Are South Africa's Predatory Pricing Rules Suitable?

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In certain competition law jurisdictions, such as the United States and Europe, predatory pricing rules have been developed by courts. These rules have been refined over time to reflect advancements in economic theory, and fit the circumstances of the country in question. By contrast, in South Africa the primary rules forbidding predatory pricing are entrenched in legislation. The Competition Act prohibits a dominant firm from *'selling goods or services below their marginal or average variable cost'*, if this has an anti-competitive effect which is not outweighed by technological, efficiency or other pro-competitive gains[2]. This provision has not yet been properly tested, although a case of predatory pricing is underway before the Competition Tribunal[3].

This paper examines whether South Africa's law prohibiting predatory pricing is suitable. This requires more than simply picking a foreign jurisdiction and comparing our law to its equivalent provisions. An appropriate rule should be tailored to the economic environment in which it must operate, and reflect local enforcement priorities. Of course, it should also incorporate modern economics and draw on relevant international competition law experience.

Section 1 sets out the basic theoretical considerations which must be taken into account in designing a predatory pricing rule, and summarises the development of these rules in the US and Europe. **Section 2** identifies the essential characteristics of South Africa's economy and then suggests the features that an appropriate 'South African' predatory pricing rule should exhibit. **Section 3** evaluates whether the predatory pricing rules contained in section 8(d)(iv) of the Competition Act are suitable, in light of South Africa's circumstances, economic theory and international experience. It appears from this analysis that the test in the Act is unduly narrow. **Section 4** searches for a solution. It tests whether the shortcomings in South Africa's predatory pricing law may be remedied by judicial[4] interpretation, or whether the only option would be to amend the Act. **Section 5** summarises the conclusions drawn in the previous sections.

In short, it is argued below that South Africa's economy exhibits features which make under-inclusive abuse of dominance rules particularly costly. Section 8(d)(iv) requires that prices must be below a firm's Average <u>Variable</u> Cost (AVC) in order to qualify for an effects analysis, and a potential administrative penalty. This standard is unnecessarily under-inclusive. International 'best practice' seems to consider that Average <u>Avoidable</u> Cost (AAC) is usually a more accurate benchmark against which to assess potential predatory pricing. It is also a more inclusive standard, which makes it desirable for South Africa. However, because the standard of AVC is cast in legislation, there is little scope to develop our law in the direction of this preferable alternative.

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[2] Section 8(d)(iv), Act 89 of 1998
[3] Commission Press Release, 31 October 2011, *'Commission refers predatory pricing case against Media 24'*
[4] This means interpretation not only by judges, but also by the Competition Tribunal.

It is submitted that the difficulties identified in reconciling South Africa's predatory pricing provisions with up-to-date economic views are symptomatic of a bigger problem. By housing specific abuse of dominance rules in the iron-clad confines of legislation, our law is deprived of the *'inherent flexibility and evolutionary quality'*[5] which is evident in other competition law systems. Therefore, it would appear that the only way to harness the benefit of developments in international practice would be to amend the Competition Act accordingly.

SECTION 1: BASIC PRINCIPLES IN DESIGNING A COST-BASED PREDATORY PRICING RULE AND EVOLUTION IN THE US AND EUROPE

An introductory comment on the scope of this paper is required. Predatory pricing is a notoriously controversial topic[6]. For decades, experts have disagreed on whether predatory pricing should be illegal at all[7]. Between those that agree that it should be illegal, there is argument as to what standard should be used to determine its legality – some support an initial analysis of the market, to see whether it is conducive to predation[8], while others prefer to use game theory to identify harmful low pricing strategies[9]. Another group advocate an approach of presuming illegality if a cost-based test is met[10]. Within this latter group, there is disagreement about the appropriate cost standard[11]. Even those whose views on the optimal cost standard are aligned will disagree on the how that cost benchmark should be calculated[12].

This paper is focused on South Africa's cost-based predatory pricing standard - how it might apply and whether it can be improved. It deliberately skirts the virtual rabbit-warren of economic theories, technical criticisms and debates. It also does not delve into a number of the complex aspects of predatory pricing, such as how the effect of an alleged predatory price should be determined, what defences the respondent firm should be allowed to raise, and how the onus of proof should be allocated. This means that these issues may sometimes be canvassed in a simplistic manner, but this should not detract from the salient points made below.

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[5] Gellhorn, Kovacic and Calkins, *'Antitrust Law and Economics in a Nutshell'* 5th Edition (2004), Thomson West page 39

[6] Gellhorn *et al* at page 164 suggest an *'enormous ferment in judicial analysis of predatory pricing'* during the last few decades. Hovenkamp, *'The Antitrust Enterprise: Principle and Execution'*, (2006) Harvard page 159 explains that economics provides an abundance of predatory pricing theories. Fox, *'Price Predation-US and EEC: Economics and Values'*, Fordham Corp L Inst (1989) 687, page 687 suggests that *'predatory pricing is one of the most daunting subjects confronting nations with competition policy'* - cited in Jones and Sufrin, *'EU Competition Law: Text, Cases and* Materials', 4th Edition (2010) Oxford University Press, page 392. Jones and Sufrin state at page 393 that, *'In short, there is great controversy about predatory pricing'.* See Motta, *'Competition Policy: Theory and* Practice', Cambridge (2004) from page 412 to 422 for explanations of the range of predatory pricing theories that have been used.

[7] Commentators from the Chicago School suggested that predatory pricing is a rare strategy which is seldom profitable, and therefore does not warrant the law's attention. See Bork, *'The Antitrust Paradox: A Policy at War with Itself'*, 1st Edition (1978) Basic Books, pages 144 to 159.

[8] This is described by Gellhorn *et al* on page 165 as the 'structural filter school', which advocated cost-based rules only if market conditions suggested a likely anti-competitive effect may ensue. The authors point to an article by Elzinga and Mills, *Testing for Predation: Is recoupment feasible?'* 34 Antitrust Bulletin 869 (1989).

[9] See Gellhorn *et al* at page 165 where a number of game-theoretic approaches are pointed out.

[10] See Areeda and Turner, *'Predatory Pricing and Practices under Section 2 of the Sherman Act'* 88 Harvard Law Review 697 (1975)

[11] *The Department of Justice 'Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act' (2008)* [Available at www.usdoj.gov] sets out the various cost-based approaches and their proponents from page 62. This document is referred to numerous times in this paper. It was withdrawn by Christine Varney soon after her appointment as Head of the Department because of disagreements the Federal Trade Commission had with the document (see the press release entitled 'Justice Department Withdraws Report on Antitrust Monopoly Law', 11 May 2009). However, it provides a coherent statement of US monopolisation law and a valuable excursus of the relevant policy debates.

[12] Jones and Sufrin introduce the debate about how fixed and variable costs should be defined at page 394.

Abuse of dominance rules

As a starting point, it is relatively uncontroversial to state that, when it comes to abuse of dominance, rule-makers and decision-makers make mistakes[13]. Designing rules that minimise the harm caused by unavoidable errors mean considering: first, the self-righting power of markets, and, second, the effectiveness of government's attempts to remedy market imperfections[14].

