

**Regulatory Standards as a means of creating a Barrier to  
Entry, the case of The Competition Commission  
and Netstar Vehicle Tracking.**

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## 1. Introduction

The recent Tribunal decision of Netstar<sup>1</sup> tracking (“Netstar”) has raised the issue of whether a regulatory body which sets standards for entry to industry can be used by competing firms as a means of preventing new entrants from entering the relevant market.

In the Netstar case the regulatory body tasked with setting industry standards was used as a means of creating a barrier to entry. This paper discusses the jurisdiction of the Competition Commission and the Tribunal in relation to barriers to entry created by regulatory bodies and discusses the various forms of barriers to entry. The paper proceeds to show the ways in which competing firms can be shown to have entered into an agreement to defeat competition. Finally we discuss the recent Netstar case, which is a clear illustration of how firms can act, in agreement, to use a regulatory body to set standards which operate as barriers to entry.

The topic, we believe, is relevant since in a growing economy such as South Africa there is perhaps a need to regulate new entrants to an industry so as to protect us the consumer from fly by night operators and their products which may harm the consumers. However South Africa must be careful not to allow over regulation of an industry and thereby prevent new firms and new technology from entering the market and must further ensure that, as in the Netstar case, that existing firms are not enabled by regulation to entrench their positions in a market so as to prevent new entrants to the market.

We trust that this paper will clearly illustrate the above while also providing a brief yet workable suggestion for future regulation of the growing South African Economy.

## 2. JURISDICTION: Conflict between the Jurisdiction of the Competition Commission and the Regulatory Body

Many industries in South Africa are governed by Regulatory bodies. The question may then arise as to whether a regulatory body has jurisdiction to hear a competition issue or whether this falls within the jurisdiction of the Competition Commission and the Tribunal.

This question arose and was determined in the recent Supreme Court of Appeal decision of *The Competition Commission of South Africa v Telkom SA Limited*<sup>2</sup>. The case dealt with the concurrent jurisdiction of the Competition Commission and ICASA (the Independent Communications Association of South Africa). The Commission investigated a complaint against Telkom for an alleged contravention of sections 8(a),(b),(c),(d)(i) and 9 of the Competition Act. Telkom sought to allege that neither the Commission nor the Tribunal had either the power or the competence to adjudicate the conduct of Telkom. What followed was the answer to the question of whether the Commission and the Tribunal have the Jurisdiction to adjudicate matters in which a Regulatory body, such as ICASA, also has the power to adjudicate the matter.

Telkom, which was established by the Post Office Act, Act 44 of 1958, had the exclusive power to conduct the telecommunications service. Telkom was however

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<sup>1</sup> *Competition Commission of South Africa and Tracetec (Pty) Ltd v Netstar (Pty) Ltd and three others*, case no: 17/CR/Mar05

<sup>2</sup> *Competition Commission of South Africa v Telkom SA Limited* [2009] ZASCA 155

obliged under the Post Office Act to lease the facilities to a person providing a telecommunication service. Should Telkom refuse to grant such a lease, ICASA was entitled and tasked with the adjudication of the dispute.

There were four complaints lodged against Telkom with the Commission and all related to the failure by Telkom to grant a licence of its facilities to the prospective licensees. The First Complaint related to a contravention of section 8(b) and (c) of the Act which provide:

*“It is prohibited for a dominant firm to*

*8(b) refuse to give a competitor access to an essential facility when it is economically feasible to do so;*

*8(c) engage in a exclusionary act, other than an act listed in paragraph (d), if the anti-competitive effect of that act out-weighs its technological, efficiency or other pro-competitive gain.”*

It was alleged that because although Telkom would grant a licence, that such licence included a restriction that the licensee was prohibited from *inter alia* providing private networks, reselling spare capacity and from carrying voice on behalf of the customers. These restrictions as alleged required the licensee not to compete with Telkom and thus enabled Telkom to maintain its dominance.

The second complaint related to Telkom’s refusal to lease the facilities to the licensees as principals and required the customers of the licensees to do so directly from Telkom.

The third related to Telkom’s excessive pricing or discriminatory pricing, in that Telkom charged its own customer a lower price than that of the licensees.

The fourth complaint against Telkom is that its refusal to provide facilities amounted to an exclusionary act in contravention of section 8(b).

