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MARGIN SQUEEZE IN THE SOUTH AFRICAN CONTEXT:

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I hereby declare that I have read and understood the regulations governing the submission of LLM Degree dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

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CHAPTER 1

I. INTRODUCTION

A margin squeeze is said to occur when a vertically integrated firm (i.e a firm that operates in both an upstream and downstream market) leverages its dominance in the upstream market by selling its upstream commodity to its downstream competitors at such a price as to reduce or possibly even extinguish the downstream competitor's profit margin.[1]

On 12 April 2012, the Constitutional Court of South Africa delivered a decision[2] bringing to its head a series of judgments pertaining to an application brought against Senwes Limited ("Senwes") a public company (formally a cooperative) operating in the agricultural sector in respect of an allegation that it had engaged in conduct meeting the criteria of a margin squeeze abuse. First, the Competition Tribunal confirmed that Senwes had engaged in conduct meeting the criteria of a margin squeeze abuse. The Competition Tribunal's decision was appealed by Senwes to the Competition Appeal Court. The Competition Appeal Court upheld the Competition Tribunal's finding. Senwes was successful in appealing this decision to the Supreme Court of Appeal despite the fact that the Competition Appeal Court did not grant it leave to appeal. The Supreme Court of Appeal's ruling was ultimately overturned by the Constitutional court which confirmed the Competition Tribunal's ruling save a caveat regarding the use of the term margin squeeze.

The Constitutional Court's ruling has invariably affected the manner in which future complaints of a margin squeeze[3] in South Africa will be addressed. Other than the fact that the decision was handed down by the highest court for all constitutional matters,[4] this decision is of particular significance because there have been no other South African judicial decisions that have dealt with the concept of a margin squeeze as the primary complaint.

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[1] Alison Jones & Brenda Sufrin *EU Competition Law* 4 ed (2011) 413.
[2] *Competition Commission of South Africa v Senwes Limited* 2012 (7) BCLR 667 (CC).
[3] Whereas this dissertation will refer to margin squeeze for purposes of consistency, the term 'price squeeze' is also widely used in literature to refer to the same concept.
[4] Constitution of the Republic of South Africa Act 108 of 1996 s 167(3)(a).

There has been much debate internationally regarding the margin squeeze abuse including a stark division in approach between one the one hand the United Kingdom ("UK") and the European Union ("EU") which recognizes its application versus the United States ("US") which has rejected margin squeeze as a standalone cause of action.[5]

Following the introduction of the margin squeeze cause of action into South African competition law jurisprudence, the question arises whether the Senwes decisions, have definitively clarified the criteria against which future margin squeeze abuse cases will be dealt with and whether these criteria have evolved into a standalone cause of action. This dissertation will demonstrate the absurdity of the Constitutional Court decision, to delete all references to margin squeeze in the decision of the Competition Tribunal which it upheld while retaining the underlying criteria against which future margin squeeze cases will be adjudicated. This dissertation will additionally demonstrate that the Senwes cases, in particular the Tribunal decision read with the Constitutional Court decision, have on the one hand only marginally delineated and elaborated on the elements necessary to establish a margin squeeze abuse, but have on the other hand established margin squeeze as a standalone cause of action in terms of which offending firms can be prosecuted in South African competition jurisprudence.

(a) Scope

Following the introduction contained in Chapter 1, Chapter 2 will expound on the meaning of abuse of dominance in general and will specifically demonstrate the manner in which the margin squeeze cause of action fits into the abuse of dominance framework. This chapter will then review the various forms that a margin squeeze may take and will conclude with an analysis of the application of the margin squeeze principle in foreign jurisdictions. Chapter 3 will contain an analysis of the Senwes decisions in an effort to give context to the critical analysis of the margin squeeze cause of action in the following chapter. Chapter 4 will consider the applicability and relevance of a margin squeeze in South Africa's competition law dispensation

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[5] Gianluca Faella & Roberto Pardolesi 'Squeezing Price Squeeze Under EC Antitrust Law' *European Competition Journal* (2010) Vol. 6 Issue 1 at 255.

(hereafter referred to as the "Competition Act"),[6] critically unpack the elements of a margin squeeze complaint, and critically evaluate the future of the concept of a margin squeeze as the basis of a potential South African competition law complaint. Chapter 5 will contain conclusions.

(b) Definitions

In order to better understand the margin squeeze cause of action, it is helpful to explain a number of terms that recur in literature in relation thereto.

Principles such as 'dominance' and 'market' will be described in greater detail below under the subheading of abuse of dominance.

Before looking at the concept of a vertically integrated firm, it is important to understand the difference between the upstream and downstream market, as these terms are central in explaining vertical integration.

At an elemental level the upstream market refers to the supply of an input that is relevant (i.e. that can be converted, manufactured or used) in the supply of a product or service at the retail (downstream) level.[7] The upstream market relates to the production or supply of inputs that normally take the form of raw materials, a network or facilities. It is at this level that the dominance of the supplier is considered important.[8] On the other hand, the downstream market refers to the retail market for products that have been processed or have received some input from the upstream input.[9]

A vertically integrated firm is a firm that is dominant or controls the supply of products in the upstream market and simultaneously participates in a competitive market downstream.[10] In other words, if the upstream and downstream divisions of a firm form part of or fall within a single economic entity, then it can be said that the firm is vertically integrated.[11] By virtue of its dominance in the upstream market, the vertically integrated firm would be able to manipulate the price it charges at the

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[6] Competition Act of South Africa Act 89 of 1998.

[7] Pietro Crocioni & Cento Veljanovski 'Price Squeezes, Foreclosure and Competition Law: Principles and Guidelines' (2003) 4 1 *Journal of Network Industries* 28 at 42.

[8] Crocioni & Veljanovski op cit note 7.

[9] Richard Whish *Competition Law* 6 ed (2008) 744-745.

[10] Ibid note 9 at 744; see also Luke Kelly & Tjarda van der Vijver 'Less is More: Senwes and the Concept of Margin Squeeze in South African Competition Law' (2009) 2 *SALJ* 246 at 246.

[11] *Viho Europe BV vs the Commission* 1996 Case C-73/95P E.C.R 1-5457.

upstream and/or downstream level in such a manner as to impede the downstream firm's ability to cover its costs.[12] This would be considered a competition law offence because the dominant firm would limit the ability of its rivals from entering into or expanding within a market.[13]

(c) Delimitations

This dissertation will not contain an analysis of the economic theory or workings of the margin squeeze concept. Instead, it will focus on the jurisprudential application of the concept.

This dissertation will also not contain a comparative analysis of the margin squeeze concept between South Africa and international jurisdictions. International references will instead describe the manner in which the cause of action is applied in the relevant jurisdiction.

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[12] Chares River Associates 'Competition Memo: Margin Squeezes and the Inefficient "Equally Efficient Operator"' 2010, available at *http://www.crai.com/ecp/assets/Margin_squeezes.pdf* accessed on 19 November 2012.

[13] Competition Act op cit note 6 section 1 for the definition of exclusionary act; see also Lizél Blignaut, Louise du Plessis & Judd Lurie 'Vertical Integration and the refusal to supply scarce goods – legal and economic framework for analysis of prohibited practices' 2010 para 7.5, available at *http://www.compcom.co.za/assets/Uploads/events/Fourth-Competition-Law-Conferece/Session-3A/Vertical-integration-and-refusal-to-supply-scarce-goods-LB-LdP-JL-final.pdf* accessed on 10 August 2013.

CHAPTER 2

I. INTRODUCTION TO THE 'MARGIN SQUEEZE' COMPLAINT

A margin squeeze is in most instances classified under the general prohibited conduct of abuse of dominance.[14] The abuse of dominance framework therefore sets the foundation on which allegations of margin squeeze will be prosecuted.

II. ABUSE OF DOMINANCE

The Competition Act[15] prohibits anti-competitive conduct that is performed by two or more parties acting in concert with one another by for example dividing markets through the allocation of customers. It also prohibits anti-competitive conduct that is performed by a firm acting unilaterally in the form of abuse of dominance as contemplated under Part B of Chapter 2 the Competition Act.[16]

The abuse of dominance provisions are structured such that section 6 sets out thresholds to ascertain whether a firm qualifies to be scrutinised under Part B of Chapter 2 the Competition Act. Section 7 of the Competition Act sets out the dominance test while sections 8 and 9 describe the characteristics of prohibited conduct.[17]

(a) Threshold

When determining whether the abuse provisions apply, one must firstly enquire whether the respondent firm's gross annual turnover in, into or from South Africa is valued at or exceeds R5 million, or its gross assets in South Africa are valued at or

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[14] OECD: Policy Round Tables 'Margin Squeeze 2009' 2009 at 8 available at *http://www.oecd.org/regreform/liberalisationandcompetitioninterventioninregulatedsectors/46048803.pdf* accessed on 19 November 2012.
[15] Competition Act op cit note 6.
[16] Desmond Rudman & Sima Ostrovsky 'Dominance Test: a superfluous jurisdictional hurdle?' 2010 at 1, available at *http://www.compcom.co.za/assets/Uploads/events/Fourth-Competition-Law-Conferece/Session-4B/article-dominance-test.pdf* accessed on 15 July 2013.
[17] Ibid at 2.

exceed R5 million.[18] If a firm meets or exceeds this threshold, it will then qualify to be prosecuted under the provisions of Part B of Chapter 2 of the Competition Act.

