

Dominance test: a superfluous jurisdictional hurdle?

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Abstract

In abuse of dominance complaints, competition authorities follow a two-step approach in terms of which they first determine whether the allegedly offending firm is dominant in the relevant market, and only then assess the conduct of the firm and its effect on competition. The dominance test, which focuses on whether the firm concerned has market power, is a jurisdictional hurdle for the application of the competition provisions dealing with abuses of dominance.

In this paper, we argue that the dominance test is an unnecessary and undesirable jurisdictional hurdle in abuse of dominance cases based on alleged exclusionary behaviour. In such cases, if there is evidence that the firm's conduct has an anti-competitive effect, it is unnecessary to first determine whether the firm is dominant because the firm's actions would not be capable of resulting in anti-competitive harm if it does not have market power – i.e. if it is not dominant.

Given the complexity of the dominance test, competition authorities should therefore focus on evaluating the anti-competitive effects of implicated conduct rather than following a two stage form-based approach. This is consonant with the move in most jurisdictions towards an effects-based approach to assessing competition complaints.

The dominance test remains relevant as a jurisdictional hurdle in the case of excessive pricing. This is because excessive pricing is an outright prohibition and dispensing with the dominance test could result in firms without market power being found to have contravened the prohibition against excessive pricing for merely following the prices set by the dominant firm.

1. Introduction

South Africa's Competition Act 89 of 1998 ("**Competition Act**") prohibits anti-competitive practices arising out of both co-ordinated and unilateral conduct of firms. Unilateral conduct is caught by the Competition Act where it amounts to an abuse of dominance by a particular firm in a relevant market. The mechanics of the Competition Act provide that the conduct of a firm may be scrutinised under the abuse of dominance provisions only if it is first established that the implicated firm is dominant in the relevant market.

Therefore, the evaluation of abuse of dominance cases involves a two stage approach where the first stage requires the establishment of dominance before progressing to the second stage, which involves assessing whether the conduct amounts to an abuse of dominance. This two stage approach to evaluating abuses of dominance by firms is unexceptional and has been adopted in several other jurisdictions.

In this paper we argue that the dominance test is a superfluous jurisdictional hurdle in that it is both unnecessary and undesirable in cases involving abuses of dominance

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stemming from exclusionary conduct. We suggest that an effects-based approach is more suitable to evaluating such abuse of dominance cases.

However, we accept that in cases involving exploitative abuses of dominance in the form of excessive pricing, the dominance test is an appropriate preliminary step.

The structure of this paper is as follows:

- In section 2, we outline the dominance tests adopted in South Africa, the European Union (“**EU**”) and the United States of America (“**USA**”) and highlight the differences between these tests. We focus on these two foreign jurisdictions as they are the leading competition law jurisdictions to which the South African competition authorities usually look for guidance.
- In section 3, we explain why a dominance test is an unnecessary and undesirable jurisdictional hurdle.
- In section 4, we propose an effects-based approach to evaluating abuses of dominance.
- In section 5, we explain why a dominance test is appropriate as a pre-requisite to assessing exploitative abuses of dominance in the form of excessive pricing.
- In section 6, we conclude this paper by summarising our arguments against using the two stage approach in respect of abuses of dominance that stem from exclusionary conduct, as well as arguments in favour of retaining the dominance test as a jurisdictional hurdle in cases involving excessive pricing.

2. Abuse of dominance provisions

In the competition statutes of South Africa, the EU and the USA the provisions relating to abuses of dominance involve a two stage enquiry that entails a preliminary dominance test followed by an assessment of the challenged conduct. However, only South Africa's Competition Act contains a statutory dominance test. In the other two jurisdictions this test has been developed by the courts. Below we briefly set out the relevant abuse of dominance provisions and judicial interpretation of these provisions in each of these three jurisdictions.

2.1 South Africa

The abuse of dominance provisions are contained in sections 7 to 9 of the Competition Act. Section 7 sets out the dominance test while sections 8 and 9 set out the type of conduct that a dominant firm is prohibited from engaging in. These provisions are summarised below.

