

EXPLOITATIVE ABUSES – a note on the *Harmony Gold v Mittal Steel* excessive pricing case

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O, it is excellent to have a giant's strength: but it is tyrannous to use it as a giant

William Shakespeare *Measure for Measure*

Section 8 of the South African Competition Act describes dominant firm conduct which may be considered abusive. Section 8 (c) proscribes an 'exclusionary act' – defined in Section 1(x) as 'an act that impedes or prevents a firm entering into, or expanding within, a market' - provided that the complainant is able to establish that 'the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive gain'. The five sub-clauses of Section 8(d) describe specific acts that are exclusionary – including a refusal to supply, tying and predatory pricing – unless the firm engaging in these named acts can show countervailing pro-competitive gains that outweigh the anti-competitive effects of the conduct in question.

Section 8(b) prohibits another exclusionary act, namely denial of access to an essential facility which is defined in Section 1(viii), as 'an infrastructure or resource that cannot be reasonably duplicated, and without access to which competitors cannot reasonably provide goods or services to their customers'. No pro-competitive defence is provided for in respect of Section 8(b) offences.

The single exploitative abuse is described in Section 8(a) which prohibits a dominant firm from 'charg(ing) an excessive price to the detriment of consumers'.

Section 1(ix) – essentially following the wording used in *United Brands*, the leading European excessive pricing case² – defines an excessive price as

'a price for a good or service which (aa) bears no reasonable relation to the economic value of that good or service; and (bb) is higher than the value referred to in sub-paragraph (aa)'

As with Section 8(b) the Act provides for no pro-competitive defence in respect of Section 8(a) conduct.

Neither the record of the tri-partite discussions between government, business and labour that effectively negotiated the Competition Bill nor the subsequent parliamentary record indicates any significant consideration of the controversy that attaches to the

¹ Chairperson, Competition Tribunal of South Africa. I am indebted to Ipeleng Selaledi for her assistance in preparing this note.

² Case 27/76 *United Brands v Commission* [1978] ECR 207, [1978] 1 CMLR 429.

creation of an offence of excessive pricing, the most commonly cited 'exploitative abuse'. Indeed, the sensibilities of competition professionals notwithstanding, popular opinion everywhere generally views the achievement of competitive prices – which is a stated objective of the Act - as an analogue to the proscription of excessive prices.

In South Africa this general approach to allegations of excessive pricing conduct has received particular expression in widespread condemnation of the practice of import parity pricing. This describes the practice of constructing the price of a domestically produced product by using the prevailing price in another jurisdiction – generally the closest alternative geography from which the product in question is available – and adding in notional transport and other freight costs in order to arrive at the local price of the domestically produced product. The notion that domestic prices are then effectively determined by the cost structure prevailing in another distant country supplemented by freight charges that are not actually incurred is, correctly or otherwise, widely construed as an elaborate fiction designed to manipulate pricing in the producer's favour. It is a practice widely associated with key intermediate industrial products and is thus thought to undermine the competitiveness of downstream fabrication. This practice has been condemned by public opinion as well as by political and business leaders.

There has only been one excessive pricing case decided by the Competition Tribunal in the first nine years of operation of the Competition Act,³ this being a case brought by two gold mining companies – the Harmony Gold Mining Company and Durban Roodepoort Deep ('Harmony') – against Mittal Steel South Africa Ltd ('Mittal SA'), the dominant producer of flat steel products and, as second respondent, Macsteel International BV ('Macsteel'), a joint venture between Mittal SA and Macsteel Holdings, a large South African owned trader of steel in the domestic market and in the international market (through the second respondent). The complainants alleged that Mittal SA imposed an excessive price on its sales of flat steel products in the domestic market.

The Competition Commission elected not to refer the complaint to the Tribunal and so the complainants litigated their complaint themselves. After a lengthy trial the complainants prevailed and Mittal SA was indeed found to have contravened Section 8(a) of the Act by charging an excessive price. An administrative penalty of R691,8 million rand was imposed upon Mittal SA. The Tribunal also prohibited Mittal SA from imposing conditions of resale on any flat steel products supplied by it.⁴ The significance of this latter remedy will become apparent. Mittal SA and Macsteel have appealed the Tribunal's findings as well as the remedies imposed.

³ There have indeed been very few Section 8 prosecutions – that is, abuse of dominance – brought before the Tribunal. See David Lewis *Chilling Competition* in this volume.

⁴ The Tribunal's findings are in case no 13/CR/Feb04. There was a separate hearing on remedies the outcome of which are recorded under the same case number above. This article draws liberally without detailed attribution from the decision of the Tribunal referenced in this footnote. The detailed evidence, which was voluminous and is represented in the record of the decision, is, for the most part, omitted here.

This note will summarise the decision of the Tribunal and will reflect on some of the scholarly work and international jurisprudence that has considered the question of excessive pricing and the appropriate role, if any, of competition enforcement therein.

BACKGROUND

The first respondent, Mittal SA, was incorporated by a 1928 act of parliament as The South African Iron and Steel Corporation (“Iskor”). It was wholly owned by the South African state. Some 61 years later, in 1989, it was converted into a public company by another act of parliament. Iskor was selected to lead the then South African government’s privatisation programme, ushering in a new era in the company’s history with its listing on the Johannesburg Securities Exchange (“JSE”) in November 1989. Iskor was restructured in 2001 with the separate listing on the JSE of Kumba, a company which contained the mining assets previously owned by Iskor, leaving Iskor as a focused steel producer. This restructuring has some echo in the excessive pricing case at least insofar as its terms gave the steel company access to a large portion of its iron ore requirement on extremely favourable terms, an important reason why Mittal SA is able to describe itself as *‘among the world’s lowest cash cost producers of steel’*.

In late 2001 LNM Holdings B.V. (“LNM”) – soon to be renamed Mittal Steel - then the world’s second largest steel producer, bought 34,81% of Iskor’s issued share capital, increasing to 50% by late 2003. Iskor ultimately changed its name to Mittal Steel SA. The Mittal multinational subsequently merged its interests with those of Arcelor, then the world’s largest steel producer. Since August 2006 Mittal Steel SA has been controlled by Arcelor Mittal, the world’s leading steel producer.

Mittal SA is the primary producer of both long and flat steel products in South Africa with four production facilities, two producing flat steel products and two producing long steel products. It is noteworthy that the most modern of Mittal SA’s four plants, the coastal Saldanha plant producing flat steel products, was initially controlled by a Joint Venture in which Mittal SA (or Iskor, as it was then known) held a 50% share with the remainder held by the Industrial Development Corporation (‘IDC’), a state-owned development finance institution which provides loan and equity capital in support of industrial development. The IDC’s 50% share of the Saldanha plant was purchased by Mittal SA in 2002 as part of the restructuring programme referred to above. During the period in which Saldanha was controlled by the JV, an agreement between Iskor and the JV provided that all Saldanha output was to be exported. In other words, a market sharing agreement provided that Saldanha output would not compete with Iskor in the domestic market for flat steel products.

The second respondent is Macsteel International, a joint venture company owned in equal parts by Mittal SA and Macsteel Holdings (Pty) Ltd (“Macsteel Holdings”). Macsteel International was established in the Netherlands in 1995 pursuant to an agreement between Iskor and Macsteel Holdings. Macsteel International is exclusively entitled to conduct all of the export sales of Mittal SA. Although Macsteel Holdings also wholly owns a steel merchant that operates in the South African domestic market, the JV, Macsteel International, is contractually limited to trading in the international market - conversely

expressed, it is prohibited from trading in the domestic market. This has an important bearing on the excessive pricing case.

While it was common cause that the relevant product market was for flat steel products, there was clear contention surrounding the identification of the relevant geographic market. Harmony contended for a national geographic market, while Mittal SA's contention that the prospect of import competition constrains its pricing power – a cornerstone of its case - effectively argued for an international geographic market. A range of evidence supported the contention that the geographic market is national not least Mittal SA's own description of its South African market as one that is 'naturally protected' – and by this is meant protection by dint of its distance from competing producers of steel and the consequent high cost of transportation and is thus geographic in nature – and its explicit concessions of its market power. This interface between a competitive international market and a monopolistic domestic market underpinned Mittal SA's pricing regime.

