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Abuse of Dominance in South Africa: A Critical Appraisal of Enforcement since Inception and implications for future policy direction

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ABSTRACT

Economic research suggests that a lack of effective competition in markets in the manufacturing sector is a major impediment to achieving the greater levels of productivity growth needed to kick-start economic growth and lower unemployment. This means that there are great expectations for competition law and policy to address sub-optimal outcomes in concentrated markets in the manufacturing sector. While anti-cartel enforcement has been robust the authorities have not been as successful in dealing with abuse of dominance. Given the expectations regarding the benefits of more effective competition in facilitating greater productivity in markets that are the focus of industrial policy it is likely that there will be increasing pressure to see more robust outcomes in the enforcement of the abuse of dominance provisions in the Competition Act. In this paper we provide an appraisal of the performance of the authorities in respect of enforcement abuse of dominance provisions so far. Some tentative recommendations will be made on how best to assess enforcement performance on the basis of an understanding the limitations of the scope of chapter 8, as well as recommendations on how policy and legislation might be improved to aid more effective enforcement given the particular economic challenges facing the South African economy.

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Introduction

Since inception in 1999 the competition agencies in South Africa have achieved notable successes in dealing with cartels and collusive conduct. A substantial number of cases have ended in penalties being paid by contravening parties, mainly through settlement. This indicates significant progress in detection and enforcement in respect of cartel conduct. The South African competition authorities have also established themselves as credible and effective in the area of merger control. However, the track record of the competition agencies in dealing with abuse of dominance has not been as impressive. Although there have been some notable successes these have been few and far between. This seems inadequate considering the prevalence of market power positions throughout the economy. For example, Aghion et al² report on the average estimated mark-up by three digit manufacturing sector, over the 1971-2004 period. They found that more than half the sectors have a mark-up in excess of 50%, and approximately thirty per cent of sectors have a mark-up in excess of 77%.³

Given the effectiveness of the competition agencies in anti-cartel enforcement and merger control it is unlikely that the poor track record in dealing with abuse of dominance can be attributed solely to an institutional failure to enforce effectively. Roberts⁴ highlights, among other things, the various challenges in successfully meeting the legal standards required by the rule of reason based approach stipulated in the Act, the designation in the Act of distinct seemingly artificial forms of abusive conduct (as opposed to a more holistic approach), and the legalistic procedure that has developed in the Tribunal processes resulting in lengthy proceedings. The recent amendments to the Competition Act providing explicit powers for market enquiries arises at

² Aghion, Braun, Fedderke (2008) 'Competition and Productivity Growth in South Africa' *Policy Brief CID/Harvard - South Africa Growth Initiative*

³ Ibid. pg

⁴ Simon Roberts (2012) 'Effects-Based Tests For Abuse Of Dominance In Practice: The Case Of South Africa', Centre for Competition Economics, University of Johannesburg.

least in part from a recognition of the limitation of the abuse of dominance provisions in dealing with markets in which competition is not effective. This suggests that the factors impacting on enforcement performance of the competition agencies on abuse of dominance are rooted not only in institutional performance but also connect with problems and challenges in the legislation, the judicial process, the policy framework and the features of the South African economy.

The purpose of this paper will be to critically appraise the performance of the South African competition law and policy regime from a contextual perspective taking into account the factors indicated. Some tentative recommendations will be made on how best to assess enforcement performance on the basis of an understanding the limitations of the scope of section 8, as well as recommendations on how policy and legislation might be improved to aid more effective enforcement given the particular economic challenges facing South Africa.

Challenges facing the South African Economy

The challenges facing the South African economy today arise from a combination of domestic and global factors. The particular circumstances of its history, as well as its geographic location have played an important role in the development of the South African economy. As noted in Weeks⁵ (2011) remoteness from world markets and dependence on natural resource extraction, together with the race based policies of the apartheid government in the twentieth century, produced an isolated inward looking economy in which strong relationships between government and business were forged, monopoly concessions granted, major corporations protected, and strategically important industries developed under state ownership. By the 1980s there had been an escalation of policies such as import substitution

⁵ Keith Weeks (2012) 'Building Credible Competition Agencies in Developing Countries: lessons from South Africa' in Richard Whish and Christopher Townley *New Competition Jurisdictions: Shaping Policies and Building Institutions*, Edward Elgar Publishing.

and other protectionist measures, often in response to economic sanctions against apartheid.

