

CHILLING COMPETITION

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The anxiety that errors committed by anti-trust enforcers may give rise to business decisions that forego pro-competitive conduct for fear that it will be erroneously found to contravene anti-trust rules ('chilling competition'), may arise as a result of merger regulation or through the prosecution of horizontal and vertical agreements and unilateral conduct or, as it is termed in the South African and many other statutes, abuse of dominance. However the prospect of chilling competition is most powerfully asserted and most strenuously cautioned against in the context of enforcement action against unilateral conduct. The proffered reason is that it is in the unilateral actions of dominant firms that the line between conduct that has pro-competitive impact or anti-competitive impact is said to be most blurred.

Erroneous anti-trust enforcement action that inadvertently discourages a dominant firm from pursuing vigorous pro-competitive conduct may not only punish success – and so may even discourage a firm from striving for dominance – but, in discouraging pro-competitive conduct, will negatively impact on welfare across a broad front, one that extends way beyond the markets implicated in the original sin, in the initial erroneous decision. These latter are the *ex ante* costs of erroneous enforcement – the costs imposed as a result of restraining the conduct of all dominant firms who may otherwise have engaged in the pro-competitive conduct that has been erroneously impeached – as opposed to the *ex post* costs, the costs imposed on the firm whose actual conduct has been impeached in consequence of an erroneous enforcement decision.

The errors referred to here are of course Type 1 errors, false positives reflected as 'over enforcement' of the proscriptions that apply to unilateral conduct. Errors may also be of the Type 11 variety, false negatives, where anti-competitive conduct is erroneously permitted and is thus reflected as 'under-enforcement' of the strictures against abusive unilateral conduct. These will also potentially incur both *ex post* and *ex ante* costs. However the prospect of Type 11 error receives little more than lip service in the literature.

A report commissioned by the Office of Fair Trading on the erroneous enforcement of Article 82 asserts that there is a *'higher probability that some conducts normally investigated by competition*

¹ Chairperson, South African Competition Tribunal. I am indebted to Londiwe Xaba for her assistance in preparing this paper and to Simon Robert for his valuable comments.

authorities are competitive rather than abusive'.² It appears that the basis for this claim is the rather anodyne observation that more vertical restraints investigated by anti-trust authorities are likely to be pro-competitive than anti-competitive, a conclusion which, in part, appears to be based on the low number of successful prosecutions of abuse of dominance.³ We will argue that there are a range of more compelling reasons why there is a low rate of prosecution, let alone of proven contravention, of abuse of dominance.

On the other hand, it is widely held that to the extent that Type 1 error can be reduced to a single general source this is to be found in the alleged proclivity of anti-trust enforcers and courts to apply legal rules rather than economic standards in their assessment of unilateral conduct. In other words, despite the well established influence of economic analysis in the assessment of unilateral conduct, the fact that the economics has ultimately to find expression in statutory rules and in judicial or quasi-judicial decisions, is, it appears, implicitly assumed to pre-dispose the analytical and interpretative approach in favour of legal over economic disciplines and principles and is, for this reason, prone to Type 1 error. The adoption of legal rules as the decision making basis relies upon the identification of pre-determined triggering facts, and, so it is argued, uniquely risks the prospect of the triggering facts being found to be present, when, in fact, the conduct may not be abusive. This too is thought to make enforcement based on legal rules more prone to 'over-inclusiveness' or 'over-enforcement', than when enforcement decisions are based on economic standards which are, the proponents of this argument insist, not triggered by the breach of pre-determined rules, but whose economic effects are evaluated on a case-by-case basis.⁴ So not only is the rate of prosecution likely to be low (because vertical restraints tend to be pro-competitive) but, within the universe of those vertical restraints that are actually prosecuted, the rate of Type 1 error or false positives is likely to be high.

I am however going to argue that not only is the likelihood and consequence of Type 1 error in the enforcement of unilateral conduct vastly exaggerated but that the likelihood and consequence of Type 11 error is significantly understated. Indeed I will argue that, at least in South Africa and in a great many economies characterised by broadly similar historical and structural features, the

² The cost of inappropriate interventions/non-interventions under Article 82 - A report prepared for the Office of Fair Trading by Lear (Economic Discussion Paper September 2006, OFT 864) Para 6.84

³ 'The cost of inappropriate interventions...' Para 6.46

⁴ Op cit para 5.15ff

likelihood of Type 11 error in the enforcement of unilateral conduct rules is almost certainly greater than that of Type 1 error.

Surely any economic analysis worthy of the name must begin an assessment of the likelihood of the direction of error in anti-trust enforcement with an attempt to specify the pertinent features of the actual economy in which the enforcement is carried out, rather than with the application of industrial organisation theories to abstracted generic conduct in abstracted generic economies. The strong tendency towards a 'black box' treatment of the broader economic context within which anti-trust is enforced precisely privileges form over content, or, more accurately, privileges the application of general theoretical propositions to a widely divergent and pertinent range of concrete circumstances whose actual general features can in fact be easily ascertained. It's my strongly held view that much of the micro-economic theory that dominates thinking about firm conduct and its consequences, has tunnelled so deep into the entrails of the conduct that it has lost sight of the features of the actual economies in which the rules are being applied, economies of vastly differing sizes, structures and histories. This is particularly pertinent in the analysis of errors in application, that is to say in the application of theories where it is explicitly acknowledged – for why, after all, the concern with likely error – that actual outcomes may go either way. My contention is that the likelihood, direction and cost of the error – and so the approach towards enforcement - will be significantly influenced by history and structure of the economy in which unilateral conduct rules are being enforced.⁵

Take South Africa for example. A wide range of key markets are highly concentrated with single firm dominance in the 60%-plus market share range not uncommon.⁶ This is particularly true of markets in key intermediate industrial products and services such as steel, basic chemical feedstocks, various forms of transport, energy and telecommunications characterised by high entry barriers and a history of state ownership. And it is also true of significant consumer goods markets - beer, cigarettes, detergents, magazine publishing and glass to list but a few important random examples that have recently come to the attention of South African anti-trust enforcers.

