

# **“All that Glitters is not Gold”\*: An Essay on a Competition Law Transplant**

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William Shakespeare, [The Merchant of Venice](#) (II, vii).

**PRELIMINARY AND INCOMPLETE DRAFT –  
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## 1. Introduction

Developing (and transition) economies have at least one advantage: they can imitate some of the features of developed economies. One way that they regularly do so is by adopting, by means of a transplant, a legal rule from a developed economy.<sup>1</sup> The widespread perception in fact is that if a legal rule is from a developed economy, then it is efficient. Consequently, the rule can be transplanted. This paper questions this perception by evaluating the transplant of an “excessive price” definition – i.e., a definition about a price that differs from marginal cost that creates net harmful social effects – from European Union case law to South African statute law.<sup>2</sup>

The transplanting of a social institution – such as a legal rule, a constitution, the law in general and many others – must be performed with caution. One must be cautious when considering the feasibility of a transplant vis-à-vis the idiosyncrasies of both original and host environments. Since the host (as the original) environment is a historical product, there in fact exists the possibility of a “transplant effect” (Wise, 1990). A transplant effect occurs when there is a divergence between a transplanted institution and the pre-existing socioeconomic matrix of the recipient country (Berkowitz, Pistor and Richard, e.g., 2003a: 171). Here we point out how *ab ovo* institutional quality matters at least as much as history and context.<sup>3</sup>

To date, the body of literature dealing with legal transplants has centered either around the phenomenon of transplants of entire legal orders (e.g., Kahn-Freund, 1974; La Porta, 1998, 1999; Berkowitz, Pistor and Richard, 2003a,b) or with when these transplants are expected to be successful or not (e.g., Glaesar and Schleifer, 2002). This paper covers new ground in that it assesses the transplant of a specific legal definition. The empirical setting of the paper is the first set of competition law cases in the Republic of South Africa to deal with the provision for excessive pricing. The cases are the 2007 Competition Tribunal ruling against Mittal Steel South Africa Limited (Mittal I) and the subsequent 2009 Competition Appeal Court ruling (Mittal II). Mittal I and Mittal II both deal with a complaint against Mittal Steel South Africa Limited (Mittal SA), brought before the South African competition authorities, that Mittal SA had been charging excessively high prices for its flat steel products.

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<sup>1</sup> The imitation and transplant of laws (and of other institutions, e.g., separation of powers, democracy) is a practice that is far from novel and uncommon, and that is not confined to developing and transition economies. For example, the California Fair Trade Law Act of 1931 was copied verbatim by ten other American states – typographical errors included. There are also many cases at the constitutional level. For example, the US constitution is an imitation of the constitution of the original American states. There are numerous other historical examples of imitation and transplant, from all continents and many historical periods.

<sup>2</sup> An excessively *low* and *high* price are both contemplated in the general definition of an excessive price. See [Treaty of Amsterdam](#) Art. 82, now Art. 102 of [Treaty of Lisbon](#). The concrete case considered here regards an excessively high price.

<sup>3</sup> Some warn that too much attention to the social and economic origins of law is improper. For instance, Wise (1990), presenting a gloss on the philosophical writings of Alan Watson and Roscoe Pound, warns that because law is influenced to a large extent by intellectual debates as well as dogma, the interrelationship between a law and its environment should not be overstressed. And classical natural lawyers would have argued that man has no influence over the content of law at all, that judges merely apply the law of a deity and give authority to it in the physical world (Watson, 1974). Hans Kelsen, on the other hand, argues that the content of law is neither determined by the collective society, nor by natural law conceptions such as morality, justice and reasonableness, but is determined by the legislator, who considers its prescriptions to be just and reasonable (Cowan, 1971). In Kelsen’s view, law is imposed from above and as such is not the subject of organic evolution. The notion of the autonomy of law was also part of Karl Marx’s criticism of the German Historical School. Marx (1859) stressed that law, as a part of ideology, in fact determined, rather than was determined by, forms of social consciousness.

The consideration of the effectiveness of this South African transplant is of particular interest given the general controversial character of excessive pricing. This is particularly clear if one considers the contrasting practices of the two regions that are most often object of imitation: the United States and the European Union. Under Section 2 of the Sherman Act, the United States does not regulate excessive pricing. Rather than follow the more sensible US practice, the Republic of South Africa chose to imitate the European Union, which regulates excessive pricing. In the EU, the mode of identification of excessive pricing by the courts has been through a number of arithmetic (including statistical) methods, which are widely acknowledged to be fraught with complexities. The Competition Tribunal in *Mittal I* rejected these arithmetic methods in favor of a novel conceptual approach. The Competition Appeal Court, in *Mittal II*, given its adherence to the interpretation of the Act, instead reverted to the arithmetic methods. We shall see that not only did the complexities of the arithmetic methods not spare South Africa, but that the general controversial character of excessive pricing did not spare South Africa either.