Until 1984, Mittal SA – or Iscor as it then was - was subject to price control with prices determined on a 'cost-plus' basis. From 1984 until about 1992 Iscor's prices simply followed the domestic inflation rate. Mittal SA's witnesses testified that by 1992 this pricing policy resulted in flat steel imports entering the country (presumably because of a relatively high domestic inflation rate) and so from then on the import parity price principle was applied.

In brief, the import parity price was calculated by establishing an FOB price based upon one or other European price (the prevailing Black Sea price was often referred to) and then adding on the relevant logistical costs of transporting the product to South Africa, such as the shipping, the stevedoring, the handling, and the port costs, a commission of 2.5%, an import duty (recently scrapped) of 5%, the South African logistical cost for port and railage delivered into the inland Gauteng region and, finally, a 5% 'hassle factor' reflecting the additional costs or 'hassle' entailed in importing over the advantage of utilising a domestic supplier. This is then converted from a dollar price to a rand price based on the prevailing exchange rate. This, the import parity price (IPP), is determined monthly by Mittal SA and is conveyed to customers as a discount off or surcharge on a list price that is published every three months.

The complainants submit that the IPP is an artificially established price rather than a price determined through effective competition in the domestic market. We note – and the significance of this will become apparent – that those customers who receive a price below import parity, be this the rate charged to Macsteel International for export purposes or the rates charged to those who qualify for one or other of a number of rebate schemes, are contractually prevented from redirecting this discounted product into the higher priced domestic market.

Mittal SA testified that the import parity price had formed the basis of its price formation until late 2005 at which time the pricing basis changed from the import parity price to one based upon a basket of domestic prices prevailing in a range of selected domestic markets. The Tribunal did not however find this credible – that is, it appeared that import parity pricing remains to this day Mittal SA's price determination methodology. However

the point is of no great moment. As we shall elaborate below, the Tribunal's decision holds that a non-excessive price is one that is determined by competitive conditions in the relevant market. The 'representative basket' methodology then falls foul of the same argument that the Tribunal used to condemn the targeting of import parity as the basis for setting the domestic price: that Mittal SA has effectively targeted a pre-selected price and has then utilised its monopoly position to reduce supply in the domestic market in order to achieve this target price.

In the following section we will outline the Tribunal's general approach to excessive pricing as outlined in its decision in this matter. We will then discuss the threshold tests applied by the Tribunal in adjudicating an excessive pricing claim. We will finally discuss the Tribunal's approach to the remedies to be applied in an affirmative finding of excessive pricing.

THE TRIBUNAL'S APPROACH TO EXCESSIVE PRICING

The complainants' approach relied upon a series of comparisons of prices in different markets. Hence they submitted testimony comparing the price for flat steel products levied by Mittal SA on the vast majority of its domestic customers with prices charged by Mittal SA for flat steel products to its export customers; with prices charged for the same flat steel products to a select number of Mittal SA's domestic customers who receive varying degrees of rebate off the list price; with prices charged for Mittal SA's long steel products; with prices charged by other steel producers of flat steel products in a variety of markets across the world; and with Mittal SA's costs of production. They sought to use these comparisons to demonstrate that South African consumers of Mittal SA flat steel pay a price that is excessive in relation to the prices charged to those other purchasers of steel listed above. This approach – the use of comparators with other consumers and with costs – finds echo in a number of decisions of the courts of the European Union and those of its member states.

Mittal SA, for its part, did not engage much with the comparative approach of its adversaries. It rather argued that a charge of excessive pricing can only be sustained if it is demonstrated that this is reflected in excessive profits. This entailed a detailed excursion into the complex world of profit measurement, a concept which has different meanings for economists, on the one hand, and, on the other, for the accountants and auditors responsible for preparing the accounts of companies. The Tribunal heard the deeply contending views of a range of experts on, inter alia, the measurement of profit and the cost of capital and on the correct approach to the question of depreciation.

This latter approach gave rise to some rather bizarre testimony. Mittal SA's expert economist attempted to persuade the Tribunal that his client, far from profiting excessively from its pricing practices, is, the judgement of the investment community notwithstanding, a firm in dire commercial straits, indeed is a firm whose very future existence is placed in doubt. Not only was this assessment at odds with Mittal SA's current performance and its own bullish, public assessments of its future prospects, but the complainants counsel lost little time in pointing out that were these criteria to be applied to other companies, most of the blue chip companies listed on the Johannesburg Securities Exchange would suffer from a similarly negative assessment.

Moreover, because Mittal SA's expert rightly conceded at the outset that his contentions regarding profit assumed the 'efficiency' of the firm in question – an inefficient firm may charge excessive prices and still not show excessive profits – the Tribunal also had to consider the question of efficiency and its various measurements, also an issue that generated much conceptual debate. This has also meant that because of the concession regarding efficiency, Mittal SA's economist was constrained to argue that his client was simultaneously efficient *and* commercially unsuccessful.

The Tribunal has taken a quite different view of the question of excessive pricing. As will be elaborated below, the arguments of both the complainants and Mittal SA would effectively have the competition authorities adopt, by virtue of Section 8(a), the methodologies of price regulation. The Tribunal has rather cast the problem of excessive pricing using principles and methodologies firmly rooted in the practice of competition law and economics.

The reluctance of competition practitioners to assume a price regulating function derives not only from the massive technical difficulties entailed in determining the 'right' or, for that matter, the 'wrong' price, but from the founding principle underpinning the philosophy and practice of competition law and economics that holds that price determination is best left to the interplay of independent actors engaging in the market place. The fundamental task of competition regulators is then to promote and defend competitive market structures and to guard against conduct on the part of market participants which seeks to undermine the promise of those competitive structures to deliver quality goods and services at competitive prices.

Core to competition enforcement is the recognition that the promise held out by competitively structured markets may be denied by co-operation between notional competitors. It is additionally recognised that a number of factors ranging from the acquisition of market share by pro-competitive means through to past or present governmental support and subsidy, may result in single firm domination of markets. Faced by single firm domination the principal function of competition enforcers is to guard against 'exclusionary conduct', that is, unilateral conduct of the dominant firm that reproduces its dominance not through 'competition on the merits' but rather through the exclusion of actual or would-be competitors from the market.

Price determination is thus not characteristically part of the armoury of competition enforcement. And yet Section 8(a)'s proscription of the charging of an excessive price appears precisely to require the South African competition authorities to determine whether existing price levels are 'right' or 'wrong' (non-excessive or excessive) and, if 'wrong' (excessive) to determine and impose the 'right' (non-excessive) price.

However, the view taken by the Tribunal is that the prohibition of excessive pricing in a competition statute does not provide the competition authority with the license – or the powers and resources – to convert itself into a regulator of steel or any other prices. If excessive pricing is to be identified and remedied by a competition authority rather than a duly empowered and appropriately resourced price regulator, then it must do so by recourse to its standard approaches and instruments. If the legislature had intended Section 8(a) to convert a competition authority into a price regulator then it would surely

have provided it with the powers and resources appropriate to that considerable task. Consider the process by which the sector regulators – each with their own statutory foundation and specialist powers and resources – determine and police pricing in the telecommunications and electricity markets and then consider whether the legislature can possibly have intended that this be replicated in the steel or any other market by way of the insertion of a single nine word clause in the Competition Act.

The standard approaches and instruments of competition enforcement comprise analyses of and interventions in the structure of the affected markets and the conduct of its participants so as to produce outcomes that are, as far as possible, undistorted by the abuse of market power. As already noted, there are compelling conceptual and practical reasons why a competition authority should eschew a price regulation role.⁵

The Tribunal held that if an excessive pricing allegation is to be approached in the manner of a competition authority, then it must first be asked whether the structure of the market in question enables those who participate in it to charge excessive prices. As elaborated below, the Tribunal held that this requires clearing a significantly higher hurdle than that which must be cleared in order to establish ‘mere’ dominance. If that higher hurdle is cleared, the competition authority must ask whether Mittal SA has engaged in conduct designed to take advantage of – to ‘abuse’ – those structural opportunities in order to impose excessive prices on its customers. If the second question is also answered in the affirmative, the excessive pricing must be proscribed by imposing a remedy which addresses the underlying structural basis for the offending conduct and/or any ancillary conduct arising from the structural advantage that enables the firm in question to charge a price in excess of that which would have prevailed in the absence of the anti-competitive structure and/or the ancillary conduct. Only if both forms of these remedies are impossible to devise should an actual price level be specified.⁶ In

⁵ A competition authority may conceivably be called upon to act as a price regulator in instances that may be characterized as price ‘gouging’. For example were Section 8(a) to be invoked in the event of a natural disaster which had given rise to a temporary monopoly in some or other unregulated product or service that was vital to the life of the affected community, say ambulance services or fuel for heating, and this was exploited to effect a significant temporary price rise, the competition authority could easily assume the role of a temporary price setter. This would not only demand urgent action but it would also be a relatively simple technical task – the excess would simply be determined by reference to the price that prevailed immediately prior to the disaster and the ‘non-excessive’ price would be set accordingly. However where excessive pricing is alleged to flow from a systematic and systemic abuse of dominance in a complex market, the price setting task becomes infinitely more complex and unsuited to the powers and resources of a competition authority. We will argue that where, in these latter cases, it is possible to isolate underlying structural conditions and ancillary behavior that enables the setting of a price in excess of that which would prevail in the absence of that anti-competitive structure and conduct, then, in the first instance at least, this is what should be addressed by the competition authority. Of course if a competition authority is not able to carry out its excessive pricing mandate in this manner then it may have to resort to the fixing of a price but, we stress, in our view this should only be done as a final resort.