The issue of Jurisdiction was raised when Telkom sought to rely on the defence that the four complaints laid against Telkom related to conduct which it was authorised to do by the Telecommunications Act or alternatively by ICASA. Section 3 of the Competition Act provides that the Act “*shall apply to all economic activity within, or having an effect within, the Republic*”. Originally a regulatory body such as ICASA would have had jurisdiction, since section 3(1)(d) which has now been repealed provided that the Act did not apply to acts which were subject to or authorised by public regulation. The acts of Telkom were authorised by the Telecommunications Act, however this section has been repealed and the Act has jurisdiction granted to it by the very broad section 3 of the Competition Act<sup>3</sup> (“the Act”).

However this leads to the concurrent jurisdiction of the Act alongside the jurisdiction granted to the regulatory body ICASA. The court looked at the primary object of the telecommunications Act, which is to “*provide for the regulation and control of telecommunication matters in the public interest*”. Telkom however contended that its conduct was authorised by the Telecommunications Act and that the legislature could not have intended the competition authorities to have the power to adjudicate on conduct which was authorised by an Act or Parliament, being the

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<sup>3</sup> Competition Act 89 of 1998

Telecommunications Act, or by the regulations made under the Act and authorised by the Regulatory body ICASA.

The Supreme Court of Appeal affirmed that the Act applies to all economic activity within or having effect within South Africa and that ICASA can not and does not have exclusive jurisdiction with regard to Telkom and went further to hold that the Competition authorities are the appropriate authorities to deal with the complaint.

There is thus no question that even though an Act of Parliament can authorise a code, or company to perform and act or to make a decision which is under the Act prohibited, that such conduct or decision is subject to the adjudication and scrutiny of the Act and the authorities established under the Act, namely the Competition Commission, Competition Tribunal and the Competition Appeal Court.

### 3. Barriers to entry

“Barriers to entry are factors which prevent or deter the entry of new firms into an industry even when incumbent firms are earning excess profits<sup>4</sup>.” These barriers can generally be described as either behavioural barriers or economic barriers to entry. Industry characteristics can be barriers to entry, such as demand, technology, costs and licenses. George Stigler “suggests that barriers to entry arise only when an entrant must incur costs which incumbents do not bear<sup>5</sup>.” Barriers to entry can often arise through collusions.

Collusion seems to suggest some sort of conspiracy or agreement to fix prices among sellers, in order to increase their profits. Collusions can be found without formal agreements, but is ultimately bad for the consumer. Collusion falls under section 4(1)(b) of the competition act, as previously mentioned, are per se contraventions and have no defences available to the offenders. Collusions are difficult to prove due to the conspiracy nature of the collusions, and that the parties to the collusions will attempt to avoid the authorities in all ways possible.

“Cases drawn from across different countries reveal that collusion may be reached through informal *gentlemen’s agreements* where mutual regard, social convention and personal contacts and connections provide sufficient basis for ensuring adherence to agreed prices and related business practices by members<sup>6</sup>.” Collusions could even result in the market sharing agreements. Associations can be evidence of collusions as they could coordinate “economic activities and exchange of information which may facilitate collusion<sup>7</sup>.”

“A dominant firm is one which accounts for a significant share of a given market and has a significantly larger market share than its next largest rival. Dominant firms are typically considered to have market shares of 40 per cent or more. Dominant firms can raise competition concerns when they have the power to set prices independently.” Dominant firms are generally in a strong position to collude with one another to lessen competition within a market.

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<sup>4</sup> O Economics *Glossary of industrial organization economics and competition law* accessed at [www.oecd.org/dataoecd/8/61/2376087.pdf](http://www.oecd.org/dataoecd/8/61/2376087.pdf) on 6 August 2010

<sup>5</sup> Ibid

<sup>6</sup> Ibid

<sup>7</sup> Ibid

Regulations and standards have been said to be in place to protect the consumer, but may in certain circumstances be a disguise to reduce competition within a particular industry. The regulation could be said to protect the standard of the industry, to ensure consumer confidence with the industry of product. Standards is said to refer “to defining and establishing uniform specifications and characteristics for products and/or services<sup>8</sup>.” Standards can act as a non tariff barrier to entry within the industry.