Tariff protection, for example, was extensive and served to protect various industries, often in intermediate industrial products, but also in textiles, food and agro-processing. Many agricultural markets had been regulated by control boards for decades and cartels were sanctioned in certain markets: for example, there had been a legalized cartel in cement until as late as 1996. By the time of the transition to democracy in 1994, 84 per cent of the capitalization of the Johannesburg Stock Exchange was constituted by five investment conglomerate.⁶ This concentration of ownership was also manifest in concentrated markets characterized by complex crossholdings and extensive vertical integration across the value chain. This situation presented considerable barriers to potential entrants who also had to contend with a closed club of insiders who had benefited from government support and protection during the years of apartheid isolation. In addition to this, concentration in many sectors has been magnified by the presence of natural scale economies in a domestic market that is small by global standards and geographically remote from world markets.

The South African economy has performed poorly since the transition to democracy in respect of both economic growth and employment. Research by the Harvard University Center for International Development Project on South Africa attributes this to underperformance in the non-resources tradable sector and manufacturing in particular.⁷ If one compares the performance of the South African economy to countries like Malaysia, which faced similar structural problems, there is a good case to be made that a rapid expansion of the manufacturing sector creates growth and employment for low-skilled workers. Unfortunately, unlike Malaysia, South Africa has not had much

⁶ OECD (2002)

⁷ Dani Rodrik 'Understanding South Africa's Economic Puzzles' John F. Kennedy School of Government - Harvard University September (2006) Harvard University Center for International Development Project on South Africa

success in developing its manufacturing sector and consequently suffered low rates of growth and unacceptably high levels of unemployment.

An examination by Fedderke⁸ of the distribution of output across the principal aggregate sectors between 1970 and 2009 shows a steady decline in the relative contribution of primary and manufacturing sectors and a rise in the contribution of services. The distribution of employment across sectors shows a similar pattern, with the relative contribution of primary and manufacturing sectors to total employment declining, and financial and business services showing strong growth. The decline in manufacturing in particular has not been conducive to achieving a sustained growth path and the shift to services has exacerbated inequalities in the labor market, with the associated skills bias having a particularly pernicious effect on the employment prospects of low-skill labor.

The reasons for this poor performance are manifold. South Africa's history and its geographic disadvantages are certainly a major impediment. Other factors that have been sited are rigidities in the labor market, a failure to develop human capital, declining terms of trade and a lack of competitiveness in global markets. Over the last few decades South African industries have generally not fared well in the face of increasingly competitive global markets and have languished "between advanced countries at the high end and China at the low end."⁹

For purposes of this article it is appropriate to consider what role market structure and competition rigidities have played in South Africa's poor growth performance.

⁸ J.W.Fedderke (2012) 'Competition, industrial structure and economic growth'
Economic Research South Africa Working Paper 330.

⁹ Dani Rodrik 'Understanding South Africa's Economic Puzzles' John F. Kennedy School of Government - Harvard University September (2006)
Harvard University Center for International Development Project on South Africa, pg

Fedderke¹⁰ examines the impact of competitive pressure on industrial structure and performance. In this study a lack of competitive pressure is reflected in the market power of firms in industries as measured by the average mark-up of price over marginal cost in manufacturing and other sectors in South Africa. Earlier studies, Fedderke¹¹ and Aghion¹² suggest these are on the high side, finding that the average mark-up of price over the marginal cost of production for South African manufacturing sectors, for the 1970-97 period, was between 77% and 79% and for the 1971-2004 period an average of 54% for South African manufacturing was reported. Fedderke¹³ extended this analysis to compare mark-ups in a sample of 56 countries in which South Africa is included. The analysis also compared the ratio of net income to assets of South African listed firms to that reported on average for the other 55 countries in the sample. For the period 1980 to 2004 Fedderke found that:

“across all sectors of the South African economy, the return on assets is considerably higher than in the rest of the world. For no sector is the ratio lower than 1.42 as high as elsewhere in the world, and in the majority of sectors the return on assets in South Africa is twice as high as elsewhere in the world. What is more, for a number of sectors returns on assets are three times as high as elsewhere in the world, and in one instance 4.5 times as high.

To the extent that mark-ups are related to the net return on assets therefore, the inference is thus not only that mark-ups are high in South Africa, but that they are high in comparison with other countries.