⁶ *‘The paper then argues that, while it may sometimes be appropriate to intervene against excessive pricing, the authorities must wherever possible endeavour to address the causes of the abuse – that is, the market circumstances that allow the excessive pricing to occur – rather than using price regulation to*

short, the Tribunal treated excessive pricing as a phenomenon that may arise from a particular structure which may itself constitute the basis for ancillary conduct that is utilised in order to sustain supra-competitive prices, to sustain, as per the definition of the Act,

*‘a price for a good or service which (aa) bears no reasonable relation to the economic value of that good or service; and (bb) is higher than the value referred to in subparagraph (aa)’.*⁷

Although this definition is drawn from *United Brands*, the Tribunal’s approach to excessive pricing differs significantly from the price regulating approach that has generally been taken by the various national and multinational authorities in Europe to both the identification and, particularly, the remedying of excessive pricing.

These differences are at one with the striking differences between, on the one hand, the treatment of pricing offences in Section 82(a) of the Treaty of Rome and, on the other, the manner in which Section 8 of the South African Competition Act treats various pricing offences. Section 82(a) proscribes a range of ‘unfair pricing’ practices including predatory pricing and excessive pricing. The term “excessive pricing” is in fact not to be found in the Treaty of Rome at all, but is a product of case law, which decided that a species of the ‘unfair’ pricing targeted by Section 82(a) of the Treaty was to charge an excessive price and the test in *United Brands* is an attempt by the court to define when a price is excessive. By contrast, in the South African statute there is a provision – Section 8(a) – directed at the practice of excessive pricing while predatory pricing is dealt with separately under section 8(c) and 8(d)(iv). Moreover, in contrast with the European treatment, our Act explicitly defines an excessive price – it does not leave this up to case law, except to the extent that case law reads meaning into the language provided in the statute.

Because the South African statute contains a definition of what constitutes excessive pricing as opposed to an undefined term such as ‘*unfair*’ which then relies on case law to give it meaning from time to time, the Tribunal’s interpretive efforts focused on the language in the definition section. The concepts in the statutory definition that give rise to interpretive difficulty are contained in the phrase ‘*bears no reasonable relation to the economic value*’.

The Tribunal held that the choice of words in the definition, ‘*bears*’, ‘*reasonable*’ and ‘*relation*’ - all words connoting imprecision rather than exactness – immediately suggests that the legislature did not intend that the relationship between the alleged excessive

address the symptoms.’ Amelia Fletcher and Alina Jardine ‘Towards an Appropriate Policy for Excessive Pricing’ 12th Annual Competition Law and Policy Workshop, June 2007. This paper clearly outlines the various arguments for and against a degree of intervention against excessive pricing. See also Massimo Motta and Alexandre de Streele ‘Excessive Pricing in Competition Law: Never say Never?’ *Swedish Competition Authority Journal* (2007).

⁷ Competition Act Section 1(1)(ix).

price and its economic value be capable of precise calculation, that is to say, it is not intended that the Tribunal is required to find that the price is 34,5% over the 'economic value' and then find that, on some or another basis, that this differential is 'excessive'. Rather the choice of language directs the Tribunal to have regard to the 'relationship' between, on the one hand, pricing that is alleged excessive, and, on the other hand, a notion of the good or service's economic value and then to judge whether that relationship is reasonable.

Approaching this from the perspective of competition law and practice one can safely assume that a price that is the subject of functioning market forces will not be deemed excessive or unrelated to the economic value of the good in question. After all the critical premise of competition law is that functioning markets determine what prices are reasonable. In other words, the Tribunal decided that it was not required to make a judgement of the price level itself but rather of the market conditions that generated the price level. In order to make this judgement, the Tribunal asked itself whether the relevant market in question is capable of functioning in a manner that is likely to produce a reasonable relationship of price to economic value, or, conversely, whether the structure of the market and, conceivably, ancillary conduct that depends on that anti-competitive structure, forestalls the effective functioning of the market – forestalls 'normal and effective competition' in the words of *United Brands* - thus generating a price, the level of which, is unrelated to, is not influenced by, any cognisable competition considerations.

Thus the use of the phrase 'reasonable relationship' requires the South African competition authorities to examine the origin and extent of the dominant firm's pricing power and then to enquire whether the price of the good or service in question derives purely from an anti-competitive market structure and, which it determined to be the case in the flat steel market, from ancillary conduct that relies upon the existence of that anti-competitive structure.

The Tribunal adopted the same approach when defining the vexed concept of 'economic value'. Just as the practice of law is comfortable with terms like 'reasonable', terms which have no precise meaning and intrinsic content but are given meaning by their context, so with the term 'economic value' in the discipline of economics. It too has no intrinsic, quantifiable meaning. It is not a fixed level capable of prior specification. That is, there is no fixed point that reflects the intrinsic 'economic value' of a good or service. 'Economic value' like 'reasonableness' is also a product of context, and that context is competition.

Evans and Padilla note:

There is no generally accepted definition of what an "unfair" price is. For Marxist economists, the "fair" price of a product is equal to the value of labor involved in its production. Classical economists like David Ricardo also held a cost-based theory of value. For neo-classical economists, the "fair" value of a good or service is given by its "competitive" market price, which is the equilibrium price that would result from the free interaction of demand and supply in a competitive market. This was also the interpretation given to the

*notion of “fair” prices by Scholastic economic thought, and is also the interpretation used by the ordo-liberal school of economic thought, which had a major impact on the development of competition policy in Europe.*⁸

The term ‘economic value’ in the South African act is clearly not intended to impute a cost-based theory of value, much less one that is rooted in any particular version of cost because if the legislature intended economic value to mean marginal cost or average variable cost it would have said so since it uses these terms explicitly in defining predatory pricing. That is to say, in assessing predatory pricing the legislature intends the authorities to use a cost-based test and clearly prescribes the cost standard to be used. However when dealing with excessive pricing, the relevant section of the Act and its accompanying definition makes no reference at all to the relationship between an excessive price and a particular measure of cost. The reference is rather to the relationship between price and economic value.

The concept of economic value consistent with the principles and practice of competition law and economics is, in the words of Evans and Padilla, ‘*the equilibrium price that would result from the free interaction of demand and supply in a competitive market*’ or the ‘competitive market price’.⁹ Following this approach, the Tribunal’s judgement of the relationship between price and economic value rested on its evaluation of the market conditions (the ‘*interaction of demand and supply*’) that underpin the price. If the examination of the structure of the market and any relevant ancillary conduct reveals that price is indeed determined by, what the Tribunal termed ‘cognisable competition considerations’, then that price will bear a reasonable relationship to the economic value of the good in question. However, if the price is the product of a market structure and of ancillary conduct that reflects precisely the absence of cognisable competition considerations then that price will be excessive in relation to the economic value because it will not have been determined by ‘the free interaction of demand and supply in a competitive market’.

The Tribunal’s approach is not dissimilar to United Brands’ concern with ‘*normal and effective competition*’¹⁰ or Napp’s fear that prices would be excessive in a market with high entry barriers and is devoid of ‘*effective competitive pressure*’.¹¹ The Tribunal was careful to clarify that there is no warrant for reading ‘*normal and effective competition*’ or prices at ‘*competitive levels*’ as reflecting conditions of perfect competition. Far from that, the Tribunal clearly recognised that the statute explicitly admits of the possibility of dominance – hence Section 8 of the Act – and the pricing power that is a product of dominance. Hence there

⁸ David S. Evans and A. Jorge Padilla, “*Excessive Prices: Using Economics to Define Administrative Legal Rules*”, CEMFI Working Paper No. 0416 (September 2004) at page 5.