If markets are poorly equipped to discipline the behaviour of dominant firms, then competition laws should err on the side of 'over-inclusion'[15]. In other words, the rules should prevent anti-competitive practices as a priority, even if this means that some neutral or pro-competitive conduct is erroneously prohibited[16]. These mistakes are known as 'false positives' or 'false convictions', and result in so-called 'over-deterrence' and 'over-enforcement'[17].

Conversely, if markets are viewed as robust, and able to remedy harm caused by firm conduct, then competition law should err on the side of 'under-inclusion'[18]. This means that the law should intervene only in those cases where anti-competitive effects are conclusively evident, even if some harmful conduct escapes (the market is deemed competent to deal with these). These errors are known as 'false negatives' or 'false acquittals', and result in 'under-deterrence' and 'under-enforcement'[19].

A particular stigma attaches to over-inclusion in international discourse for two reasons. First, it may deter firms from engaging in certain pro-competitive conduct for fear of unwarranted investigation and prosecution[20]. This would be a perverse result, as competition law interventions may end up harming the very process they are designed to protect[21]. Second, the market has no means to rectify false convictions[22].

Although strongly influential, these general policy prescriptions should not be dogmatically followed. It is also necessary to carefully consider the particular economy and society to which the system will apply. In countries where there is a history of state ownership in key industries, protected monopolies, and highly concentrated markets, the risks and consequences of under-inclusion errors are significant[23]. The market mechanism is less likely to erode market power without intervention[24]. Brusick and Evenett argue convincingly that abuse by dominant firms can be much more damaging to developing economies than to developed ones[25].

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[13] Whish and Bailey, *'Competition Law',* 7th Edition (2012), Oxford University Press at page 194
[14] Hovenkamp, *op cit* at page 31. See also Rubinfeld, *'The Economic Foundations of Antitrust'* in Hawk, B. (ed.) International Antitrust Law & Policy: Fordham Competition Law (2009) at page 457.
[15] Fingleton and Nikpay *'Stimulating or chilling competition'*, in Hawk, B. (ed.) International Antitrust Law & Policy: Fordham Competition Law 2008. New York: Juris page 36 [Available at www.oft.gov.uk]
[16] Jones and Sufrin *op cit* at page 59
[17] *Ibid*
[18] *Ibid*
[19] *Ibid*
[20] *Ibid*; Whish and Bailey *op cit* at page 194, citing *Verizon Communications v Law Office of Curtis V Trinko LLP* 540 US 398 (2004) p 414
[21] Whish and Bailey *op cit* at page 740; Fingleton and Nikpay *op cit at* page 3.
[22] Evans and Padilla *'Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach'* The University of Chicago Law Review, Vol 72 (1) 2005 at page 84; Whish and Bailey *op cit* at page 740
[23] Fingleton and Nikpay *op cit* at page 36
[24] *Ibid*
[25] Brusick and Evenett, *'Should developing countries worry about abuse of dominant power?'*, Wis. L. Rev. 269 2008

Basics of cost-based approaches to predatory pricing

To understand the advantages and disadvantages of section 8(d)(iv)'s formulation, an explanation of some basic theory on low pricing abuse is useful. Every textbook chapter that deals with the topic will include a trite statement to the effect that *'consumers generally benefit when firms compete with each other by offering low prices'*[26]. However, a deep-pocketed firm may set its prices so low over a sustained period that its rivals are unable to survive, and are forced to leave the market[27]. New entrants will also be deterred from entering the market. The firm may then, free of competitive constraints, raise its prices above competitive levels. This would harm consumers in the long run.

Competition laws should prohibit dominant firms from engaging in this type of exclusionary strategy. However, if in the process the law was to deter firms from charging low prices, aggressive competition would be avoided and consumers would lose out – an obvious 'own goal' for competition law[28]. Expansive rules may also trigger a flood of complaints and litigation, where every firm harmed by a rival charging low prices seeks redress[29]. The law therefore has to be careful when declaring illegal the charging of low prices by a dominant firm[30]. The Tribunal has held:

> [Predatory pricing] must be adjudicated with extreme caution because the likelihood of judicial error is considerable and the costs of error are impressive.[31]

A popular first step towards solving this problem has been to employ an effective filter to screen out all those cases where low pricing is probably the product of healthy competition. But where to draw the line? In an influential article published in 1975, Areeda and Turner proposed that the firm's costs would be an appropriate yardstick[32]. The logic of this approach begins with one of the building blocks of neoclassical economics: a profit maximising firm makes its production decisions by comparing the cost of producing an additional unit of output (marginal cost[33]) with the price that it can achieve on the market. If the price exceeds marginal cost, then it makes sense to produce an additional unit. If it costs more to produce a unit of output than the firm can charge, then the rational firm would not produce that unit. Sales below cost are may therefore be *'economically irrational but for their apparent exclusionary effect'*[34]. Therefore, if a firm is pricing below its marginal cost over a sustained period, it suggests something is up. The firm is wilfully sacrificing revenue and one explanation may be that it is engaging a predatory strategy to exclude efficient competitors[35]. The law should thus place an onus on this firm to explain the reason for its below-cost pricing[36].

Of course, the statement that 'below cost prices might be predatory', does not imply that *above* cost pricing can never be anti-competitive. Usually, above-cost pricing will only exclude less efficient competitors (an outcome synonymous with healthy competition). However, economists have suggested a range of circumstances in which above cost pricing can have anti-competitive effects[37]. The problem is that in the realm of above-cost pricing, it

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[26] Hovenkamp *op cit* at page 159; Whish and Bailey *op cit* at page 740; Motta *op cit,* at page 412
[27] Motta *op cit* at page 413; Gellhorn, Kovacic and Calkins *op cit* at page 164
[28] Fingleton and Nikpay, *op cit* at page 3
[29] Hovenkamp *op cit* at page 159
[30] Vickers, *'Abuse of Market Power'*, The Economic Journal Vol 115 2005 page 248
[31] *Nationwide Airlines v South African Airways* case 92/IR/Oct00 page 11
[32] Areeda and Turner *op cit* page 716 to 718
[33] Whish and Bailey *op cit* at page 716
[34] DoJ Report *op cit* at page 69
[35] DoJ Report *op cit* at page 51 and 53
[36] This paper does not engage in debate about the merits of using profit sacrifice as an indicator of predatory pricing. Vickers *op cit* sets out a number of criticisms of this approach on pages 253 to 256.
[37] Hovenkamp *op cit* at page 161. See Vickers *op cit* at page 249 and 250. In *Compagnie Maritime Belge v Commission*, cases C-395/96 P etc [2000] ECR I-1365, [2000] 4 CMLR 1076, the European Court of Justice held that

is extraordinarily difficult to distinguish pro-competitive from anti-competitive prices. Hovenkamp illustrates this difficulty with an example of a further problem – if we prohibit above-cost prices it is nearly impossible to design an appropriate remedy[38]. Suppose a monopolist knows that it is more efficient than its potential rivals. It may set its price above its marginal cost but slightly below the costs of its most efficient rival (so-called 'limit pricing'). This means pricing below the monopoly level. It thereby sacrifices some immediate profits (which could be reaped by charging the monopoly price), but maximises its profits over the long run by deterring entry. What could be done about this? It would take an extremely self-confident competition authority or court to order that firm to charge the monopoly price, so that rivals could enter.