¹⁰ J.W.Fedderke (2012) 'Competition, industrial structure and economic growth' *Economic Research South Africa Working Paper 330*.

¹¹ Feddeke 2007.

¹² Aghion, Braun, Fedderke (2008) "Competition and Productivity Growth in South Africa" Policy Brief CID/Harvard - South Africa Growth Initiative

¹³ J.W.Fedderke (2012) 'Competition, industrial structure and economic growth' *Economic Research South Africa Working Paper 330*.

What is more, the high rates of return on assets are not restricted solely to the manufacturing sectors.

Note that the Transport and Financial sectors return the second and fourth highest rate of return on assets relative to the rest of the world (a return on assets approximately three times as high as elsewhere), while the Retail, Construction and Recreational service sectors all show rates of return on assets approximately twice that observed on average elsewhere in the world. Once again therefore, not only are South African mark-ups high, but the manufacturing sector does not appear to be exceptional relative to other sectors in the economy.

It is also worth noting that over time, the structure of returns on assets (and by inference the mark-up) in South Africa has changed from favouring small firms, to dramatically favouring large producers.”¹⁴

What does this mean for the South African economy? Fedderke¹⁵ argues that the persistence of high mark-ups across sectors in South Africa has had dramatic implications for productivity growth and employment. In one scenario it is estimated that had mark-ups been lowered by 20 percentage points, GDP would have been 50% higher. A much more moderate reduction (a 10 per cent lowering of average mark-ups) shows GDP 21% higher compared to the actual level achieved by 2009. The impact on employment from the growth in manufacturing associated with lower mark-ups would also have been substantial. Although the South African economy would still have experienced high levels of unemployment had there been a moderate reduction in mark-ups this rate would have been significantly lower¹⁶.

¹⁴ Fedderke pg.

¹⁵ J.W.Fedderke (2012) ‘Competition, industrial structure and economic growth’ *Economic Research South Africa* Working Paper 330 pg 14-24.

¹⁶ “The broad unemployment rate would still have been substantial, peaking at 29%, but nonetheless by 2005 it would have stood at 28% (simulated) rather than the 41% actually observed”. Fedderke, page 22.

Policies to address economic challenges

Addressing these challenges requires a combination of macroeconomic and microeconomic policies. A discussion of these is beyond the scope of this paper as that would lead to a discussion of issues that would clearly fall outside the remit of competition law and policy. There is also the danger of confusing competition policy objectives with other policy objectives, like industrial policy. However, competition policy cannot function in a vacuum. Its effectiveness, indeed the rationale for its very existence, will be judged on its contribution to improving economic conditions in South Africa. It is therefore important to understand how competition policy connects with various other policy instruments for addressing market structure problems in the South African economy.

Fedderke notes that industrial policy can be conceived from two different perspectives. The first perspective sees an active role for state intervention in nurturing and developing industries and sectors. The second perspective is skeptical about the effectiveness of targeted intervention given the difficulty of judging success *ex ante*. This perspective thus emphasizes the importance of promoting effective competition in industries to generate production efficiencies.¹⁷

The first perspective embodies targeted industrial policies aimed at stimulating private investment and entrepreneurship. Such an approach is reflected in the Industrial Policy Action Plan of Department of Trade and Industry¹⁸, an ambitious plan for implementing this approach.

It is less clear what policy prescriptions are implied in the second approach. As it proposes creating conditions for more competitive pressure on industries this would suggest a role for competition policy. However, looking at the case

¹⁷ J.W.Fedderke (2012) 'Competition, industrial structure and economic growth' *Economic Research South Africa Working Paper 330* pg 37.

¹⁸ Department of Trade and Industry (2010) *Industrial Policy Action Plan 2012/13 to 2014/15*.

of China Fedderke observes that lower mark-ups there were most likely due to the role of the State in the economy. In particular, it appears that extensive State ownership in firms may have had a moderating impact on the behavior of those firms.¹⁹

Although Fedderke appears to eschew the active industrial policy of the Hausmann/Rodrik variety his observations about China suggest that the two perspectives are in fact complementary. In this regard it is likely that extensive ownership of the State in firms in China is a consequence of active State led industrial policy. Competition policy may also have played a supporting role, though the extent of this is not known.