The creation of barriers to entry in some instances could be described as strategic behaviours, as the firms attempt to influence the industry or market within which they compete.

Conditions that constitute entry barriers may be structural or strategic.

Structural barriers have more to do with basic industry conditions such as cost and demand than with tactical actions taken by incumbent firms. Structural barriers may exist due to conditions such as economies of scale and network effects.

### **Other Countries**

American competition law is called the Sherman Antitrust Act 15 U.S.C (“Sherman”), and it “does not prohibit concentration in the form of oligopoly as long as it is the product of coordination, absent agreement. Interdependent, yet individual, decisions made on the basis of observed and expected price and output decisions by rivals are not actionable under the Sherman Act<sup>9</sup>.”

Concerted practices are not explicit under Sherman, but American courts<sup>10</sup> have considered conspiracy as constituting concerted practices. This is something less than a contract, but requires some form of agreement (which can be knowledge or understanding).

Higher entry barriers create opportunities for firms within that market to enjoy greater profits. There seems to have been two schools of thought with regard to barriers to entry, namely the Harvard school who derived most of their thought from J.S Bain, who “stressed that barriers to entry are necessary for undertakings with significant market share to acquire market power and reap monopoly profits<sup>11</sup>.” The Chicago School followed the works of Stigler who mentioned that “entry barrier analysis must distinguish between desirable entry and undesirable entry.<sup>12</sup>”

Three categories of barriers were identified in this paper<sup>13</sup>, namely legal, economic and strategic barriers. Legal barriers prevent new entrants by ways of governmental regulation (eg licensing). These barriers are generally not under competition law scrutiny. Economic barriers are generally linked to “production or proprietary

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<sup>8</sup> O Economics *Glossary of industrial organization economics and competition law* accessed at [www.oecd.org/dataoecd/8/61/2376087.pdf](http://www.oecd.org/dataoecd/8/61/2376087.pdf) on 6 August 2010

<sup>9</sup> Ibid

<sup>10</sup> Ibid page 5. Reference to the American cases *American Tobacco Company v United States* 328 U.S 781, 810 (1946) and *Monsanto Company v Spray Rite Corporation* 465 U.S. 752

<sup>11</sup> Oluseye Arowolo Application of the concept of barriers to entry under Article 82 of the EC Treaty: Is there a case for review?

<sup>12</sup> Oluseye Arowolo Application of the concept of barriers to entry under Article 82 of the EC Treaty: Is there a case for review?

<sup>13</sup> Oluseye Arowolo Application of the concept of barriers to entry under Article 82 of the EC Treaty: Is there a case for review?

technology, scale or scope economies, product differentiation or branding<sup>14</sup>.” Strategic barriers are usually a result of preventing new entrants into an industry or market.

Article 82 is said to view dominance through market shares and then only the level of barriers (entry and exit) according to Harbord and Hoehn as seen in the paper.

“In the *Continental Can*<sup>15</sup> case, the ECJ stated that the provisions of Art 82 are “*not only aimed at practices which may cause damage to consumers directly, but also at those which are detrimental to them through their impact on an effective competition structure ... abuse may therefore occur if an undertaking in a dominant position strengthens such position in such a way that the degree of dominance reached substantially fetters competition*”.

Jones and Sufrin note that if barriers to entry are too readily identified that a firm may be wrongly found to have market power and thus have its conduct constrained by competition law. Furthermore costs of entry to a market are focused on by the EC competition authorities rather than mere economic barriers. The analysis of defining entry barriers should not start and end at the cost of entry to the market, but go further to include any other relevant consideration, for example branding product differentiation and marketing. Firms should also not become victimised for cost efficiency.<sup>16</sup>

#### 4. Restrictive horizontal practices

##### Section 4

- “(1) An **agreement**<sup>17</sup> between, or **concerted practice**<sup>18</sup> by, firms<sup>19</sup>, or a decision by an association of firms, is prohibited if it is between parties in a **horizontal relationship**<sup>20</sup> and if –
- (a) 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; or
  - (b) it involves any of the following restrictive horizontal practices:
    - (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<sup>21</sup>, or

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<sup>14</sup> Ibid

<sup>15</sup> Case 6/72 Europemballage Corporation and Continental Can Co. Inc [1973] ECR 215.