The next stage of the enquiry is set out in section 7 of the Competition Act which requires that one determine the relevant market followed by an enquiry into whether the firm is in fact dominant in such market.[19]

(b) Determination of Market

The Competition Act does not define the criteria to be used when defining a market.[20] Whereas various disciplines adopt different approaches to defining a market, within the realm of competition law in general, and in South Africa in particular, the approach adopted is theoretical and involves outlining that part of the market that would be worth monopolising, taking into consideration any substitutes that would limit a firm's ability to exercise its monopoly.[21] This approach is also referred to as the Hypothetical Monopolist test, and is primarily attributed to the US competition universe.[22]

The Hypothetical Monopolist test is most commonly applied by means of the thought experiment methodology otherwise known as the SSNIP (small but significant and non-transitory increase in price) test.[23] The test involves conducting an economic analysis on an initially narrowly defined market so as to ascertain whether it is the relevant market. This entails increasing the price levied by the respective hypothetical monopolist by a small but significant margin above a notional competitive price (usually by 5% to 10%). If the increase causes consumers to switch to substitutable products or new entrants are attracted to the market then this indicates that the relevant market is wider than the initially narrowly defined market. With this

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[18] Competition Act op cit note 6 section 6; see also Determination of Threshold Regulations in GN 253 GG 22025 of 1 February 2001; see also Amendment to Determination of Threshold Regulations in GN 562 GG 22128 of 9 March 2001.

[19] *Competition Commission v South African Airways (Pty) Ltd* 2005 18/CR/Mar01 ZACT 50 at 4 para 11.

[20] Willem H. Boshoff 'Why Define Markets in Competition Cases?' 2013 at 4 available at *https://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0CDMQFjAB&url=http%3A%2F%2Fwww.ekon.sun.ac.za%2Fwpapers%2F2013%2Fwp102013%2Fwp-10-2013.pdf&ei=LnX1UcDIDobF7AbK7YA4&usg=AFQjCNExfOQiT48IMaOmyshQ8whS9nEZJA&bvm=bv.49784469,d.ZGU* accessed on 28 July 2013.

[21] Boshoff op cit note 20 at 4.

[22] Ibid at 7-8.

[23] Rudman & Ostrovsky op cit note 16 at 7 para 3.2.1; see also Boshoff op cit note 20 at 3.

is mind, the relevant market is therefore the collection of goods or services in respect of which an hypothetical monopolist would be able to charge a price that is significantly above the notional competitive price.[24]

The SSNIP test has been criticised for its conceptual, empirical and even theoretical challenges. This has resulted in competition literature developing a range of tools for purposes of defining a relevant market.[25] As illustrated in the judgement of *Primedia and others v The Competition Commission and another*[26] it is generally agreed that "*it is far more meaningful to state propositions about relative relations between potential competitors than to make conclusions about absolute boundaries to markets*". This conclusion is noteworthy as it elevates the enquiry of defining markets from a two dimensional theoretical exercise to a three dimensional enquiry that makes provision for the relative nuances of the respective market.

The need to ascertain the relevant market affected by the abuse also extends to the territorial limits within which firms operate.[27] This relates to both the geographical as well as product markets.[28]

The enquiry into territorial limits seeks to answer the question whether the offending conduct took place within the territorial limits prescribed by section 3 of the Competition Act which, subject to certain exceptions, encapsulates all economic activity within, or having an effect within the Republic of South Africa. Conduct falling outside of these limits will not trigger the provisions of the Competition Act, unless it can be shown that such conduct has an effect within the Republic.

The fundamental principle to keep in mind when working out the relevant market (whether one is applying the SSNIP test or ascertaining the territorial limits prescribed by section 3 of the Competition Act) is that it is the market wherein the abuse took place that should form the basis of the determination.[29] Knowledge of the relevant market also aids in calculating a firms market share within the defined market.[30]

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[24] Rudman & Ostrovsky op cit note 16 at 7 – 8 para 3.2.1.
[25] Boshoff op cit note 20 at 3 - 4.
[26] *Primedia and others v The Competition Commission and another* 2008 39/AM/MAY06 ZACT 13 at 17 fn 39.
[27] J Neethling & BR Rutherford LAWSA 'Competition' *Law of South Africa* Vol 2(2) para 244.
[28] Ibid para 244.
[29] Ibid para 52.
[30] Boshoff op cit note 20 at 4.

(c) Dominance

Once the market has been ascertained, the next step of the enquiry is to determine whether the firm is dominant within that market.[31] Section 7 of the Competition Act provides that a firm is dominant if it:

- has at least 45% of the market;
- has at least 35% but less than 45% of that market, unless it can show that it does not have market power; or
- it has less than 35% of that market but has market power.

Market power as defined in section 1 of the act is deemed to exist when a firm can satisfy either of three conditions being when a firm has the ability to -

- control prices;
- exclude competition; or
- behave to an appreciable extent independently of its competitors, customers or suppliers.

Section 7 connects the concepts of market shares and market power by using presumptions of dominance based on a mixture of meeting certain market share thresholds or having market power.[32]

In the South African context, the methodology employed in determining whether a firm is dominant is,

> *'commonly…based on the relative sales revenues of the firms in the particular market. Whilst sometimes other figures are used, number of goods sold etc, this is often because sales revenue figures are not available, rather than the fact that they are not considered a reliable statistic for the purpose of determining market share.'*[33]

Emphasis is placed on relative sales figures although room is made for other factors to be taken into consideration. In this regard, one should bear in mind that market shares are viewed as proxies for the determination market power of firms.[34]

It should be noted that it is not the possession of market power that is problematic, but instead, its abuse that should attract censure.[35]

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[31] *FFS Refineries (Pty) Ltd v Eskom CT* 2002 *64/CR/Sep02* ZACT 9 at 4 para 13.
[32] Rudman & Ostrosvky op cit note 16 at 4 para 2.1.
[33] Neethling & Rutherford LAWSA op cit note 27 at 14 para 58.
[34] Boshoff op cit note 20 at page 18.

(d) Prohibited Conduct/Abusive behaviour

Once it has been established that the respondent firm has triggered the above requirements, the next stage of the enquiry is to ascertain whether the respondent firm has engaged in any prohibited conduct as set out in sections 8 and 9 of the Competition Act.[36] Prohibited conduct describes the legislatures understanding of the various manifestations of abusive behaviour.

An abuse (prohibited conduct) essentially occurs when a firm, acting within a particular market, is powerful enough (even if acting alone) to distort competition.[37] Section 8 prohibits the following type of abusive conduct:

- charging an excessive price to the detriment of consumers;
- refusing to give a competitor access to an essential facility when it is economically feasible to do so;
- engaging in an exclusionary act (other than those listed under paragraph iv below) if the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive gain;
- engaging in any of the following specific exclusionary acts, unless the firm concerned can show technological, efficiency or other pro-competitive gains which outweigh the anticompetitive effect of its act -
  - requiring or inducing a supplier to not deal with a competitor (also referred to as an inducement not to deal);
  - refusing to supply scarce goods to a competitor when it is economically feasible to do so;
  - selling products on condition that the buyer purchase separate goods or services unrelated to the object of a contract, or forcing a buyer to accept a condition related to an object of the contract (also referred to as tying or bundling);
  - selling products below their marginal or average variable cost (also referred to as predation);

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35 Phillip Sutherland *Competition Law of South Africa* (2011) para 7.1

36 Sutherland op cit note 35 para 7.4.

37 Ibid para 7.1; see also *Deutsche Telekom AG vs the Commission* 2008 Case T271/03 ECR II-447 para 233.

- buying up a scarce supply of intermediate goods or resources required by a competitor.

Section 9 prohibits a dominant firm from engaging in price discrimination if such discrimination is likely to have the effect of substantially preventing or lessening competition and it relates to the sale of goods and services in equivalent transactions of like grade and quality to different purchasers.

III. CATEGORIES OF ABUSE OF DOMINANCE

For the sake of convenience, abuse of dominance may be categorised as either (i) exclusionary or exploitative; and/or (ii) pricing or non-pricing. It must however be appreciated that these categories of abuse are interrelated.[38]

(a) Exclusionary verses Exploitative Abuses

Exclusionary abuses occur when a dominant firm prevents or hinders competition within a market.[39] An exclusionary act as defined in section 1 of the Competition Act means an act which impedes or prevents a firm from entering into or expanding within a market. Exclusionary abuses are generally prohibited under section 8(c) while section 8(d) and its five sub-clauses and section 8(b) proscribe specifically defined forms of exclusionary conduct. Sections 8(b) and 8(c) require that the "*anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive gain*" in order for there to be an abuse.

An exploitative abuse occurs when a dominant firm takes advantage of its market power in order to exploit its customers.[40] Section 8(a) contains the sole exploitative abuse of the Competition Act,[41] in terms of which a dominant firm is prohibited from "*charg[ing] an excessive price to the detriment of its consumers*". Margin squeeze is generally categorised as a form of exclusionary abuse.[42]

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[38] Jones and Sufrin op cit note 1 at 386.
[39] Ibid at 358.
[40] Ibid at 358.
[41] David Lewis 'Exploitative Abuses – A Note on the Harmony Gold v Mittal Steel Excessive Pricing Case' available at *http://www.comptrib.co.za/assets/Uploads/Speeches/lewis12.pdf* accessed on 20 July 2013.
[42] OECD: Policy Round Tables op cit note14 at 21.