Section 7 of the Competition Act presumes that a firm is dominant in a market if it holds –

- at least a 45% share of that market;
- at least a 35% share of that market, but less than 45%, unless it can show that it does not have market power; or
- less than a 35% share of that market, but has market power.

Once a firm is established as being dominant under section 7, section 8 prohibits that firm from engaging in the following types of conduct:

- charging an excessive price to the detriment of consumers;
- refusing to give a competitor access to an essential facility when it is economical to do so;
- generally engaging in an exclusionary act³ where that act has a net anti-competitive effect⁴; and
- engaging in the following specific exclusionary acts, unless the dominant firm is able to show that such acts do not have a net anti-competitive effect:
 - requiring or inducing a supplier or a customer to not deal with a competitor (inducement not to deal);
 - refusing to supply scarce goods to a competitor when it is economically feasible to do so;
 - selling products 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 related to an object of the contract (tying or bundling);
 - selling products below their marginal or average variable cost (predation); and
 - buying-up a scarce supply of intermediate goods or resources required by a competitor.

Section 9 of the Competition Act contains a separate prohibition which precludes a dominant firm from engaging in price discrimination in respect of the sale, in equivalent transactions, of products of like grade and quality to different purchasers where such price discrimination is likely to have the effect of substantially preventing or lessening competition.

The structure of the dominance provisions in the Competition Act entails a two stage approach to evaluating abuses of dominance cases in that a firm must first be found to be dominant in terms of section 7 before the prohibitions in sections 8 and 9 apply to it. This has been confirmed by the Competition Tribunal (“**Tribunal**”) in its interpretation of these provisions. In *Competition Commission v South African Airways (Proprietary) Limited*,⁵ the Tribunal outlined its approach to abuse of dominance cases as follows –

*“We first, as is customary, analyse the relevant markets, then consider if the respondent is dominant in these markets and then move on to consider the abuse.”*⁶

³ An “exclusionary act” is defined in the Competition Act as an act that “impedes or prevents a firm from entering into, or expanding within, a market”.

⁴ A net anti-competitive effect is achieved where the anti-competitive effect of an act outweighs its technological, efficiency or other pro-competitive gains.

⁵ Case no 18/CR/Mar01.

⁶ Ibid at para 11.

The first stage of the analysis accordingly requires the competition authority to determine whether a firm is dominant using the statutory dominance test contained in section 7 of the Competition Act. The dominance test entails the following three elements:

- definition of the relevant market;
- calculation of market shares; and
- depending on the size of the calculated market shares, determination of market power.

The Competition Act defines market power as the “power of a firm to control prices, or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers”. Section 7 creates a connection between market power and market shares by introducing presumptions of dominance based on a combination of market share thresholds and the presence of market power. For example, it is presumed that a firm with a 35% market share has market power, and is thus dominant, unless it can show that it does not have market power. Furthermore, section 7 creates an irrebuttable presumption of dominance where a firm has a 45% market share. In this case, the firm is presumed to have market power and thus to be dominant.

2.2 EU

Article 102 of the Treaty on the Functioning of the European Union 2009 (“**TFEU**”) prohibits the abuse by undertakings of a dominant position within the common market in so far as it may affect trade between Member States. This Article expressly enumerates four such abuses as follows –

- directly or indirectly imposing unfair purchase or selling prices or trading conditions;
- limiting production, markets or technical development to the prejudice of consumers;
- applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them in a competitive disadvantage (price discrimination); and
- making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to their commercial usage, have no connection to the subject of such contracts (tying and bundling).

In interpreting the above provision, the European Commission and courts have adopted a two stage approach where the determination of dominance is a precursor to considering whether the relevant firm has engaged in any of the acts contemplated in Article 102. Although Article 102 does not itself set out a dominance test, the criteria for determining whether a firm is dominant have been developed and articulated in the decisions of the European Commission and the judgments of the European Court of Justice (“**ECJ**”).