⁹ ‘*Respectfully, it is however submitted that a reference to the economic value of a service or product is not self-explanatory. In essence, the economic value of something would rather seem to be decided by the market*’. See Nils Wahl ‘Exploitative high prices and European competition law – a personal reflection’ in Swedish Competition Authority Journal (2007).

¹⁰ See *United Brands*, para 249.

¹¹ See *Napp Pharmaceutical Holdings Ltd and Subsidiaries and Director General of Fair Trading* Competition Appeals Tribunal, January 2002, 1001/1/01.

can be no presumption that a price that reflects a 'reasonable' degree of market power will, for that reason, fall foul of Section 8(a) and its accompanying definition.

Price formation under conditions of imperfect or oligopolistic competition is, to repeat the phrase used above, clearly influenced by '*cognisable competition considerations*', even if it also reflects a degree of pricing power. Price formation in a duopolistic market, particularly if entry barriers are not insurmountable, may well reflect fierce rivalry and, hence, a competitive pricing outcome. In other words, albeit that these markets are 'imperfectly' structured, their pricing outcomes may well be the result of cognisable competition considerations. In these circumstances the competition authority will be alert to the prospect of exclusionary conduct or collusion but it will not attempt to second-guess the price because, in the absence of collusion or exclusionary conduct, the price will be determined by cognisable competition considerations and hence will bear a reasonable relationship to economic value.

Many of the scholars that have examined the concept of excessive pricing are concerned that the high priced product that is the subject of significant innovation will fall foul of the proscription of excessive pricing. However, while on a simple arithmetic interpretation of price and value along the lines conducted by the various European authorities, the relationship may be construed as excessive or unreasonable, on our interpretation which requires an examination of the underlying market circumstances that produce the price in question, the price of an innovative product is unlikely to be at risk precisely because by dint of the process of innovation and differentiation – a cognisable competition consideration – it is likely to 'bear' a 'reasonable' relation to its value. By contrast, we emphasise again, the Tribunal held that ***where the price appears to have no explanation other than the pure exercise of monopoly power***, then the price is not reasonable in relation to economic value. In other words what is relevant is not the arithmetic relationship between the price and some or other conception of cost. Relevant are the underlying considerations that underpin the price level. Are these considerations founded in competition in its many degrees and guises or are they founded in pure monopoly?

In summary then, the Tribunal's examination as to the source of the pricing power is thus an examination into its reasonableness. 'Reasonableness' in the context of a competition statute must mean 'economically reasonable'. 'Economically reasonable' in the context of a competition statute must mean having regard to the structural aspects of markets and to the conduct of its participants that are part of the normal fare of competition enforcement.

Nor, held the Tribunal, was it required to dwell on dictionary definitions of what 'excessive' means. The term is a defined one and hence it is the statutory, rather than the dictionary, definition of the word that we apply. The statutory definition as opposed to the ordinary word 'excess' does not require one to conclude when a particular level of differentiation is sufficiently large to constitute excess. Rather it requires one to find a relationship between a price and economic value that admits of no *reasonable* explanation, that is, of an explanation that does not rely upon the exercise of the degree of market power that arises from monopoly power of the extent discussed below. The finding of an excessive price is then determined not by some arbitrary measure of difference but is rather an enquiry into the rationality of pricing. It thus condemns pricing for which unchallenged and incontestable

monopoly is the only explanation as opposed to a price that may simply be high but for which innovation or even branding – that is, pro-competitive measures - provide the underlying rationale.¹²

European excessive pricing jurisprudence strongly evidences the pitfalls of the many alternative conceptions of the meaning and measure of value and cost that are all, in one way or another, bedevilled by the mistaken notion that 'economic value' has intrinsically measurable content. *United Brands* suggests comparing 'if it were possible' the selling price and the costs of production which would then reveal the profit margin and then notes 'the very great difficulties in working out production costs'.¹³ *Napp* preferred to rely on a comparison between prices in different market segments although the CAT conceded that 'there may well be other ways of approaching the issue of unfair prices' including comparing prices to costs, *Napp's* prices compared to the costs of its next most profitable competitor and *Napp's* prices compared to its competitors.¹⁴ The latter measure was favoured by the court in *General Motors Continental NV*,¹⁵ while the court in *British Leyland*¹⁶ preferred to evaluate the extent of price movements over time. In the *Port of Helsingborg* the European Commission cautioned that the difference between revenue and cost was not a sufficient basis for finding excessive pricing and suggested that 'customers demand' was also a relevant determinant of price. In this case the Commission attempted to compare the price charged for ferry services (an uncompetitive market) with the price charged by the same port for cargo services (a competitive market) but concluded that the services offered on the two markets in question were themselves not sufficiently comparable.¹⁷ In *Ministere Public v Jean-Louis Tournier* the basis of comparison used by the court were fees charged in different member states of the European Union, the so-called 'geographical comparison' test.¹⁸

¹² The question of branding and reputation answers the question posed by two economists in a newspaper column commenting on this case. They point out that a Porsche motor car is expensive, but asks whether this means that its price is excessive? The answer is no simply because, leaving aside questions of actual quality and cost of production differences with other automobiles, the manufacturer has created a brand image for which consumers are willing to pay. Indeed, the price of a Porsche may even be high relative to the price of other high performance sports cars, but as long as the market for high performance sports car is competitive, the likely explanation for Porsche's success in persuading its customers to buy its unusually expensive car will probably be found in its branding strategy and history which has produced a highly desired object which is able to command a premium price. (see Johannes Fedderke and Volker Schoer 'The price of attacking the wrong target' Business Day, 27 September 2006).

¹³ See *United Brands* para 251.

¹⁴ See *Napp* paras 391-392.

¹⁵ See *General Motors Continental NV v Commission of the European Communities*, Case 26/75. [1976] 1 CMLR 95.

¹⁶ See *British Leyland Public Limited Company v Commission of the European Communities*, Case 226/84.

¹⁷ See *Scandlines Sverige AG v Port of Helsingborg*, Case COMP/A.36.568/D3.

¹⁸ *Ministere Public v Jean-Louis Tournier*, Case 395/87, [1991] 4 CMLR 248, at paragraph 38

It is clearly not possible to glean a single European conception of a pricing standard and measure of excessiveness, that is, an arithmetic relation between price and an intrinsic, measurable economic value. It is precisely to avoid the confusion and uncertainty generated by the jurisprudential maze outlined above that price regulators are accorded a specific statutory basis which assigns them appropriate price determination powers and, indeed, often prescribes the specific price determination mechanism that is to be employed.

THE THRESHOLD TEST – SUPER DOMINANCE

The charging of an excessive price is a contravention of the Act when it is levied by a dominant firm. The criteria for establishing dominance are stipulated in Section 7 of the Act which provides:

A firm is dominant in a market if –

(a) it has at least 45% of that market;

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

(c) it has less than 35% of that market but has market power

Market power is defined in Section 1(1)(xiv) of the Act as the

'the power of a firm to control prices, or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers'.

While a firm that is presumed dominant by virtue of a market share that exceeds 45% presumptively also possesses market power and hence, per the statutory definition, the ability to *control* prices, a dominant firm's ability to unilaterally fix a price, its market power, is rarely devoid of all constraint. Market power, in other words, is seldom absolute. However, these limitations on market power do not prevent a dominant firm from enjoying and exercising a degree of pricing power, power, that is, that enables it to price at a level above that which would prevail in a perfectly competitive equilibrium.

However while the Act clearly contemplates the existence of pricing power, it effectively proscribes the exercise of 'excessive' pricing power as manifest in the clear prohibition of the charging of 'excessive prices'. But while Section 7 and the relevant statutory definitions specify the conditions under which a firm is (permissibly) dominant and thus possessed of a degree of pricing power, it is silent on the standard that would enable the competition authorities to identify 'excessive' dominance which, following the Act's schema for dealing with exclusionary conduct, would produce 'excessive' pricing power and the possibility of an 'excessive price'. This required an examination of the structure of the market in question and of the scholarly literature and jurisprudence that has grappled with the question of excessive pricing.