⁵ A similar point has been made with reference to differences in unilateral conduct enforcement between the US and Europe: 'arguably there should be transatlantic differences in policies towards abuse of dominance. The European economy has historically been more monopolized than that of the US, and its competitive self-righting mechanisms may be more robust'. John Vickers Competition Law and Economics: a Mid-Atlantic Viewpoint European Competition Journal 3

⁶ See also Liberty Ncube – What are the implications of the 'post-Chicago synthesis for competition policy in South Africa? Competition Commission of South Africa Research Brief – March 2003

Moreover many of these dominant positions clearly do not originate in the superior competitiveness of the products and services of the firms in question. Historically poor anti-trust enforcement, protectionism, geographic isolation, state ownership and privatisation combined with weak regulatory structures are major contributors to single firm dominance in key markets. Hence, and merely by way of several pertinent examples, the structure of the country's beer and wine and spirits markets have their origins in a public market allocation agreement which, though contested by an earlier, and significantly weaker, incarnation of the contemporary anti-trust agencies, was nevertheless approved on blatantly political grounds by the then government. Autarkic industrial policies characterised by high levels of tariff and other forms of protection in the post 2nd World War period, subsequently bolstered by the isolating effect of economic sanctions, have contributed to high levels of concentration in many markets for both key intermediate products and consumers goods. Key markets are dominated by firms that were privatised or partially privatised into unregulated or weakly regulated markets. Steel, basic chemical feedstocks, and fixed line telephony exemplify these markets. Defective licensing regimes coupled with weak regulation account for dominated markets in, inter alia, mobile telephony, commercial radio and pay television. Markets in important segments of transport, energy, broadcasting and telecommunications are still dominated by state controlled enterprises many of which persistently attempt to leverage the dominance achieved through license into related, unlicensed markets.⁷

Under these actual economic circumstances, those charged with promoting competition in South Africa should be forgiven for fearing the direct consequences of abusive conduct by dominant firms and the chilling effect that this will have on potential new entry rather more than the possible competition chilling consequences of restricting, albeit occasionally erroneously, the freedom of action of these dominant firms. And if this assessment is applicable to the South African economy how much more does it apply to a transition economy in which in the recent past every market had been subjected to dominant SOEs and in which, to this day, dominance cannot remotely be ascribed to pro-competitive conduct? And I suspect that the chickens will come home to roost for the developed economies when Chinese and Indian competition law enforcers start soft-peddling enforcement of the abuse of dominance provisions in their laws, all no doubt in the name of extending to their dominant domestic firms the right to compete vigorously. The first to feel the shoe pinching will be very large north American and European firms who will struggle to penetrate the vast and growing domestic Chinese and Indian markets and will wish to invoke abuse of

⁷ Telkom SA and Business Connexion Group Ltd, Case No: 51/LM/Jun06

dominance allegations against alleged exclusionary conduct by dominant Chinese and Indian firms just as Phillip Morris and JTI, with their powerful Marlboro and Camel brands, have sought to invoke them in our dominated domestic cigarette market.

So we begin in our country with a historical and structural predisposition – fully justified I would contend – that apprehends the likelihood of abuse of dominance. And we then move to our statute, in which both the definition of dominance itself, as well as the identification of potentially abusive conduct is articulated in the form of elaborate rules.

To start with the definition of dominance, a firm found to have a market share of 45% or greater is irrebuttably presumed dominant. At market shares of 35% or more but less than 45% a firm will be dominant unless it can show that it does not possess market power. And below 35% a finding of dominance requires a showing from the Competition Commission or the private complainant that the firm has market power.

Potentially abusive conducts are described in some detail in the statute. Two of these practices are subject to a form of *per se* prohibition at least to the extent that the statute does not provide for a pro-competitive defence once the elements of the conducts have been established. These are excessive pricing and denial of access to an essential facility. Then there is a general prohibition of an 'exclusionary act' in respect of which the complainant, in addition to proving the conduct, is required to establish the absence of countervailing pro-competitive gains. And then several conducts are described including a refusal to deal, tying and bundling and predatory pricing, in which the complainant has the onus of establishing the conduct while the onus of establishing the existence of pro-competitive gains shifts to the respondent. Price discrimination practiced by a dominant firm is also, under very highly specified circumstances, proscribed.

So our economic circumstances predispose towards vigorous attention directed at the prospect of abuse of dominance and our statute, at least according to the wisdom received from those who live in fear of 'false positives', appears to make proof of dominance as well as proof of abusive conduct a simple matter of establishing a breach of pre-determined rules. If the literature on unilateral conduct enforcement is to be believed, one would, under these circumstances, expect significant over-enforcement, particularly from an authority that has developed a reputation for robust enforcement of the merger provisions of the Act and, more recently, for aggressive pursuit of cartels.

