>422</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 17 para 70 also referencing *Zondi v Member of the Executive Council for Traditional and Local Government Affairs and Others*

482. The Tribunal did warn, however, that:

*“This does not mean that every case that is brought to the Tribunal on the grounds of changed circumstances or hardship should be granted. Our discretion under section 27(1)(d) should only be exercised when warranted and in cases where we do intervene such intervention must be in accordance with the principle of legality, transparency and fairness as required by the Act.”<sup>423</sup> (emphasis added)*

483. The Tribunal explained these concepts by indicating that:

*“This particular case is concerned with a consent order that was granted under section 49D. The jurisdictional threshold for an amendment would therefore require investigation by and agreement from the Commission. The principles of transparency and fairness would be met by conducting the hearing of the merits of the amendment in public and granting interested parties an opportunity to make submissions.”<sup>424</sup> (emphasis added)*

#### Application to Ability to Pay

484. After the Tribunal confirms a fine or a consent order, the order may be varied in terms of section 66 of the Competition Act. However, it seems that a Firm would be hard-pressed to show that the grounds in section 66 are applicable.

485. Based on the above analysis, the change of circumstances is not an obvious error relating to the Tribunal’s intentions to impose the fine. It is also not an error that is common to all the parties based on the facts available at the time of the decision.

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(CCT73/03) [2005] ZACC 18 to allow the grounds for variation to be expanded to meet the exigencies of the time.

<sup>423</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 18 para 74.

<sup>424</sup> *Foskor (Pty) Ltd v Competition Commission and others* (CO037Aug10/VAR240Feb165) 18 para 73.

486. The Tribunal has provided a further ground for variation outside of section 66. The Tribunal has held in the Foskor Case that section 27(1)(d) of the Competition Act may be relied upon where changed circumstances results in hardships after an order has been made. The Tribunal's reasoning seems equally applicable to Ability to Pay.
487. Changed circumstances contemplated by the Tribunal seem to include Ability to Pay where such changed circumstances cause hardship for the Firm. The Tribunal's comments that behaviour remedials are susceptible to changes in circumstance seems equally applicable to settlement amounts that need to be paid over a long period.
488. The Tribunal also included its other functions in the Competition Act to justify coming to the aid of a Firm experiencing hardship. It will be interesting to see whether the Tribunal's general functions such as promoting competition will be sufficient to found jurisdiction under section 27 for Ability to Pay or whether the Tribunal will require a more specific power, such as in the Foskor which regulated the conduct of a dominant Firm.
489. It may well be argued that the overriding principle of fairness when confirming a settlement amount is such a specific function. If sufficient, such a specific function could also be extended for the duration of the consent order like a behavioural remedy.
490. The Tribunal did, however, require an investigation and support by the Commission to found jurisdiction to consider changed circumstances. Such an investigation by the Commission may very well include the Ability to Pay

factors proposed in this paper including financial ratios and indicators of commercial insolvency.

## CHAPTER 6: RECOMMENDATIONS

491. This chapter summarises the research by listing the factors that have been distilled from the research. This chapter then recommends that these factors form part of the Tribunal and Commission's consideration of Ability to Pay both before and after a fine is levied.

### Summary of research

492. Chapter 1 describes the relevant factual background which informs the problem for research. Chapter 1 indicates that Ability to Pay is currently a nascent concept in South African competition law. Owing to such novelty, the relevant factors for considering Ability to Pay have not yet been considered casuistically over time. To assist with this problem, this paper sought to propose the factors for evaluating Ability to Pay.

493. Chapter 2 begins the presentation research for this problem by setting out the relevant provisions of the Competition Act to provide the necessary statutory background for approaching Ability to Pay. This statutory background provides the context for understanding the case law that forms the foundation of Ability to Pay in South Africa.

494. This legal framework for Ability to Pay is then compared to the EU experience in Chapter 2. This comparison explores whether certain concepts from the EU experience are similar to South Africa's understanding of Ability to Pay and whether the EU experience can inform South African thinking about Ability to Pay.