In summary then the Tribunal followed the schema of the Act and the standard approach to allegations of abuse of dominance which first identify dominance from specified *market shares* and the possession of *market power*. Following this approach, the Tribunal held that

the power to price 'excessively' is the preserve of firms of overwhelming size relative to the market in which they are located and which are, in addition, markets characterised by unusually high entry barriers. That is, the market share enjoyed by the firm in question should approximate 100% and there should be no realistic prospect of entry – *in other words the market should be both uncontested and incontestable* – a market condition which the Tribunal referred to as 'super-dominance'. The concept of 'super dominance' and the special responsibilities that attach to this privileged status is well recognised in scholarly work¹⁹ and in the decisions of competition adjudicators. In *Napp* the UK Competitions Tribunal held:

*'We for our part accept and follow the opinion of Mr. Advocate General George Fennelly in Compagnie Maritime Belge, cited above, that the special responsibility of a dominant undertaking is particularly onerous where it is a case of a quasi-monopolist enjoying 'dominance approaching monopoly', 'superdominance' or 'overwhelming dominance verging on monopoly' [2000] ECR 1-1356 at paragraphs 132 and 137. In our view Napp's high and persistent market shares put Napp into the category of 'dominance approaching monopoly' – i.e. superdominance – and the issue of abuse in this case has to be addressed in that specific context'*²⁰

This approach is also consistent with that taken by a number of scholars who have examined the question of excessive pricing.²¹ Although different standards are proposed by the various writers, it is generally accepted that mere dominance is an insufficient structural basis for the charging of excessive prices. Hence Evans and Padilla suggest that firms should, as a general rule, be free to charge prices above cost and the only exception to this rule should be

*'...situations where the dominant firm enjoys a legal monopoly and the excessive prices charged by the goods and services offered by the legal monopolist are likely to prevent the launching of new products or the emergence of adjacent markets'*²²

Motto and de Streel write

*With regard to exploitative excessive prices, we suggest that the Commission intervenes in cases of very strong dominance (confined to a monopoly or near monopoly) that are caused by past or current legal entry barriers, whenever market forces alone are unlikely to lead to competitive results.'*²³

They continue

¹⁹ See Richard Whish Competition Law 5th Edition (LexisNexis, London 2003), pages 189-190.

²⁰ *Napp Pharmaceuticals* at para 219.

²¹ For a brief and useful survey of the various tests proposed see Massimo Motta and Alexandre de Streel 'Excessive Pricing in Competition Law: Never say Never?' Swedish Competition Authority Journal (2007)

²² Evans and Padilla page 5.

²³ M Motta and A de Streel, "Exploitative and Exclusionary Prices in EU Law", Paper presented in the 8th annual European Union Competition Workshop, Florence (June 2003), page 27.

*Competition rules cannot be applied in newly liberalised markets in exactly the same way as they have been applied in 'normal' sectors because the market structures and the risks for competition are substantially different'*²⁴

Evans and Padilla are, understandably, particularly wary of excessive pricing rules that rely on the establishment of competitive benchmarks

*'...in dynamic industries where investment and innovation play a paramount role'*²⁵

Mittal SA has taken up this latter theme by its reference to the right of a patent holder to extract a monopoly price:

*'...the patented price is always higher than the economic value of the product for good reason. Nevertheless, a patent holder has a legal right to the exclusive economic exploitation of an innovation (and the market power which that brings), for a limited period. Accordingly, it is not unreasonable for a patent holder to charge a price which bears no relation to the economic value of the product for the economic duration of the patent.'*²⁶

How does the Tribunal's test stack up against those proposed here? While the Tribunal expressly agreed with Evans and Padilla's view that excessive pricing allegations should be particularly carefully scrutinised in dynamic industries characterised by investment and innovation there was no claim that Mittal SA's pricing is rooted in the extraction of any innovation rents or patent rights.

While the Mittal SA monopoly is not a legal monopoly and has, to our knowledge, never operated under exclusive license, it was capitalised by the state and between its establishment in 1928 and its privatisation in 1989, it was owned and controlled by the state. It must also be borne in mind that until as recently as 1984 the state saw fit to regulate the price of steel. Moreover its privileges did not terminate with its privatisation. A former Director General of the Department of Trade and Industry, testified to the comprehensive range of subsidies that disproportionately privileged large capital intensive firms like Mittal SA, including an export incentive scheme, an accelerated depreciation allowance and a strategic investment programme that allowed significant tax advantages.

This evidence is pertinent inasmuch as while this firm may not have been a legal, licensed monopoly, it enjoyed, even after it was privatised, a degree of public largesse that would, in the assessment of the scholars cited above, qualify it for membership of that small universe

²⁴ Motto and de Streel (2003) page 28.

²⁵ See Evans and Padilla, page 7.

²⁶ See Mittal SA Heads of Argument, para 9.3. We emphasise that where a monopoly is temporarily granted by patent in to promote the innovative process, a critical element of the competitive process itself, this may provide the necessary 'reasonableness' in the relationship between a monopoly price and the goods economic value, although, as effectively suggested in *Napp*, 'patent abuse', rather than the patent itself may, in certain circumstances, be found to be the basis of market power.

of companies in whose pricing practices the state is entitled to take an active interest. Recall that until 1984 the state's interest in Iscor extended to actual price regulation. Certainly Motta and de Streel should have little difficulty – particularly given the extent of post-privatisation subsidy testified to - characterising this as a '*newly liberalised market*' in which '*competition rules*' could not be easily applied and in which '*the risks for competition are substantially different*'.

While a licensed or legal monopoly is undoubtedly sheltered behind very high entry barriers indeed, there are clearly circumstances where the entry barriers established by historical circumstance and technological and commercial considerations are, in effect, at least as insurmountable as those that are constituted by law or license. Just as legal monopolies are established by statute or by administrative fiat, so too can their monopoly status be undermined by the same process. Hence while an exclusive license to collect garbage in Johannesburg may conclusively prevent the entry of others into the protected market, were a second license to be issued the erstwhile monopolist may have little left by way of entry barriers in order to sustain its monopoly. On the other hand, a long established, licensed fixed line telephone monopoly may find itself as effectively protected by commercial and technological barriers as by its license – a telecommunications regulator may issue a new operator's licence at the stroke of a pen, but the newly licensed operator may nevertheless experience considerable difficulties in overcoming the advantages that the incumbent derives from its established network.

Of course the question of excessive pricing – or, at least, the possibility of challenging pricing conduct – is unlikely to arise in the case of a legal monopoly precisely because, in the current economic policy environment, a legal monopoly will invariably be subject to regulation. **Indeed, the Tribunal viewed its power to intervene in excessive pricing as precisely intended to apply to those rare markets that are *uncontested* (monopolised or 'super-dominated'), *incontestable* (subject to insurmountable entry barriers) and *unregulated* (not subject to price regulation).** The South African market for flat steel products is, the Tribunal concluded, just such a market, and this is why the proposal of Evans and Padilla and other writers that the powers of competition authorities to intervene in pricing conduct be reserved for the most exceptional circumstances is strictly adhered to in the Tribunal's decision even though it did not require it to be restricted to a case of a legal monopoly.

In the present case, dominance of the relevant market is indeed absolute, that is, there are, within the boundaries of the relevant market, no meaningful constraints on Mittal SA's ability to unilaterally determine price – its market share is persistently vast and there is no prospect of new entry at all, and certainly not within any time-frame that anti-trust jurisprudence and enforcement practice would regard as constituting an effective competitive constraint. Moreover, the firm in question was owned by the state, for much of its life its prices were regulated by the state, and certain of its current advantages derive from advantages accrued from the period of state ownership as well as subsequent subsidisation.

Mittal SA's overall share of sales of flat steel products in the South African market clearly established its overwhelming dominance. In the period 2002-2005 Mittal SA's share of the South African flat steel product market measured on a quarterly basis market ranged from a

low of 77.9% to a high of 85.9%. Its stated target market share over the period remained consistent at 81%. Mittal SA's leading witness acknowledged, with reference to the second largest producer of flat steel products, Highveld Steel, that not only did it offer negligible competition to Mittal SA, but that it only participated in the market at all at the pleasure of Mittal SA. The evidence showed clearly that Highveld's pricing simply followed Mittal SA's lead. Indeed the evidence strongly suggested active collaboration between the two producers, although clearly with the terms of co-operation dictated by Mittal SA.