The paper finds that although the initial quality of the excessive pricing definition is poor, the degree of caution as to its application in its region of origin is relatively high. The caution regarding the use of the rule in the South African environment appears to be fairly comprehensive as well, at least by one of the two courts considered. However, when one delves deeper, these evaluations in fact do not guide the ultimate choice of application, i.e., the conduct of whether to apply the arithmetic methods or the conceptual one to assess an excessive pricing charge. It is argued that the initial quality of the definition is an insurmountable obstacle and that the South African courts have failed to generate a suitable alternative interpretation of the prohibition against excessive pricing. The consequence of this failure is an uncertainty of outcomes and potentially a coordination failure in respect of the relevant players in the economy. The principal problem is not so much a transplant effect, but that the transplanted rule is inefficient.

## **2. Institutions, law, and transplants**

The significance of context and history in relation to legal transplants becomes clearer once laws are identified as components of the complex web of social institutions that smooth human interaction.<sup>4</sup> Institutions are in fact a society's "rules of the game" (North, 1990: 3) – those regular patterns of behavior that a society's individuals usually follow. The distinguishing mark of an institution lies in its ability to elicit some recurring patterns of human interaction.

The signaling of expected behaviors is the mechanism through which an institution assists human interaction. Institutions "are primarily informational mechanisms that complement the information contained in competitive prices ... . In so doing they help add structure and order to what would otherwise be a more chaotic situation of strategic interdependence. In short, we behave the way we do because in many of our social and economic encounters we know what type of behavior is expected of us and others, and behaving that way is the 'equilibrium thing to do.' The purpose of ... institutions is to transfer such information" (Schotter, 1981: 143).

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<sup>4</sup> The notion that for an institution context and history are not a matter of indifference can be traced at least as far back as the German Historical School (Abraham, 2004). The German Historical School held a mystical, nebulous concept of the *volksgeist* by believing the people's spirit, determined by social and economic conditions, drives the body of custom over time (e.g., Friedman, 2008). The School further suggested that custom then becomes codified as law, and keeps pace with society's changes through its interpretation by jurists.

The degree to which an institution assists productive human interaction is the quintessential sign of its quality. The signaling of expected behavior is thus what defines a good institution, which serves at least two critical functions. At one level, a good institution serves to align individual and group incentives (e.g., Page, 2008: 116). For example, the transaction cost approach in the economics of organization suggests that when assets are nonfungible there can be opportunistic behavior and a tussle for quasirents if transactions are governed by standard market contracts. As a result, only the contract – the “institution” – of vertical integration can solve these perverse incentives (Williamson, e.g., 2010). At another level, a good institution facilitates the coordination of conduct and of expectations (e.g., Langlois, 1986). For example, institutions such as the law can facilitate coordination without agents having to think through the costs and benefits of their actions in each case (e.g., Posner, 2005: 158).<sup>5</sup>

We may generalize the two critical functions of a good institution – incentive alignment and coordination of conduct and of expectations – by simply saying that the basic purpose of a good institution is to reduce uncertainty. For a good institution ultimately aids the calculation of the expected return of purposive action by creating predictability. A “bad” institution instead does the opposite: it increases uncertainty by, for instance, increasing transaction costs or not clearly signaling which pattern of behavior to follow.<sup>6</sup> This paper mostly considers uncertainty tied to matters of coordination of conduct and of expectations by looking at some rules of the game that cloud rather than clarify the action set.

The birth and evolution of an institution is determined by the economic, political, and social character of its environment. As such, an institution generally should not be seen as a monolithic artifact that can be crudely transferred from one environment to another. The relevance of context and history for an institution also transpires from a Supreme Court ruling of a South African neighbour. The Namibian Supreme Court held that the Namibian Constitution is an “organic instrument,” which should be continually interpreted in order to keep pace with the changing values of the Namibian people.<sup>7</sup> The quality of an institution thus is informed by time and place,<sup>8</sup> and even a good institution must evolve over time in order to keep pace with change.