The ECJ has formulated the dominance test by interpreting the requirement for a firm caught by Article 102 to hold “a dominant position” to mean –

*“a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers”.*⁷ (Emphasis added.)

This test has been adopted by the European Commission in its guidelines (“**Guidelines**”).⁸ The European Commission has noted in the Guidelines that a firm may be regarded as acting “independently” where it does not face sufficiently effective competitive constraints and therefore enjoys substantial market power over a period of time.⁹

The Guidelines emphasise the competitive structure of the market in assessing dominance, and in particular the following constraints –

- *“constraints imposed by the existing supplies from, and the position on the market of, actual competitors (the market position of the dominant undertaking and its competitors);*
- *constraints imposed by the credible threat of future expansion by actual competitors or entry by potential competitors (expansion and entry); and*
- *constraints imposed by the bargaining strength of the undertaking's customers (countervailing buyer power)”.*¹⁰

Market shares are used in evaluating the first constraint, being the market position of the dominant undertaking and its competitors. However, the Guidelines indicate that while the European Commission will look at market shares as a useful preliminary indication of dominance, it will interpret these market shares in light of the relevant market conditions, the dynamics of the market and the extent to which products are differentiated.¹¹

2.3 United States of America

In the USA, abuses of dominance are primarily dealt with in terms of section 2 of the Sherman Act 1890 which prohibits monopolisation. Section 2 provides that –

“Every person who shall monopolise, or attempt to monopolise, or combine or conspire with any other person or persons, to monopolise any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony”.

⁷ *United Brands v EC Commission* [1978] ECR 207, [1978] 1 CMLR 429 at para 65. This definition has generally been accepted by the ECJ, see *Hoffmann-La Roche v EC Commission* [1979] ECR 461 at paras 38-39; *Nederlandsche Banden-Industrie Michelin NV v EC Commission* [1983] ECR 3461, [1985] 1 CMLR 282.

⁸ Guidance on the Commission's enforcement priorities in applying Article 102 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (2009/C 45/02).

⁹ *Ibid* at para 10.

¹⁰ *Ibid* at para 12.

¹¹ *Ibid* at para 13.

Monopolisation requires proof that the defendant possesses monopoly power, and has acquired, enhanced, or maintained that power by the use of exclusionary conduct.¹² Therefore, the monopolisation formulation also relies on a two stage process, whereby first it is necessary to determine whether a firm has “monopoly power” and only then the conduct of the firm may be assessed. Conduct prohibited by section 2 of Sherman Act includes predatory pricing, refusal to deal, tying, exclusive dealings, refusing access to an essential facility and a variety of other exclusionary acts where the necessary harm to competition has been established.¹³

The preliminary dominance test in the monopolisation formulation is based on the interpretation of monopoly power. Monopoly power traditionally has been defined as the power to control prices or exclude competition in the relevant market.¹⁴ The courts sometimes use the terms “market power” and “monopoly power” interchangeably.¹⁵

Given that direct evidence of price control or exclusion is seldom available, courts in the USA generally rely on indirect (or circumstantial) evidence of monopoly power, specifically by looking at market shares in the relevant market, the existence of barriers to entry and market structure and performance.¹⁶ Although market shares are generally regarded as the starting point in assessing whether a firm possesses monopoly power, they are not the only factor considered in determining whether monopoly power exists.

2.4 Summary of dominance tests

As described above, the evaluation of abuse of dominance cases in all three jurisdictions begins with a dominance test. In South Africa, the firm concerned has to be shown to have a large market share or to possess market power; in the EU it must hold a dominant position; and in the USA the firm must have monopoly power. Despite the use of different terminology in the three jurisdictions, they refer to the same concepts (call them Dominance Requirements).

Each jurisdiction then has given content to the respective Dominance Requirements by providing definitions of dominance, market power, dominant position and monopoly power. These definitions contain some or all of the following elements: the ability to prevent effective competition, to behave independently, to control prices or exclude competition.