<sup>16</sup> Oluseye Arowolo Application of the concept of barriers to entry under Article 82 of the EC Treaty: Is there a case for review?

<sup>17</sup> ‘agreement’ includes a contract, arrangement or understanding, whether or not legally enforceable according to the definition in the Act

<sup>18</sup> ‘concerted practice’ means 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 according to the definitions in the Act according to the definition in the Act

<sup>19</sup> ‘firm’ includes a person, partnership or a trust according to the definition of the Act

<sup>20</sup> ‘horizontal relationship’ means a relationship between competitors according to the definition of the Act

(iii) Collusive tendering<sup>22</sup> (own emphasis)

Often the difficulty in successfully prosecuting section 4 contraventions is to find or define the agreement between the parties. "Agreement refers to an explicit or implicit arrangement between firms normally in competition with each other to their mutual benefit."<sup>23</sup> These agreements may restrict competition with regards to production, prices, customers or even markets. These agreements may result in collusions or the formations of cartels. These types of behaviours are generally in contravention of the Act.

Agreements can be written or verbal, and give rise to anti competitive behaviours. These agreements are usually done in a manner so that the competition authorities are not easily aware of them. Not every agreement is in contravention of the Act, and some agreements are exempted under the Act. "In several countries, competition legislation provides exemptions for certain co-operative arrangements between firms which may facilitate efficiency and dynamic change in the marketplace. For example, agreements between firms may be permitted to develop uniform product standards in order to promote economies of scale, increased use of the product and diffusion of technology. Similarly, firms may be allowed to engage in cooperative research and development (R&D), exchange statistics or form joint ventures to share risks and pool capital in large industrial projects<sup>24</sup>."

The concepts of agreement and concerted practices "are mutually exclusive<sup>25</sup>." These agreements or understandings are not required to be legally enforceable. Most prohibited practices would have agreements or understandings that are verbal, which makes proving such practice more difficult. Australian authority<sup>26</sup> has explained the difference of agreement and understanding to be that understanding "does not involve any mutuality of obligations<sup>27</sup>." The tribunal will usually check if some sort of consensus has been reached between the parties, and this will suffice. Concerted practices generally involve some collusive actions instead of independent actions. The difficulty is that a firm may set a trend, and other firms may follow, but this is not necessarily collusive conduct. The action alone is not prohibited, unless backed up by some sort of agreement or understanding. The "European Court of Justice has found that it can constitute 'strong evidence' if it results in abnormal conditions of competition, but no presumption can arise where such parallel conduct 'can be accounted for by reasons other than the existence of concerted action<sup>28</sup>.'"

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<sup>21</sup> 'goods or services', when used with respect to particular goods or services, includes any other goods or services that are reasonably capable of being substituted for them, taking into account ordinary commercial practice and geographical, technical and temporal constraints according to the definition in the Act.

<sup>22</sup> This is where firms behave like cartels. M Brassy, *Competition Law*, page 111 defines a cartel as "an agreement by a number of firms to set a monopoly price and to limit their joint output to the monopoly output", with the collusive conduct being the agreement between these firms in question.

<sup>23</sup> O Economics *Glossary of industrial organization economics and competition law* accessed at [www.oecd.org/dataoecd/8/61/2376087.pdf](http://www.oecd.org/dataoecd/8/61/2376087.pdf) on 6 August 2010

<sup>24</sup> O Economics *Glossary of industrial organization economics and competition law* accessed at [www.oecd.org/dataoecd/8/61/2376087.pdf](http://www.oecd.org/dataoecd/8/61/2376087.pdf) on 6 August 2010

<sup>25</sup> M Brassy, *Competition Law*, page 130

<sup>26</sup> M Brassy, *Competition Law*, page 131, *Morphett Arms Hotel (Pty) Ltd v Trade Practices Commission* (1980) ATPR 40-156

<sup>27</sup> M Brassy, *Competition Law*, page 131

<sup>28</sup> M Brassy, *Competition Law*, page 136, *Ministere Public v Jean Louis Tournier and Jean Verney* (SACEM) [1991] 4 CMLR 248 at paragraph 24.