(b) Pricing Abuse verses Non-Pricing Abuses

Pricing abuses occur when firms either raise their prices to unacceptably high levels or when they cut their prices to below normal levels.[43] Pricing abuses include practices such as excessive pricing as well as predatory pricing. Conversely, non-pricing abuses relate to practices that are not related to a firm's pricing policies and include for instance, a refusal to supply. Margin squeeze is classified as a form of pricing abuse.[44]

(c) Conceptual Considerations for Abuse of Dominance

The challenges with the concept of abuse of dominance in general are that first, if the anti-competitive effects of dominant conduct are proven, then the allegedly offending firm will by implication have had the necessary market power and secondly, the application of the dominance test is complex and cumbersome. Its elements are also not certain and are not always indicative of dominance.[45] It has accordingly been argued that it is preferable to adopt an effects based approach towards assessing cases of abuse without being preceded by the assessment of the dominance of a firm.[46] This is of relevance, as it speaks to the debate of whether a firm that is not dominant can nevertheless be said to conduct a margin squeeze abuse if such conduct has a negative effect on a market.

It should also be noted that intention is not one of the criterion for proving abuse of dominance. This is not to say that proof of a firm's aim to misuse its market power or to create an anti-competitive effect will not be admissible as evidence in showing that the firm was abusing its dominance.[47] This is particularly relevant in that it would be challenging for a competing firm to adduce evidence of its dominant competitors pricing practices leading to an abuse of margin squeeze.

Finally, a firm cannot be absolved of its contravention of the abuse of dominance provisions by the waiver or consent of a third party with whom it entered into a prohibited agreement. In other words, abuse of dominance does not require a third

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[43] Richard Whish *Competition Law* 7 ed (2012) 716.
[44] Whish op cit note 43 at 755.
[45] Rudman & Ostrovsky op cit note 16 at 7 paras 3.1 and 3.2.
[46] Ibid para 3.
[47] Sutherland op cit note 35 para 7.8.

party victim.[48] It is debatable whether this principle will be applicable to a margin squeeze abuse due to the fact that one of the criteria which a complainant will have to satisfy is that its margin (or that of competitors of the dominant firm in the relevant market) has been impaired by the offending pricing practices of the dominant firm. In other words it is arguable that margin squeeze abuses do in fact require a victim.

IV. WHAT IS A MARGIN SQUEEZE?

(a) Liberalization of Markets

As stated above, margin squeeze as a competition law cause of action is relatively new in South African jurisprudence. One of the reasons for this is that margin squeeze cases (when viewed against international trends) often occur following the liberalization of markets[49] such as in the water, railway, postal service and pay television sectors.[50] This trend is however most evident in the telecommunications sector which has seen a large number of margin squeeze cases in jurisdictions such as Italy, France, Denmark, Germany and the United Kingdom.[51] The South Africa telecommunications industry like its international counterparts has not been exempt from this trend as is illustrated by the failed attempt by the Competition Commission to amend its pleadings in its case against Telkom SA Limited to include the additional contravention of a margin squeeze abuse.[52] Margin squeeze nevertheless remains a fairly novel concept in South Africa. It is opined that this is because South Africa has

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[48] Sutherland op cit note 35 para 7.8; See also *Patensie Sitrus Beherend Beperk v Competition Commission* 2003 16/CAC/Apr02 ZACAC 4 24 and 30.

[49] *Competition Commission of South Africa v Senwes Limited* 2009 110/CR/Dec06 ZACT 8 para 117.

[50] OECD: Policy Round Tables op cit note14 at 8.

[51] Damien Geradin and Robert O'Donoghue ‘The Concurrent Application of Competition Law and Regulation: The Case of Margin Squeeze Abuses in the Telecommunications Sector’ (2005) 1 2 *Journal of Competition Law & Economics* 355.

[52] A settlement package agreed to between the Competition Commission and Telkom SA SOC Limited requires Telkom SA SOC Limited to maintain separate internal accounts for its retail corporate VPN and Internet access products so as to avoid engaging in margin squeeze conduct: see Competition Commission of South Africa ‘Media Release: Comission reaches settlement agreement with Telkom’ 2013 at 1 available at *http://www.compcom.co.za/assets/Uploads/AttachedFiles/MyDocuments/Commission-reaches-settlement-agreement-with-Telkom.pdf* accessed on 3 November 2013. See also *The Competition Commission v Telkom SA Ltd* 2011 11/CR/Febr04 ZACT 39.

experienced slow liberalization of its public sector[53] in comparison to its international peers. It is therefore likely that additional cases of margin squeeze may emerge as South African markets become more liberalized.

(b) Definition of Margin Squeeze

A margin squeeze has been defined as,[54]

> *'situations in which a vertically integrated firm not only engages in self-supply of an input used on a downstream market, but also supplies independent third parties active on the downstream market, which are in competition with its own business.'*

A margin squeeze occurs when,[55]

> *'a vertically integrated firm with a dominant position in an upstream market prevents its non-vertically integrated downstream rivals from achieving an economically viable price-cost margin.'*

The above definitions are of value as they pin point key concepts of a margin squeeze. Although dealt with in greater detail below, it is useful to note that these key concepts are: [56]

- the offending dominant firm is vertically integrated;
- the vertically integrated firm is the supplier of the input to itself as well as to an independent competing firm in a downstream market;
- the input is essential for downstream competition;

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[53] Afeikhena Jerome 'Privatization and Regulation in South Africa: An Evaluation' 2004 at 3 available at *http://www.competition-regulation.org.uk/conferences/southafrica04/Afeikhena.pdf* accessed on 20 November 2012.

[54] Robert O'Donoghue and Jorge Padilla *The Law and Economics of Article 82* (2006) at 304 cited in *Competition Commission of South Africa v Senwes Limited* supra note 49 at 29 para 117.

[55] Ibid.

[56] The elements are an amalgam of the writer's views as well as a paraphrase of the popular definitional elements of O'Donogue & Padilla op cit note 54 at 310.

- the vertically integrated firm's prices would render the activities of an efficient non-vertically integrated (competitor) firm in the downstream market uneconomic; and
- there is no objective justification for the vertically integrated firms pricing strategy.

(c) Regulated Markets

As stated above, a margin squeeze may occur when a previously regulated market becomes unregulated.

A margin squeeze is most likely to occur when a vertically integrated firm is subject to some form of price restriction at the upstream level while simultaneously having little if no regulation at the downstream level.[57]

It may not necessarily be sufficient however, for a vertically integrated firm to rely on the fact that it is subject to regulation in order to get away with a claim that the prices it imposed resulted in a margin squeeze. *TeliaSonera*[58] confirmed the principle that regulations will only be considered a defence to anti-compeitive conduct when such regulations eliminate any discretion the firm may have with respect to its pricing practices. If however the firm can remove or reduce the margin squeeze, then it can be held liable for its anti-competitive conduct.

(d) Types of Margin Squeeze

The criteria for the determination and the existential necessity of the margin squeeze concept has been subject to much debate.[59]

Although the fundamental principle behind a margin squeeze remains unchanged, various forms of the margin squeeze concept can be distinguished.

Margin squeezes can be distinguished on the basis of a vertically integrated firm's pricing strategy. On this basis, three types of margin squeeze could occur. A vertically

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[57] OECD: Policy Round Tables op cit note14 at 7.

[58] *Konkurrensverket v TeliaSonera Sverige AB* 2011 Case C-52/09 ECR 1-000 at 49;

[59] Liyang Hou 'Some Aspects Of Price Squeeze Within The EU: A Case Law analysis' (2011) 32 European Competition Law Review 250 at 250.

integrated firm could increase its upstream price, lower its downstream price or do both simultaneously.[60]

Margin squeezes can also be distinguished on the basis of whether the price levied at the upstream level is discriminatory or non-discriminatory.[61] According to these distinguishing criteria, a margin squeeze would be discriminatory if a vertically integrated firm charged its downstream competitors a higher price for the upstream input than it would charge its own downstream operation. On the other hand, a margin squeeze would not be considered discriminatory if the vertically integrated firm charges an increased price for the upstream input to both its own affiliate in the downstream market as well as to its competitors in the downstream market.[62]

A margin squeeze may also occur where a vertically integrated firm has market power downstream rather than upstream. In this situation, the vertically integrated firm would act as a monopsonist (in contradistinction to a monopolist) enabling it to purchase an upstream input at a more favourable price (potentially dictating the price) than its downstream rivals. By doing so, the vertically integrated firm would be in a position to undercut its rivals thereby affecting their profit margins.[63]

Predatory margin squeezes occur when a vertically integrated firm charges a lower price at the downstream level than the joint costs of input at the upstream level, transformation at the downstream level and a margin.[64] In other words, this is a margin squeeze that takes on the characteristics of predatory behaviour[65] (as understood in the competition law context).[66]

The above types of margin squeeze might differ in structure but, as mentioned above, remain fundamentally similar in principle. In effect, a margin squeeze will by definition, occur when a firm manages to leverage its vertical integration in such a manner as to put pressure on it's downstream rivals profit making capacity.[67]

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[60] Crocioni & Veljanovski op cit note 7 at 31.
[61] Ibid at 32.
[62] Crocioni & Veljanovski op cit note 7 at 32.
[63] Ibid at 30.
[64] Ibid at 33.
[65] Ibid; see also Competition Act op cit note 6 at s 8(d)(iv).
[66] According to the European Commission, predatory pricing requires that a firm incur a loss as a result of its predatory activity. On the other had a margin squeezes can be profitable even with lower downstream prices. This is not to say that higher profits could not be extracted from higher retail prices once a firm's competition has been forced out; see also OECD: Policy Round Tables op cit note14 at 9.
[67] O'Donogue & Padilla op cit note 54.

(e) Status of Margin Squeeze in International Jurisdictions

Before delving into the specifics of the Senwes case and the status of the margin squeeze principle as understood in the South African context, it is of benefit to understand the manner in which this principle is handled in the foreign jurisdictions of Europe, United Kingdom and the US. These territories have been selected for their global influence, as evidenced by the reliance of South Africa's Competition Tribunal and the Competition Appeal Court on,[68] as well as for their similarity to South African jurisprudential landscape (due to a number of the provisions of the Competition Act having been taken from foreign jurisdictions).[69] South African courts also rely on Canadian and Australian competition law jurisprudence for guidance[70] albeit to a much lesser extent than the European, United Kingdom and the US jurisdictions. This dissertation will accordingly place greater emphasis on the application of margin squeeze in the European, United Kingdom and the US jurisdictions as opposed to the Canadian and Australian jurisdictions.