In all three instances, the analysis starts with the definition of the relevant market in order that it can be determined whether a firm meets the Dominance Requirements. Market shares are also used in all three jurisdictions as part of the dominance enquiry.

¹² 1-2 *Antitrust Law Developments* Chapter 2: Monopolisation and related offences ALD 6 Treatise at 2A.

¹³ L Reyburn updated by P Sutherland *Competition Law of South Africa*, LexisNexis last updated November 2008, at 7.3.

¹⁴ Lexstat 1-2 *Antitrust Law Developments*, Chapter 2: Monopolisation and related offences ALD 6 Treatise at 2B. See for example *ex rel. Hartigan v. Panhandle E. Pipe Line Co.*, 730 F. Supp. 826, 902 (C.D. Ill. 1990) (quoting *American Tobacco*), *aff'd sub nom. Illinois ex rel. Burris v. Panhandle E. Pipe Line Co.*, 935 F.2d 1469 (7th Cir. 1991).

¹⁵ *Ibid.*

¹⁶ *Ibid* at 2B[2][a].

3. Dominance tests are superfluous

In this paper, we argue that the application of a dominance test as a precursor to the assessment of alleged abuses of dominance is a superfluous jurisdictional hurdle where the abuse takes the form of exclusionary conduct. The reason for this is that a separate dominance test is both unnecessary and undesirable.

3.1 Dominance tests are unnecessary

Our first proposition is that it is unnecessary to conduct a dominance test as a stand-alone pre-requisite to the assessment of alleged abuses of dominance on the following basis.

In terms of South Africa's Competition Act, almost all the prohibited abuses of dominance that arise out of exclusionary conduct require proof of an anti-competitive effect. We argue that a dominance test is unnecessary in assessing whether a firm has contravened any of these prohibitions, because a firm that lacks market power would either not be able to engage in the exclusionary conduct in the first place or, if it could, the conduct would not have an anti-competitive effect

To illustrate, market power (which endows a firm with dominance) entails the ability of a firm to do at least one of the following things: control prices, exclude competition or to act independently. A firm that cannot control prices, exclude competition or act independently would not be able to successfully engage in predatory pricing. A firm that cannot exclude competition would generally not be able to require or induce customers or suppliers not to deal with a competitor and, if it could, the resulting exclusivity would not have an anti-competitive effect. Indeed, market power is defined in the Competition Act in terms of the ability to engage in the very conduct that is prohibited as unlawful exclusionary abuses of dominance in terms of section 8 and 9 of the Competition Act.

Accordingly, if the anti-competitive effect of the conduct is proven, the allegedly offending firm will necessarily have had market power and therefore will have been dominant.

3.2 Dominance tests are undesirable

Our second proposition is that not only are dominance tests unnecessary but that they are also undesirable. Broadly, the criticism of the dominance tests is that their application is complex and cumbersome and that their constituent elements are not always certain or indicative of dominance. As a result, they are prone to abuse in legal proceedings and yield unreliable results.

Below we look at the shortcomings of the dominance tests by analysing their constituent elements, being market definition, interpretation of the Dominance Requirements and the utilisation of market shares in the dominance analysis. We also highlight the practical implications of using a dominance test as a precursor to assessing alleged abuses of dominance.

3.2.1 Market definition

A pre-requisite for the dominance tests is defining the relevant market in which the firm alleged to be dominant operates. Market definition requires the application of the hypothetical monopolist test, otherwise known as the SSNIP (small but significant and non-transitory increase in price) test.

The SSNIP test involves starting with a narrow provisional market and then conducting an economic analysis in order to determine whether this is the relevant market. This entails establishing whether it would be profitable for a hypothetical monopolist in that market to increase the price by a small but significant increment above the notional competitive price, usually 5% to 10%. If such a price increase is not profitable because consumers would switch to substitutable products or new entrants are attracted to the market, then the hypothetical monopolist would be constrained from raising prices above competitive levels. This indicates that the relevant market is wider. Therefore, the provisional market must be expanded to include substitutable products and producers until a hypothetical monopolist would be able profitably to apply a 5% to 10% price increase in that market, in that the consumers would not have any other substitutes to switch to. On the basis of this test, the relevant market is therefore a collection of products or services in respect of which a hypothetical monopolist would be able to charge a price significantly above the notional competitive price.