It has been said that some sort of agreement is needed as co-operation and co-ordination “cannot be achieved by a party acting independently<sup>29</sup>”. Concerted practice widens the scope of application. It has been noted that “anticompetitive concerted practices must be distinguished from parallel behavior undertaken independently by competitors.<sup>30</sup>”

An association of firms can be described as an umbrella organization. Standards are created and barriers raised to keep out competition. Horizontal relationships are not necessarily bad, it depends on the impact of this relationship on the market. Various tests have been developed over the years to test competition affects by firms in these horizontal relationships. The applicant would have to prove that the relationship is substantially lessening competition and the respondent would have to raise a defence of technology, efficiency or some other pro competitive gain.

Section 4(1)(b) can be described as explicit cartels which have anti competitive agreements between horizontal firms. This includes price fixing (quantity is decreased and price is increased), carving up the market (firms stick to allocated territories or products) and tendering (which could be rigged to appear pro competitive). There are certain practices which are “per se<sup>31</sup>” illegal. These are found under Section 4(1)(b) of the Act. Section 4(1)(a) is to be scrutinized using the “rule of reason<sup>32</sup>” to see if they “substantially prevent or lessen competition in the market.”

Defining a market is one of the most difficult parts of establishing competition compliance. The person wanted to prove that they are not performing prohibited practices, will attempt to define the market as broadly as possibly, to reduce the appearance of great market power. The person trying to show that competition laws are being contravened, will attempt to define the market in the most narrowest form. Competition law is applied to markets. Markets can be defined by using product substitutability, or geography. Economist use cross-price elasticity as the measure of substitutability, which is defined “as the percentage change in the quantity demand for good A divided by the percentage change in the price of good B<sup>33</sup>.” If you run out of a product and are able to use another product in its place, this would be an example of a substitutable product. A market can thus also be defined through location. Parties may argue that the firms are in separate locations and thus consumers do not view them as competitors.

Once a market has been defined (both parties will have to present their evidence before the tribunal who will decide on the market definition of that matter, as most markets are identified on a case by case basis), market concentration will be established. This attempts to see how much power the firm has within that market, and their influences on consumers.

The Herfindahl-Hirschman Index (HHI)<sup>34</sup> is a popular instrument used to measure the degree of concentration within a market. The HHI<sup>35</sup> found by “summing the squares

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<sup>29</sup> Siber ink, Competition Law SG 3/2008, page 3

<sup>30</sup> Ibid page 4

<sup>31</sup> Explicit examples of practices that are prohibited by the Competition Act.

<sup>32</sup> M Brassy, *Competition Law*, page 120

<sup>33</sup> M Brassy, *Competition Law*, page 110

<sup>34</sup> M Brassy, *Competition Law*, page 111

<sup>35</sup> M Brassy, *Competition Law*, page 111. The writer shows that the HHI can be calculated on a percentage base or on a fractional base. Such technicality is not required for this report and will not be dealt with.

of the market percentage shares of the firm in the industry<sup>36</sup>.” The HHI is especially used in mergers, to test the degree of concentration pre merger and post merger. HHIs which are less than 1000 are generally considered unconcentrated, HHIs between 1000 and 1799 are generally considered to be moderately concentrated and HHIs over 1800 are generally considered to be highly concentrated<sup>37</sup>.

Once a market has been defined and the degree of concentration established, the competition commission has to look at various aspects that indicate firm behaviour, such as the difficulty of a new firm to enter the market (these are called barriers to entry which could result from finances, legislation, regulations etc), are the larger firms working together to drive out the smaller firms. These are some of the questions that the tribunal will have to ask when looking at a firm’s behaviour.

Firms can form joint ventures where they work as a team. These ventures could have positive effects as they “lower transactions costs..., economies of scale and scope, increase in market capacity and access, reduction of risk and duplication, distribution of technology, combination of specialized capabilities and better appropriate of the returns of innovation<sup>38</sup>.” These aspects are for consumers positive as it ultimately could reduce costs and provide better production. These ventures could have risks which are to “diminish competition, increase price, reduce product quality or reduce innovation incentive<sup>39</sup>” and ultimately work like a monopoly.