Fedderke also addresses the often-used argument that in order to be competitive abroad domestic firms depend on significant market power in the domestic market to support an effective export strategy. The evidence from Fedderke's research suggests that the reverse is likely true:

Neither pricing power nor industry concentration is statistically significantly associated with any of the trade variables - though pricing power is negatively associated with export, import and net export levels, while concentration levels are positively associated. There is thus no support for the suggestion that significant market power in the domestic market, allows South African manufacturers to pursue more aggressive export strategies in international markets. If anything the reverse is true. Moreover, the negative impact of pricing power on imports, suggests that the presence of pricing power in domestic markets, may prevent entry into markets by foreign producers, thereby limiting competitive pressures on domestic markets²⁰.

An important insight from this report is that measures which incentivize firms to moderate their pricing behavior in the domestic market may have

¹⁹ J.W.Fedderke (2012) 'Competition, industrial structure and economic growth' *Economic Research South Africa* Working Paper 330 pg 38.

²⁰ Ibid, page 36

significantly large benefits for improving productivity and output if it becomes a generalized practice.

A further insight is that such moderating behavior need not arise from direct regulatory intervention but from a combination of positive and negative incentives. In the case of China negative incentives would include the threat of negative sanction by state interests through the influence of ownership, while positive incentives would have include the pressure of competition and opportunities to expand and grow profits through exports.

South Africa is, of course, not China and so caution is needed before blindly replicating policies that might work there but that would not be practical given circumstances here. For example, active involvement by the state in South Africa through extensive ownership stakes is probably not feasible and, if the track record of state owned enterprises is anything to go by, would probably do more harm than good. However, it would still be beneficial to determine if there is an appropriate mix of positive and negative incentives that might bring about a more generalized moderation in the pricing behavior of dominant firms. In this regard the role of competition policy is of particular relevance.

The role of competition policy

In a policy brief for the CID South Africa Growth Initiative Aghion, Braun, and Fedderke identify competition policy as an important instrument for achieving productivity growth through more effective competition in markets:

“A second direction where to direct competition policy, is the conduct of anti-trust actions. In South Africa, unlike in other countries worldwide, the Competition Commission used to intervene only upon request by private parties, but never on the government’s sole initiative. Thus, if private firms decide to collude on maintaining high mark ups and preventing entry, and then collude on not denouncing such practices, nothing happens to prevent such collusions. We propose instead that competition authorities in South Africa adopt a pro-active rather than a

complaints-driven approach, with the SA equivalent of the US Department of Justice playing an active role in enforcing higher competition”.²¹

Although Aghion et al refer to cartel conduct the Competition Commission has in fact been quite proactive in this area and significant progress has been made in addressing this issue. However, to the extent that the problem of productivity growth relates to the behavior of firms in concentrated markets it is appropriate that attention should also be paid to the unilateral conduct of firms with market power. The problem of unilateral market power abuses is far more intractable than that of hardcore cartel conduct. The reason for this is that while there is a clear line that is crossed when there is an explicit agreement to collude there is no clear line in the case of unilateral conduct. In a concentrated market with dominant firms independent decisions such as to follow a price leader or charge the highest price the market will bear are consistent with rational commercial behavior. Likewise the line between aggressive but legitimate competition and exclusionary abuse is also very difficult to ascertain. The reality is that even if there were no cartels left in the South African economy that, on its own, would not address the problem of significant market power in the many concentrated markets in the South African economy.

Although they referred to cartel conduct Aghion et al likely had in mind all the relevant level instruments for addressing anticompetitive behavior. Therefore, the issues regarding the role of competition policy, as raised by Aghion et al remain relevant.²²

The proposals by Aghion et on policy raise some interesting questions about the role of competition policy and the independence of the regulator:

²¹ Aghion, Braun, Fedderke (2008) “Competition and Productivity Growth in South Africa” Policy Brief CID/Harvard - South Africa Growth Initiative, pg 2.

²² Ibid.

1. **Directing competition policy and the role of government in enforcing higher competition.** In this regard the issue to be addressed is where competition policy should be directed and who will be doing the directing? What is meant by a greater role for government in enforcing higher competition? What does this mean for the independence of the competition authorities?
2. **Proactive versus reactive approach.** Significant resources are committed towards responding to third party complaints. Do the investigation of these complaints produce results in terms of addressing competition problems in the relevant markets? Would a more targeted proactive approach produce better results?