The Tribunal noted the existence of some effective competition from alternative products – for example, from plastic in the production of cans used to hold liquid – and from alternative geographies. The auto industry, where the potential allegedly exists for the importation of body panels from other parts of the multinational auto assemblers' supply chains, exemplifies the latter. These are the customers who enjoy varying level of rebate off the IPP. However the extent of the rebates varies greatly. Certain of the rebates offered are, by any measure, insignificant, and so result in an ultimate price for the rebated product that differs only slightly from the price at which the vast bulk of Mittal SA's output of flat steel products is sold.

Moreover, the complainants testified that the manner in which Mittal SA grants its rebates is, if anything, further *confirmation* of its market power. There is little evidence of a genuine negotiating process – rebates are granted, are bestowed, rather than agreed. They are subject to capricious and sudden unilaterally determined amendment which, several customers testified, made pricing of his product, the downstream product, a complex task.

This is true even of the rebates granted to the auto original equipment manufacturers, those of Mittal SA's customers who may reasonably be thought to possess the greatest countervailing power *vis a vis* Mittal SA. Mittal SA explained that the auto rebates are driven by the prospect that, should domestic flat steel prices diverge too greatly from those available in other parts of the world, the domestic auto OEMs may move the production of significant steel components offshore by utilising their well established international supply chains, with the South African plant then used only for purposes of assembling the components produced offshore. This, insisted Mittal SA, is evidence of its responsiveness to its customers. However testimony from auto industry representatives contradicted that view. Certainly even the auto rebates are erratic in the basis of their formulation and are, in their amounts, also subject to capricious and significant and sudden change. At best for Mittal SA, what the evidence on the auto rebates suggests is that at a certain point in the auto OEMs' decision making process Mittal SA may be somewhat vulnerable to the OEMs' international supply chain but that once an OEM has committed itself to the production of a particular model at a particular site and has established its supply chains accordingly, the bargaining power then shifts right back to the super-dominant steel producer.

Indeed the Tribunal concluded that the most important learning to be derived from the Mittal SA rebate system, is not its implications for the assessment of market power. What the rebating system and the manner of its operation does eloquently evidence – and this is elaborated in our discussion of Mittal SA's ancillary conduct - is the length to which Mittal SA is prepared to go in order to immunise the lion's share of, on the one hand, its domestic

market in which its customers pay the full list price, from, on the other hand, those markets, be they domestic or export, in which it discounts or rebates off the list price.

Nor does it appear that there is any realistic prospect of new entry. Certainly it has never been suggested by any witness that this is a feasible prospect.²⁷ When the giant LNM – now the Arcelor Mittal multinational – chose to enter South Africa it did so by way of acquisition of ISCOR rather than by way of green-fields investment in steel producing plant. Arcelor had, prior to its merger with Mittal, been a *de minimis* participant in the South African market supplying, it appears, only grades of steel not produced in the Mittal SA plants. There was some indication that it, Arcelor, had intended setting up steel service plants in South Africa in order to better serve, by way of imports, the steel requirements of South African auto manufacturers. However these remained at the level of intention only and, with the merger of Mittal and Arcelor, an intention that will now certainly not be realised.²⁸ Note too that any new entrant that would want to serve the domestic market would have to confront the massive advantage bestowed on Mittal SA by its extraordinarily favourable arrangements with respect to iron ore pricing.

In summary then, Mittal SA is, for the purposes of the Act, clearly dominant in the relevant market, the South African market for flat steel products. However the Tribunal held that in order to establish the structural basis for charging excessive prices, something more than mere dominance is required. Section 8(a) demands a showing of extraordinary or ‘excessive’ market power, the power to price at a level beyond that available to a mere dominant firm. The extent of Mittal SA’s market share taken together with the height of entry barriers and its recent history of state support established its status as a super-dominant firm within the relevant market. It has been proved, to the Tribunal’s satisfaction, that Mittal SA is indeed an uncontested firm within an incontestable and unregulated market.

THE ANCILLARY CONDUCT

The ancillary conduct by which Mittal SA ensures its ability to price excessively comprises principally the segmentation which it studiously maintains between its export market and its domestic market. It markets its domestic output through a group of traders whose activities are confined, by agreement with Mittal SA, to the domestic market. And it markets its output on the international market through a single trader, Macsteel International, the second respondent, whose trading activities are confined by agreement with Mittal SA, which is a 50% joint venture partner in Macsteel International, to the international market. Hence the pertinent terms of the agreement between Macsteel Holdings and Mittal SA that govern the

²⁷ Note that Mittal SA characterises the view of the UK Competition Appeal Tribunal (“CAT”) in terms that would certainly suggest that the CAT would find that the underlying conditions in the South African market for flat steel products would render Mittal SA a strong candidate for pricing excessively: *‘The CAT thus appeared to suggest that what distinguishes excessive pricing from reasonable monopoly pricing is that the former takes place in circumstances where there is no threat of competitive entry to restore prices to competitive levels, with the result that the monopolist can earn supra-competitive profits in a completely uninhibited manner’*. Mittal SA Heads of Argument, para 7.22.

²⁸ See *Mittal Steel Company N.V. and Arcelor SA*, Tribunal Case No.: 53/LM/Jun06.

joint venture, Macsteel International, the second respondent, are that Mittal SA undertakes to market a specified range of steel products, which include flat steel, only through Macsteel International in the international market; that Macsteel International undertakes not to sell any of these steel products in the domestic market without Mittal's consent; that the Macsteel Group also makes a similar undertaking to Mittal SA that as long as the agreement persists it will not market Mittal SA products in the international market other than through the joint venture; and that Mittal SA undertakes to sell steel to Macsteel International at "international related market prices".

This is conduct that is only available to an uncontested firm in an incontestable market. If this were not the case, Mittal SA's traders would be able to turn to alternative suppliers of flat steel products in order to meet unrealised demand. Mittal SA of course insists that there is no unrealised demand. It insists that it satisfies all domestic demand and that its export activities are simply a vent for a surplus that it would much rather sell into the more lucrative domestic market. However the crucial caveat is that Mittal SA meets all domestic demand at its unilaterally targeted price level. If a would-be purchaser of steel for use in South Africa were to approach Macsteel International with an offer to purchase at a price below the prevailing domestic price but above that which Macsteel International could realise on the international market, the trader would, as a matter of profit maximising rationality, accept such an offer. However, it is by agreement with Mittal SA, prohibited from accepting the offer because to do so would be to reduce the price of steel across the whole range of Mittal SA's domestic sales.

As noted, in addition to maintaining the strict separation of its domestic and international market Mittal SA also segments the bulk of its domestic consumers from consumers in those market segments in which it faces more competitive conditions. As we have outlined above, from the perspective of this decision, the hallmark of these arrangements is not the level of the various rebates offered, but rather the anxious efforts by Mittal SA to ensure that these market niches are segmented from the rest of the domestic market. A striking feature of the rebate schemes – and much mentioned by witnesses who testified before the Tribunal - is the combination of, firstly, surgical precision in deciding which sales to discount and, secondly, the extraordinarily complex bureaucracy required to actually pass the rebate on to the carefully chosen beneficiary.

In fact this combination of precision and bureaucracy is all of a piece. If a local fabricator is producing for the domestic market and the international market and it has successfully persuaded Mittal SA that it requires assistance to maintain or extend its presence on the international market, then Mittal SA's overriding concern will be to ensure that the only steel that gets rebated is that which is exported – conversely expressed, Mittal SA is anxious to ensure that rebate does not undermine its ability to extract its pre-selected target price on the steel used by the fabricator for output sold on the domestic market because this is not where Mittal SA's rebate is 'required'. Mittal's leading witness characterised these as efforts to prevent the creation of a 'grey market' in steel.

Recall too that Mittal SA's practice of segmenting its differently priced markets in order to protect its ability to charge its targeted domestic price has, in the past, been bolstered by other conduct. The arrangement between ISCOR and the JV that previously controlled the

Saldanha plant prohibited Saldanha from marketing its output on the domestic market. In other words, when Mittal SA's predecessor, ISCOR, faced potential competition from another domestic steel producer (namely, the Saldanha JV), it sought to rely on a market allocation cartel to maintain its pre-selected domestic price. Having absorbed, through merger, its potential competitor, it no longer required an anti-competitive horizontal agreement to divide markets. It now relies on the unilateral imposition of anti-competitive conduct – effectively a withholding of supply from most of its domestic market - in order to price to the full extent of its uncontested market power.