On the international level, Margin squeeze cases are somewhat common and a number of competition authorities have adjudicated at least a few cases of margin squeeze complaints.[71] In most of these cases, it is dealt with under the general prohibition of abuse of dominance.[72] One exception to the abuse of dominance classification is found in German legislation which has specific provisions addressing margin squeeze cases pertaining to small and medium-sized companies.[73]

The following paragraphs will examine not only the manner in which the margin squeeze principle is applied in the abovementioned foreign jurisdictions but also examine the various arguments for and against the benefit of maintaining the margin squeeze principle as a component of Competition Law in light of foreign jurisprudence.

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[68] Sutherland op cit note 35 para 2.2.
[69] Ibid paras 2.2 & 2.6.
[70] Ibid.
[71] OECD: Policy Round Tables op cit note14 at 8.
[72] Ibid.
[73] OECD: Policy Round Tables op cit note14 at 8; see also Dr Matthias Lang & Prof U Mutschler German Energy Blog 'BMWi Presents Ministerial Draft Bill for 8th GWB Amendment' 2011 available at *http://www.germanenergyblog.de/?p=7812* accessed on 11 November 2012; see also Act Against Restraints of Competition in the version published on 15 July 2005 Bundesgesetzblatt (Federal Law Gazette) I, page 2114; 2009 I page 3850) section 20 para 4.

(i) European Union

In the European Union ("EU"), Margin Squeeze abuses have been classified under Article 102 (previously article 82) of the Treaty on the Functioning of the European Union[74] ("EU Treaty"). In essence, article 102 prohibits a firm from abusing its dominant position within a market if it would affect trade between member states of the EU.

The Commission as well as General Court decisions of *Deutsche Telekom*[75] classifies the margin squeeze abuse as specifically falling under Article 102(a) (or article 82(a) at the time) with the effect that the abuse is classified as imposing unfair prices. It has however been argued that this classification is erroneous in that article 102(a) relates to the unfairness of the price itself rather than the unfairness of the effects of the price as would be the case with a margin squeeze abuse.[76] It has also been submitted that the wording of Article 102(a) makes provision for only one aspect of the margin squeeze.[77] It is not clear at which level the 'unfair' pricing takes place, but it is certainly clear that the Article does not make provision for a vertically integrated firm leveraging its upstream market dominance.

The initial cases dealing with margin squeezes in the EU did not, however, handle this form of abuse as an infringement of article 102 of the EU Treaty. For instance, the first margin squeeze ruling in the EU was the *National Carbonising* case[78] in which the National Coal Board, a vertically integrated firm that was both dominant on the upstream market for coal and downstream market (through its subsidiary) for coke (derived from coal) was censured for its un-proportional increase

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[74] Consolidated version of the Treaty on the Functioning of the European Union, 13 December 2007, 2008/C 115/01.

[75] European Commission decision 2003/707/EC (Case COMP/C-1/37.451, 37.578, 37.579 — Deutsche Telekom AG) (OJ 2003 L 263) at para 199; *Deutsche Telekom* supra note 37 at paras 44 and 250.

[76] John Kallaugher 'The "Margin Squeeze" under Article 82: Searching for Limiting Principles' (2004) at 18 - 19 presented at conference titled Margin Squeeze under EC Competition Law with a special focus on the Telecommunications Sector available at *https://www.coleurope.eu/fr/website/recherches/global-competition-law-centre/conferences/conferences-and-workshops* accessed on 24 August 2013.

[77] Geoff Parr 'Squeezing the Margin Squeeze Abuse into the South African Competition Act' University of Johannesburg: conference on competition law and economics 2011 at page 3 available at *http://www.compcom.co.za/assets/Uploads/events/Fifth-Annual-Conference/UJ-Margin-Squeeze-Geoff-Parr-26-Sept-2011.pdf* accessed on 20 November 2012.

[78] *National Coal Board, National Smokeless Fuels Limited and the National Carbonizing Company Limited* 1976 OJ L35/6.

of its upstream prices relative to its downstream prices. This case adopted wording similar to that of *Commercial Solvents*[79]alluding to the fact that the margin squeeze abuse was in fact a form of a refusal to supply as opposed to an independent type of abuse. It is submitted that this decision highlights the similarity between the margin squeeze cause of action against other generally more recognised causes of action such as predatory pricing and refusal to supply.

In the next EU decision of *Napier Brown – British Sugar*[80] it was found that British Sugar was dominant in the upstream market for the supply of raw sugar. British Sugar was also confirmed to be vertically integrated and competing in the downstream market for derived sugar. It was determined that the prices that British Sugar charged itself for raw sugar in comparison to the prices charged to Napier Brown, amounted to a pricing strategy aimed at forcing Napier Brown out of the downstream market for derived sugar. Much like the *National Carbonising* case, the margin squeeze abuse appears to have been viewed as a subset of a refusal to supply as the courts held that Napier Brown's conduct had fulfilled the criteria set out in *Commercial Solvents*.[81]

In the case of *Industrie des Poudres Sphériques,*[82] Pechiney Electrometallugie ("PEM") a company that was the only producer of primary calcium metal (upstream input) as well as broken calcium metal (which is derived from primary calcium metal and was marketed downstream), was accused of engaging in margin squeeze by *Industrie des Poudres Sphériques* ("IPS") when it set a high price for primary calcium metal and an allegedly low price for broken calcium metal such that IPS (which competed with PEM in the downstream market for broken calcium metal) was not able to effectively compete with PEM. This claim was nevertheless rejected by the

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[79] *Instituto Chemioteapico Italiano SpA v Commission of the European Communities (Commercial Solvents)*1974 (C-6-7/73) E.C.R. 223; 1 C.M.L.R. 309.

[80] The 1988 European Commission decision of *British Sugar-Tate & Lyle plc -Napier Brown & Company*-(1988) OJ L284/41, (1990) 4 CMLR 196, was subsequently upheald by the then Court of First instance (and now European General Court) in *Tate & Lyle Plc British Sugar plc and Napier Brown & Co. Ltd v Commission of the European Communities* (2001*) Joined cases T-202/98, T-204/98 and T-207/98.*

[81] *British Sugar* supra note 80 at para 64.

[82] *Industrie des Poudres Sphériques SA v. European Commission* 2000 Case T-5/97 E.C.R. II-3755.

European General Court due to the fact that IPS failed to prove that, amongst other aspects, PEM's pricing policy was abusive.[83]

Whereas it is opined that the European position on margin squeeze concept is aligned with that of the UK,[84] it is also opined that European case law does not offer a benchmark definition of a margin squeeze, let alone define it consistently.[85] It is only in the case of *Industrie des Poudres Sphériques* that the European Court of first instance defined a margin squeeze as follows:

> *'[Margin][86] squeezing may be said to take place when an undertaking which is in a dominant position on the market for an unprocessed product and itself uses part of its production for the manufacture of a more processed product, while at the same time selling off surplus unprocessed product on the market, sets the price at which it sells the unprocessed product at such a level that those who purchase it do not have a sufficient profit margin on the processing to remain competitive on the market for the processed product.'*[87]

This is noteworthy considering that the definition does not address a number of elements considered relevant for establishing a margin squeeze abuse.[88] For instance, it does not address the requirement that the competing downstream firm must be equally efficient as compared to the vertically integrated firm's downstream division. It also does not address the significance of the duration of the margin squeeze, nor does it address the fact that a margin squeeze could take place if the vertically integrated firm lowered its downstream price.[89] It is submitted that this definition is nevertheless relevant in that it signifies the first concrete attempt at marking out the parameters against which a margin squeeze abuse could be classified.

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[83] *S*upra para 179.
[84] Kelly & van der Vijver op cit note 10 at 251.
[85] Crocioni & Veljanovski op cit note 7 at 30.
[86] Whereas the original text referred to 'Price Squeeze' the writer has amended the wording to 'margin squeeze' so as to allow for consistency in this text.
[87] *Industrie des Poudres Sphériques* supra note 82 para 178.
[88] Crocioni & Veljanovski op cit note 7 at 30.
[89] Ibid.

Margin Squeezes have progressively become recognised as an independent abuse in Europe. As mentioned above, the abuse falls to be considered under Article 102 (previously article 82) of the EU Treaty which has found application in a number of cases.