The transplant effect typically has been raised as problematic with respect to imposed transplants of entire legal orders (Berkowitz, Pistor and Richard 2003a,b). The English common law tradition is considered to be the best alternative in these circumstances as it better protects property rights if compared to the French civil law and socialist traditions (e.g., Mahoney, 2001). German and Scandinavian civil law traditions have been found to perform only slightly better than French civil law (La Porta, 1998). Berkowitz, Pistor and Richard (2003a,b) are in disagreement, and find empirical evidence to support the view that it is the legal transplant itself rather than the family of

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<sup>5</sup> Compare Alfred North Whitehead's (1911: 61) assertion: it “is a profoundly erroneous truism, repeated by all copy-books and by eminent people when they are making speeches, that we should cultivate the habit of thinking of what we are doing. The precise opposite is the case. Civilization advances by extending the number of important operations which we can perform without thinking about them. Operations of thought are like cavalry charges in a battle – they are strictly limited in number, they require fresh horses, and must only be made at decisive moments.”

<sup>6</sup> The view that an institution may not always be good is relatively recent (e.g., van Cayseele and van den Bergh, 1999). This view helped to shift the analytical focus from one that considers institutions as corrective instruments to remedy negative externalities, to one that appreciates also their ability to create positive externalities (Posner, 1998; Mackaay, 1999).

<sup>7</sup> *Government of the Republic of Namibia and Another v Cultura 2000 and Another 1 NmS 407 (1994).*

<sup>8</sup> To “transplant” the famous claim of Hayek (1945) about knowledge into another context.

law from which the transplant is taken from that has an indirect negative effect on economic development. Hall and Leeson (2007) instead consider the interface between the content of law and the level of development of a country to be the determining factor in the effectiveness of a legal transplant. Although the transplant effect is typically evaluated with respect to the involuntary imposition of legal orders, it applies equally to voluntarily accepted transplants and transplants of components of these orders, such as statutes and common law precedent.<sup>9</sup>

The consequence of ignoring context in the incorporation of even a good institution at its initial stages means that the good institution stands an inferior chance of being institutionalised as there is no demand for it (cf., e.g., Ruttan and Hayami, 1984; Gray, 1997; Ruttan, 2006; Boettke, Coyne and Leeson, 2008). To illustrate, the first law and development movement in the early 1960s was an attempt by US academics to impose American ideas and policies on developing economies in order to aid economic growth, and it failed for precisely the reason that it was an imposition. The economies in which the first law and development movement was introduced lacked the background to be able to fully internalise the aims of the architects of the movement (Trubek and Galanter, 1974; Merryman, 1977). Alternatively, a good institution which does endogenise context initially, but fails to adjust to changing circumstances, may progressively turn into a bad institution and stagnate (North, e.g., 1994).<sup>10</sup>

Even a problematic institution in one jurisdiction may be successfully transplanted within a new jurisdiction if it is integrated with caution to its new context. The problematic character may even be remedied by using an appropriate alternative application. But, where such alternative application is either not possible or is not attempted, if the institution is adopted, the result will simply be the perpetuation of an institution that is inefficient – a lock-in (e.g., David, 1985; North, 1990). Berkowitz, Pistor and Richard (2003a) suggest that the consequence of lock-in is the loss of legitimacy as the institution fails to align incentives and coordinate conduct, and becomes perceived as less trustworthy. Consequently, the demand for the institution declines.

The lock-in of an institutional path essentially occurs where there is no incentive on the part of those introducing the institution to adapt it to the new environment (e.g., Klein, 1999). The common law is considered by some to be particularly susceptible to lock-in as it is bound by the system of precedent (Liebowitz and Margolis, 1999). This argument is contrary to Posner's (1973) well-known assertion that the common law is essentially efficient, being a constant evolution towards the minimisation of waste in society. The validity of this assertion, however, has been disputed by a number of writers (e.g., Tullock, 1971, 1980; Rizzo, 1980a,b; Aranson, 1992; Hadfield, 1992). One argument in particular, which more recently has been accepted by Posner himself (Landes and Posner, 2007), is that judges' and litigants' incentives are often not in the interests of the

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<sup>9</sup> An example of the latter is that according to certain provisions of the Criminal Procedure Act 51 of 1977, where there are legislative gaps in the law of evidence, South African courts are bound by pre-1950 precedent of the English Privy Council, or pre-1961 precedent of the English Supreme Court of Judicature or the House of Lords, in respect of the law of evidence. The relevance of these cut-off dates is that South African appeals to the Privy Council were abolished in 1950 and South Africa attained status as a Republic on 30 May 1961.