So enforcement agencies and courts face severe theoretical and practical difficulties in the realm of potential 'above-cost predatory pricing'. Therefore, Areeda and Turner's suggestion to use the firm's costs as a cut-off point is appealing, even if it results in some above-cost predatory pricing escaping scrutiny.

The authors proposed that marginal cost would be the most accurate benchmark[39]. However, marginal cost is extremely difficult to compute[40]. Comparing price with the true marginal cost – the cost of producing the last unit – tells us only whether the dominant firm is losing money on the last unit, rather than on all sales at the potentially predatory price[41]. So the Areeda-Turner test recommends a surrogate – Average Variable Cost. This is the sum of the firm's variable costs divided by the number of units produced[42]. Variable costs are costs that vary as output increases, as opposed to fixed costs, which do not. Using this proxy, the same logic would appear to hold – if a firm charges a price which does not cover its variable costs, it intentionally suffers a loss on every sale. Canada's Enforcement Guidelines on Predatory Pricing state:

> If revenues were insufficient to cover variable costs, the firm's profit maximizing decision would be to cease production altogether as continuing production would only serve to exacerbate its losses.[43]

Two pertinent criticisms of using AVC are relevant. First, AVC tends to drop below marginal costs at high levels of output[44]. Because predatory pricing is generally a high output strategy, this makes AVC a somewhat under-inclusive dividing line. This has invoked suggestions that the Areeda-Turner test is 'toothless'[45] and a 'defendant's paradise'[46]. Dominant firms in theory have leeway to embark on deliberate, damaging predatory strategies by pricing above AVC but below true marginal costs. Second, some industries (such as software, telecommunications and pharmaceuticals) are characterised by extremely high fixed costs, and negligible marginal and variable costs[47]. In these circumstances prices

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selective low but above-cost pricing to particular customers could be predatory. See Jones and Sufrin *op cit* at pages 408 to 413. See pages 57 to 60 of the DoJ Report.

[38] Hovenkamp *op cit* at pages 161 and 162

[39] Areeda and Turner *op cit* page 716. See page 62 of the DoJ Report, which cites several sources confirming that, in theory, marginal cost would be the ideal measure against which to assess profit sacrifice.

[40] Areeda and Turner state at page 716: *'The incremental cost of making and selling the last unit cannot readily be inferred from conventional business accounts, which typically go no further than showing observed average variable cost. Consequently, it may well be necessary to use the latter as an indicator of marginal cost.'*. Jones and Sufrin at page 394 state that *'short run marginal cost is… almost impossible to compute in practice'*.

[41] Niels, Jenkins and Kavanagh, *'Economics for Competition Lawyers*' (2011) Oxford University Press at page 191

[42] *Ibid*; Whish and Bailey *op cit* at page 717

[43] Canadian Competition Bureau, *'Enforcement Guidelines: Predatory Pricing*' (2008) [available at http://www.competitionbureau.gc.ca/] pages 14 and 15

[44] Jones and Sufrin, *op cit* at page 394

[45] Gellhorn *et al*, *op cit* at page 170

[46] Oliver Williamson, 'Predatory Pricing: A Strategic and Welfare Analysis', 87 Yale Law Journal 284 (1977) cited in Hovenkamp, *op cit* at page 164

[47] Whish and Bailey, *op cit* at page 747

will almost never drop below AVC (or marginal costs)[48]. A measure of costs which includes the fixed costs (such as research and development) of production is preferable in these cases. Long Run Average Incremental Cost (LRAIC[49]) has been suggested as a better measure in such industries[50]. Both these instances point towards AVC being an under-inclusive standard.

But erring on the side of under-inclusion is generally a safe option. As explained above, over-inclusive predatory pricing prohibitions would create particularly acute risks of subverting one of the main purposes of competition law itself (enhancing consumer welfare by delivering low prices). Hovenkamp therefore suggests:

> An intentionally *under-deterrent* predatory pricing rule may do much good by reaching many instances of predation while permitting all instances of *bona fide* competition.
>
> …
>
> Given the enormous stake that antitrust has in low prices, and our extraordinary difficulties assessing predation claims, the best course is to develop predation rules that are both simple and somewhat under-deterrent.[51]

Therefore, AVC may generally be considered an adequate benchmark on which to base a predatory pricing rule in light of the practical difficulties with working out marginal cost, even if it is under-inclusive.

A third criticism of AVC is more difficult to deal with. AVC *'measures the average cost of the entire output, not just of the incremental output that is the focus of the predation claim'*[52]. It may therefore be inaccurate compared to a measure focused only on the 'incremental output' involved in the predatory strategy.

To complete this discussion, an obvious observation must be made: prices below cost are not necessarily anti-competitive. There are a number of legitimate reasons that a firm may decide to price below its costs[53]. For example, perishable goods approaching their expiry date must be flogged at low prices. Also, so-called 'loss-leaders' may be sold cheaply in order to attract customers to a store, who may then purchase other, higher margin products. Therefore, cost-based tests for predation should only be used to sift out pricing which is *probably* harmless and focus on pricing which is *more likely* to exclude competitors unmeritoriously. Illegality should only be determined after a subsequent, more detailed analysis.

Predatory pricing in the US

US law on predatory pricing lacked direction until 1993 when the Supreme Court pronounced on the definitive *Brooke Group* case[54]. The 1967 case of *Utah Pie*[55] provided a vague conception of illegal low pricing. This was followed by a period of discord among the

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[48] As a result, the European Commission has suggested that AVC is not an appropriate measure in a network industry such as telecommunications. See the European Commission's *Notice on the Application of the Competition Rules to Access Agreements in the Telecommunications Sector* OJ [1998] C 265/2

[49] LRAIC is Long-run the average of all the (variable and fixed) costs that a company incurs to produce a particular product.

[50] DoJ Report, *op cit* at page 63

[51] Hovenkamp, *op cit* at page 161

[52] DoJ Report, *op cit* at page 63

[53] See Felet and Ranchod, *'Key insights into assessing below cost pricing in South Africa'*, paper for 5th Annual Conference on Competition Law, Economics and Policy, University of Johannesburg, 4 and 5 October 2011, pages 5 to 9.

[54] *Brooke Group Ltd v Brown & Williamson Tobacco Corp* 509 US 209

[55] *Utah Pie v Continental Baking Co* 386 US 685

Circuit Courts, which each adopted different standards. *Utah Pie* drew severe criticism[56] and triggered a flurry of debate amongst enforcers, scholars and economists (the Areeda-Turner test was devised during this period of disarray).

Brooke Group brought order[57]. The case established that:

- an unlawful predatory strategy must entail pricing below an 'appropriate measure' of costs[58], and
- market conditions must allow a 'dangerous probability' of the defendant firm recouping the losses that it deliberately incurred during the period of below-cost pricing (by charging high prices, which harm consumers)[59].