A number of these cases have arisen from the telecommunications sector, such as the previously mentioned *Deutsche Telekom* case[90] as well as the *Telefonica* decision[91] and *TeliaSonera.*[92]

As mentioned above, in *Deutsche Telekom* it was held that margin squeeze conduct contravenes article 82(a) (now 102(a)) of the EU Treaty. In this matter *Deutsche Telekom* was fined €12.6 million by the European Commission for engaging in abusive margin squeeze behaviour with relation to its local networks.[93] *Deutsche Telekom* had a dominant position with respect to the 'local loop' which comprised the final section of the telecommunications network that connects a customer's premises to the local switching point. *Deutsche Telekom* not only provided downstream retail access to the local loop, but also provided wholesale capacity to other competitor operators who then also provided downstream retail access in competition with *Deutsche Telekom*. Whereas *Deutsche Telekom* was obliged since 1998 to provide these competitors with access to its networks, the retail and wholesale prices that *Deutsche Telekom* was entitled to impose was subject to regulatory oversight by the German telecoms regulator. The Commission indicted *Deutsche Telekom* for abusing its dominant position by charging low retail prices which could have been avoided if it had increased its existing retail charges.[94] The Commission's decision was upheld on appeal to the General Court[95] as well as to the European Court of Justice.[96] This decision is noteworthy in that it recognised margin squeeze as an independent form of abuse,[97] bringing much clarity to this aspect of the law (at least within the EU

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[90] *Deutsche Telekom* supra note 37.
[91] *Wanadoo Espana v Telefonica* 2007 Comp/38.784 (EC).
[92] *TeliaSonera* Supra note 58.
[93] *Deutsche Telekom* (European Commission decision) supra note 75.
[94] Supra para 163.
[95] *Deutsche Telekom* supra note 37 para 631.
[96] Supra para 1495.
[97] Jones and Sufrin op cit note 1 at 414.

context). It also confirmed the principle that a margin squeeze may occur even when the industry in question is regulated.[98]

In *Telefónica*[99] (which is similar to *Deutsche Telekom* in that they both fell within the telecommunications sector) *Telefónica* enjoyed a legal monopoly over the Spanish national fixed telephone network before its liberalisation in 1998 and enjoyed a dominant position thereafter.[100] *Telefónica* provided broadband at both the retail level (i.e. to individuals) as well as wholesale services to other telecommunications services providers. Both the Commission as well as the General Court[101] confirmed that *Telefónica* had engaged in margin squeeze type conduct due to its unfair prices at both retail and wholesale levels at both national and regional level. The General Court confirmed the fine of €151 875 000 as imposed by the Commission.

In the most recent EU decision dealing with margin squeeze abuses of *Konkurrensverket v TeliaSonera Sverige AB*,[102] *TeliaSonera* a telecommunications operator in Sweden, much like *Deutsche Telekom* and *Telefónica* also enjoyed a dominant[103] position on the wholesale supply of the fixed telephone network in Sweden. The Swedish competition authority on application to Stockholms tingsrätt (the Stockholm District Court) alleged that *TeliaSonera* was guilty of margin squeeze. The Stockholm District Court sought clarity from the European Court of Justice (in terms of article 267 of the EU Treaty)[104] on the circumstances in which the spread between the wholesale prices for ADSL on the one hand and the retail prices for broadband connection on the other hand may constitute an abuse in terms of Article 102 of EU Treaty. The European Court of Justice confirmed the criteria for a margin squeeze as contemplated in the *Deutsche Telekom* decision,[105] and also emphasised that there is a need to show negative effects of anti-competitive pricing practices.[106]

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[98] Niamh Dunne 'Margin Squeeze: From Broken Regulation to Legal Uncertainty' (2001) vol 70 Cambridge Law Journal issue 34 at 34.
[99] *Telefónica v Commission of the European Communities* (T-336/07) 2007.
[100] Supra para 167.
[101] *Telefónica* supra note 99 para 6 and 463.
[102] *TeliaSonera* supra note 58.
[103] Due to procedural rules, TeliaSonera's dominance had not been determined. This conclusion is reached by implication rather than fact; see *TeliaSonera* Supra note 58 para 13.
[104] *TeliaSonera* supra note 58 para 15.
[105] Supra paras 31-35.
[106] Supra paras 60 - 68.

The court also expanded on factors that are generally not relevant when establishing a margin squeeze in terms of Article 102 of the EU treaty. These factors are:

- the absence of a regulatory obligation on the vertically integrated dominant firm to supply the wholesale market;[107]
- the degree of market dominance;[108]
- necessity for dominance at the retail market level;[109]
- relevance of whether the supply concerned is to a new customer;[110]
- necessity for the dominant undertaking to recoup losses sustained as a result of its anti-competitive pricing practices;[111] and
- the relevance of the fact that the markets concerned are growing rapidly and involve new technology which require high levels of investment.[112]

This finding is of great interest in that it not only solidifies the recognition of margin squeeze as a separate cause of action under EU jurisprudence, but that it also crystalizes the European position on the assessment of a margin squeeze abuse.

(ii) United Kingdom

In the United Kingdom ("UK") margin squeeze abuses have been classified as falling under section 18 of the Competition Act[113] which relates to abuse of dominance. Interestingly, section 18(2) contains wording that resembles the provisions of article 102(a)) of the EU Treaty.

In the *Genzyme*[114] decision, which was upheld on appeal to the Competition Appeal Tribunal[115] it was found that Genzyme had abused its dominant position by adopting a pricing policy over the drug Cerezyme (over which Genzyme enjoyed dominant supply) which effectively restricted competition in the market for home delivery of Cerezyme and provision of homecare services, thereby reserving this

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[107] Supra paras 47 – 59.
[108] Supra paras 78 – 82.
[109] Supra paras 83 – 89.
[110] Supra paras 90 – 95.
[111] Supra para 96 – 103.
[112] Supra para 104 - 111.
[113] Competition Act 1998 Chapter 41 (United Kingdom).
[114] Decision of Director General of Fair Trading 'Exclusionary Behaviour by Genzyme Limited' 2003 No CA98/3/03 Case CP/0488-01.
[115] *Genzyme Ltd v Office of Fair Trading* 2004 Case No 1016 /1/03 CAT 4.

market for Genzyme.[116] An effects based approach was also adopted in reaching its conclusion of abuse of dominance taking the form of a margin squeeze.[117]

The courts went further in clarifying the margin squeeze abuse in the decision of *Albion Water Limited v Dŵr Cymru Cyfyngedig.* The decision of the Office of Water Affairs of non-infringement[118] was overturned by the Competition Appeal Tribunal[119] which decision was confirmed by the Court of Appeals.[120] In confirming the existence of a margin squeeze, the Competition Appeal Tribunal considered both the 'equally efficient competitor test' as well as the 'reasonably efficient competitor test' and confirmed its preference for the former despite the fact that the later test remains recognised.[121] This is of relevance as it clarifies the UK approach to determining the economic effects of a margin squeeze.

(iii)United States of America

The US is somewhat different from the UK and EU systems for a number of reasons including that the applicable legislation (i.e. section 2 of the Sherman Act)[122] does not specifically deal with abuse of dominance abuses. The judiciary has had to set precedent in this regard.[123]

The US has relatively recently adopted a new approach to its handling of margin squeeze cases. By way of a background, in *Alcoa*[124] a 1945 decision, Alcoa a vertically integrated firm with an upstream monopoly in the supply of virgin aluminium ingot was held to be charging a price higher than a 'fair price' for its upstream product, thereby suggesting that its practices were exclusionary.[125] This was

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[116] Decision of Director General supra note 114 para 386.
[117] Supra paras 386 and 387; see also *Genzyme Ltd v Office of Fair Trading* supra note 115 para 639.
[118] Decision of the Office of Water Affairs 26 May 2004 UKCLR 1317.
[119] *Albion Water Limited v Water Services Regulatory Authority* 2006 Case No 1046/2/4/04 CAT 36 paras 385 – 419.
[120] *Dŵr Cymru Cyfyngedig v Water Services Regulation Authority* 2008 EWCA Civ 536 UKCLR 457.
[121] Fiona Parker 'The Albion Water Case' 2008 available at *http://www.worldservicesgroup.com/publications.asp?action=article&artid=2469* accessed on 27 August 2013.
[122] Sherman Anti-Trust Act 1890 (15 U.S.C.A. §§ 1 et seq).
[123] Parr op cit note 77 at 3; see also Kelly & van der Vijver op cit note 10 at 252.
[124] *United States v Aluminum Co of America et al* 1945 case number 148 F.2d 416 (Circuit Court of Appeals, Second Circuit).
[125] *Alcoa s*upra note 124 at para 437; see also Kelly & van der Vijver op cit note 10 at 251.

however eventually overturned in the *Linkline* case[126] in which it was determined that margin squeezes[127] should be dealt with either as predation as contemplated in *Brooke Group*[128] or as a constructive refusal to supply as contemplated in *Aspen Skiing*.[129] *Linkline* refers to the decision of *Trinko*,[130] a decision that had already narrowed down the margin squeeze criteria contemplated in *Aspen Skiing.*[131] In *Trinko* Justice Scalia referring to the *Colgate*[132] case confirmed that the Sherman Act does not create an obligation to trade or deal, and that a private enterprise may freely exercise its discretion as to whom to interact with where there is no such duty.[133]

Clearly, by rejecting the margin squeeze principle, the US courts have moved in the opposite direction of the European and UK courts. The question now remains which approach South Africa will adopt, particularly as it has the advantage of being able to observe the application of the margin squeeze concept in various jurisdictions.

(iv) Australia

A margin squeeze abuse is also recognised in Australian jurisprudence and has been prosecuted in terms of section 46 of the Australian Competition and Consumer Act.[134] As in most jurisdictions, the margin squeeze abuse is classified as an abuse of dominance abuse, and has been adjudicated in a number of cases[135] notably none of which are recent.