<sup>10</sup> It is anticipated that an identical rule will be interpreted differently when applied in different jurisdictions (Berkowitz, Pistor and Richard 2003a,b; North, 1994). As elaborated in a moment, alternative interpretations are desirable when they are done with the local environment in mind and local factors are receptive to the transplant. And yet, the risk of rejection is concrete even in this case (Kahn-Freund, 1974). Even where the rule is not rejected, Grajzl and Grajzl (2009) point out that in comparison to indigenously developed rules, transplanted laws mean that even though the initial costs of legislating are avoided, the likelihood of incurring subsequent costs of amendment is higher.

economy as a whole, resulting in inefficient outcomes (Baumol, 1990; Niblett, Posner and Schleifer, 2008; Rubin, 1999). Notwithstanding the fallibility of the judiciary – if one accepts the basic premise that the law generally evolves for the better through sequential decisions due to its adaptability (Lopez-de-Silanes and Schleifer, 2008; Niblett, Posner and Shleifer, 2008) – the best method of law reform is that of having an initially good legislated rule which makes it less likely that politics plays a hand in the outcome of litigation. This is in fact a recent suggestion of Posner (1998) in a related context. Thus, the clarity and quality of the initial rule is key to maximizing the probability of obtaining efficient outcomes in common law systems.

A seemingly ideal place to look to for a rule of good quality is a developed country with efficient markets. The borrowing of laws from such countries is not uncommon – the American colonies' adoption of English common law after independence (Wise, 1990) and the Japanese and Chinese adoption of European codes are just two examples (Posner, 1998). Within South Africa, Roman Dutch law and English common law were transplanted after colonization with a relatively successful reception.

Overall, the literature suggests that in order for there to be an optimal legal transplant, two factors should be evaluated. First, the origins of the legal rule should be considered. As the presiding judge in a Supreme Court of Appeals judgment notes, before “simply transplanting a legal concept from one system to another, it is imperative first to examine the context in which the concept originated and developed in its system of origin.”<sup>11</sup> This means that the quality of the rule and the mode of application in the donor country should be analyzed by, for example, considering whether the rule successfully minimizes uncertainty in the donor country. Second, there should be caution to the application of the rule in the context of the new environment, in order to determine whether an alternative application will be appropriate to minimize uncertainty.

### **3. The case**

#### *3.1 Background*

Section 8(a) of the South African Competition Act 89 of 1998 (the Act) classifies the charging of an excessive price as a prohibited abuse of dominance. The section reads as follows: “8. Abuse of dominance prohibited. It is prohibited for a dominant firm to – (a) charge an excessive price to the detriment of consumers ... .”

For the definition of an excessive price, one must then return to Section 1 of the Act, the “definitions and interpretation” section. Section 1(ix) defines an excessive price as “a price for a good or service which – aa) bears no reasonable relation to the economic value of that good or service; and bb) is higher than the value referred to in subparagraph (a)... .”

This definition, like much of the content of the Competition Act, borrows heavily from a jurisdiction in the developed world (Reyburn, 2000: 36)<sup>12</sup>. Specifically, it borrows from the European case of *United Brands*<sup>13</sup>, in which the European Court of Justice held that there is an abuse of dominance when “charging a price which is excessive because it bears no reasonable relation to the economic value of the product... .”

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<sup>11</sup> *Meyer v Iscor Pension Fund* 2003 (2) 715 (SCA) at 733

<sup>12</sup> The jurisdictions that have primarily influenced the drafting of the Competition Act are the United States, Canada and the EU (Reyburn, 2000: 2-9, 2-30).

<sup>13</sup> *United Brands & Co. and United Brands Continental BV v Commission of the European Communities*, 1 CMLR 429 (1978).

The statutory provision that was before the Court in *United Brands*, then Article 82 of the Treaty of Rome, is a broader section than Section 8(a), and targets “unfair pricing” in general, prohibiting “directly or indirectly” imposing “unfair purchase or selling prices or other unfair trading conditions.” This umbrella provision prohibits predatory pricing alongside excessive pricing, whereas the South African Act distinguishes these offences and affords them separate recognition. The South African Act also gives legislative content to these terms, rather than leaving this up to the judiciary, by prohibiting the “selling of goods or services below their marginal or average variable cost” and defining the term “excessive pricing” as above. As will be discussed presently, both the Competition Tribunal and the Competition Appeal Court make reference to these legislative differences in their arguments against allowing foreign donor jurisdictions to unduly influence the judicial process in South Africa.