495. Chapter 3 distils the proposed factors for evaluating Ability to Pay from Chapter 2's legal groundwork on Ability to Pay. Chapter 3 then goes further by exploring other areas of law and research to give a fuller understanding of the factors proposed in Chapter 3.
496. Chapter 4 puts Chapter 3's factors to the test through hypothetical scenarios. The purpose of these tests is to see whether there are any interactions between the factors when applied together and whether the ultimate outcomes seem intuitively reasonable.
497. Chapter 5 diverges from the previous chapters as the previous chapters all contemplate an application of the proposed factors before levying a fine. Chapter 5 explores a different temporal aspect as it investigates the period after the Tribunal levies a fine. Chapter 5 investigates whether the factors for considering Ability to Pay may also be applicable after a fine has been levied.

### **Recommendations: Proposed factors for Ability to Pay**

498. As described in this paper, the problem currently facing Competition Authorities is that the CAC has recognised the possibility of Ability to Pay but the Competition Authorities have minimal experience with Ability to Pay arguments.<sup>425</sup> This means that the relevant factors for evaluating Ability to Pay have not yet developed over many cases. To assist with this process, this paper recommends that the following factors be considered as part of an Ability to Pay analysis:

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<sup>425</sup> Paragraph 11 above.

- 498.1. *The proposed fine*: Determined in accordance with section 59 which may be through the application of the Tribunal's six-step method or Fining Guidelines.<sup>426</sup>
- 498.2. *Probable exit*: Imposing the proposed fine would probably result in the Firm's exit either through liquidation or winding-up through business rescue proceedings. A useful indicator of such exit is commercial insolvency resulting from the fine. However, such anticipated exit should be of such a nature that exit would not be prevented by a creditor compromise and/or restructuring in terms of a business rescue plan.<sup>427</sup>
- 498.3. *Causation*: The "but for" test is applied to determine whether the fine is the sole probable factual cause of the Firm's exit or whether another cause leads to the Firm's exit.<sup>428</sup>
- 498.4. *Competitive effects from Firm's exit*: Analysis borrowed from Merger control, such as the failing firm factor, are applied to determine the probable competitive effects of a Firm's exit. Where significant negative competitive effects are probable, the Tribunal may be prompted to use its inquisitorial powers or procedural powers of postponement to gain greater certainty on whether such harmful effects can be avoided by softening the fine.<sup>429</sup>
499. This paper submits that possible negative employment effects from the Firm's exit should not be included in Ability to Pay. Employment considerations in the Competition Act are policy considerations that require legislative intervention

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<sup>426</sup> Chapter 2 above.

<sup>427</sup> Chapter 3 above.

<sup>428</sup> Chapter 3 above.

<sup>429</sup> Chapter 3 above.

to be considered for Ability to Pay. Such amendments to the Competition Act need to be balanced against other employment policies, including the State's creation of employment opportunities which are partially funded by fines.<sup>430</sup>

500. As indicated in Chapter 5, the proposed factors seem to be applicable even after a fine is imposed. Ability to Pay factors may be useful to the Tribunal and/or Commission when determining whether to vary a settlement amount in a consent order or fine in an order based on changed circumstances.

### **Further research**

501. As mentioned in Chapter 1, the scope of this paper does not extend to what occurs after applying the proposed factors and concluding that the fine should be softened based on Ability to Pay. This limitation excludes an evaluation of how to determine an appropriate discount to a fine and the appropriate form of such a discount i.e., payment plan or absolute discount.
502. This paper also assumes that Firms are raising *bona fide* arguments based on Ability to Pay. The possibility of Firms manipulating its financial statements and corporate structures to unjustifiably benefit from Ability to Pay falls outside the research. Exploring such possibilities would require research into other areas of law such as insolvency.
503. It is likely that the factors for considering Ability to Pay will be developed over time by the Commission, Tribunal and CAC. The legislature may also seek to

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<sup>430</sup> Chapter 3 above.

regulate the analysis of Ability to Pay to add public interest factors such as employment effects.

504. Based on such casuistic development of Ability to Pay, further research may be required after the first novel cases before the Tribunal focussing on Ability to Pay. Ability to Pay is currently developing in South Africa and may develop in a different direction to the factors proposed above. Further research may be needed to see whether the proposed factors stand up to real-world testing.
505. The aim of this research is to be useful to authorities and practitioners alike in approaching Ability to Pay and to spur further research and development on Ability to Pay. The current economically strained environment may result in Ability to Pay becoming more common place and requiring more thought and development.

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