It is generally understood that although a vertically integrated firm with upstream market power is entitled to act in its own self-interest, such a firm is not

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[126] *Pacific Bell Telephone Co., DBA AT&T California, et al v Linkline Communications, Inc et al* 2009 case number 07-512 (US Supreme Court).
[127] This is the case, particularly where there is no duty to deal at the upstream level and no predatory pricing at the downstream level; see in this respect *Linkline* supra note 126 at 12 para III-B-3.
[128] *Brooke Group Ltd v Brown & Williamson Tobacco Corporation* 1993 509 U.S. 209 (US Court Supreme Court).
[129] *Aspen Skiing Co v Aspen Highlands Skiing Corp* 1985 472 US 585, 601 (US Court Supreme Court); see also Kelly & van der Vijver op cit note 10 at 252.
[130] *Verizon Communications Inc. v Law Offices of Curtis v Trinko*, LLP 2004 540 US 398 (US Court Supreme Court).
[131] See Kelly & van der Vijver op cit note 10 at 252.
[132] *United States v Colgate & Co* 1919 250 US 300, 307 (US Court Supreme Court).
[133] *Trinko* supra note 130 at page 8; see also Kelly & van der Vijver op cit note 10 at 252.
[134] Act No. 51 of 1974.
[135] Stephen Corones (1991) "Crossing a shadowy barrier: recent price squeeze cases" (1991) 19 Australian Business Law Review 284-296, presents a summary of some of the Australian cases including *Pont Data Australia Pty Ltd v. ASX Operations Pty Ltd* 1990 ATPR 41-007 and *Taprobane ToursWA Pty Ltd v. Singapore Airlines Lt* 1990 ATPR 41-054.

precluded from taking precautions against harming a markets competitive processes that have already been destabilised by the firm's dominance.[136] This view is supported by the judgment of *Pont Data*[137] in which it was confirmed that a firm in a dominant position could not simply refuse to supply an essential upstream input.[138] One can therefore assert that Australian competition law jurisprudence has adopted an approach aimed at protecting market processes as opposed to one aimed at directly protecting consumer interest. It is arguable that this approach differs somewhat with the approach contemplated in the Competition Act which envisages a balance between consumer and market interests.[139]

(v) Canada

Canadian competition law explicitly recognises margin squeeze in section 78(1)(a) of the Canadian Competition Act[140] as an anti-competitive act constituting an abuse of dominance in terms of section 79 of the same act. This clarity and certainty does not however, automatically translate into ease of application and use of the principle. For instance, whereas the Enforcement Guidelines on the *Abuse of Dominance Provisions on sections 78 and 79 of the Competition Act*[141] provide some insight into the application of these sections, the guidance provided is superficial meaning that guidance would have to be obtained from case law. Unfortunately however, margin squeezes allegations have thus far been few and far between in Canada implying that the body of case law applicable (if any, due to a number of investigations of these complaints having been discontinued due to a lack of evidence)[142] will simply not be sufficient to provide the required guidance.

Canada's Competition Bureau has adopted a logical approach when reviewing margin squeeze abuse decisions by *inter alia* classifying conduct that could be categorised as an abuse of dominance as a margin squeeze, except when the conduct

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[136] S.G. Corones 'Competition Law in Australia' (2013) Thompson Legal & Regulatory Limited at para 8.130.
[137] *Pont Data* supra note 135.
[138] Supra.
[139] Competition Act op cit note 6 see the Preamble as well as section 2.
[140] *Competition Act,* R.S. 1985, C. c-34.
[141] Competition Bureau Canada 'The Abuse of Dominance Provisions: Sections 78 and 79 of the Competition Act' 2012.
[142] OECD: Policy Round Tables op cit note14 at 79.

complained of results in a lowering in prices at the retail level only in which event the suspected conduct will be classified as predatory pricing.

CHAPTER 3

I. BACKGROUND TO THE SENWES CASES

With the fundamentals in place, it is now possible to discuss the Senwes matter, starting with a brief factual background. As mentioned above,[143] margin squeeze cases tend to arise in newly liberalized markets, such as with the liberalization of the market for the storage of grain, which gave rise (in part) to the Senwes matter.

Established in 1909[144] Senwes existed as a co-operative for approximately 88 years before being converted into a public company in 1997.[145] Senwes provides a number of services including the provision of input products for agricultural production, market access for grain produce as well as financial, technical and logistical services to grain producers.[146] For purposes of the case (and this dissertation), the business in question relates to it being a silo owner and by virtue thereof, storing grain for itself and for third parties. It also markets and trades in grain.[147]

Senwes' concrete silos ("silos") are located primarily in the Free State, but are also located in the Northwest, Gauteng and the Northern Cape provinces. It was common cause that each silo constituted a local grain storage market for a radius of approximately 60 kilometers. Cumulatively, the areas in which the silos were located (of which Senwes owns 56 out of the 80 silos) were referred to as the 'Senwes area'.[148]

The silos were built between the mid 1960s and 1980s. During this period, grain co-operatives enjoyed a unique role in respect of the storage, handling and marketing of large quantities of grain which was largely attributable to their appointment as agents of the Maize Board.[149] The Co-operatives Act prohibited co-operatives from

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[143] *Competition Commission of South Africa v Senwes Limited* supra note 49.
[144] Senwes 'Company Profile' available at *http://www.senwes.co.za/en-ZA/Corporate/*, accessed on 6 November 2012.
[145] *Senwes Limited v Competition Commission of South Africa* 2009 87/CAC/FEB09 ZAWCHC 61 at 2 para 3.
[146] Senwes 'Company Profile' op cit note 144.
[147] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 2 para 4.
[148] Supra para 5-6.
[149] *Senwes Limited v Competition Commission of South Africa* supra note 145 at 2 para 4.

competing against one another.[150] This led to their being only one silo in a particular region, in most cases owned by a co-operative.[151]

All this changed in 1995 when the regulatory framework governing the trade in grain changed.[152] In 1997, Senwes was converted from a co-operative into a public company ostensibly in response to the change in the regulatory framework. Grain production was no longer subject to a centralised system of planning nor were farmers obliged to sell their product to the Maize Board at a regulated price. Instead, grain was traded as a commodity on the South African Futures Exchange ("Safex").[153]

Whereas farms and trade in grain are now subject to market forces, silos remained unaffected by these forces. Senwes was fortunate in that the silos retained a monopoly in their respective areas for two reasons: firstly, because they are significantly expensive to construct and secondly, because the silos were rarely at full capacity, resulting in little if no demand for additional silos.[154]

The ability to trade grain on Safex plays an important role in the Senwes case. Although the physical trade in grain continued to take place, trade in grain through the Safex forum became the primary place through which trade in grain took place (it was estimated that trade in grain on Safex exceeded the trade in physical grain by a factor of eight).[155] This also means that a large proportion of traders of grain in Safex are only involved in trading in grain as a commodity through Safex and not in the physical trade in grain.[156] This is of significance because silo owners (Senwes being one of them) are also major players in the trade of grain in Safex, so much so that it was alledged that Senwes' trading strategy informed its storage policy.[157]

The significance of silo owners being involved in trading grain via the Safex market becomes apparent when one examines the manner in which prices in this market are determined. Market forces determine the prices at which grain is traded on Safex. This does not mean however, that the price of grain on Safex is the actual price

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[150] *Senwes Limited v Competition Commission of South Africa* supra note 145 at 3 para 5.
[151] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 2 para 7.
[152] *Senwes Limited v Competition Commission of South Africa* supra note 145 at 3 para 6.
[153] Supra paras 5-9.
[154] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 3 para 10.
[155] *Senwes Limited v The Competition Commission of South Africa* 2011 JOL 27305 (SCA); 1 CPLR 1 (SCA) at 5 para 15.
[156] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 5 para 14.
[157] Supra.

of grain at the 'farm' level. In order for grain to be traded on Safex, it is practice for the prices of grain to include a set (non-binding) tariff for storage and transport inputs. This is done in order to standardize the costs of these inputs.[158]

Traders will use the Safex price for a particular day when purchasing grain from farmers. The traders will deduct from the Safex price the handling, transport and storage tariffs and also the trader's commission. Where a trader can offer a farmer a saving on one of the tariffs (for instance, if the cost of transportation is lower than the tariff rate), then the trader will pass on the savings to the farmer in order to influence a sale. The difference between the actual cost and the cost reflected in the tariff is referred to as the Safex premium.[159]

Another factor worth mentioning is the effect that the seasonality of maize (which constitutes 80% of the grain stored in silos) has on the grain price. Because maize is planted from October to December, and is typically harvested from June to August the demand and supply of maize has a noteworthy effect on the price throughout the various seasons. Prices are lowest during the harvest period (due to increased supply) and progressively rise as supply decreases. Farmers will therefore spread the outflow of their product supply in such a manner as to obtain cash flow at the beginning of the harvest season, but also enjoy higher prices later on.[160]

The farmers will either sell their grain to traders (Senwes being one of them) or will cut out the 'middleman' and sell directly to millers. However, millers prefer to purchase grain from silos (for reasons such as quality control, their limited storage capacity and in order to take advantage of fluctuation in market prices). This means that a large portion of a grain harvest will have to be stored at either the farmers or traders expense.[161]

Grain is only capable of being traded on Safex by way of a negotiable instrument referred to as a silo certificate. This certificate is obtained when a farmer delivers 100 tons of a product (which has been graded and stored according to its grade) at a silo.

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[158] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 5 para 16.
[159] Supra paras 18 and 19.
[160] Supra paras 22 – 25.
[161] Supra paras 26 – 28.