The Tribunal noted that the flat steel market is not the only market in which this practice has been encountered. In the *Tongaat Hullet/TSB*²⁹ sugar merger and in the *Sasol/Engen* liquid fuel merger, both of which were prohibited, the firms in question maintained the targeted import parity pricing despite the existence of excess supply at that price level. In both the sugar and fuel markets this was achieved, despite competitive market structures, by means of anti-competitive conduct – in these instances a combination of regulation and collusion – which effectively segmented the international and domestic markets. The Tribunal observed in *Sasol/Engen*, and this was much referred to in the steel pricing hearings, that

*'import parity pricing of fuel – or BFP – in a fuel exporting economy can only be artificially maintained by administrative fiat...or by collusive agreement...or by the unilateral exercise of market power.'*³⁰

This conclusion is confirmed by the facts of this case. Here the mechanism for maintaining the target price is neither regulation (there is none), nor cartelisation (there is a single producer), but through the unilateral action of a monopolist imposing upon those that trade in its product conditions that are designed to reduce the supply available on the domestic market.

Indeed Mittal SA's leading witness explicitly conceded that were Mittal SA not deliberately, through its agreement with Macsteel International, relying on its super-dominance to engage in the ancillary conduct of 'shorting' the South African market, that is, deliberately depriving South African customers of steel produced by Mittal SA, the price of its flat steel product would tend towards the export, rather than import, parity price, that is the price at which Macsteel International purchases steel for export. This does not, of course mean that all price differentiation will be eliminated. Indeed domestic consumers will certainly be willing to pay a premium for the benefit, including greater value added services, that are generally conceded to derive from having a local source of steel products. However this differentiation would precisely be based on superior service levels – 'cognisable competition considerations' - rather than on a deliberate shorting of the domestic market.

In short, there is no magic in Mittal SA's mechanism to achieve its targeted price in its monopolised domestic market. It does what any elementary textbook on competition law and economics will reveal in its opening chapter about monopolistic conduct – it exploits its

²⁹ See *Tongaat Hullet Group and Transvaal Suiker Bpk* [1999-2000] CPLR 127 (CT).

³⁰ *Sasol Ltd and others / Engen Ltd and others* [2006] 1 CPLR 189 (CT) at 233F-G.

structural power by reducing output in order to increase price. In this instance it does not physically reduce its level of output. But it contrives to remove this 'excess' output from the domestic market in order to maintain its pre-selected target price, which closely approximates the import parity price. This it achieves by resort to the ancillary conduct which comprises the maintenance of segmentation between a number of differently priced markets, most particularly the international and domestic markets.

This establishes Mittal SA's contravention of Section 8(a) – it has, by virtue of its super-dominance, the structural market power to pre-select a target price in its domestic market; it has imposed this pre-determined target price, in this instance the import parity price, on most of its domestic market; and to support this pre-selected target it has withheld supply from the domestic market, the most elementary monopolistic conduct. This does not mean that Mittal SA's offence is its super-dominance; nor does it mean that a firm that is not super-dominant is not entitled to determine its level of output – if such a firm reduced output its competitors would quickly move to replace the lost output. However, it is the cumulative impact of its structural advantage (its super-dominance) and the conduct thereby enabled (its purposeful, unilateral withholding of supply from the domestic market) that results in a price that is unconstrained by any competitive considerations whatsoever.³¹ By withholding output, an option only available to a super-dominant firm, it has assured its ability to charge its pre-selected target price, a price unconstrained by any competitive considerations in its relevant market, and thus has contravened the Act's proscription of excessive pricing.

Mittal SA was found to have contravened Section 8(a) of the Act.

THE REMEDIES

The Tribunal is empowered to impose wide ranging remedies for contravention of the Act. Of relevance here, the Tribunal's remedial powers include interdictory relief, declaratory relief, the power to impose an administrative penalty, the power to order divestiture and the power to void all or part of an agreement.³²

Prohibition on Conditions of Resale

The Tribunal was asked to declare that Mittal SA's practice of employing import parity pricing in the South African flat steel market amounts to an abuse of dominance in terms of Section 8(a) of the Act.

However, as emphasised at length in the Tribunal's judgement, its approach to excessive pricing has not been to determine a 'right' or 'wrong' price level. Accordingly, the Tribunal refused to declare the import parity price level an abuse of dominance, the 'wrong' or 'excessive' price level. It emphasised that Mittal SA's offence resides in the fact that it has

³¹ We use 'purposeful' advisedly. Note statements from Mittal's leading witness in which it is acknowledged that the *purpose* of the market segmentation that is maintained through the Macsteel arrangements and the various resale conditions contained in the rebate schemes is precisely to maintain the pre-selected target price.

³² Competition Act Section 58.

administratively selected a price and adjusted the amount that it, the super dominant player, supplies to the domestic market so as to ensure that it achieves the pre-selected price. From the Tribunal's perspective it did not have to determine whether the preselected price was the import parity price or, as Mittal SA contended, a price based upon a random basket of prices that prevail in other national markets. What concerned the Tribunal was Mittal SA's manipulation of the supply of flat steel products available on the domestic market precisely to ensure that the domestic price of these products was not influenced by any cognisable competition considerations. Accordingly the Tribunal declared that

Mittal SA's practice of reducing the supply of flat steel products available for sale on the domestic market, through the imposition of conditions of resale on the steel merchants and those of its customers who receive a rebate off the Mittal SA list price, is an abuse of dominance in terms of Section 8(a) of the Competition Act.

Note that declaratory relief is a necessary prerequisite for a complainant to commence a civil claim for damages in terms of the Act.³³

This remedy strikes at the ancillary conduct that enables Mittal SA to maintain excessive prices. As already elaborated the contractual limitations which are declared to be an abuse of dominance all come down to measures which prevent customers who receive steel at prices lower than the pre-selected domestic list price from on-selling this product to domestic customers who may be prepared to pay a price higher than the discounted price but lower than the list price. This will be remedied by prohibiting Mittal SA from imposing conditions on the resale of flat steel products purchased from it.

This remedy did not oblige the Tribunal to engage with the issue of discounting. That is, the declaration leaves Mittal SA free, within the terms of the law and particularly the prohibition on price discrimination contained in Section 9 of the Act, to discount on whatever basis it chooses. However if it wishes to engage in selective discounting and it wishes to discourage arbitrage between the differentially priced markets for its flat steel products, then it will limit the size of the differential. Hence it will take a relatively large differential to encourage an auto manufacturer to engage in steel trading – these manufacturers purchase steel in large quantities at specified grades and quality for the purposes of fabrication and are extremely unlikely to take advantage of any discount that they may receive for the purposes of trading in steel. By the same token, because, as the evidence suggests, most fabricators are probably willing to pay a premium for the benefit of purchasing steel from a domestic producer, a modest differential between the domestic and international price is likely to prevail and will not encourage arbitrage.

However a profit maximising professional steel trader that purchases large quantities of product in order to take advantage of, say, a volumetric discount, will seek out the best customer and, to the extent that the trader is faced with a large historical differential between prices in the domestic and international markets, it will seek to take advantage of the higher domestic prices and will thereby rapidly reduce the price differential and reduce the

³³ Section 65(6)(b) of the Competition Act read with Section 58(1)(v).

opportunity for arbitrage between the two markets. Of course if meaningful volumetric discounts are granted, traders who are currently contractually confined to the domestic market are likely to attempt to secure international customers in order to take full advantage of the volumetric discounts. By the same token Macsteel International will be free to seek domestic customers, and the domestic price of flat steel products should decline, it should 'tend', as Mittal SA witnesses have conceded, towards the export price.

The Tribunal was cognisant of the opportunity that exists for circumvention of the remedy. Mittal SA may attempt to utilise alternative mechanisms and arrangements in order to inhibit arbitrage and so to maintain the basis for excessive pricing. However the Tribunal pointed out that were Mittal SA to accept in good faith the remedy imposed then pricing outcomes in the flat steel market will be determined by what we have termed 'cognisable competition considerations' and, hence, it will not be vulnerable to a further charge of excessive pricing. Of course if Mittal SA attempted to circumvent the remedy, and was once again confronted by a charge of excessive pricing before the Tribunal, then the prospect of more invasive remedies will loom large. These may include the enforced divestiture of steel producing plant.