Since the competitive benchmark price is only notional, it is difficult to compute with any degree of accuracy. In fact, rigorous econometric analysis is seldom used to estimate this competitive benchmark price. In practice, the SSNIP test is applied merely as a conceptual construct in which intuitive reasoning about the substitutability of different products is used to define the relevant market with reference to current prices, rather than with reference to the notional competitive price.

This practice makes the application of the SSNIP test vulnerable in dominance cases to the so-called Cellophane fallacy. The fallacy stems from the use of the current price instead of the competitive price as the benchmark price in application of the SSNIP test. By virtue of its market power, a dominant firm is usually capable of charging prices that are significantly higher than the competitive price. Therefore, the use of the current price that is charged by the dominant firm as the benchmark price will erroneously expand the market by including in it products that are not true substitutes. Such products would be perceived to be substitutes because of the incorrect use of the already supra-competitive price as a benchmark price in the analysis. As a consequence, market shares calculated in a market that has been defined too broadly due to the Cellophane fallacy problem will not be reliable indicators of market power and are therefore likely to result in incorrect conclusions regarding dominance.

The Cellophane fallacy has particular implications for the South African Competition Act which contains statutory presumptions of dominance.¹⁷ Therefore, the South African competition authorities have to take extra care in defining the relevant market.

3.2.2 Interpretation of the Dominance Requirements

Once the relevant market is defined, the competition authorities have to determine whether the implicated firm meets the Dominance Requirements by trying to determine whether the definitional elements of the Dominance Requirements are met. The definitional elements, as adopted in the three jurisdictions, consist of an amalgam of the following indicators: the ability to prevent effective competition, to behave independently, to control prices or exclude competition. However, what is entailed by each of these definitional elements is not always clear and their interpretation by the competition authorities and courts is not always consistent.

¹⁷ Sutherland supra note 13 at 7.7.4.3.

For example, in the EU the relationship between the two definitional elements of “position of dominance”, being the ability to prevent effective competition and to behave independently, is unclear. There is still some debate as to whether both elements must be proved or whether the one element is parasitic upon the other, in which case it is argued that it is not clear which is parasitic on the other.¹⁸ Furthermore, the concept of “independence” has encountered the criticism of being nebulous and lacking foundation in economic theory.¹⁹

3.2.3 Use of market shares

Given the difficulty in directly establishing the definitional elements of the Dominance Requirements, the competition authorities use market shares as an indication, and in some instances as proxies, of these Dominance Requirements.

In South Africa market shares form the basis of the dominance test, where passing a particular market share threshold, being 45%, serves as more than just an indication but rather triggers an irrebuttable presumption of dominance. In all other instances, market shares are used to trigger rebuttable presumptions of dominance. The main criticism of this approach is that market shares are an indirect and imperfect estimation of market power.²⁰ Furthermore, determining the market share threshold for inferring dominance is not an exact science and has been a subject of debate in case law.

Despite high market shares, the existence of market power depends on entry barriers, the responsiveness of the existing rivals and the intensity of demand.²¹ Furthermore, market shares cannot indicate the competitive pressure exerted by firms not yet operating in the market but with the capacity to enter it in a reasonably timely manner.²² These shortcomings form the basis on which the competition authorities in the EU and the USA have emphasised the need to supplement market share calculations with considerations related to the relevant market conditions, the dynamics of the market and the extent to which products are differentiated, as well as barriers to entry, market structure and performance.