Note that the farmer need not deliver 100 tons of grain in one go, but may do so over a period of time until the threshold is met.[162]

Senwes had historically charged at the beginning of each annual seasonal cycle, a daily rate for storage which is caped at 100 days. There would be no additional charge from day 101 until the end of the season. The daily rate was charged again once a new season begins. This practice was applied to any storage customer irrespective of whether they were a farmer or trader.[163]

This practice changed in May 2003 when Senwes ceased to apply the capped tariff principle to traders, retaining it only for farmer customers. This new tariff, referred to as a 'differential tariff' resulted in traders paying daily rates even after the 100 days, effectively increasing their cost of storage after that period. Farmers who opted to obtain silo certificates were also deemed to be traders, and were also charged the differential tariff. Senwes conceded that it treated its own storage unit differently, and did not lead any evidence to suggest that it had any internal storage cost recovery.[164] It was alleged by the Competition Commission that it was around this time that Senwes informed farmers that Senwes would be able to offer the farmers a better price for their produce because Senwes would either not charge them for storage or offer a reduced price for storage. In contrast, traders would have to deduct from their offer to a farmer the costs of storage (including the new cost of the differential tariff).[165]

II. SENWES BEFORE THE COURTS

With the above background in mind, one can now examine briefly the manner in which the different South African courts adjudicated the case in its various stages, with an emphasis on their findings in respect of the margin squeeze abuse.[166]

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[162] Supra para 29; see also *Senwes Limited v Competition Commission of South Africa* supra note 145 at 5 para 10.
[163] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 8-9 para 30-31.
[164] Supra para 149.
[165] Supra para 32-33.
[166] Sutherland op cit note 35; see also Office of Fair Trading 'Abuse of a Dominant Position: Understanding Competition Law' at 3 para 2.2, available at *http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft402.pdf* 2004 accessed on 20 November 2012.

(a) The Competition Tribunal

The Competition Tribunal addressed the charges against Senwes as constituting two forms of abuse: an 'inducement' abuse and a 'margin squeeze' abuse.[167] The inducement abuse arose as a result of the allegations that Senwes constructively induced farmers not to deal with traders due to increased storage costs. The margin squeeze abuse arose as a result of the application of the differential tariff by Senwes (a vertically integrated firm) to its downstream competitors in such a manner as to reduce the ability of its downstream rivals to earn a viable price cost margin.[168]

The Competition Tribunal concluded that Senwes contravened the provisions of section 8(d)(i) from a conduct point of view[169] but not from an anti-competitive effect point of view,[170] and reached a similar conclusion in respect of the margin squeeze conduct allegations. The Competition Tribunal confirmed that the Senwes' conduct amounted to an exclusionary act by a dominant firm in the form of a margin squeeze. This was because it had the effect of limiting the ability of Senwes' downstream rivals from competing with its own downstream operation.[171] It was also confirmed that the margin squeeze would be classified as conduct falling under section 8(c) of the Competition Act.[172]

It is important to note that throughout the proceedings of the Competition Tribunal, Senwes pointed out that the Competition Commission did not plead a case for margin squeeze from the outset. Senwes therefore argued that it did not have to answer these charges as it was not permissible for the Competition Commission to change its case without formally applying to amend its pleadings.[173] It was held by the Competition Tribunal that the amendment of the Competition Commission's case to include the margin squeeze case was not a major departure from the pleadings with

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[167] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 12 para 42.
[168] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 12 para 43 and at 30 para 118.
[169] Supra para 164.
[170] Supra para 272.
[171] Supra para 151.
[172] Competition Act op cit note 6; for ease of reference, the provisions of section 8(c) of the Competition Act are as follows "*It is prohibited for a dominant, firm to…engage in an exclusionary act, other than an act listed in paragraph (d), if the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive, gain*"; see also *Competition Commission of South Africa v Senwes Limited supra* note 49 at 42 para 168 and at 70 para 271.
[173] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 72 para 279.

the result that Senwes would not have been prejudiced by its introduction.[174] It was also held that to allow Senwes to succeed on a technical defence would be significantly unfair for both the Competition Commission and the competitive markets that the Competition Commission represents.[175]

(b) Competition Appeal Court of South Africa

Senwes appealed to the Competition Appeal Court[176] on the basis that the Competition Commission had not pleaded the margin squeeze case properly, that the Competition Commission had failed to lead evidence in support of a margin squeeze allegation and that there was no basis for the importation of the margin squeeze concept in South African law.

The Competition Appeal Court responded to each of the allegations. In respect of the first allegation, it concluded that the Competition Act envisaged a flexible forum allowing a more robust approach towards its adjudicative proceedings, in effect allowing for the manner in which the Competition Commission introduced the margin squeeze case. In respect of the second allegation it also held that the case was set out with sufficient clarity as to allow Senwes to prepare an appropriate defence.[177]

Finally, the Competition Appeal Court rejected Senwes' reliance on arguments against the utility of the margin squeeze concept on the basis of arguments derived from US jurisprudence. Instead it concluded that the Competition Commission's reliance on the open ended provisions of section 8(c) of the Competition Act was well founded.[178] The appeal was accordingly dismissed.

(c) Supreme Court of Appeal

Although leave to appeal to the Supreme Court of Appeal was denied by the Competition Appeal Court[179] leave to appeal was granted by the Supreme Court of Appeal.[180] The appeal was ultimately upheld on the basis that the Competition

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[174] Supra paras 302 - 303.
[175] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 77 para 304.
[176] *Senwes Limited v Competition Commission of South Africa* supra note 145.
[177] Supra paras 36 to 43.
[178] Supra paras 45 to 55.
[179] Supra.
[180] *Senwes Limited v The Competition Commission of South Africa* supra note 155.

Tribunal, being a creature of statue is restricted to arguments raised in a referral. This was in summary, based on Senwes' consistent stance that the margin squeeze case was improperly raised as well as the Competition Tribunals reluctance to formally amend its pleadings.[181]

(d) Constitutional Court

The Competition Commission appealed the Supreme Court of Appeal decision, and leave to appeal was granted by the Constitutional Court. The grounds on which it was granted was that it was a constitutional issue and in the interests of justice to determine whether the Competition Tribunal exceeded its statutory power and violated the principle of legality when adjudicating the Senwes margin squeeze abuse case.[182]

In the main judgement, the Constitutional Court held that the Supreme Court of Appeal erred in concluding that the Competition Tribunal had considered a complaint that was not dealt with in the referral. The Constitutional Court held that the complaint relating to the contravention of section 8(c) of the Competition Act, addressed the essential elements of the section. In other words, the mistake made by the Competition Tribunal was not one of law, but of placing the label of 'margin squeeze' on its allegations.[183] This was supported by the fact that the evidence clearly showed that Senwes did in fact contravene the provisions of section 8(c) of the Competition Act.[184] The appeal was accordingly upheld, with the unique order requiring that the reference to margin squeeze be deleted.[185]

The minority judgement focused instead on the functions of the Competition Tribunal, and opined that the appropriate remedy would be to refer the matter back to the Competition Tribunal in order to determine the appropriate ambit for the referral. The hearing would then be able to proceed on the basis of that ruling.[186]

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[181] Supra paras 52-55.
[182] Judgment of the Constitutional Court Supra note 1 at 10 paras 16 to 18.
[183] Supra paras 36 and 39
[184] Supra para 44.
[185] Supra para 58.
[186] Supra paras 59 and 80.

(e) Order Confirming Settlement Agreement Between The Competition Commission And Senwes

Following the ruling of the Constitutional Court the Commission and Senwes reached settlement on the remedies in terms of a Settlement Agreement which was thereafter confirmed and made an order of the Competition Tribunal in terms of section 58(1)(a) and 58(1)(b) of the Competition Act.[187] Interestingly, the salient terms of the settlement agreement largely mirrored the remedies sought by the Competition Commission in its pleadings.[188]

The Competition Commission and Senwes agreed that the remaining part of Senwes' grain marketing business would be transferred to a separate legal entity (referred to as "Newco") by either 31 May 2014 or a day falling nine months after confirmation of the settlement agreement.[189] This allowed Senwes more time to execute the operational aspects required to transfer the business when compared to the 90 day transfer period contemplated in the remedies sought by the Competition Commission.[190] The underlying reason for the transfer is firstly to ensure operational independence of Senwes' grain trading business and its storage business and secondly to ensure that Senwes' grain trading business is treated equally to other traders in respect of storage. This independence would be additionally entrenched by the requirement for separate board of directors comprising non-executive directors not affiliated to Senwes as well separate employee incentive schemes.[191]

Senwes will also be entitled to retain a grain procurement arm alongside but distinct from its silo business. The grain procurement arm will be entitled to contract with any grain trader including Newco provided that this is done on an arm's length basis. It would also be required to pay the standard storage and handling rates offered on identical terms to all who store grain with it,[192] and would additionally be required

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[187] *Competition Commission of South Africa v Senwes Limited* 2013 110/CR/Dec06 (016484) ZACT 34.
[188] Supra para 1.6.
[189] Supra para 4.1.1.2.
[190] Supra para 1.6.5.
[191] Supra para 4.1.1.6.
[192] Supra para 4.1.1.5.

to retain separate accounts so as to enable the monitoring of its compliance with the conditions of the Settlement Agreement.[193]

The Settlement Agreement effectively introduces mechanisms aimed at circumscribing Senwes' ability to leverage its upstream dominance of its grain storage division against its downstream rivals engaged in the trading of grain. Compliance with the terms of the Settlement Agreement is to be monitored and confirmed in writing by Senwes with compulsory verification by external auditors for the first five years following the date of the order and thereafter as and when required by the Competition Commission.[194]

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[193] Supra para 4.1.1.4.
[194] Supra para 4.1.1.12.

CHAPTER 4

I. STATUS OF MARGIN SQUEEZE AS A SOUTH AFRICAN COMPETITION LAW PRINCIPLE

As a precursor to delving into the intricacies of the margin squeeze concept as understood in South African competition law jurisprudence, and with a background of the approach to cases of margin squeeze abuses in foreign jurisdictions, it is important to determine whether it is in fact recognised as a viable course of action by our courts.