The approach of the European courts to excessive pricing as one type of “unfair pricing” may be described as arithmetic. Specifically, the methods of determining such a price include: (i) a price-cost analysis as an indirect measure of profitability; (ii) a direct profitability analysis using accounting methods; (iii) comparisons with the prices of the same firm for the same or a similar product within the same or different Member State; and (iv) benchmarking with the prices of a competitor or the prices of a non-competitor which produces a similar product (Reyburn, 2000: 7-37). What these methods have in common is that they are targeted at distinguishing a “fair price,” that is, a “competitive” price plus a reasonable rate of return, from an unfair price which exceeds this level (Motta and de Streel, 2003: 94).

The first method listed above, price-cost analysis, aims to distinguish between a price which bears a direct relation to the costs incurred in developing the product, and a price which is either innately unfair or is unfair when compared to competing products (*United Brands*, 1978: ¶252). This analysis is considered the first port of call in an excessive pricing analysis. Drawbacks of this analysis include the following. Firstly, the correct measure of costs has never been established – should these costs include historical costs or are current costs sufficient (Green, 2006: 83)? Should the dynamics of the market be taken into consideration (Gal, 2004: 45; Evans and Padilla, 2005a: 101)? How should the opportunity cost of capital be determined? Apart from these questions surrounding measurement, there are also concerns regarding competence<sup>14</sup>. Specifically, a competition authority, unlike a price regulator, may not possess the intricate industry-specific knowledge that would inform a price-cost analysis (Motta and de Streel, 2003: 109; Evans and Padilla, 2005a: 108; Ehlermann and Atanasiu, 2006: xxix). As will be seen later, the Competition Tribunal made much of this price-regulation role (which also applies to the other three methods) to justify an alternative approach to the arithmetic one used by the European courts.

The second method, profitability analysis, is also problematic. It relies solely on accounting determinants of profitability. This means that the opportunity cost of capital is not accounted for (Gal, 2004: 32), nor is it possible to extract the effect of a single product among a range of products over the time horizon of interest (Motta and de Streel, 2003: 109). This time horizon should be of reasonable duration for there to be any indication of sustained high prices. However, what constitutes such a reasonable period has not yet been agreed upon. A further problem with this method is that low

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<sup>14</sup> To use the terminology of Heiner (e.g., 1986: 256, note 36), suggesting that an agent can suffer from a Competence-Difficulty (C-D) gap deriving from the environmental complexity surrounding the choice faced or from the lack of decision skills tied to the choice faced. The C-D gap – as the crux of the matter more generally, as we attempt to show here – rests on knowledge problems and the law, being a “cognitive institution,” can help narrow it (e.g., Means, 1980; Berkowitz, Pistor and Richard, 2003b: 177).

profitability may disguise excessive pricing where the firm is in fact inefficient (Evans and Padilla, 2005a: 102, 105). This point was made by the Competition Tribunal in the first Mittal judgment (Mittal I, 2007: ¶36).

The third and fourth methods, which both involve making use of comparator prices, are the favoured methods of the European authorities alongside price-cost analysis, but are similarly marred by difficulties of application. The benchmark prices are either the prices of the firm which is under scrutiny or the prices of suitable comparator firms. However, in many instances, this suitability is questionable. For instance, in Europe as in South Africa, price discrimination by a single firm within a single market is justifiable when it is in the context of price-matching. Furthermore, in order for prices to be comparable, the products themselves should be of the same type and quality, which is often difficult to establish (Motta and de Streel, 2003: 18).

The European courts have in the past used these four methods either independently or in conjunction, despite their flaws. The general approach has been that the difficulties associated with performing an excessive pricing investigation are no reason to exclude it altogether<sup>15</sup>. However, the consequence of such an acceptance is the possibility of false convictions or false acquittals in any given case and the costs associated therewith (Evans and Padilla, 2005a: 114-118).

In brief, in their application of Section 8(a) of the Competition Act, the options before the South African authorities were either to accept the European approaches and lay out guidelines for their application, or to reject them in favour of an alternative approach. The Competition Tribunal chose the latter option, while the Competition Appeal Court chose the former option.

### **3.2 Mittal I: The decision of the Competition Tribunal**

In February 2004, Harmony Gold Mining Company Limited (Harmony) and Durban Roodepoort Deep Limited (DRD) lodged a complaint with the Competition Tribunal of South Africa regarding the prices which Mittal SA was charging for its flat steel products.