3.2.4 Practical implications

As outlined above, dominance tests require complex economic analysis involving the consideration of many elements, which in turn require judicial interpretation and often are not evidenced by any directly quantifiable considerations. This process is cumbersome and time-consuming. Aside from the criticism stemming from the application of the dominance test, we argue that the use of this test as a jurisdictional hurdle results in a number of unintended practical implications which are also undesirable.

Given that the dominance test is a precursor to the assessment of abuses of dominance and in light of the complexity of this initial jurisdictional hurdle, firms facing an abuse of dominance complaint may be encouraged to use this as a dilatory tactic. The two stage approach provides firms with an opportunity to stall the regulatory

¹⁸ R Whish *Competition Law*, LexisNexis, Competition Law/5 Article 82/4, “Dominant Position”, at 5.14.

¹⁹ Butterworths Competition Law Service, Lexisnexis, Division VI Dominant Firms and Monopolists/Chapter 3 EU Law: The Finding of a Dominant Position under Article 102 at 348.

²⁰ Sutherland supra note 13 at 7.7.6.1.

²¹ PE Areeda & H Hovenkamp *Antitrust Law IIA* (2004) 114, at pp 190, 191–192.

²² Whish supra note 18 at 5.29.

enforcement process by challenging the market definition or the interpretation applied to the definitional elements of the Dominance Requirements. This can be avoided if the two stage approach is collapsed into one composite analysis.

A two stage approach to abuse of dominance cases is a form-based approach that attempts to pigeon-hole firms based on criteria other than the firm's conduct and its effect on competition. Given the added responsibility placed on dominant firms to self-regulate and self-censor their conduct,²³ firms that believe that they are dominant on the application of the dominance criteria, may feel inclined not to engage in conduct which, but for their "dominance", would amount to aggressive competition, for fear that the conduct would have an anti-competitive effect in the relevant market.²⁴ Similarly, firms that believe that they do not meet the dominance criteria may be lulled into a false sense of security while their conduct may nevertheless result in anti-competitive effects and cause consumer harm.

4. Effects-based approach

Having outlined the shortcomings of applying a two stage analysis to abuses of dominance provisions, based on exclusionary conduct, we argue that the prudent approach to be adopted in such cases is an effects-based approach.

The thrust of an effects-based approach is to determine whether a firm's conduct is likely to result in anti-competitive harm, irrespective of the firm's pre-determined dominance status.

In terms of the approach adopted by South Africa's Tribunal, an anti-competitive effect can be proven by evidence of either actual harm to consumer welfare or, if such evidence is not available, by evidence that the exclusionary act substantially or significantly foreclosed the relevant market to competitors so that harm to consumers can be inferred from such foreclosure.²⁵

Therefore, in terms of the effects-based approach we propose, the contravention could be proven on the basis of evidence of the particular exclusionary act and of actual harm to consumers in the form of higher prices, less choice or inferior service.²⁶ Where evidence of harm to consumer welfare is not available, it would be necessary to define the relevant market and adduce evidence to show that competitors were foreclosed to a significant extent from that market. In some instances an important element of such evidence would be the fact that the allegedly offending firm has a large market share in the relevant market or that it has market power. In this alternative approach, the assessment of dominance is not excluded from the effects-based approach, but instead may in certain circumstances be viewed as an element of the overall appraisal of whether the relevant exclusionary conduct has an anti-competitive effect.

The approach that we advocate, as set out above, finds support in the report by the European Advisory Group²⁷ on Competition Policy (Advisory Group) in July 2005. The

²³ See *Michelin v Commission* [1983] ECR 3461, [1985] 1 CMLR 282 at para 10.

²⁴ Sutherland supra note 13 at 7.7.6.5.

²⁵ South African Airways case supra note 5 at para 132.

²⁶ Ibid at para 285.

²⁷ Report by the European Advisory Group on Competition Policy on "An Economic Approach to Article 82" July 2005 (Advisory Group Report). The Advisory Group is an independent discussion forum on competition policy matters between academics with a recognised reputation in the field of industrial organisation. Members come from different fields of research and academic research centres in Europe.