Aghion et al suggest more active enforcement of higher competition through an institution like the Department of Justice in the US. If by this they mean a role for competition policy in addressing competition problems that are of national importance or that affect numerous markets across different regions then that is already within the mandate of the existing competition agencies in South Africa. South Africa is not a large economy like the United States and distinct regionally based competition agencies (like the FTC in the USA) are probably not justified.

However, if by this Aghion et al mean to propose the direct involvement of the state in enforcing competition in markets then this raises serious questions about the independence of the competition agencies. The current legislative framework provides for the establishment of independent investigative and adjudicative agencies that are clearly not subject to direct interference from government. As well as being independent the judicial process is such that decisions are not left to the discretion of a particular entity but must follow due legal process including rights to appeal through a specialist appeal court. Now this does not rule out the possibility of greater state involvement at the investigative stage while still retaining independence and due process by allowing adjudication through the courts (as is the case in the United States).

The question then becomes whether or not greater state involvement is desirable in the investigative stage. As the investigative agency in South Africa, the Competition Commission has considerable independence. While it may be subject to political influence and lobbying (as any institution in this position would be) it nevertheless has considerable discretion in directing its own enforcement activity. There is no legal mechanism that obliges the Commission to align with or adopt the priorities of the state.

There are distinct benefits to retaining this independence and discretion. In particular, given interdependencies in the South African economy any politicization of policy is more likely to take place when a government department leading industrial policy becomes involved. The temptation to use competition law to support short-term goals²³ around industrial policy would be too great and the end result would most likely be a misdirection of enforcement activity and a neutering of competition agencies.

An independent competition agency is nevertheless still responsible for its own effectiveness. If it is not able to contribute toward improving competitive conditions where they need to be improved then it risks irrelevance, which could result in its funding being deprioritized or in disruptive legislative review.

The Commission therefore finds itself in the difficult position of managing expectations and directing its own activity in a manner that achieves maximum impact and relevancy. This is preferable however to a situation where its independence is compromised by direct intervention by government. The very good track record of the competition agencies so far in merger control and anti-cartel enforcement suggest that this is a model that can work.

²³ For example, industrial policy actions often involve industry discussions that bring competitors around the same table. This may be legitimate for industrial policy purposes but nevertheless creates an opportunity for collusion. The temptation to co-opt the competition agencies in such a situation or remove them as an obstacle so that policy objectives can be expedited would be significant. An independent agency standing at a healthy distance and focused on its mandate is preferable and more conducive to firms ensuring their own compliance with competition laws when engaged in such processes.

Assuming general acceptance of the benefits of strong independence, our view is that the attention should be on how the Commission should best direct its enforcement activity in a manner that achieves relevance and impact. The attention of policy makers should then be on how best to support the Commission in achieving its objectives in terms of its mandate. This may include support in the form of more resources but also, importantly, constructive legislative amendments aimed at making the Competition Commission more effective.

It is from this perspective that we see merit in a critical appraisal of the enforcement of the abuse of dominance provisions.

Appraisal of the performance of the authorities in enforcing abuse of dominance provisions

In a review of the competition authorities enforcement of abuse of dominance provisions conducted in 2012 Roberts found that:

The Competition Tribunal has only decided on nine dominance cases over the past eleven years, finding that abuse occurred in six (on the part of Patensie, South African Airways (twice), Sasol, Mittal Steel SA and Senwes). However, in three of these the finding was overturned (against Sasol and Senwes) or set aside and remitted by the Competition Appeal Court (against Mittal Steel SA). Nor has the Commission been aggressive enforcer, only referring five of the cases on which the Tribunal has ruled, the other four having been referred by private parties after the Commission declined to pursue them. (In the second SAA case the Commission settled without an admission and the complainants subsequently launched their own case on which they got a favourable Tribunal decision).

This means that over the twelve years under review, only two firms, Patensie and South African Airways, have conclusively been found guilty of abusing a dominant position. And, only SAA has been subject

to a penalty.

There are 18 abuse cases in all that have been referred to the Tribunal, meaning an average of approximately 1.5 per year. A further two cases that were not referred were subject to settlements, making 20 cases in total in Table 1. Other than the nine on which the Tribunal has made a determination, a further six have been referred and are awaiting a Tribunal hearing or the hearing is underway. The further five cases that make up the 20 were the subject of settlements with the Commission, one of which the Tribunal did not confirm²⁴.