These cartel behaviours between firms are not always easy to spot, and the competition commission has to keep an eye on the behaviours of firms to protect consumers and allow healthy competition in industries. “Perfect competition means that the individual seller or buyer is so small relative to the total market that the actions of that seller or buyer have no effect on the market price. In short, the structure of the market (number of firms and their size distribution), barriers to entry, and privately initiated or government sanctioned collusion generally determine the extent of competition.”<sup>40</sup>

No guidelines have been issued in South Africa, although these can be found in other jurisdictions<sup>41</sup>. It has been suggested that the Competition Commission should issue guidelines on the exchange of information, as to reduce uncertainty within industries<sup>42</sup>. Prohibited practices can also occur between an association of firms. This seems to be the part that is most applicable to the medical aid industry. These practices are widely defined to give the competition commission leeway when conducted their investigations.

As previously mentioned, Section 4(1)(b) creates per se prohibitions. Collusive tendering has been used to divide markets and increase profits. Collusive tendering is where firms will compete for a tender, where an agreement is reached between some firms where one firm will offer a low priced tender and the rest high priced tender, to ensure the low priced tenderer of receiving the tender. This scheme is then rotated between the firms in the agreement<sup>43</sup>. Market allocation can be in the “form of

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<sup>36</sup> M Brassy, *Competition Law*, page 111

<sup>37</sup> M Brassy, *Competition Law*, page 127

<sup>38</sup> M Brassy, *Competition Law*, page 112

<sup>39</sup> Ibid

<sup>40</sup> Victor R. Fuchs, *The competition revolution in healthcare*, essay by the professor of economics at Stanford University, Page 3, accessed at <http://content.healthaffairs.org/cgi/reprint/7/3/5.pdf> on March 2009

<sup>41</sup> Examples of guidelines are European Commission Guidelines and Canadian Guidelines

<sup>42</sup> Supra note 149, page 15

<sup>43</sup> M Brassy, *Competition Law*, page 142

territories or specific types of goods or services.<sup>44</sup> Per se prohibitions were especially looked at in the case of *American Natural Soda Ash Corporation and another v Competition Commission*<sup>45</sup> (Soda Ash). The applicant in this case argued that these prohibitions were not absolute, and argued based on the interpretation on the wording of the section. The tribunal regarded that statute as “elaborately detailed and ... admits of no ambiguity<sup>46</sup>.”

Section 4(1)(a) requires “an anti-competitive effect.<sup>47</sup>” The definition of effect would be important to understand this section. Is effect in the narrow sense which is actual effect, or in the broader sense of possible future effect. The European authorities generally analyse the market and the consequences of these agreements or understandings. South African authorities want an effect in the market. The core of section 4(1)(a) is the “preventing or lessening of competition.” Section 4(1)(a) provides defences for firms that appear to be contravening the section. The firm will have the onus of proving the technological, efficiency or pro-competitive gain. The evidence will then be evaluated on a balance of probabilities and the tribunal would make a ruling.

## **5. Regulation and barriers to entry, the recent case of Tracetec (Pty) Ltd and Netstar<sup>48</sup>**

This case involved three vehicle tracking companies, namely Netstar, Matrix and Tracker and the industry association being the Vehicle Association of South Africa (VESA). The market was defined as the Stolen Vehicle Recovery (SVR) Market. Vesa in turn was responsible for the setting of standards for admission into the SVR market<sup>49</sup>. The applicant Tracetec argued that the standards set by VESA for admission into the SVR market created barriers to entry that prevented competitors from entering the market and competing.

The case goes on to show how regulatory bodies and the regulation of a market can create barriers to entry and also how the regulatory body can be used as a means to prevent competitors from entering market and thus eliminating the potential for competition from new entrants to the market. The case I believe can be applied to any market in which the admission thereto is regulated by industry standards.

Before dealing with the complaint lodged by Tracetec it is necessary to explain how the SVR market was regulated. Following a sharp increase in the number of vehicle thefts, products were introduced to the market which allowed stolen cars to be traced and also recovered. Following the success of these products the vehicle insurance industry, motorists were either told to install a vehicle tracking unit or they were incentivised to do so by the insurer offering the motorist lower premiums<sup>50</sup>. There was at this point a rush of companies which claimed to be able to track and recover vehicles, the insurance industry however wanted a regulator to set standards for the industry. As such a sub-committee of VESA was established to develop the standards and to grant membership. The insurance industry would later only endorse

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<sup>44</sup> M Brassy, *Competition Law*, page 148