In March 2007, the Competition Tribunal handed down its judgment that Mittal SA was guilty of excessive pricing, making it the first firm in South Africa to fall foul of this prohibition. Mittal, Macsteel International BV (Macsteel International) and Macsteel Holdings (Pty) Limited (Macsteel Holdings) appealed both decisions before the Competition Appeal Court, which handed down judgment in May 2009. The Competition Appeal Court's judgment dismisses what it considered to be the fallacious reasoning of the Tribunal. What follows is a summary of the Competition Tribunal's application of Section 8(a).

In its application, the Competition Tribunal eschews the traditional arithmetic approach of the European courts, in favour of a novel "conceptual approach" (Mittal I, 2007: ¶31), which relies on the traditional structure-conduct-performance (SCP) framework. The steps in the reasoning of the Tribunal are as follows.

The Tribunal affirms its view in its judgment that the role of a competition authority is not to act as a price regulator (Mittal I, 2007). It specifically notes that an application of Section 8(a) "requires an examination of the underlying market circumstances that produce the price in question" (Mittal I, 2007: ¶151). Underlying competitive structures and conduct will organically give rise to competitive prices, and it follows that it is only

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<sup>15</sup> For example, in *Napp Pharmaceutical Holdings Limited and Subsidiaries and Director General of Fair Trading* Case No. 1001/1/1/1/01 at paragraph 392, the United Kingdom Competition Appeals Tribunal held that "the fact that the exercise may be difficult is not, however, a reason for not attempting it."

these underlying components with which the Tribunal need be concerned. So, the role of the authorities should be to promote competitively structured markets and to guard against exclusionary conduct of dominant firms (Mittal I, 2007: ¶175). To support this view, the Tribunal points out that neither Section 8(a), nor the definition of excessive pricing in Section 1, make any reference to cost benchmarks as does Section 8(d)(iv), the predatory pricing provision, nor does the Act as a whole endow the competition authorities with the mammoth powers and resources that it would require to undertake a price regulatory task (Mittal I, 2007: ¶180).

The Tribunal dismisses the European authorities as relying on a “simple arithmetic interpretation of price and value,” which is superficial and short-sighted. The first in a number of shortfalls pointed out by the Tribunal is that the arithmetic approach is “too static” (Mittal I, 2007: ¶157) for the reason that considering precise snapshots of prices may be incorrectly diagnosed as excessive, blinding the adjudicator to the underlying conditions which cause persistent high prices.

A further criticism is that it is a false assumption that “economic value” has “some intrinsically measurable content” (Mittal I, 2007: ¶157). The *United Brands* and *Port of Helsingborg*<sup>16</sup> cases are presented as illustrations of this failure. The court in the *United Brands* case suggested the comparison of prices and costs, but acknowledged that there are frequently great technical difficulties in working out production costs.<sup>17</sup> The court in the *Port of Helsingborg* case abandoned an own-price comparison approach because of the insufficient comparability of the services offered by the port.

The Tribunal points to the diversity of methods and to the fact that they present technical difficulties unique to the circumstances of each case as evidence of the ineffectiveness of any single arithmetic approach and the ineffectiveness of using the arithmetic approaches collectively. The Tribunal traces these various arithmetic attempts back to the nature of the European political climate – namely, that in Europe, the courts have all too readily adopted the mantle of a price regulator in order to promote the integration of the players in the region (Mittal I, 2007: ¶187). Its disdain for the adoption of this role and the approaches it dictates is reflected in the following extract:

It is clearly not possible to glean a single European conception of a pricing standard and measure of excessiveness, that is, an arithmetic relation between price and an intrinsic, measurable, economic value. Indeed a survey of the European jurisprudence serves to confirm our view of the pitfalls of competition authorities assuming a price regulating function as part of their excessive pricing jurisdiction. It is precisely to avoid the confusion and uncertainty generated by [our] jurisprudential maze ... that price regulators are accorded a specific statutory basis which assigns them appropriate price determination powers and, indeed, often prescribes the specific price determination mechanism that is to be employed (Mittal I, 2007: ¶159).

After having rejected price determination on the basis of its (lack of) competence, the intention of the legislature, and the recommendations of competition law and economics generally, the Tribunal proceeds to formulate its purely conceptual approach.

Putting its SCP framework in place, the Tribunal begins by considering the structure of the market. Its first criterion for excessive pricing is a firm's

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<sup>16</sup> *Scandlines Sverige AG v Port of Helsingborg*, Case COMP/A.36.568/D3 (Mittal I: 157).