US law has left open the precise cost standard below which a price should be set to qualify for a more detailed analysis. A cost standard suited to a particular case may therefore be used.

It should also be pointed out that 'recoupment' requirement in *Brooke Group* sets a very high bar for plaintiffs pursuing predatory pricing cases[60]. The plaintiff must show that rivals will be excluded, the firm will be able to charge high prices, this will be sufficient to compensate for the losses incurred in the period of below-cost pricing, and the high price will not elicit entry by new rivals (which would drive the price back down again)[61].

This is the product of a deliberate policy choice by the Supreme Court: markets in the US are usually equipped to deal with the problem of monopoly, and antitrust should only intervene when harm to consumers can be shown. In technical language, the Court has opted for an under-inclusive approach. It believes the market will eradicate the effect of false acquittals (predatory prices that go unpunished), and seeks to guard against false convictions (competitive low prices that are punished by mistake).

Predatory pricing in Europe

Since 1991, European competition law has applied AVC as a lower threshold, below which prices are presumed predatory[62]. The European Court of Justice, in the *Akzo* case, held that prices above AVC but below Average Total Cost (ATC) are considered predatory only if accompanied by evidence of a deliberate strategy to eliminate a competitor[63]. If a firm's prices are found predatory on either test, an anti-competitive effect must be proved before the conduct can breach Article 102 TFEU[64]. Prices above ATC are not automatically legal, but are unlikely to be found predatory.

The EU has explicitly rejected the 'recoupment' element required in the US[65]. Once again, this reflects a specific policy choice. The European authorities take a more sceptical view of markets' abilities to self-correct than in the US. Consumer harm is inferred if the low pricing is likely to damage the competitive process.

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[56] DoJ Report, *op cit* at page 50
[57] *Loc cit*, at page 53
[58] *Brooke Group,* page 222 to 227
[59] *Brooke Group,* page 224
[60] Jones and Sufrin, *op cit* at page 400
[61] See Temple Lang and O'Donoghue, '*Defining Legitimate Competition: How to Clarify Pricing Abuses Under Article 82EC'*, (2002) Fordham International Law Journal, 83, page 144 and 145
[62] *AKZO Chemie v Commission* case 62/86 [1991] ECR I-3359.
[63] *Ibid,* paragraph 72
[64] Whish and Bailey, *op cit* at page 742
[65] *Tetra Pak International SA v Commission* [1996] ECR I-5951, paragraph 39 to 44; *France Telecom SA v Commission* [2009] ECR I-2369, paragraph 103 to 113

Fine-tuning the cost benchmark

In 2009 the European Commission published a guidance document setting out the enforcement priorities it will follow when investigating potential abuses of dominance[66]. This document refers to the test set out in *Akzo*, but explains that (in the European Commission's view) a firm will be considered to be deliberately incurring losses or foregoing profits in the short term (sacrificing profits) if it charges a price below Average Avoidable Cost (AAC), as opposed to AVC[67].

AAC is the average of the costs that the firm could have avoided if it had not produced particular units of output. In a predatory pricing case, AAC will be calculated over the 'predatory increment' – the additional units which are produced and sold at a low price as part of the potentially predatory strategy[68]. This includes variable costs *and* any fixed costs that have been incurred specifically to produce the predatory increment.

The Guidance Document explains:

> In most cases the [AVC] and AAC will be the same, as often only variable costs can be avoided. However, in circumstances where AVC and AAC differ, the latter better reflects possible sacrifice: for example, if the dominant undertaking had to expand capacity in order to be able to predate, then the sunk costs of that extra capacity should be taken into account in looking at the dominant undertaking's losses. Those costs would be reflected in the AAC, but not the AVC.[69]

In other words, AAC is thought to more closely resemble marginal cost than AVC. The European Commission considers that AAC is therefore a more precise benchmark against which prices should be compared to determine whether a firm is sacrificing profits. This issue is, unsurprisingly, debatable. However, Whish and Bailey remark that:

> [T]he suggestion that AAC, as a matter of economics, is a sounder standard than AVC in a case such as this seems compelling, and this is one of those areas where the EU Courts might, in future, be prepared to defer to the compelling logic of the Guidance.[70]

The US Department of Justice concludes that (although there is not unanimity on the issue):

> The emerging consensus is that average avoidable cost typically is the best cost measure to evaluate predation claims…
>
> The Department agrees that average avoidable cost is the most appropriate cost measure to use when evaluating an alleged predatory-pricing scheme because it focuses on the costs that were incurred when the predatory pricing was pursued[71]

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[66] Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, 2009/C 45/02

[67] Guidance paper paragraph 64. The Guidance document also suggests that it would recommend replacing ATC with LRAIC in the *AKZO* test. This approach has been accepted in *Danish Post*. The DoJ Report at page 63 proposes that LRAIC would be a more appropriate measure for assessing predation in industries with high fixed costs and relatively low marginal and variable costs. This shows the flexibility of EU and US law to adopt a cost-standard which is suitable in a particular case.

[68] In other words, if a dominant firm would have produced 1 500 units, but in response to new entry increases production to 2 000 units, then the predatory increment will be the *additional* 500 units.

[69] Guidance paper, *op cit* at footnote 3

[70] Whish and Bailey, *op cit* page 743. Jones and Sufrin appear to agree with this proposition on page 405

[71] DOJ Report, *op cit* at page 65

In *United States v. AMR Corp.* the tenth circuit held:

> Sole reliance on AVC as the appropriate measure of cost may obscure the nature of a particular predatory scheme and, thus… we do not favour AVC to the exclusion of other proxies for marginal cost.[72]

The Canadian Predatory Pricing Enforcement Guidelines provide:

> While variable costs can be a proxy for marginal costs, the Bureau's view is that [AAC] is the most appropriate cost standard to use when determining if prices are predatory…
>
> By addressing certain incremental costs, including opportunity costs, associated with a practice or policy of predatory pricing, avoidable costs provide a closer proxy of marginal costs than variable costs alone.[73]

AAC is also a more inclusive basis for a predatory pricing rule. It would include any fixed costs incurred in order to execute the predatory strategy in addition to relevant variable costs, whereas AVC would not. AAC is therefore either equal to AVC (if no such fixed costs are incurred) or it is higher. Coates states:

> This recognition that sunk costs may be relevant to a predation analysis if they were incurred for the purpose of predation <u>expands the net of the predation test</u> in the sense that where such costs have been incurred, AAC will be higher – sometimes significantly – than AVC.[74] (my underlining)

A predatory pricing rule based on AAC would therefore be able to reach more potentially predatory prices, without significantly increasing the risk of prohibiting legitimate competitive behaviour. Such a rule would also arguably be more administrable, as any confusion regarding whether a particular cost item is fixed or variable is negated[75].

It is likely that at the next opportunity the European Courts will adjust the prevailing legal test to bring it into line with the Commission's proposed measure[76]. This illustrates the flexibility that Europe's open-textured approach to abuse of dominance engenders. Through case precedent and official guidelines, the applicable standard is able to adapt as more suitable measures become available. This allows for improved accuracy in the legal test applied, without any significant sacrifice to legal certainty.