Chief Economist of DG Competition commissioned this report from the Advisory Group in anticipation of the release of its discussion paper on the application of Article 82 of the European Treaty to exclusionary abuses (now Article 102 of TFEU),²⁸ which formed the basis for the Guidelines.

The Advisory Group recommended to the DG Competition that –

"In contrast to a form-based approach, an effects-based approach needs to put less weight on a separate verification of dominance, except possibly for a de minimis consideration. If an effects-based approach yields a consistent and verifiable account of significant competitive harm, that in itself is evidence of dominance. Traditional modes of establishing 'dominance' by recourse to information about market structure are merely proxies for a determination of 'dominance' in any substantive sense, i.e., the ability to exert power and impose abusive behaviour on other market participants. If an effects-based approach provides evidence of an abuse which is only possible if the firm has a position of dominance, then no further separate demonstration of dominance should be needed – if no separate demonstration of dominance is provided, one may however require the abuse to be clearly established, with a high standard of proof. Traditional considerations about the presence or absence of dominance do not therefore become moot. They merely become part of the procedure for establishing competitive harm by the practice under investigation."²⁹

The DG Competition accepted that an effects-based approach is preferable and in response to the Advisory Group's recommendation stated that the "Commission will adopt an approach which is based on the likely effects on the market".³⁰ However, neither the DG Competition discussion paper nor the Guidelines accepted the Advisory Group's proposition that an effects-based approach envisages the collapsing of the two stage approach to abuses of dominance. This was an opportunity missed.

The collapsing of the two stages of the abuse of dominance enquiry is a rational step grounded in sound economic theory. It is clear that the two stages of such an enquiry are inextricably linked and that the division of the test for abuse of dominance into two independent steps leads to undesirable and unnecessary tests and analyses that can and should be avoided.

5. Exploitative abuses of dominance

Whilst we argue that in the cases of exclusionary abuses, the dominance test and the enquiry into the effects of the conduct under scrutiny should be merged into one enquiry, this approach is not appropriate for cases involving exploitative abuses of dominance in the form of excessive pricing. This is one exception where the dominance test is an appropriate preliminary step.

An "*excessive price*" is defined under the Competition Act as a price for a good or service which bears no reasonable relation to, and is higher than, the economic value

The Advisory Group's main purpose is to support DG Competition in improving the economic reasoning in competition policy analysis.

²⁸ "DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses" Brussels, December 2005 (DG discussion paper).

²⁹ Advisory Group Report at p 14.

³⁰ DG discussion paper supra note 28 at para 4.

of that good or service.³¹ The Competition Appeal Court has held that an assessment of "excessive" pricing entails the evaluation of whether a dominant firm's price has a reasonable relation to the "economic value" of the product concerned, being a notional price of the product under assumed conditions of long-run competitive equilibrium.³² In keeping with the duty imposed on dominant firms to self-regulate their conduct in general, the prohibition against charging an excessive price places a duty on dominant firms to self-regulate their pricing in order to ensure that the price they charge is not excessive.

In contrast to exclusionary abuses, in relation to which we argue that a firm would not be capable of engaging in the exclusionary conduct, or alternatively that such conduct would not have a net anti-competitive effect, unless that firm has market power, in the case of excessive pricing, firms with no market power (call them small firms) are capable of charging an excessive price in certain circumstances.

This will be where the excessive price is set by a dominant firm as the price leader in the market, and the small firms in the market merely follow the price set by the dominant firm. The small firms have no market power and are therefore not able to charge the excessive price on the basis of their own ability to control prices or act independently of their competitors. They are only able to do so because they are able to "shelter" under the higher price that is set by the dominant firm.

Small firms that do not have market power are more likely to shelter under the excessive price set by the dominant firm, if they are unable themselves to affect the market price or gain significant market share by undercutting the dominant firm. In such circumstances, it is perfectly rational for a small firm without market power to charge the excessive price set by the dominant firm for two reasons.