<sup>45</sup> *American Natural Soda Ash Corporation and another v Competition Commission* (CT 49/CR/Apr00, 27.3.2001)

<sup>46</sup> M Brassy, *Competition Law*, page 150

<sup>47</sup> M Brassy, *Competition Law*, page 156

<sup>48</sup> *Competition Commission of South Africa and Tracetec (Pty) Ltd v Netstar (Pty) Ltd and three others*, case no: 17/CR/Mar05

<sup>49</sup> *Ibid*, note 46, at [2]

<sup>50</sup> *Ibid*, at [5]

a company's SVR product on the proviso that it was approved by VESA, as such motorists were either told to use a company with VESA approval or incentivised to use a company with VESA approval.

In order to be VESA approved a company had to meet the following requirements: it had to reach certain targets, it had to have been in operation for at least one year and have installed at least 3000 units and have made at least 100 recoveries. These requirements, it was argued, had the effect of operating as a *de facto* barrier since any company which was not VESA approved would not succeed in the market since insured motorists were given incentives to only use a VESA approved SVR.

In order for a company in the SVR market to have any hope in succeeding, it would have to attempt to become a member of VESA. Once VESA approved the company would be able to source customers, being motorists, and these motorists would choose this company because of the incentives of the relevant insurance company. The regulation had two types of membership, provision and full membership.

Provisional membership did not require a minimum number of recoveries, have a basic infrastructure and have security clearance of all personnel.

However full membership to VESA required security clearance and a recovery rate of 90% of the six month floating industry average and additionally comply with two of the following: have a minimum client base of 3000 installed units, have been in operation for a year, have made 100 successful recoveries and / or have a basic infrastructure<sup>51</sup>.

The only advantage to being provisionally approved was that the company could hope to one day be fully approved. The advantages of full approval, i.e. having the insurance industry offer incentives for your product, did not attach to provisional membership. As such there was only one real form of membership, being full membership and as is evident from the requirements only established companies could attain full membership and the advantages thereto.

This meant that the three established vehicle tracking companies being Netsar, Matrix and Tracker were the only three firms with VESA approval and as such these three companies were the only companies for which the insurance industry gave incentives to purchase their products. Any prospective new entrant to the SVR market could well offer its product, however the consumer motorist would not purchase their product since they were not offered any reduction in their insurance premium, these prospective new entrants would then wither away leaving the market to Netstar, Matrix and Tracker.

The law:

Though this may or may not have been the intention of regulation, one must always look at the effect which any given conduct has on competition within the market. A complaint was then brought in which contraventions of section 4(1)(a) and section 8(c) of the Act were alleged to have been contravened.

The Tribunal found that there was an agreement between the between the Netstar, Matrix and Tracker. The next question was whether this agreement had the effect of preventing or lessening competition in the market.

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<sup>51</sup> *ibid*, at [60]

VESA's primary purpose was to set standards which would protect the consumer. However the Tribunal realised that when it is the rival firms which set the standard, this poses a risk of potential danger to competition.

As quoted:

*“joint standard setting can facilitate collusion or impede progressiveness by excluding from the market firms that threaten their rivals with lower prices, higher quality, or other innovations that consumers would prefer if given the opportunity”<sup>52</sup>*

The tribunal in this case went on to set out the test which can be used in order to establish whether the standard setting is harmful to competition. The following factors must be considered:

1. Market Power:

Here the Tribunal asked whether the standard setting body has market power? If the answer to factor 1 is no, then it is unlikely to have an exclusionary effect.

The Tribunal had no doubt in finding that the SVR Respondents being Matrix, Tracker and Netstar did have market power since firstly they represented over 90% of the industry. The SVR respondents formed the Vesa subcommittee. Secondly once the SVR respondents left the committee, the committee ceased to exist. The Tribunal went on to find that since the sub-committee had market power, that Vesa therefore had market power<sup>53</sup>.

The answer to factor 1 was therefore yes, the standard setting body, Vesa, did have market power.

2. Who drove the standards.

A standard which is set by rivals will be *prima facie* suspect for that reason alone as they will be presumed to be intended to limit the entry of other rivals. However a standard set by customers would not attract this conclusion as customers would not be considered to be setting standards with the exclusionary intent.