Since the time of writing of Roberts' article the Tribunal has made a conclusive finding in only one other abuse case. In August 2012 the Competition Tribunal found that Telkom had abused its dominance and imposed an administrative penalty²⁵. This case had been referred by the Commission in 2004 after a two-year investigation, and so took ten years to be finalized from the filing of the complaint to adjudication.

According to the 2011/2012 Annual Report of the Competition Commission there were 258 cases under investigation during that year, of which 156 complaints had been received during the course of that year. A total of 84 investigations still underway were carried over from the previous year and a further 18 investigations were initiated by the Commission. According to the report 138 cases did not make it past the Commission's screening, and most of those that were not investigated further were complaints of abuse of dominance. A quick look at the annual reports of previous years shows a similar pattern, with the number of complaints received increasing and the number of investigations increasing but very little change in the number of abuse cases referred and successfully prosecuted.

²⁴ Simon Roberts (2012) 'Effects-Based Tests For Abuse Of Dominance In Practice: The Case Of South Africa', Centre for Competition Economics, University of Johannesburg page 10, 11.

²⁵ Competition Commission versus Telkom SA Limited, Case Number: 11/CR/Feb04

Despite the large number of complaints of abusive conduct received there clearly is a very low success rate of successful referrals. Indeed, it appears that very few abuse complaints are taken forward for further investigation.

These very low investigation and referral rates are strikingly incongruent with the story told by Fedderke and others about the pervasive lack of competition and high mark-ups across markets and sectors in the South African economy. Even the small number of complaints that survive the screening process for further investigation relative to the large number of complaints of abusive of dominance seem incongruent, though it must immediately be recognized that a great many of those complaints may have been spurious or otherwise outside the jurisdiction of the Commission.

Be that as it may, there is a disconnect between the level of enforcement of the abuse of dominance provisions and the severity of the problem of concentrated markets and ineffective competition across sectors in South Africa.

One would be tempted to conclude that the Commission has simply not been an effective investigator of this kind of conduct. While there is certainly merit in the Commission increasing its investigative capacity in this area, and undoubtedly scope for improving performance, it seems unlikely that this is the primary cause, especially given the Commission's track record in dealing with other conduct where it has been able to do so.

An important contributing factor has been the Commission's prioritization strategy given its resource constraints. The Commission is a relatively young institution and has had to focus its attention on those areas where an allocation of resources would be more likely to produce results. It should not be surprising that the Commission focused first on mergers and then on cartels. The framework for merger control lends itself to expedited outcomes. In that case the big test was whether the Commission and Tribunal could be competent and credible in administering this function. They passed the test with flying colors, but in doing so had to commit significant resources and

attention to mergers, particularly in the early years when it was still in its infancy. The next big priority area for the Commission had to be cartels. Again the Commission has had success in this area but also because considerable resources were directed to dealing with cartels. One reason to prioritize enforcement in the direction of cartels is because this is considered the most egregious form of anti-competitive conduct and, to the extent that it is was a pervasive problem in the South African economy, in need of urgent attention.

Another major consideration is the fact the burden of evidence in establishing a s4 violation is different to a that of abuse of dominance. With cartel conduct prohibited per se but abuse of dominance being decided on a rule of reason basis it was always going to be the case that the return on investment in anti-cartel enforcement will be greater than the return from investing resources on enforcement of the abuse of dominance provisions.

However, these resource and prioritization considerations notwithstanding, the Commission's experience in those cases where it has committed resources to pursue abuse of dominance cases has been fraught with difficulties and challenges.

Roberts ²⁶ highlights, among other things, the various challenges in successfully meeting the legal standards required by the rule of reason approach stipulated in the Act, the designation in the Act of distinct seemingly artificial forms of abusive conduct (as opposed to a more holistic approach), and the legalistic procedure that has developed in the Tribunal processes resulting in lengthy proceedings. The recent amendments to the Competition Act providing explicit powers for market enquiries arises at least in part from a recognition of the limitation of the abuse of dominance provisions in dealing with markets in which competition is not effective. This suggests that the factors impacting on enforcement performance of the competition agencies on abuse of dominance are rooted not only in institutional performance but also

²⁶ Simon Roberts (2012) 'Effects-Based Tests For Abuse Of Dominance In Practice: The Case Of South Africa', Centre for Competition Economics, University of Johannesburg.

connect with problems and challenges in the legislation, the judicial process, the policy framework and the features of the South African economy.