Against this background, we can proceed to examine South Africa's economic circumstances, which should be taken into account when setting the standard for assessing potential predatory pricing cases.

SECTION 2: SOUTH AFRICA'S ECONOMY AND POLICY IMPLICATIONS

The distinctive features of the South African economy are typically ascribed to the historical discriminatory and interventionist policies of the apartheid government[77]. During apartheid,

[72] *United States v. AMR Corp.* 335 F.3d 1109, 1115 (10th Cir. 2003) footnote 136
[73] Canadian Competition Bureau Guidelines, *op cit* at page 13
[74] Coates, *'Competition Law and Regulation of Technology Markets'* (2011) Oxford University Press at paragraph 4.17 (pages 61 and 62)
[75] Niels *et* al, *op cit* at page 192; DoJ Report page, *op cit* at pages 63 to 68
[76] Unsurprisingly, the European Court of Justice has followed the Commission's Guidance Paper in adjusting the upper threshold for predatory pricing under their law (Average Total Cost) to Long Run Incremental Cost, a measure also suggested by the Commission in its Guidance paper. See Case C-209/10 Post Danmark A/S v Konkurrencerådet of 12 March 2012.
[77] See Roberts, *'Administrability and Business Certainty in Abuse of Dominance Enforcement: An Economist's Review of the South African Record'*, World Competition 35, no. 2 (2012): 273-30; Lewis, *'Chilling Competition' in Hawk, B ed. International Antitrust Law & Policy: Fordham Competition Law (2008),* Fox, '*Equality, Discrimination and Competition*

government subsidies, strict market controls, high tariffs, low foreign direct investment and high levels of government ownership produced concentrated markets[78]. When the ANC was elected in 1994 it inherited an economy characterized by inequality, poverty, an uncompetitive manufacturing sector, a number of state-owned monopolies, large conglomerates and high concentration levels[79].

Since 1994 markets have been exposed to increased domestic and international competition. This means that incumbent firms (now faced with the threat of competition for the first time) have an incentive to thwart new entrants and exclude their smaller rivals by engaging in anti-competitive conduct[80]. Roberts argues that in South Africa, *'the ability to effectively participate in the economy without being unjustly impeded by dominant incumbents therefore has particular resonance'*[81]. Promoting the entry of small firms into previously inaccessible markets was (and continues to be) a priority of the democratic government[82].

The Competition Act, which became effective in 1999 was viewed as a key policy tool to achieve a more inclusive economy[83]. Given the concentrated structure of many key industries, one of its primary aims was to protect markets from exclusionary behaviour by dominant firms. This is borne out by the Act's explicit list of goals in its preamble[84] and section 1, which include *'to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy'*[85].

The apartheid government also bequeathed a lax 'competition culture'. The previous competition law, the Maintenance and Promotion of Competition Act[86]had little bite. Its prohibitions were broad and ultimately fell subject to assessment against a 'public interest' standard[87]. The enforcement authority, the Competition Board, effectively only had advisory capacity. Decisions under the Act required ministerial authorisation[88]. Enforcement activity was sporadic and weak[89]. As a result, competition law compliance, awareness and enforcement were left in poor shape when the current Act was promulgated. As Fox notes, *'when South Africa adopted its post-apartheid competition law, it needed to counter the toothless competition regime preceding it, which had reinforced the white oligarchy'*[90]. This sentiment is echoed by the preamble of current Act, which states that the apartheid laws resulted in *'inadequate restraints against anti-competitive trade practices'*[91].

Law: Lessons from and for South Africa and Indonesia', 41 Harv. Int'l. L. J. 579 2000; Organisation for Economic Co-Operation and Development Policy Brief July 2008: Economic Assessment of South Africa page 2-3.

[78] Kampel, *'Competition Law and SMEs: Exploring the Competitor/Competition Debate in a Developing Democracy'*, Paper No. 109 (2004) Centre on Regulation and Competition - Working Paper Series, pages 4 and 5.

[79] OECD Peer Review: Competition Law and Policy in South Africa, (2003) at page 11

[80] Kampel, *op cit* at page 5; Roberts *op cit*

[81] Roberts, *'Effects-based tests for abuse of dominance in practice: the case of South Africa'* University of Johannesburg Centre for Competition Economics, Working Paper version 30 September 2012 [Available online at http://www.uj.ac.za/EN/Faculties/ecofin/departments/economics/research/cce/], at page 1

[82] Proposed Guidelines for Competition Policy, A Framework for Competition, Competitiveness and Development, Department of Trade and Industry Pretoria, 27 November 1997 [Available at http://www.compcom.co.za]

[83] Davis and Granville, *'South Africa'*, in *'Process, Procedure and Design of Competition Law Institutions: Global Norms, Local Choices'*, Ed Fox and Trebilcock, Oxford University Press, forthcoming.

[84] The Act's preamble recognises *'That apartheid and other discriminatory laws and practices of the past resulted in excessive concentrations of ownership and control within the national economy, inadequate restraints against anti-competitive trade practices, and unjust restrictions on full and free participation in the economy by all South Africans'.*

[85] Section 1(e) Act 89 of 1998

[86] Act 96 of 1979

[87] Legh in Brassey *et al*, *'Competition Law',* 1st Edition (2002) Juta at page 75

[88] *Ibid*

[89] *Loc cit* at pages 71 to 81

[90] Fox, *'Antitrust Institutions: Design and Change'*, Loyola University Chicago Law Journal 473 Vol 41(2010) at page 475

[91] Preamble of Act 89 of 1998

Implications for abuse of dominance rules in South Africa

In summary, at the time the Act was drafted, South Africa exhibited many concentrated markets (often dominated by former or persisting state monopolies) and a permissive attitude to anti-competitive practices. We would therefore expect exclusionary abuse of dominance to be common. Markets would probably struggle to self-correct if exclusionary conduct was not detected and stopped, and small firms would continue to battle against powerful incumbents. After explaining in detail the relevant structural features typically found in developing economies, Roberts concludes:

> These factors imply that abuse by dominant firms is more widespread, more persistent and is more damaging in many countries like South Africa.[92]

The upshot is that the cost of under-inclusive exclusionary abuse of dominance rules would appear to be significant (and potentially even greater than the cost of over-inclusion, despite the abhorrence with which international practice views the latter). Roberts explains:

> The South African experience… 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.[93]

Therefore, in the South African context under-inclusive rules should be avoided where possible. Under-enforcement and under-deterrence may simply perpetuate the unhealthy economic position which prevailed under apartheid – a substantial cost by any measure. However, as explained above, the literature would suggest that predatory pricing rules should err on the side of under-inclusion because the risk of chilling competitive behaviour is unacceptable.

SECTION 3: EVALUATING SOUTH AFRICA'S PREDATORY PRICING RULES

Before the efficacy of South Africa's predatory pricing rules can be evaluated, the law's main provisions must be summarised.