It was argued that the consumer was the insurance industry. This argument was however rejected by the Tribunal as firstly the Tribunal found that although the insurance industry may have been the driving force behind the requirement for standards, it was however not responsible for the content of the standard<sup>54</sup>.

The Tribunal also found that in this case the standards set by VESA were not aimed at the benefit of the consumer, but were in fact aimed at its own business interests, in that an industry which was not controlled may force insurance companies to further lower its premiums. The intent here is clear, a controlled market meant that the insurance companies were able to control the discount they would give, however if the market was not controlled and there were many SVR firms, the insurance companies would have to compete by lowering their premiums.

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<sup>52</sup> Ibid at [237], Herbert Hovenkamp, “*Antitrust law*”, par 2230 page 343.

<sup>53</sup> Ibid, note 46, at [239] to [240]

<sup>54</sup> Ibid at [242]

### 3. Effect of the standard?

Is a competitor as a result of the standard, prevented from entering the market. Since Competition Law is focused on the effect which conduct has on the market, this is by far the most important factor. It was argued that a non VESA approved firm could target the uninsured market. However as the Tribunal noted, the uninsured market did not demand vehicle tracking equipment. As such a non VESA approved firm would not be able to meet the threshold of membership to VESA and was as such barred, de facto, from entry into the market.

### 4. Is the standard reasonable?

Is the standard consistent with its rationale, is there evidence that a reasonably efficient firm or a firm that is at least as efficient as the respondent firms could comply?

The Tribunal in finding that the standard was not reasonable took into account the difficulty that already VESA approved firms had in having their new products VESA approved. This prevented innovation in the market and as we know the lack of innovation or the prevention thereof is to the detriment of the consumer.

Since the standards were found to be unreasonable, it was also found that the standards could not be defended on the grounds that they technological efficiency or other pro-competitive gain achieved by the standard<sup>55</sup>.

The effect was to prevent consumers the advantage of competition in the market, while at the same time preventing the consumer benefiting from any new technology which may have been introduced to the market.

However, we note that any new technology or any new entrant to the market would have, without regulation, have been testing his product or innovation on the consumer itself. Perhaps a better way of regulation would have been to allow new entrants to the market provided their product or innovation could show success, not via application by the consumer, but by practical tests which could have been carried out by an independent sub-committee of VESA.

This case has however become academic since the SVR respondents have resigned from VESA. However the case does show that regulation can operate by competitors as a barrier to entry to new firms and also internally as a barrier to entry of innovation by an existing approved firm. A standard can therefore have the effect of preventing competition both externally and internally, the consumer and the market are harmed twofold.

The case further sets out the factors to be considered when questioning whether a standard is a barrier to entry and thus anti competitive. This is important since a standard may be aimed at the benefit of the consumer and may prevent harm, we are thinking for example the entry of a new drug into the market. Its entry is subject to strict standards which are aimed at the benefit of the consumer, since if the drug is allowed into the market without approval, this would mean that its affects may only be

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<sup>55</sup> Ibid, at [286]

determined once the consumer has taken the drug. In the European Union the need to comply with administration authorization has been seen as a barrier to entry. For example in the case of *Accor / Wagons – Lits* the requirement of having a licence to operate a toll road was seen as a barrier to entry, similarly in *Vodafone / Airtouch* the requirement of a mobile telecommunications licence was seen as a barrier to entry<sup>56</sup>.

## 6. CONCLUSION:

Section 4 of the Act deals with restrictive horizontal practices which is divided into per se contraventions and contraventions that can be explained away by defences offered by the Act. Market definitions are important when considering whether or not a firm conduct is in contravention of the Act, as the market definition will provide evidence of market power that a firm possesses.

The creation of barriers for the purpose of lessening competition within a market is a contravention under South African competition laws as well as against Article 82 EC Treaty. The Netstar case demonstrated the questions that the tribunal has to ask in determining if the standards set by an industry is for the protection of consumers, or actually used as a method of keeping out competition.

VESA failed to control the committee, and as quoted by the court “that the dog allowed its tail to wag it is no defence open to the dog.” All the respondents in the Netstar were found to have contravened section 4(1)(a) of the Act.

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<sup>56</sup> Ivo Van Bael, Van Bael & Bellis (Firm) “*Competition law of the European Community*”, accessed at <http://books.google.co.za/books>

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