In fact it is manifestly clear that over-enforcement of unilateral conduct has not occurred. The Tribunal has, in the nine years of its existence, decided five abuse of dominance cases.⁸ One case was brought against the dominant producer of steel which was previously state owned and is now part of the Arcelor Mittal group;⁹ another was brought against the dominant producer of chemical feedstocks (and also previously state owned);¹⁰ a third case involved a large international print media group;¹¹ a fourth case involved the bottler of a multinational carbonated soft drink bottler;¹² and the fifth case involved the dominant passenger air travel carrier which is still owned by the state.¹³ Of these only one was actually brought by the Commission while the others were brought by private parties after the Commission declined to prosecute. Three of the five adjudicated complaints were upheld by the Tribunal and two were dismissed. Two of the Tribunal's affirmative findings of abuse were appealed. One of these appeals was upheld by the Appeal Court, while the appeal on the second is pending. Needless to say even if we had erred in every one of our affirmative findings – and that is certainly not the case – the direct or *ex post* cost of these errors would be trivial.

We have no evidence regarding the *ex ante* consequence of this enforcement – in fact despite the confident assertions of those anti-trust practitioners who apprehend likely Type 1 error, and fear, in particular, their *ex ante* costs, I have yet to see actual evidence of unilateral firm conduct being restrained for fear of erroneous prosecution. Although, as elaborated below in our discussion of deterrence, I would like to believe that the high profile nature of our affirmative findings in the pricing and discounting practices that have come before us has indeed generated some degree of internal appraisal of the conduct of dominant firms engaged in practices similar to those that were

⁸ In the early days of the Tribunal's existence several more abuse of dominance cases were decided in applications for interim relief that were not taken through to the trial stage. The reasons why these cases were not pursued further is varied and, while these definitely include a change in the offending practice – and so the possibility of erroneous chilling or effective deterrence - in other cases they unquestionably revealed to the plaintiffs just how difficult it was from both a substantive perspective and from the perspective of the prosecutorial resources required, to pursue an abuse of dominance complaint.

⁹ Harmony Gold Mining Limited Durban Roodepoort Deep Limited and Mittal Steel SA Limited Macsteel International Holdings BV, CT Case No.: 13/CR/Feb04

¹⁰ Nationwide Poles v Sasol (Oil) Pty Ltd, CT Case No.: 72/CR/Dec03

¹¹ Mandla-Matla Publishing (Pty) Ltd v Independent Newspapers (Pty) Ltd, CT Case No.: 48/CR/Jun04

¹² Mapula Restaurant v Coca-Cola Fortune (Pty) Ltd, CT Case No.: 91/CR/Aug07

¹³ The Competition Commission v South African Airways (Pty) Ltd, CT Case No.: 18/CR/Mar01

impeached and more attention to our abuse of dominance provisions in general, I have no evidence to support this.

Why, in what appears to be an intensely rule-focused unilateral conduct enforcement regime, and contrary to the predictions of some economic theory, has over-enforcement clearly not occurred?

The simple answer is that abuse of dominance allegations are extremely difficult and resource consuming to investigate and to prosecute. First, a complainant in a unilateral conduct matter is, per definition, inevitably up against an extremely well resourced opponent – a dominant firm. Inevitably what is at issue is a widespread and long standing practice across a large group of companies and so will be vigorously defended. There is little imperative to settle – not all of the first-time unilateral conduct offences even carry the prospect of a fine and so it is highly likely that after a massive trial involving years of litigation all that may be imposed on the guilty party is a behavioural direction.¹⁴ Private damages claims are not easy to make – in fact in only one of our abuse of dominance cases has the complainant proceeded to the high court on the basis of our finding and instituted a claim for damages. We do not have standing for class action suits to recover damages. Accordingly prudent advice to the Commission or, more especially, to a prospective private plaintiff in an abuse of dominance suit, would counsel a long, hard look at the consequences of proceeding even with a prosecution that is *prima facie* strong. It will tie up huge resources merely in dealing with the range of interlocutory and invasive discovery applications that inevitably precede a trial. And then the trial itself will, of necessity, presuppose the retention of expensive counsel and economic experts. Note that our statute only gives a private plaintiff the right to proceed once the Commission has elected not to proceed and if unsuccessful an adverse costs order almost inevitably follows. And then, even if successful, the retribution is limited particularly in the form of recompense to the direct victims.

¹⁴ Note that in *South African Airways* the complaint was initially filed with the Commission in October 2000 and the (affirmative) decision of the Tribunal was finally handed down by the Tribunal in July 2005, slightly under 5 years later. In *Arcelor-Mittal* the complaint was filed with the Commission in September 2002 and the Tribunal's affirmative decision was handed down in March 2007. The appeal before the Competition Appeal Court in the latter case will be heard later this year and, should the CAC uphold the Tribunal's appeal there is the further possibility of appeal to the Supreme Court of Appeal. These extraordinary time frames appear to be mirrored in many other jurisdictions and reflect the complexity of these cases and the endless opportunity for extensive pre-trial litigation rather than the tardiness of the competition authorities. They certainly suggest that complainants who elect to prosecute unilateral conduct cases require high levels of commitment and extremely deep pockets.