Predatory pricing in South Africa

The Tribunal has only heard one case of an alleged contravention of section 8(d)(iv) of the Act. This was an interim relief application brought by Nationwide Airlines against South African Airways in 2000.[94] This case makes some useful remarks, but, it is submitted, is not entirely reliable as a precedent because it was decided before the *South African Airways* case[95]. The *Nationwide* case was therefore decided on the basis that establishing that a dominant firm's price is below its marginal or average variable costs raises a presumption of anti-competitive effects (rather than the complainant[96] or the Commission having to prove such effects). This was changed in *South African Airways*, where the Tribunal held that the complainant or the Commission bares the onus to prove the conduct's anti-competitive

[92] Roberts, *op cit* at page 227
[93] *Loc cit* at page 35
[94] *Nationwide Airlines v South African Airways* case 92/IR/Oct00
[95] *Commission v South African Airways* case 18/CR/Mar01
[96] A complaint may be initiated by the Competition Commission or a third party. The Commission must then, following investigation, decide whether to refer the complaint to the Competition Tribunal for adjudication. If the Commission decides that third-party-initiated complaint does not make out a contravention of the Act, the complainant may refer the complaint to the Tribunal for adjudication – effectively a private prosecution.

effect[97]. It is therefore submitted that the section remains largely untested, although the first real case of predatory pricing before the Competition Tribunal is underway at the time of writing[98].

The predominant source of South Africa's predatory pricing law is therefore the Act itself. Section 8(d)(iv) adopts AVC as a filter, following the logic of Areeda and Turner. A dominant firm contravenes the section if:

- it charges a price below the *marginal or average variable cost* of the relevant goods or services;
- this has an anti-competitive effect (which means it substantially forecloses the market to rivals or harms consumers directly[99]), and
- that anti-competitive effect is not outweighed by technological, efficiency or other pro-competitive gains.

Section 8(d)(iv) therefore does not raise a conclusive presumption of illegality if prices are below AVC – it simply defines the gateway through which a low price must pass in order to warrant closer scrutiny. Only once the effects of the low pricing have been analysed can a contravention be found, which carries a potential administrative penalty of up to 10% of the firm's turnover for the previous financial year.

Despite also including marginal cost as a potential measure, it is submitted that when section 8(d)(iv) is enforced, the focus will probably be on the more operable concept of AVC. But this is not the only basis on which a potentially anti-competitive low price may be assessed.

Section 8(c) is a catch-all which ensures that potentially harmful conduct that falls outside of section 8(d)'s scope does not escape scrutiny. It therefore aims to guard against the risk of under-inclusion. Conduct that is similar to the acts listed in section 8(d), but which do not meet the descriptions set out in that section will often fall to be assessed under section 8(c)[100]. Section 8(c) prohibits any 'exclusionary act' that:

- Is not listed in section 8(d), and
- Has an anti-competitive effect that is not outweighed by the act's technological, efficiency or other pro-competitive gains.

An 'exclusionary act' is defined as *'an act that impedes or prevents a firm entering into, or expanding within, a market'*[101]. This broad definition catches both pro-competitive and anti-competitive conduct within its ambit[102]. This explains the need to balance the harmful effects of the conduct against their pro-competitive gains to determine legality[103]. The onus to establish that the anti-competitive effects of the conduct outweigh any justifications put forward by the dominant firm lies with the complainant or the Commission[104]. First-time contraventions of section 8(c) cannot be penalised with an administrative penalty, although repeat offences may attracts a fine of up to 10% of the firm's annual turnover.

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[97] *South African Airways* at paragraphs 132 to 135
[98] Commission Press Release, 31 October 2011. 'Commission refers predatory pricing case against Media 24'
[99] *South African Airways* at paragraph 132
[100] Sutherland and Kemp, '*Competition Law of South Africa*', Issue 13 (2010), LexisNexis at page 7-24
[101] Section 1(1)(x) of the Act
[102] *South African Airways* at paragraph 108
[103] Unterhalter in Brassey, *op cit* at page 198
[104] Sutherland and Kemp page 7-56

A low price which is above AVC may well constitute an *exclusionary act*. This has been confirmed by the Tribunal in the *Nationwide* case[105]. However, if a firm contravenes section 8(c), the likely consequence is an interdict or mandatory order. Anti-competitive low prices above AVC could not be subject to an administrative penalty.

Relevance of the difference between section 8(c) and 8(d)

The difference between sections 8(c) and (d) is crucial to the argument pursued below. It is submitted that the Tribunal's inability to impose an administrative penalty for contraventions of section 8(c) creates an insurmountable practical problem. Once a firm's conduct has been found to contravene section 8(c), only that firm is deterred from replicating that conduct. If another dominant firm was to imitate the exclusionary strategy, after a complex investigation and protracted adjudication proceedings (possibly involving a number of appeals) the most significant likely sanction that could be imposed is an order that the firm cease the impugned behaviour. As a result, the section has a weak deterrent effect, and is therefore prone to under-inclusion.

Furthermore, investigating and litigating cases under section 8(c) is costly, and yields more limited tangible outcomes than other prohibited practices (which incur administrative penalties). It is therefore also possible that the primary enforcement authority, the Commission, may be disincentivised from bringing cases under this section, choosing rather to focus resources on cases that, if successful, will act as a stronger deterrent. Section 8(c) may therefore suffer further under-enforcement.

In theory, a first-time lawbreaker could be sued for damages in a civil court[106] by affected parties or subjected to an order of divestiture[107]. In practice, the risk of a successful damages claim is remote. There has only been one such claim since the Act's inception, which was settled by the parties early on in the proceedings[108]. Potential damages actions currently provide little reason for dominant firms to shy away from a lucrative, exclusionary strategy which could be prohibited under section 8(c). Although, divestiture remains a legitimate and significant threat in particular circumstances, it is a severe and seldom used intervention, and is not warranted in the majority of cases.

Analysis

The test set out in section 8(d)(iv) is conceptually clear[109]. Prices which are below a dominant firm's AVC fall to have their effects analysed. If, on balance, they are found to be anti-competitive, punishment may include an administrative penalty. Prices above AVC may still contravene the Act, but they must be assessed under the less exacting standard of section 8(c).

It is submitted that this is likely to result in under-inclusion. First, as explained, predatory pricing is complex. It is expensive and time-consuming to investigate and litigate these cases. Second, based on the reasoning above, AVC by its nature provides an under-inclusive filter for prices to qualify for an assessment under section 8(d)(iv). Third, predatory prices set above AVC cannot be subject to an administrative penalty. Therefore, a dominant firm may embark on a deliberate and harmful strategy to foreclose competition by charging prices which are slightly above AVC, and be liable only for a behavioural direction to desist.

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[105] *Nationwide Airlines* at page 10
[106] Section 65 of the Act
[107] Section 60 of the Act
[108] Carter, *'South Africa's First Private Competition Damages Claim Settled out of Court',* Global Competition Litigation Review, Issue 1 (2008), R-14
[109] Unterhalter in Brassey *et al*, *op cit* at page 215

The question is then whether the provisions in the Act are suitable? We have ascertained that under-inclusive predatory pricing rules are generally not a bad thing. The danger of prohibiting pro-competitive behaviour is so great, and identifying predation is such a slippery task, that the law should steer clear of this outcome. However, we have also established that under-inclusion is particularly undesirable in South Africa's economic circumstances. If anti-competitive low pricing is allowed to proceed unchecked, markets may not be robust enough to correct the harm done.