<sup>17</sup> *United Brands* judgment (¶251; cited in Mittal I, 2007: 157).

"superdominance", a higher hurdle to pass than the simple condition of "dominance," defined under the Act in Section 7. Section 7 provides as follows (emphasis removed):

#### 7. Dominant firms

A firm is dominant in a market if –

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

Market power is defined in Section 1 of the Act 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".

The Tribunal, drawing on some recent academic literature on the topic (Mittal I, 2007: 95; cf. Whish, 2003 and Evans and Padilla, 2005a), finds that superdominance is the utmost form of dominance, which requires that the market share of a firm approximate 100% and that there be insurmountable barriers to entry. In the Tribunal's words, superdominance requires that the market should be both uncontested and incontestable (Mittal I, 2007: ¶96).

The Tribunal goes on to identify Mittal SA as superdominant in the market for flat steel products. It points out that Mittal SA was state-owned for a number of years, had its prices previously regulated by the state and is not considered a dynamic industry, e.g., characterised by investment and innovation (Mittal I, 2007: ¶102). Consequently, the market for flat steel products can be viewed as a "newly liberalised market," where the entry barriers behind which it operates are "at least as insurmountable as those constituted by law or licence" (Mittal I, 2007: ¶104-105). Mittal SA holds a vast share of this market (Mittal I, 2007: ¶107). Thus, concludes the Tribunal, Mittal SA satisfies the structural requirement of superdominance.

To this "superdominance" requirement, the Tribunal appends a caveat. The Tribunal points out that superdominance, when it is not the result of historical and technological barriers, is the consequence of a legal monopoly, where the firm in question has been granted an exclusive licence to operate. Such a firm would invariably be subject to regulation and would have no reason to be the focus of an investigation by the competition authorities. Hence, in order to be found capable of charging excessive prices, the firm should also be unregulated (Mittal I, 2007: ¶106).

The Tribunal then proceeds to acknowledge that competition authorities should not prohibit mere structural advantages (Mittal I, 2007: ¶131). Although not rational, it is conceivable that a superdominant firm may exercise some self-restraint in the face of public and governmental criticism (Mittal I, 2007: ¶132). What is more, Section 8 relates to an *abuse* of dominance (Mittal I, 2007: ¶133). This introduces the next leg of the SCP analysis, the conduct one.

The conduct which enabled Mittal Steel to persistently charge excessive prices, its "ancillary conduct", was found to be the effective segmentation of the export and domestic markets (Mittal I, 2007: ¶164). This segmentation was achieved by the production of a large quantity of flat steel, the quantity that enabled Mittal to produce at the lowest possible point on its cost curve, in order for it to produce profitably on international markets. Mittal then limited domestic supply by contractually preventing its joint venture partner and exporter, Macsteel, and certain of its rebate customers, from reselling the product at this lower price back into the domestic market (Mittal I, 2007: ¶165). The price which the domestic consumers paid was the Import Parity Price (IPP), the landed price of the imported product plus a 5% margin for "hassle factors."

The result was a local price that was lower than the landed price for imported flat steel, but higher than the price at which Mittal provided the steel to Macsteel and its rebate customers, and the contractually-enforced prevention of arbitrage between these two groups of customers.

In sum, the Tribunal has applied an SCP paradigm to identify a firm which is pricing excessively – it is one which is uncontested, incontestable, unregulated and engaging in abusive ancillary conduct.

### **3.3 Mittal II: The decision of the Competition Appeal Court**

The first criticism of the Competition Tribunal's approach by the Competition Appeal Court is that the Tribunal incorrectly focuses on the import parity price charged by Mittal to the domestic market as a signal of excessive pricing. The Tribunal emphasises that:

...the mere fact that if prices up to the constraining limit, to the point at which the boundaries [of the] geographical market dissolve and an alternative source of supply becomes realistic for its customers, provides no basis for determining whether ... price at that limit is higher than and bears a reasonable relation to economic value or not. The question is simply whether the actual price level at which imports constrain the price of domestic supplies is excessive or not when charged by the domestic supplier (Mittal II, 2009: ¶45).

The second basis on which the Appeal Court finds fault with the reasoning of the Tribunal is that the Tribunal goes beyond the scope of the Act in its interpretation of Section 8(a). The Tribunal introduces the concept of “superdominance” over and above the concept of dominance in Section 7, which is in fact the only prerequisite for an adverse finding under Section 8. In this way the Tribunal disregarded the principle that the legislature is primarily responsible for determining the content of punishable acts, whereas the role of the judiciary is to flesh out the application of these legislative rules (Mittal II, 2009: ¶30).