In short then, whatever high economic theory suggests about the likelihood of over-enforcement in a rule-based enforcement regime, the more prosaic incentives to proceed against a firm for abuse of dominance all suggest the likelihood that these conducts will be under-enforced. It is conceivable that a unilateral conduct enforcement regime, even one putatively based on economic standards rather than legal rules, in which potential retribution and recompense incentivises private abuse of dominance actions may have greater reason to apprehend the prospect of frivolous, adventurous unilateral conduct litigation. In fact given the frequency with which the spectre of frivolous litigation is invoked by the US courts as the basis for the *a priori* scepticism directed at unilateral conduct cases, it is clear that the incentive given to private complainants by the prospect of treble private damages plays a significant role in explaining the excessive caution of US courts in relation to claims of monopolisation.¹⁵ However this is not a problem that we, or, to my knowledge, any other jurisdiction, faces. Clearly the first-best solution is to reduce the incentives for vexatious competitor-driven litigation rather than to adopt an approach that would effectively treat most unilateral conduct as *per se* legal or, at best, as potentially frivolous or vexatious.

Secondly, the substantive hurdles that have to be cleared in proving abuse of dominance are formidable. Hence the provision in our legislation of an irrebuttable presumption of dominance based upon market share has occasioned much hand-wringing in anti-trust circles. The impression that critics of this provision create is that dominance is established on the basis of a cursory arithmetic exercise. Of course nothing could be further from the truth. It is rather rooted in a

¹⁵ Note *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act* (U.S. Department of Justice, September 2008) at Page 15: *'The Court's concern about overly inclusive or unclear legal standards may well be driven in significant part by the particularly strong chilling effects created by the specter of treble damages and class-action cases.'* See also *Comments of Federal Trade Commission Chairman William E. Kovacic: Modern U.S. Competition Law and the Treatment of Dominant Firms: Comments on the Department of Justice and Federal Trade Commission Proceedings Relating to Section 2 of the Sherman Act* at Page 4 *'Judicial Concerns about over-deterrence also appear to stem from perceptions that the existing system of private rights of action is unduly expansive. Fears about unduly expansive private enforcement are driving doctrine in an increasingly non-intervention minded direction that encumbers public agencies as well. In their efforts to correct what they believe to be overreaching by private litigants, courts are embracing liability standards that inevitably curb public enforcement bodies'* and further at Page 8: *'If, as I believe, judicial perceptions of overreaching by private suits are narrowing the zone of substantive liability, public agencies may eventually be unable to do their job. This consideration points to the need for a deeper empirical examination of how the operation of private rights actually affects business decision making and how public agencies can prosecute cases without carrying burdens that courts have imposed on private litigants to cure perceived deficiencies in the system of private rights'*.

rigorous identification of the relevant market a requirement which, as the DOJ report on single firm conduct acknowledges,

'..brings discipline and structure to the monopoly-power enquiry, thereby reducing the risks and costs of error'.¹⁶

Market definition would include an analysis of supply-side substitution which has the potential to greatly influence our definition of the boundaries of the relevant market and hence the finding of dominance within that market. We would also require evidence of the durability of the market share - we would never make a finding of dominance on the market share of a single year particularly if that share was at or close to the 45% threshold. I should add that even though our test of dominance is satisfied by proof of a market share of 45% or higher we have generally, in order to bolster our conclusions, gone beyond our legal requirement and shown evidence of the existence of market power. Note too that the lowest market share on which we have actually found an abuse of dominance is 56% - the abuse of dominance cases that have actually come before the Tribunal for final adjudication involved market shares of 56%, 57%, 66% and 81%. In fact I can't recall many allegations of abuse that are filed when dominance is at or even near the threshold 45%. What our Act achieves is to explicitly put in place a somewhat lower hurdle for proving dominance than that involved in proving a significantly more elusive and less settled concept like market power. Market power, I should add, can rarely be proved by direct evidence but involves the use of proxies and indicia and much inferential reasoning. Our Act simply cuts to the chase and provides for proof of dominance on the basis of the most commonly used proxy or index for market power, namely, market share.

And then, of course, proof of dominance has no direct bearing on the question of whether or not an abuse of that dominance has occurred. For that much more is required. As already noted, our Act describes in terms that are fairly elaborate the conduct that may qualify as an abuse. However, in respect of most of the described conduct the elements that are required to be proved require crossing some significant hurdles by way of the economic evidence that is explicitly demanded. Indeed our statute effectively imports economic standards into an assessment of its stated rules, the contravention of which may trigger a finding of abuse. Hence in respect of the two contraventions which do not permit an efficiency defence, the charging of an excessive price and denial of access to an essential facility, the elements that have to be proved in order for a price to be defined as

¹⁶ *Competition and Monopoly* p.25

excessive or for a facility to be deemed essential are formidable.¹⁷ As noted, in respect of the other abusive conducts described in the statute an efficiency defence is expressly provided for. Hence, as already noted, for the general category of exclusionary acts to constitute an abuse the complainant has to establish that ‘the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive gains’, a clear economic effects based approach.¹⁸ In respect of the named abuses – predatory pricing, tying and bundling, refusal to supply, etc – the respondent is invited to present an effects-based defence by establishing that the pro-competitive gains outweigh the anti-competitive effects that are proved to arise from the conduct described.¹⁹ Moreover, the necessity to prove economic effects has been strongly emphasised in the Tribunal’s jurisprudence on unilateral conduct. The Tribunal’s approach to a decision making process that requires both the application of legal rules and economic standards in exclusionary unilateral conduct cases is summarised in *South African Airways*:

In summary, we find that the Act sets out the following approach to exclusionary standards. In the first place we examine whether the conduct in question is exclusionary in nature. In terms of Section 8(c) that would be conduct that fits the definition of the Act for what constitutes an exclusionary act. In terms of 8(d) it is conduct that meets the definition set out in the sub-paragraphs of that section. If the conduct meets the requirement of the definition, we then enquire whether the exclusionary act has an anti-competitive effect. The question will be answered in the affirmative if there is (i) evidence of actual harm to consumer welfare or (ii) if the exclusionary act is substantial or significant in terms of its effect in foreclosing the market to rivals. This latter conclusion is partly factual and partly based on reasonable inferences drawn from proven facts. If the answer to that question is yes, we conclude that the conduct will have an anti-competitive effect. Whichever species of anti-competitive effect we have, consumer welfare or likely foreclosure, we have evidence of a quantitative

¹⁷ Section 1(ix) defines an ‘excessive price’ as ‘a price for a good or service which (a) bears no reasonable relation to the economic value of that good or service, and (b) is higher than the value referred to in paragraph (a)’. Section 1(viii) defines an ‘essential facility’ as ‘an infrastructure or resource that cannot reasonably be duplicated, and without access to which competitors cannot reasonably provide goods or services to its customers’.

¹⁸ Section 8(c)

¹⁹ Section 8(d)

nature and hence we can return to the scales with a concept capable of being measured against the alleged efficiency gain.²⁰

There is thus no robotic or mechanistic ‘box-ticking’ approach to the application of the rules and standards that have to be proved in order to sustain an allegation of abuse of dominance. Instead experienced anti-trust enforcers and adjudicators, bolstered by access to many years of scholarly reflection and international jurisprudence (which Section 1(3) of the Act specifically directs us to consider), are required to exercise their judgement in investigating and deciding a case brought before them. Indeed it would seem that the open-ended and vague wording of the Sherman Act is more likely to lend itself to the vicissitudes and caprices of intellectual fashion – and so potentially to alternating bouts of over- and under-enforcement - than is an Act such as the South African Competition Act relatively elaborately crafted on the basis of long-standing international experience.

So, in summary, the investigation and prosecution of abuse of dominance is a resource consuming exercise, with limited prospect of success and remedies that are not particularly dis-incentivising. Moreover, the substantive hurdles that have to be cleared in the form of onerous legal and economic tests are formidable. And so, as might be expected, under-enforcement, or Type 11 error, is the likely upshot even in an economy whose history and structure suggests the strong likelihood of anti-competitive unilateral conduct and whose enforcement agencies are strongly committed to enforcing the rules proscribing this type of conduct.

Given then the caveats, the economic standards, with which our Act and our jurisprudence qualify our rule-based approach, why not merely opt for a pure economics standard? Why not replace our elaborate rules that describe dominance and abusive conducts with a pure economic standard that simply provides that firms possessed of market power are prohibited from engaging in conduct likely to cause harm to competition. This would seem to best capture an abuse of dominance proscription that would find favour with those intent upon reducing the prospective chill on competition arising from over-enforcement of unilateral conduct.

Note that our view is not simply that over-enforcement is unlikely to occur, but that everything points to under-enforcement occurring. Under these circumstances it appears that the correct approach to take is one that provides the prospect of an antidote to the likelihood of Type 11 error. The approach adopted by our law – an approach that essentially interfaces legal rules and economic

²⁰ *South African Airways* Para 132

standards – provides, I would contend, for greater deterrence, certainty and administrability than an approach based on economic standards alone.

First, regarding deterrence, it should be acknowledged that anti-trust enforcement is law enforcement and, in common with other law enforcement activity must, for the most part, rely upon deterrence rather than prosecution. We use market share as a proxy for market power and while, given the uncertainties that often surround the precise location of the boundaries of a relevant market, precise market shares cannot always be known in advance, a firm whose market share significantly exceeds a chosen proxy – in our case 45% - will generally know that it is likely to be found to be dominant. As for the potentially abusive conducts described in our law, these represent the most frequently identified and prosecuted abusive conducts. What is then achieved is to signal to a firm that is likely to be found to be dominant that, before engaging in the well known forms of potentially abusive conduct enumerated in our statute, it should take a view based on well established jurisprudence and much scholarly writing of the likelihood that its conduct will actually be found to be abusive. If it is so advised it will either refrain from such conduct or undertake it fully cognisant of the risk, which we would describe as low, that it will be successfully prosecuted for abuse of dominance.²¹ As already noted we have no evidence on the extent to which there is effective deterrence, however the prospect of deterrence is clearly promoted by the use of clear rules and standards.