It is submitted that a sensible approach to predatory pricing would therefore be for the law to err on the side of under-inclusion, but not unnecessarily so. This brings us back to the alternative benchmark which has been proposed in Europe and endorsed by authorities in the US – Average Avoidable Cost.

It was stated in the introduction that an appropriate rule '*should be tailored to the economic environment in which it must operate, and reflect local enforcement priorities'.* AAC is apparently a more accurate proxy for marginal cost, and therefore provides a more rigorous basis for identifying when a firm is sacrificing profits in most cases. Crucially, it is also more inclusive. If this is correct, and South Africa persists with the unnecessarily under-inclusive standard of AVC, when a preferable alternative is available, then we could conclude that South Africa's law is not suitable.

SECTION 4: SEARCHING FOR A SOLUTION – JUDICIAL INTERPRETATION OR LEGISLATIVE AMENDMENT?

This section uses the above conclusion – that AAC is a more suitable proxy for South Africa's predatory pricing law than AVC – as its starting point. It examines whether there is scope within South Africa's present law to base a predatory pricing case on the allegation that a firm's prices are below AAC. In other words, it asks whether the law is able to effectively deal with a firm that:

- incurs some fixed costs (for example, it must turn on an unused furnace) in order to flood the market with excess produce (the predatory increment), and
- then charges a price for the predatory increment which is below the AAC (and marginal cost), but above AVC, and
- this has the effect of substantially foreclosing the market to competition.

Section 8(d)(iv) – below marginal cost?

The most effective solution would be to impugn the firm's pricing under section 8(d)(iv). Of course, if the firm's price is not below AVC, then the only way that it could qualify for assessment under section 8(d)(iv) would be if it could be shown to be below marginal cost.

Whether this scenario would qualify for assessment under section 8(d)(iv) is a matter for debate. As explained above, marginal cost is very difficult to calculate. Therefore, there would probably be two avenues of argument available to the Commission or a complainant:

- The price charged is below the firm's AAC, and its AAC is below marginal cost at the relevant level of output. Therefore, we can infer that the price is below marginal cost.

- The price charged is below the firm's AAC, and AAC is an adequate proxy for marginal cost at the relevant level of output. Therefore, by inference, the price is below the firm's marginal cost.

Both of these approaches necessarily involve some inferential reasoning – we must infer that the price is below the firm's marginal cost without distilling marginal cost into a specific figure (or range of figures). It is submitted that, as a result, this sets the scene for a classic clash between economic reasoning and legal interpretation.

The plain language of the statute would suggest that to qualify for assessment under section 8(d)(iv), the alleged predatory price should be compared to the firm's AVC or its marginal cost. Had the legislature wished to catch prices below AAC in the section, then it would surely have simply included AAC as an alternative proxy. On this basis, difficulty with calculating marginal cost should not be an excuse for using some other measure not provided for in the Act. Indeed, this was the attitude of the Competition Appeal Court to a similarly incalculable proxy – the 'economic value' of a good – in the context of an excessive pricing case[110].

The CAC held:

> The wording of s 8(a), read with the definition of 'excessive price' in s 1, calls for the making of certain distinct enquiries. First, the determination of the actual price of the good or service in question and which is alleged to be excessive. Secondly, the determination of the 'economic value' of the good or service <u>expressed in monetary terms, as an amount of money</u>.[111]

The Tribunal itself has held, in *Nationwide Airlines*, that:

> We however must enforce a statute and not academic opinion and we cannot add a qualification to a section, which the legislature did not seek to impose.
>
> …
>
> Unless the record shows unequivocally that a respondent is pricing below the prescribed cost levels the Tribunal should not make a finding under section 8(d)(iv) but consider the complaint in terms of section 8(c).[112]

Following this logic, the Tribunal would probably not be able to 'read in' AAC as a proxy for marginal cost. This is, of course, unless it could be convincingly shown that in the particular case AAC was equal to the firm's marginal cost. This could probably not be done without demonstrating what the firm's marginal cost actually was.

On the other hand, the legislature would have known that marginal cost was extremely difficult to calculate, but chose to include it in section 8(d)(iv) nonetheless. A creative interpretation may therefore suggest that the only plausible reason for this is that the legislature wished to leave scope for more accurate proxies for marginal cost than AVC to be used if available. However, this may not accord with the plain meaning of the words used in the section. Had the legislature wished to achieve this outcome, it could simply have stated that prices below AVC *'or some other acceptable proxy for marginal cost'* would qualify for an effects analysis.

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[110] *Mittal Steel SA Limited and Macsteel International v Harmony Gold Mining Limited and Durban Roodepoort Deep*, case 70/CAC/Apr07. In *Commission v Telkom SA LTD* Case 11/CR/Feb04 paragraph 123, the Tribunal has confirmed that in an excessive pricing case, the test in *Mittal Steel SA* requires a factual determination of economic value.
[111] *Mittal Steel SA* at paragraph 31
[112] *Nationwide Airlines* at page 10

On balance, it is submitted that a creative approach which uses AAC as a proxy for marginal cost, or as a basis to infer that prices are below marginal cost, would probably not accord with the plain meaning of section 8(d)(iv). This approach is particularly unlikely to withstand scrutiny before the CAC or the Supreme Court of Appeal, which are more likely to give effect to the 'black letter' of the law than the Tribunal. The *Mittal Steel SA* case illustrates this.

It is worth pointing out that in industries where LRAIC may be a better basis for assessing predation, because marginal and variable costs are too low to provide meaningful guidance, section 8(d)(iv) could certainly not apply.

Section 8(d)(i) – inducement not to deal with a competitor?

The only other basis on which a predatory price below AAC but above AVC may be punishable by an administrative penalty would be under section 8(d)(i). This section prohibits a dominant firm from '*requiring or inducing a supplier or customer to not deal with a competitor'* if this has an anti-competitive effect which is not outweighed by technological, efficiency, or other pro-competitive gains.

What it means to 'require or induce a supplier or customer not to deal with a competitor' is not clarified by the Act. All that is clear is that a broad range of conduct could fall within the subsection's ambit. Perhaps the best explanation has been provided in the *British American Tobacco* case (Batsa)[113]. This case involved strategies designed to crowd a number of 'points of sale' with Batsa's cigarettes (Batsa is the overwhelmingly dominant cigarette manufacturer in South Africa). This included incentive payments to cigarette retailers in exchange for preferential placement of Batsa products at the expense of rival brands. The Tribunal found that Batsa's conduct did not induce or require retailers not to deal with its competitors[114]. Paragraph 305 of the Tribunal's decision explains as follows:

> As intimated, a payment structured around loyalty or market share, a payment that effectively rewards the recipient of the payment for *not* selling the product of a rival to a customer is likely to fall foul of Section 8(d)(i) and, in *South African Airways*, has already done so. But to view the act of offering a higher price for an input (promotional resources or any other) or a lower price for an output as an illegal inducement of, respectively, a supplier or a customer is to penalise rather than promote competition.