The difference in the two courts' interpretations of the Sections 7 and 8 is stark. The Tribunal focuses on the words “bears,” “reasonable” and “relation” to support its view that the legislature was intentionally vague in its drafting, and that it meant to reject the kind of analysis suggested by the European methods (Mittal II, 2007: ¶141). The Competition Appeal Court on the other hand looks to the words “charging,” “price” and “economic value” to support the arithmetic methods (Mittal II, 2009: ¶28, 34). In the Competition Appeal Court's view, the SCP line of reasoning employed by the Tribunal is simply not mandated by the Act. In its view, the wording of Section 8(a) requires that the alleged excessive price be identified, the “economic value” of the product be quantitatively measured, and that these two values be compared in order to determine whether there is a reasonable relation between them. The wording of Section 8(a) also requires that a value judgment be made as to whether the charging of the excessive price is to the detriment of consumers (Mittal II, 2009: ¶32).

With respect to the price regulation argument of the Tribunal, the Appeal court insists that the authorities are not being asked to set the ultimate price which should be charged by firms (Mittal II, 2009: ¶47). Furthermore, the Appeal Court denies that reference to the role of the competition authorities is absent from the Act. The power and duty of price

comparison, rather than of price regulation, is informed by the Act through the wording of Section 8(a) (Mittal II, 2009: ¶47).

Moreover, the Appeal Court is of the opinion that the Tribunal's approach is incapable of practical application (Mittal II, 2009: ¶34). It recognises the "conceptual as well as practical difficulties" of determining what constitutes an unfair price under Article 102 of the EC Treaty (Evans and Padilla, 2005: ¶97). It refers to "the difficulties of the necessary exercise, and the fact that competition authorities worldwide have struggled with excessive pricing cases." Despite this however, "none of them considered it possible to make a finding of excessive price without doing the exercise" (Mittal II, 2009: ¶53).

Unlike the Tribunal, the Appeal Court attributes the diversity of methods employed to the complexity of their difficulties (Mittal II, 2009: ¶48) rather than their complete failure, and finds that as in European jurisdictions, the South African approach to excessive pricing should employ a multiplicity of methods (Mittal II, 2009: ¶49). It traverses these methods and outlines some guidelines for their application.

First, the Tribunal emphasises that the arithmetic values obtained need merely be estimates based on the evidence before the relevant authority (Mittal II, 2009: ¶49). This it finds to be in line with the general methodology employed by the courts in dealing with probabilities to determine compensation in other fields of law (Mittal II, 2009: ¶49). Furthermore, with reference to the *United Brands* case, the Tribunal reiterates that a mere comparison of prices of the product offered to different buyers within the same market is insufficient for an excessive pricing enquiry (Mittal II, 2009: ¶39) and that a profitability approach may be preferred. The Appeal Court finds that the problems surrounding directly and precisely measuring profitability may be overcome by simply looking to the comparable prices of firms with broadly comparable cost structures at comparable levels of output (Mittal II, 2009: ¶50). However, it recognises that there may be a need for detailed adjustments to be made in the case where prices are not comparable to begin with. These adjustments may involve allowing for the opportunity cost of capital, depreciation, expansion of the firm etc (Mittal II, 2009: ¶52). The Appeal Court then goes on to consider the approach used in *General Motors*, where the court found that the real economic cost of operation of a product revealed its economic value. This approach provides that the competitive-market standards of costs should be looked at when determining economic value, without taking into account any special advantage which the particular firm enjoys. These should only be taken into account when determining whether the firm's price is justifiable in comparison to the economic value of the product. In the Tribunal's view, the advantage of this approach is that it would reveal excessive pricing even where accounting profits do not (Mittal II, 2009: ¶43).

In brief, the Appeal Court acknowledges the problems of the arithmetic approaches, but finds these to be surmountable. This conclusion must be viewed in light of the Appeal Court's preference to apply the section within the scheme of legislative design, which requires the finding of three price levels and their comparison. The impermissible alternative in the face of difficulties is that there be no excessive pricing provision at all, as in the United States (Mittal II, 2009: ¶60).

The Competition Appeal Court's ultimate order was that the evidence which was presented to the Tribunal be reconsidered by the Tribunal within the statutory framework provided by the Act, as outlined (Mittal II, 2009: ¶81).

**4. Uncertainty, institutions, and coordination**

**5. Conclusion**

**References**