A rule of reason approach to alleged prohibited conduct cases is often justified on the basis that the benefits that large firms bring to the economy through innovation and efficiencies often outweigh the harm done as a consequence of their conduct in achieving and maintaining dominance. Over enforcement against dominant firms may end up doing more harm than good by unduly penalizing dominant firms, thus chilling innovation and efficiency, by disincentivising them.

The rule of reason legal standard set in the Competition Act around abuse of dominance therefore errs on the side of under enforcement being preferable to over enforcement. It might be argued (without direct evidence) that the drafters of the current legislation were convinced by arguments that there were significant risks attached to over enforcement compared to some alternative approach which would have seen a simpler and more expedited path to enforcement against abuse of dominance. Certainly the lack of a penalty to be imposed for a first time offence for certain of the prohibited practices under s8 suggest that this might have been the case.

However, the pervasiveness of high mark-ups due to pervasive and significant market power in the South African economy, as indicated in the research of Fedderke and others, suggests that the risk of over enforcement in South Africa is often overstated.

Roberts (2012) adds to this:

The South African experience raises sharp questions about what a structured rule of reason means for a country in the 'south Atlantic'. It highlights that we are unlikely to be concerned with borderline dominance issues and instead need to pay attention to super-dominant firms in entrenched positions. The costs of over enforcement are relatively low in such cases. Instead the need is to work for more

*effective enforcement, bringing together solid analysis of strategies of exclusion with evident effects on rivals and consumers, while allowing for efficiencies. It does not mean just leaving things to a case-by-case analysis*²⁷

The challenges of the structured rule of reason framework in the Act, coupled with the fact that there are no penalties on a first offence of some of the prohibited abuses, means that the deterrent effect of possible s8 sanction is very low if not non-existent. Given how difficult it is to investigate and then prove an abuse of dominance case and the lengthy litigation that has gone in to fighting cases that have been successful it would seem that there is much to gain and little risk of losing for those firms seeking to abuse their market power.

Recommendations

Based on the arguments in this article we would submit that there are strong grounds to consider legislative amendments to the abuse of dominance provisions in order to facilitate more effective enforcement. This does not mean bringing in a form-based approach that would not allow any scope to weigh harm against efficiencies. It would be important that some form of defense on the basis of efficiency or pro-competitive benefit be retained.

However, the current provisions are problematic in that they identify a list of distinct practices constituting abuses that are then adjudicated on a rule of reason basis. This brings in a double hurdle in that in order to make a case the alleged conduct must not only be shown to harm competition but also must be identified with one or other of the listed practices in the Act. This has undermined the establishment of a common standard through precedent as it has forced a tortuous case-by-case fitting of facts to particular practices. There are therefore inconsistencies in the case law as adjudicators grapple

²⁷ Simon Roberts (2012) 'Effects-Based Tests For Abuse Of Dominance In Practice: The Case Of South Africa', Centre for Competition Economics, University of Johannesburg, page 31

with this problem and it complicates investigation because the facts in the real world do not easily fit the artificial distinctions made in s8 of the Act.

A provision which provides for a single effects based test for exclusionary abuses, as proposed by Roberts (2012)²⁸ and explored more fully in his article, would facilitate more focused investigation into the effects of conduct (rather than trying to fit facts to artificially defined practices) and would simplify the adjudication process thus allowing for better guidance to be set through precedent.

Connected with a simplified effects based test the introduction of penalties for first time offences would raise the deterrent impact of the abuse of dominance prohibitions.

Finally, there is the question of the Commission's resources. Even with a doubling of resources the Commission would never be able to tackle the problem of concentrated markets in South Africa by trying to get to all of them. What is needed is effective deterrence through strong precedents and high penalties for offenders. With time, a robust regime will lead to a change in behavior if firms face a real threat of sanction. What is needed to achieve this is a legislative framework that supports rather than hinders effective investigation and adjudication. If this is achieved, then effective enforcement against abuse of dominance can be achieved by focusing on a few quality cases rather than many cases that are a drain on resources and have little prospect of success

²⁸ Ibid