The need to provide certainty traverses similar issues. While it is widely accepted that abusive conduct should always be analysed by a rule of reason standard and judged on the factual matrix applicable to each case, this does not reduce the analysis of abusive conduct to some sort of post-modernist relativism where no outcomes can possibly be known, with a reasonable degree of certainty, in advance. Resort to pure economic reasoning provides little by way of certainty and so cannot effectively guide the actions of firms. This observation is not intended to imply that uncertainty can ever be comprehensively eliminated from fact-based anti-trust analysis. However

²¹ I have not found data on the success rate of abuse of dominance prosecutions. However note the following comment on the US DOJ's success rate in securing convictions in criminal anti-trust trials: *'The antitrust arena is a notable exception to the government's dominance in criminal trials, with conviction rates in criminal antitrust trials consistently falling well short of overall success rates. Since 1996 not even half of all criminal antitrust defendants who have gone to trial have been convicted. Although the sample set from a statistical point of view is relatively small, the numbers over the years do provide an undeniable trend – despite dedicated and skillful prosecution by DOJ lawyers, defendants in criminal antitrust cases fare far better at trial than other criminal defendants'*. F. Joseph Warin, David P. Burns and John W.F. Chesley To Plead or Not to Plead? Reviewing a Decade of Criminal Antitrust Trials – The Antitrust Source, www.antitrustsource.com July 2006

lawyers advise clients who take important decisions on the basis of this advice. In these circumstances it would not be at all surprising if both lawyer and client were willing to accept the possibility of a degree of error as a result of the application of well-established rules as a trade-off for the certainty that the latter brings to the business of providing legal advice and guiding business decisions.

Thirdly, there is the question of administration. Anti-trust enforcement does not have the luxury of indulging perpetually in the inconclusive analysis that is found in much of the scholarly work on abusive conduct and reproduced in the evidence of economic ‘experts’ – who are, in reality, better described as economic advocates - testifying in anti-trust trials. Anyone who has adjudicated an anti-trust trial alleging anti-competitive unilateral conduct or even an anti-competitive merger will testify to the extraordinary range of theories presented by expert economic witnesses, and, worse, to the extraordinary range of outcomes predicted on the basis of broadly similar theoretical positions advanced by these experts. We are not here dealing with the relative certainties of physical science, but with the uncertain predictions of social science. Moreover anti-trust enforcers are obliged to arrive at decisions based upon statutory language and reflected in the decisions of courts of law. If anti-trust laws are to be successfully administered while taking account of economic standards, administrable proxies have to be sought for these economic standards. Most anti-trust literature that has enforcement in mind has to have recourse to proxies. This includes the use of market shares as proxies for market power.

The authoritative *Antitrust Law Developments* published by the American Bar Association clearly establishes that market shares have been used as proxies for monopoly or market power in the US since at least *Alcoa*.²² The *Antitrust Law Developments* state categorically that

*courts generally regard the alleged monopolist’s market share as the most important factor in determining the existence of monopoly power.*²³

This approach is affirmed in the recent DOJ report on unilateral conduct, which, though admittedly hedged, certainly indicates that the enforcement agency too makes use of presumptions when determining monopoly power:

²² See *Antitrust Law Developments (Fifth)* American Bar Association (2002) pp234ff

²³ *Antitrust Law Developments* p234

Where courts have found monopoly power – as opposed to market power – the defendant’s market share is has been at least 50% and typically substantially higher.

When a firm has maintained a market share in excess of two-thirds for a significant period and the Department concludes that market conditions likely would prevent the erosion of its market position in the near future, the Department will presume that the firm possesses monopoly power absent convincing evidence to the contrary.²⁴

This is followed by reference to literally dozens of US court decisions that clearly affirm that market share is, to this very day, widely and explicitly used as a proxy for monopoly power. The disparate variety of positions taken by US courts regarding market share and monopoly power is also outlined the DOJ report.²⁵

A trawl through EU guidelines and jurisprudence reveals a strikingly disparate and elaborate use of market share as a proxy for market power.²⁶

Indeed US and EU jurisprudence reveal not only the importance of proxy rules based upon market share in the determination of market power, they also demonstrate that when the precise proxy is left unspecified and, particularly, when it is formally unacknowledged and even eschewed by influential scholars and even enforcers, then the range of decision makers, commonly burdened with the task of administering a legal instrument, will be obliged to select a proxy themselves, in the

²⁴ *Competition and Monopoly* pviii. See also in the main body of the report at Pages 23 and 30.

²⁵ *Competition and Monopoly* pages 21-2

²⁶ From a variety of EC guidelines and court decisions I have been able to glean the following:

90% is usually conclusive of dominance as stated in the *Hoffman-La Roche* case. However in the EC merger case of *Tetra Pak v Alfa-Laval* 90% did not confer dominance; 75% is indicative of dominance (cf *Hoffman-La Roche* case); 50% strong evidence of dominance, where held for three years except in exceptional circumstances (*AKZO v Commission* NB other factors were also taken into account); 40% or more indicate that there is evidence of dominance which has to be considered with other factors; 25-40% show that single dominance is unlikely unless a fragmented market and significant other factors; 20% the possibility of dominance is left open to be considered in the context of other factors. The relative size is also considered. Where a firm with a 45% market share is in a market with the shares of the three firms operating in the market in a 45:35:20 ratio, the largest firm would probably not be considered to be dominant whereas if the ratio was 45:15:10 it would probably be considered dominant

process undermining certainty that could be easily established by means of a simple stated rule judiciously applied.²⁷