Section 8(d)(i) has previously been held to apply to a wide range of conduct. In *Patensie Sitrus Beherend Beperk*[115], the articles of association of a dominant company that provides packing and marketing facilities to its members (who are farmers) provided that the members are required to deliver their entire output to the company for packing and marketing. In *SA Raisins*[116], a similar clause in a shareholders agreement requiring shareholders to supply all of their produce to the dominant company induced customers not to deal with competitors. In the two *South African Airways* cases[117], effective loyalty inducing rebate schemes and incentive payments were held to induce travel agents not to deal with SAA's competitors. In *Senwes*[118], representations to farmers that they would lose the benefit of a cap on the daily storage tariff offered by Senwes (the dominant supplier of grain storage services in the relevant market) if they sold their grain to rivals of Senwes' downstream grain trading division was an inducement. In the recent *Telkom SA* case[119], the monopoly provider of fixed line telecommunications infrastructure (Telkom) prevented

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113 *Commission v British American Tobacco South Africa (Pty) Ltd* case 05/CR/Feb05
114 *Ibid*
115 *Patensie Sitrus Beherend Beperk v Commission* 16/CAC/Apr02
116 *South African Raisins v SAD Holdings* case 04/IR/Oct/1999
117 *Commission v South African Airways* case 18/CR/Mar01 and *Nationwide Airlines (Pty) Ltd v South African Airways (Pty) Ltd* case 80/CR/Sep06
118 *Commission v Senwes Ltd*, Tribunal Case 110/CR/Dec06 at paragraph 116
119 *Commission v Telkom SA LTD* Case 11/CR/Feb04, decided on 7 August 2012 paragraph 109

downstream Value Added Network Service providers (VANS) from connecting to its network in their own name. Instead it required that access lines to be transferred into the names of end-customers and that VANS should act as agents for end customers. It also approached customers of independent VANS and suggested that they should migrate to Telkom's own VANS provider. This was designed to induce customers not to deal with Telkom's competitors in the VANS market. Sutherland and Kemp have suggested a further array of behaviour that could be caught[120]. This may include express contractual requirements, express inducement, pricing inducement or other practical inducement.

There is therefore no precedent which explicitly allows predatory pricing to constitute inducement. However, in economic terms the effect of predatory price may be precisely to induce customers not to deal with competitors. The *South African Airways* case held a series of loyalty-inducing rebates to constitute inducement[121]. The exclusionary effect in this case may equally have been achieved by selling below cost.

However, once again the rules of interpretation would probably get in the way of a creative reading of the Act. Section 8(d)(i) prohibits an inducement. The meaning of this term is not defined in the Act, and its 'plain meaning' is not obvious. Therefore, determining whether a price below AAC (or LRAIC) but above AVC could qualify for assessment under section 8(d)(i) may require the Tribunal or court to have regard to the section's context within the Act. On this basis it could be convincingly argued that if predatory pricing could be caught by section 8(d)(i), there would have been no need for the legislature to include section 8(d)(iv).

It is probable that the legislature had a specific meaning in mind when it used the terms 'inducing or requiring'. Given the existence of section 8(d)(iv), it is likely that it meant something different from the conduct covered by that section. If charging a price below a firm's AAC but above AVC could be prohibited under section 8(d)(i), then by analogy a price below AVC could too - section 8(d)(iv) would be redundant[122]. Parliament explicitly chose to house the 'inducement abuse' and predatory pricing in separate subsections[123].

Once again, therefore, it appears that the formalistic terms of section 8(d)(iv) prevent the Act from being interpreted in a way which would give effect to one of its main purposes – prohibiting and deterring conduct that harms the competitive process, and therefore consumer welfare. Finding that predatory pricing contravenes section 8(d)(i) would probably be a 'bridge too far', and not acceptable before the generalist judges of the SCA.

SECTION 5: CONCLUSIONS

Our dominant firm which charges a predatory price below AAC (or LRAIC) but above AVC therefore seems destined to face a case under section 8(c) only. It would not be liable for an administrative penalty for a first offence, and other firms would hardly be deterred from following suit. The result is that pricing within this band, although potentially harmful to the competitive process (and therefore, in the longer term, consumers), is under-deterred and probably under-enforced. This is despite a preferable alternative basis for identifying predation being available. The undesirable consequences of unnecessary under-inclusive abuse of dominance rules in South Africa have been explained above.

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[120] Sutherland and Kemp, *op cit* at page 7-77

[121] *Commission v South African Airways* case 18/CR/Mar01 and *Nationwide Airlines (Pty) Ltd v South African Airways (Pty) Ltd* case 80/CR/Sep06

[122] Section 8(d)(iii) which prohibits tying would, for that matter, also be rendered redundant on this basis.

[123] The same argument would, of course, apply if alleged predatory prices below LRAIC were dealt with under section 8(d)(i).

Perhaps this conclusion is too stark. After all, in the majority of cases the firm's AVC and AAC will be the same. Only in a few predatory pricing cases would it make a difference if AAC were adopted as the appropriate standard, and even then the difference between the two measures may not be significant. And in any event, section 8(d)(iv) does not raise a conclusive presumption – the effect must still be analysed before an adverse finding can be made.

It is submitted that this attitude should not be countenanced. Our law should use the most accurate methodologies available to identify potential abuses of dominance. Otherwise harmful conduct may escape scrutiny, and the limited resources required to investigate and adjudicate such conduct may be misdirected. The law should not be allowed to fall out of step with the requirements created by South Africa's economic circumstances. We should not settle for 'second-best'.

But this appears to be exactly the effect of section 8's current construction. The formalistic manner in which the legislature has described the discrete exclusionary acts in section 8(d) causes a disjoint between the law and its underlying economics. By contrast, an open-textured effects-based provision such as that adopted in the US and Europe could (as Vickers puts it) *'align the law with its economic purpose in an internally consistent manner'*[124].

The result is that South Africa may be stuck with a test for predatory pricing which is unduly under-deterrent, even though a more inclusive and accurate test is available and has been adopted elsewhere. Even if we leave aside whether AAC is in fact a preferable measure of profit sacrifice (indications are that it is), this brings into sharp focus the inability of South Africa's predatory pricing law to incorporate improvements, when economic advancement achieves '*discovery, refinement and displacement of analytical models*'[125]. As Unterhalter observes, *'the disadvantage of adopting economic theory as a legal standard is that the theory, over time, is contested'.*[126]

It is submitted that the rule in section 8(d)(iv) illustrates how casting rules in a statute stunts their ability to evolve. As explained, the proxy used for identifying potentially predatory prices should be based on a measure of costs that accurately indicates whether the respondent firm has engaged in a profit sacrifice. Although AVC is arguably an acceptable proxy, it may not be the most accurate available, or be ideally suited to South Africa.

This example therefore provides strong support for a move to an open-textured statutory provision, which would allow the Tribunal to adopt an appropriate benchmark for profit sacrifice depending on the case at hand. It shows that legislation is too rigid to house economic proxies of this sort.

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[124] Vickers, *op cit at* page 260
[125] Gellhorn *et al*, *op cit* at page 60
[126] Unterhalter in Brassey *et al*, *op cit* at page 215

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