Firstly, it makes no commercial sense for small firms to charge a lower price than the price set by the dominant firm as this strategy would result in the small firms forgoing profits that they could earn at the higher price set by the dominant firm. Even if a small firm could attract more customers by lowering its price, its limited production capacity restricts the number of additional customers that it can service. This may result in a situation where the profits gained from the additional quantities sold at the lower price do not outweigh the profits earned on smaller quantities sold at the excessive price set by the dominant firm.

Secondly, small firms may hesitate to undercut the price of a dominant firm for fear of retaliation. Such a strategy could attract predatory pricing (i.e. pricing below cost) by the dominant firm with a view to disciplining the small firm or to drive it out of the market completely. In fact, the dominant firm may not even have to resort to predation. If the dominant firm has lower costs of production due to economies of scale, it may be sufficient for it simply to drop its price to a level that is not below cost but which is not sustainable for the small firms in the market.

³¹ In determining whether the price of a particular product in South Africa is excessive, the competition authorities will have to consider: (a) what the economic value of the product in question is; (b) what price would be regarded as reasonable in relation to the economic value of the product in question; and (c) whether the price of the product in question is higher than a price that bears a reasonable relation to the economic value of the product.

³² *Mittal Steel South Africa Limited and Others v Harmony Gold Mining Company Limited and Another* case no. 70/CAC/Apr07 at para 40.

Since small firms without market power are mere price takers and charge the excessive price only because the dominant firm enables them to and since it would be irrational for them not to do so, it would not be appropriate for the law to impugn the small firms' conduct of pricing at this level. A separate dominance test therefore justifiably serves as a filter to exclude small firms without market power from scrutiny under the excessive pricing provisions.

Finally, the obligation that the prohibition against excessive pricing places on firms to regulate their own prices to ensure that they are not excessive, is not justified in the case of small firms. This self regulation requires a firm to engage in periodic and costly analysis to assess whether the prices it charges are reasonably related to the economic value of its products. A recent decision of the Competition Appeal Court³³ has highlighted the difficulty in establishing the "competitive price" which is used as a benchmark for such an analysis. Therefore, given the effort and costs incidental to self-regulation, this would be an unjustified burden to impose on small firms that do not have market power.

6. Conclusion

In this paper we argue that the two stage approach to assessing abuses of dominance in cases involving exclusionary conduct should be collapsed into one test focusing on the effects of the conduct concerned. We have illustrated that a separate dominance test is unnecessary due to the inextricable link between market power and the ability of a firm to either engage in the prohibited conduct or for that conduct to have an anti-competitive effect. Furthermore, we have explained why the test is undesirable due to its complexity and unreliability in practice.

There are important practical implications to having a dominance test as a jurisdictional pre-requisite to evaluating abuses of dominance. We have described the manner in which this jurisdictional hurdle may be used by firms to draw out proceedings and cloud the pertinent issues, being the conduct of the firm. We have also pointed to two unintended practical consequences of the two stage approach. The first consequence relates to a situation where a firm, believing that it is dominant, behaves conservatively and does not aggressively pursue profit maximising strategies for fear that such conduct could amount to an abuse under the Competition Act. The second consequence relates to a situation where a firm proceeds to engage in conduct that amounts to an abuse of dominance under the Competition Act, by virtue of its exclusionary nature and anti-competitive effect, while harbouring the false impression that it is not dominant.

We accordingly argue that an effects-based approach to abuses of dominance should be adopted where the focus is on the effect of a firm's conduct.

While advocating this approach in respect of exclusionary abuses of dominance, we argue that a dominance test is an appropriate and necessary jurisdictional hurdle in exploitative abuses of dominance in the form of excessive pricing. In support of this, we distinguished the nature of exclusionary and exploitative abuses of dominance on the basis that small firms may be able to price excessively without having market power. Finally, we argue that the costs of self-regulation should not be imposed on such firms as they are not dominant and can price excessively only as a result of the conduct of a dominant firm.

³³ Ibid.