Effective administration also dictates that familiar proxies be employed in identifying abusive conduct. Hence the OFT-commissioned report already cited is predicated on the by-now familiar argument that economic standards rather than legal rules constitute the analytically correct basis for describing and analysing alleged abuses of dominance. And so the report commences with debunking the old rule-based categories – exclusive dealing, tying and bundling, refusal to supply, predatory pricing, price discrimination, etc – in favour of a new effects-based taxonomy designated ‘output conducts’ and ‘structural conducts’ with the latter further categorised as ‘raising rivals costs’ and ‘lowering rivals demand’. But no sooner has this new taxonomy been formulated than it is immediately re-cast in the familiar old language of legal rules. So ‘raising rivals cost’ conducts are re-cast in strikingly familiar terms as, inter alia, ‘margin squeeze from above’, ‘non linear pricing’, ‘refusal to supply’ and ‘exclusive contracts’ while ‘lowering rivals demand’ is described as, inter alia, ‘fidelity rebates’ and ‘tying and bundling’. Output conducts for their part are characterised as ‘predatory pricing’ and ‘price discrimination’. The effects-based taxonomy proposed by the authors will doubtlessly assist in a rigorous identification of the economic consequences of selected conduct but, equally, in order to effectively administer an anti-trust statute proxies drawn from enforcement experience and established jurisprudence have still to be relied upon even by the proponents of an economic standards-based approach.

The dissenting judgement of Justice Breyer in *Leegin* provides an instructive outline of the role and importance of proxies in the administration of anti-trust rules. Here the court is examining the

²⁷ What the actual US and EU practice also reveals is that the recently adopted International Competition Network’s (ICN’s) ‘recommended practice’ on market power which strongly qualifies the use of market share proxies in the determination of market power is substantially at odds with actual practice in the two leading anti-trust jurisdictions and would erect substantially greater barriers to enforcement actions against unilateral conduct. See ICN Unilateral Conduct Working Group, Dominance/Substantial Market power Analysis pursuant to Unilateral Conduct Laws, ICN Recommended practice. See www.inc-kyoto.org/documents/index.html. In their response to the DOJ report three members of the Federal Trade Commission describe the report as ‘a blue print for a radically weakened enforcement of Section 2 of the Sherman Act’. (*Statement of Commissioners Harbour, Leibowitz and Rosch on the issuance of the Section 2 report of the Department of Justice* at page 1). To emphasise, if not belabor, my point: the recent DOJ report is considered by no less than three members of the FTC to be a higher hurdle for a Section 2 prosecutor than established US enforcement practice and jurisprudence while the standards recommended by the ICN are at least as onerous as those set out in the DOJ report and possibly more so. The conclusion then must be that the ICN recommended practice prescribe a more onerous regime for unilateral conduct enforcement than that reflected in current US practice.

administrative importance of using proxies in deciding whether a specific form of conduct should be judged by *per se rules* as opposed to rule of reason, however the judge's reasoning is apposite, possibly more apposite, to the issue under discussion here. Justice Breyer argues:

The upshot is as many economists suggest, sometimes resale price maintenance can prove harmful; sometimes it can bring benefits. But before concluding that courts should consequently apply a rule of reason, I would ask such questions as, how often are harms or benefits likely to occur? How easy is it to separate the beneficial sheep from anti-trust goats?

*Economic studies such as the studies the Court relies upon, can help provide answers to these questions, and in doing so, economics can and should, inform anti-trust law. But anti-trust law cannot, and should not, precisely replicate economists' (sometimes conflicting) views. That is because the law, unlike economics, is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. And that fact means that courts will sometimes bring their own administrative judgements to bear, sometimes applying rules of *per se* unlawfulness to business practices even when those practices sometimes produce benefits.²⁸*

And further, Justice Breyer identifies the prospect of error implicit in the absence of reasonably clear rules:

Are there special advantages to a bright-line rule? Without such a rule, it is often unfair, and consequently impractical, for enforcement officials to bring criminal proceedings. And since enforcement resources are limited, that loss may tempt some producers or dealers to enter into agreements that are, on balance, anti-competitive.²⁹

²⁸ Leegin Creative Products, Inc., Petitioner v PSKS Inc 551 U.S. (2007) pp7-8

²⁹ Op Cit p11. Note that the assumed superiority – from a competition perspective – of inter-brand competition over intra-brand and the willingness to sacrifice less of the latter for more of the former, is one bright line accepted without question by the majority in *Leegin*. While this economic standard – that has achieved the status of a rule - may indeed be well-established and useful for the effective administration of competition law, it may also be a somewhat outdated 'rule' of economics in a contemporary world where the distribution of goods and services is ubiquitously separated from their production and is an important arena of competition in its own right. In these circumstances should one not take care when adopting too easily the mantra that holds that inter brand competition is more important than intra brand competition? Certainly the manner in which this view of the relative

Expressed otherwise, Justice Breyer is cautioning against the prospect of *ex ante* costs that derive from Type 11 errors that in turn result from the absence of clearly formulated rules.