On this score the Tribunal noted that it was empowered to impose a divestiture order for first time contraventions of Section 8 provided that the offending conduct cannot be otherwise remedied.³⁴ While there is no doubt that excessive pricing would be cured were Mittal SA ordered to divest itself of one of its two flat steel producing plants, the Tribunal elected not to impose a divestiture order because it believed that the remedy that it had crafted would permit market determination of flat steel products. Should this not prove to be the case – and most particularly if Mittal SA took action to inhibit the efficacy of the remedy imposed – it would be vulnerable to the imposition of a divestiture remedy, that is a remedy directed at ending Mittal SA's structural super-dominance.

The complainants also requested that the Tribunal order Mittal SA to '*make known in the public domain, at all times, its list prices, rebates, discounts and other standard terms of sale for flat steel products*'. While the Tribunal indicated that it was generally reluctant to impose transparency in this manner it believed that the particular circumstances of this case warranted such an order because by compelling Mittal SA to make public details regarding discounts and rebates, it would weaken any ongoing attempts to inhibit arbitrage.

Administrative Penalty

The Tribunal is empowered to impose an administrative penalty of up to 10% of the firm's annual turnover (including exports) during the preceding financial year.³⁵ Contraventions of Section 8(a) – the prohibition of excessive pricing – are one of a select number of contraventions where the imposition of an administrative penalty on a first time offender is competent. Section 59(3) of the Act specifies a number of factors which the Tribunal must

³⁴ Section 60 of the Competition Act.

³⁵ Section 59 of the Competition Act. This has been interpreted as the turnover in the year preceding the submission of the complaint to the Tribunal.

consider when determining the size of the administrative penalty including the nature, duration, gravity and extent of the contravention, any loss or damage suffered as a result of the contravention, the behaviour of the respondent and the level of profit derived from the contravention. These have been further elaborated in jurisprudence.³⁶

In this instance the Tribunal imposed an administrative penalty of R691,8 million, equivalent to 5.5% of Mittal's turnover in the market for flat steel products in the year immediately preceding the submission of the complaint.

Fletcher and Jardine argue that '*in order to reduce deterrence, firms should not face fines for excessive pricing, and should not face the risk of private damages actions in respect of such behaviour*'.³⁷ There are, under certain circumstances, sound arguments in favour of not imposing administrative penalties in excessive pricing cases. In particular, if a price regulating approach is adopted in assessing and remedying excessive pricing, it would be difficult to justify the imposition of a fine. Not only would it be extremely difficult for a firm to predict the finding of the competition adjudicator and so to adapt its behaviour – that is, its price level – in order to avoid the imposition of a fine, but more seriously, if a firm that is vulnerable to excessive pricing charges and to the prospect of a fine were to adopt an excessively cautious pricing policy, this 'self-regulation' may engender substantial distortion and so, *ex ante* costs. As Fletcher and Jardine note:

*By limiting available sanction to the imposition of ex post penalties, such as future price regulation, firms are likely to be less concerned about breaching excessive pricing rules, and as such the distortions across the economy should be greatly reduced.*³⁸

The *ex ante* costs of the Tribunal's decision in this case are likely to be minimal. The threshold structural test that has been applied is extremely high – an uncontested firm in an incontestable and unregulated market – so that exceedingly few firms would reasonably conclude that they are vulnerable to a finding of super-dominance, the structural threshold for an affirmative finding of excessive pricing.

However more than this, while the question of the appropriateness or otherwise of an administrative penalty was raised by the Tribunal panel itself in the hearings, it ultimately concluded that precisely because it was not adopting a price regulating approach to the question of excessive pricing and because its decision rested on conduct – market segmentation and the prevention of arbitrage between the segments – that was clearly and purposefully directed at eliminating any semblance of competition from the relevant market, it was appropriate to impose an administrative penalty.

³⁶ The Competition Commission and South African Airways (Pty) Ltd, Comair Ltd and Nationwide Airlines Ltd, case no 83/CR/Oct04.

³⁷ Fletcher and Jardine Page 12. Our emphasis.

³⁸ Fletcher and Jardine Page 5. Note that the authors concede that deterrence levels for excessive pricing have been found to be substantially lower than for any other form of abuse.

We will not rehearse these aspect of the decision here – they have been fully traversed in our discussion of the finding itself. Suffice to say that this point was taken by Mittal SA. It indeed argued that because our approach was 'novel', that is, because it had not conformed to the European approach, it could not have reasonably known that it was in contravention of the Act and the provisions of Section 8(c) in particular. The Tribunal's response is outlined in the following passages from the judgement on the remedies:

Mittal SA, for its part, argues that this is not clear in terms of the precise language or case law of section 8(a), nor of any other section of the Act for which a penalty is competent for a first time contravention. As a pure matter of language that may be so. As a matter of substance it is not. As we argue later, the conduct of Mittal SA is so manifestly aimed at securing its excessive price that it unambiguously appreciated the economic effect of its conduct. The fact that it may not have considered its conduct had a mirror image in the language of the sections of the Act does not mean that it could not appreciate that its conduct had anti-competitive consequences. Section 8(a) is about an exploitative form of an abuse of dominance and Mittal SA's conduct was about constructing an administrative edifice and engaging in conduct to fix its prices at a level higher than they would be, if the conduct had not been perpetrated and that it appreciated that this was to the detriment of consumers. Expressed differently Mittal SA fully appreciated that this was conduct by a dominant firm designed to exploit consumers. This places Mittal SA in the position of a firm with knowledge of a prior rule and hence a firm liable to a penalty for a first contravention.³⁹

And further:

had we adopted what in our decision is characterised as the European approach by making our finding on the basis of a particular price level, then Mittal SA may well have been justified in arguing that it could not know in advance whether or not its pricing level was going to be found to be in contravention of the Act. For instance if we had decided that an excessive price was a price in excess of 30% of the reasonable costs of production, a firm might be justified in contending that until we had made such a ruling the meaning of an excessive price would be unclear. But we have not done this – what we have identified is conduct, reducing supply in order to increase price, that is well known to be an egregious contravention of the fundamental principles of pro-competitive conduct and it has engaged in this conduct precisely in order to leave itself free to charge prices unconstrained by any competitive considerations. Our 'novel' approach, far from exonerating Mittal SA from responsibility for its actions and the imposition of an administrative penalty, leads us to the conclusion that the nature of the offence invites the most severe repercussions.⁴⁰

CONCLUSION

³⁹ Remedies Para 43.

⁴⁰ Remedies Para 66.

This paper reports the decision of the South African Competition Tribunal in a case brought by two gold mining companies alleging excessive pricing on the part of the South African subsidiary of the Arcelor-Mittal group of companies. In particular it is alleged that the price that Mittal SA charges its domestic customers is excessive in relation to the price charged to its export customers for the same product

The Tribunal has approached the complex and controversial question of excessive pricing by eschewing a price regulation approach both with respect to the decision as to whether the price is indeed excessive and as to the appropriate remedies to be introduced in an affirmative finding. It has rather attempted to use the well-known principles and approaches of competition law and economics in examining an allegation of excessive pricing.

To this end it has examined the structure of the market as well as ancillary conduct which has relied on structural super-dominance in order to arrive at a price that is not influenced by any cognisable competition considerations.

The Tribunal has been careful to acknowledge that competition law contemplates the existence of pricing power arising from 'imperfect' market structures. Thus for a price to be judged excessive it must derive from market structures characterised by something more than mere dominance. It has decided that where a firm in a market is uncontested – that is, has a market share approaching 100% - and where the market is both incontestable (barriers to entry are insurmountable in a time period short enough to act as a competitive constraint) and unregulated, the firm will be considered 'super-dominant' and that this threshold test should be passed before a firm could be thought to possess excessive pricing power.

It has also examined aspects of the super-dominant firm's conduct that is designed to eliminate any competitive constraint. It has concluded that the strict segmentation maintained by Mittal SA between its domestic and international markets is a necessary supplement to its structural super-dominance and has effectively eliminated any form of competitive constraint from the domestic market, that which may have been provided by the possibility of arbitrage between the competitive international market and the uncompetitive domestic market.

The Tribunal accordingly found Mittal SA in contravention of the proscription of excessive pricing contained in the South African Competition Act. It has imposed an administrative penalty and it has declared the imposition of conditions imposed on its customers that limit the resale of flat steel products to be a prohibited practice.