Nor, by any means, is it only those who are concerned with Type 11 error who rely on proxy rules. It seems that even those who are exclusively concerned with Type 1 error rely on proxies despite their assertion of the superiority of economic reasoning over legal rules. Note the oft-cited passage from Justice Scalia's judgement in *Trinko*:

*The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices – at least for a short period – is what attracts ‘business acumen’ in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct.*³⁰

Certainly South African practice would support Justice Scalia to the extent that the ‘mere possession of monopoly power (is) not unlawful’. But to ascribe ‘risk taking, innovation and economic growth’ to the possession of monopoly power seems little distant from asserting that the freedom of a dominant firm to conduct itself unfettered is, in Justice Scalia's view at any rate, a proxy for consumer welfare!³¹ And this despite the powerful evidence accumulated over decades of anti-trust enforcement that dominance lends itself not merely to the charging of monopoly prices, but enables conduct (the general features of which are well documented in scholarly literature and jurisprudence) the effect of which is precisely to exclude those who, despite Justice Scalia's bold

importance of the two forms of competition is accepted is a clear example of the adoption of competition rules and proxies even by those who decry the application of bright line rules in anti-trust analysis.

³⁰ Verizon Communications Inc. v Law Offices of Curtis V. Trinko. LLP

³¹ This is precisely the conclusion that the Federal Trade Commissioners arrived at in their response to the DOJ report: *‘The Department’s report is chiefly concerned with firms that enjoy monopoly-power, or near monopoly power, and prescribes a legal regime that places these firms’ interests ahead of the interests of consumers. At almost every turn, the Department would place a thumb on the scales in favour of firms with monopoly or near-monopoly power and against other equally significant shareholders’.* (*Statement of Commissioners..Page 1*). Also see Eleanor Fox *‘The Efficiency Paradox’* forthcoming in ...for an analysis of how conservative economic theory has superceded fact and effectively established rule bound proxies for the analysis of unilateral conduct in important recent US anti-trust enforcement practice including court decisions.

assertions, would wish to enter a market whose structure has enabled the dominant incumbent to extract monopoly rents.³²

A final word on innovation: those most concerned with Type 1 error commonly assert that the *ex ante* costs are likely to be most severe in dynamic economies ‘*where firms achieve a dominant position mainly through the adoption of innovative and efficient conducts. The same type of error is much less costly in those markets with heavy-handed regulations that make rent-seeking a suitable means to gain privileged positions and market power*’.³³ In particular, it is feared that remedies imposed in refusal to deal or essential facilities claims may effectively undermine intellectual property rights and so dis-incentivise innovation. This argument – which has also assumed mantra-like proportions – requires much closer examination.

First, there are many economies which exhibit the less dynamic features alluded to and who may thus justifiably be more concerned with the positive consequences of limiting rent-seeking than with the prospect of chilling innovation, who may, in other words, derive more gain from protecting static efficiencies than from promoting dynamic efficiencies .

Indeed it should be borne in mind that in the vast majority of national economies patentable innovation based on laboratory-type research is not a common source of dynamism. Despite a proclivity on the part of those who assert the imperative of innovation most strenuously to conflate innovation with intellectual property rights, process innovation and incremental, on-the-job adaptations of technologies and processes, innovations that drive down costs of production and improve existing products, are certainly more prevalent than those that produce new products and move out the technological frontiers and which commonly invoke intellectual property rights. Process and incremental innovation is precisely driven by rivalry from new entrants with low overhead costs and a handful of entrepreneurial engineers who challenge established incumbents by introducing lower cost production techniques and small improvements to existing products. This is, for the most part, the form that innovation takes in developing and middle-income countries and may well be the most important source of dynamism even in the developed economies which are also engaged in the development of new products and services. Process and incremental innovation

³² As the Federal Trade Commissioners note in their response to the DOJ report: *‘For one reason or another, it may take a long time for rivals to surmount entry barriers or other impediments to effective competition. Indeed, the monopolist’s own deliberate conduct may further delay a market correction and prolong the duration of consumer harm.* (Statement of Commissioners at Page 4. Our emphasis)

³³ OFT report para 6.84

is precisely the sort of innovation that is positively promoted by robust unilateral conduct enforcement that promotes accessible markets by guarding against exclusionary conduct on the part of incumbents.

Secondly, it should be acknowledged that the sources of even patentable product innovation are many and complex. It is widely acknowledged that successful innovation is rooted in considerable public support, including direct and indirect state subsidy. Indeed even critics of industrial policy are hard-pressed to deny the productive and necessary role of public investment in the process of innovation. Given this, those who boldly predict the end of innovation based on the disincentives alleged to flow from the possibility of Type 1 errors in a small number of anti-trust cases, should be required to provide more evidence of the putative link between unilateral conduct prosecution and innovation before throwing out the proverbial baby with the bathwater. To the extent that innovation is the product of public rather than private investment there is no warrant for believing that anti-trust enforcement, erroneous or otherwise, will sound the death knell on innovation.

Third, one should not lose sight of the fact that – the obvious interface between competition and innovation notwithstanding – the principle legal instruments underpinning new product innovation are the rules governing the acquisition and exercise of intellectual property rights. If those rules are ‘under-protecting’ innovation or, indeed if they are ‘over-protecting’ innovation, and, hence, coming into systemic and regular conflict with competition rules and standards, then surely the first-best solution is to fix the intellectual property rules rather than to demand compensatory action from competition enforcers, which action carries with it the distinct possibility of the under-enforcement of competition rules and standards.³⁴

³⁴ See Timothy Brennan ‘Should Innovation Rationalise Supra-Competitive Prices? A Skeptical Speculation’ *Swedish Competition Authority Journal* (2007)