As stated above, the Competition Tribunal found that the complaint in respect of a margin squeeze had been established as a contravention of 8(c) of the Competition Act.[195] This finding was confirmed when the matter was appealed to the Competition Appeal Court.[196]

Following the granting of leave to appeal to the Supreme Court of Appeal of South Africa, this court upheld the appeal and dismissed the Competition Tribunal's finding on the basis that it had exceeded its powers by failing to seek an amendment to the Tribunal's referral in respect of the margin squeeze allegations.[197]

The Constitutional Court reversed the finding of the Supreme Court of Appeal. It did so by finding that:[198]

- the Constitutional Court was satisfied that Senwes had engaged in an exclusionary act as contemplated in section 8(c) of the Competition Act. This was supported by the evidence on record;
- the complaint submitted by the Competition Tribunal did not refer to a margin squeeze, nor did section 8(c) of the Competition Act use the term; and
- despite the Competition Tribunal's error of failing to refer to a margin squeeze in its referral, conduct amounting to a contravention of section 8(c) of the Competition Act had been established. This therefore fell within the ambit of the Competition Tribunal's referral.

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[195] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 77 para 305.
[196] *Senwes Limited v Competition Commission of South Africa* supra note 145 at 45 para 83.
[197] *Senwes Limited v The Competition Commission of South Africa* supra note 155 at 21 and 23 paras 55 and 59.
[198] Judgment of the Constitutional Court Supra note 2 at 20-21 at paras 43-45.

It was accordingly concluded that the Competition Tribunal's ruling was upheld, save that all references to margin squeeze be deleted.[199]

It is submitted that the effect of this judgment does not do away with the concept of margin squeeze. Instead, it allows for the principles of a margin squeeze to live within the confines of a section 8(c) contravention, but simply without the label.

The Constitutional Court's reasoning cannot be faulted particularly when considering that the substance of the Competition Tribunal's findings were based on ensuring that the Competition Commission's allegations properly satisfied the provisions of section 8(c) of the Competition Act[200] as opposed to merely making out a case for margin squeeze in isolation. This decision is nevertheless unusual and artificial in that it does not do away with the substance and applicability of the margin squeeze principle in South African jurisprudence to the extent that it falls within the confines of Section 8(c) of the Competition Act. In this respect it is submitted that it was unnecessary to do away with the label of 'margin squeeze' as the label does not of itself carry any weight in the adjudication of margin squeeze cases. It is opined that there is nothing preventing future decisions from continuing to utilise the margin squeeze label or classification, even if for the sake of convenience alone.

For the sake of continuity, this assignment will continue to use the label 'margin squeeze' in relation to the margin squeeze concept.

II. ELEMENTS OF A MARGIN SQUEEZE

It is necessary to conduct an in-depth analysis of the Competition Tribunal decision, in relation to the manner in which it addressed the margin squeeze principle. This analysis is required for at least two reasons: first, the Constitutional Court upheld the decision of the Competition Tribunal, thereby elevating the significance of the decision. Secondly, and flowing directly from the first conclusion, the decision will now stand as the platform against which future cases will be tested. It is therefore important to have a clear understanding of the parameters and potential challenges within which future 'margin squeeze' cases will be raised.

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[199] *Competition Commission of South Africa v Senwes Limited* supra note 2 at 27 para 58.
[200] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 42 para 168.

It is submitted that there are, in broad terms, two sets of elements that will need to be satisfied in order to succeed with a margin squeeze case. The first set of elements relates to compliance with section 8(c). The second set of elements being the margin squeeze elements, emanate from one of the elements required for compliance with section 8(c) that being the nature of the exclusionary act of a vertically integrated firm.

(a) Section 8(c) elements

Section 8(c) of the Competition Act provides that,

> '*8. It is prohibited for a dominant, firm to*
>
> ...
>
> *(c) engage in an exclusionary act, other than an act listed in paragraph (d), if the anti-competitive effect of that act outweighs its technological, efficiency or other pro-competitive, gain.*'

Whereas the constitutional Court stipulates that three elements need to be met in order to establish that an abuse of dominance has occurred[201] it is submitted that there are in fact four elements that need to be satisfied. The first element which the court did not refer to as an element, requires that the firm be a dominant firm. Secondly, the dominant firm must engage in an exclusionary act. Thirdly, the exclusionary act must not be one listed in section 8(d) and fourthly, the anti-competitive effect of the act must outweigh its technological, efficiency and other pro-competitive gains.[202] These elements will now be dealt with in more detail.

(i) Dominance

Proof of dominance is a well established principle both locally and internationally.[203] The principles and law relating to abuse of dominance as well as market power in their general application have been dealt with in Chapter 2 in detail.

When interpreting dominance in the South African context of a margin squeeze complaint, the general approach as has been interpreted by the South African courts will apply. The approach involves defining the relevant market, calculating the

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[201] *Competition Commission of South Africa v Senwes Limited* supra note 2 at 14 at 27.

[202] Supra paras 27-28.

[203] Rudman & Ostrovsky op cit note 16 at 2-6 paras 2.1 to 2.4.

entities market share and determination of the entities market power.[204] In essence, the purpose of this approach is to ascertain the entities ability to prevent effective competition, to behave independently of its competition and its ability to control prices or exclude competition.[205]

With reference to the Senwes decisions, Senwes' market share for the storage of grain was confirmed to be over 80% in the Senwes area,[206] thereby exceeding the threshold contemplated in section 7(a) of the Competition Act. Senwes did not dispute its dominance and in fact, conceded its position in its pleadings.[207] It is interesting to note that the Competition Tribunal did not make mention of its intention to attach any weight to the extent of Senwes' market power. In as much as it is unlikely that South African competition law jurisprudence will adopt the concept of 'super dominance' – a term used in European jurisprudence to describe a position of significant dominance – it could, as discussed in *TeliaSonera*,[208] be taken into consideration when assessing the effects of the dominant undertakings activities.

It was also established both in the Senwes Competition Tribunal decisions as well as in the *Genzyme* decision that a vertically integrated firm need not be dominant in both the upstream and downstream markets i.e. it is sufficient if it is dominant in the upstream market alone.[209] South African competition authorities have in fact concluded that it is possible to commit an abuse of dominance offense even though the effects are experienced in a different market.[210] This view was confirmed by the Competition Tribunal i.e. that a firm may be dominant in one market but have its effects felt in an 'adjacent' market.[211]

The Competition Tribunal differentiated between the two markets in which Senwes had a presence. It differentiated between the upstream market for grain storage[212] and the downstream market for trading.[213] On the evidence provided the

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[204] Ibid para 2.1.
[205] Rudman & Ostrovsky op cit note 16 at 6 para 2.4.
[206] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 15 para 58.
[207] Supra para 60.
[208] *TeliaSonera* supra note 58 paras 78 - 82.
[209] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 36 para 141 and 142; see also *Genzyme Ltd v Office of Fair Trading* supra note 115 para 534.
[210] *Competition Commission v South African Airways* supra note 19 at 10 para 36.
[211] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 13 para 47.
[212] Supra para 50.
[213] Supra para 62.

tribunal came to an uncontested finding that Senwes had a market share of over 80% in the Senwes area, resulting in Senwes being deemed to have dominance in terms of section 7(a).[214] In respect of the downstream market, although there was some debate regarding the definition of the downstream market, the Competition Tribunal importantly concluded that proving dominance on the downstream level is not necessary.[215] Of relevance is the fact that Senwes leveraged its upstream dominance to enable its exclusionary strategy.

(ii) Exclusionary Act

As discussed in Chapter 2 above, an exclusionary act is defined in section 1 of the Competition Act as behaviour that impedes or prevents a firm from entering into or expanding within a market. It casts a wide net for exclusionary acts such that those acts that do not fall under section 8(d), could be accounted for by this provision.[216] The behaviour in question must be exclusionary in nature in contradistinction to acts that directly exploit consumers.[217]

The Competition Commission has provided guidance as to the manner in which exclusionary acts are to be approached. In *Competition Commission v South African Airways (Pty) Ltd*[218] it was held that:

> '*In summary, we find that the Competition Act sets out the following approach to exclusionary practices. 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 in the Act for what constitutes an exclusionary act. In terms of 8(d) it is conduct that meets the definitions set out in the sub-paragraphs of that section. If the conduct meets the requirements of the definition, we then enquire whether the exclusionary act has an anti-competitive effect. This 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*

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[214] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 15 para 58.
[215] Supra para 75-78.
[216] Parr op cit note 77 at 9.
[217] *Competition Commission v South African Airways supra* note 19 at 35 para 136.
[218] Supra para 132.

> *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 anticompetitive effect we have, consumer welfare or likely foreclosure, we have evidence of a quantitative nature and hence we can return to the scales with a concept capable of being measured against the alleged efficiency gain.*'

The above definition reduces the enquiry to a two step process being (a) that the conduct must be exclusionary, i.e. one that impedes or prevents a firm from entering into or expanding within a market and (b) whose anti competitive effect is measured by actual harm to consumer welfare or the significance of its effect in excluding competition in a market.

The first part of the enquiry constitutes the essential difference between sections 8(c) and 8(d). As mentioned above, whereas section 8(d) lists five exclusionary types of conduct, section 8(c) is designed to allow for exclusionary conduct that may not fall under the conduct set out in section 8(d). The type of conduct that would fall under section 8(c) is not limited, but would in most cases resemble the type of conduct listed in section 8(d).[219]

The exclusionary criteria was extended relatively recently in the case of *Competition Commission and Another v British American Tobacco South Africa (Pty) Ltd* by providing that 'significant foreclosure' is required for there to be an 'exclusionary act'.[220] This has however been criticised as not only being in direct conflict with principles set out in *Competition Commission v South African Airways (Pty) Ltd*[221] but that it also combines (inadvertently and erroneously) two distinct stages in proving a section 8(c) abuse i.e. proof of an exclusionary act and proof of an anti-competitive effect.[222]

The Competition Commission found that Senwes' margin squeeze conduct amounted to an exclusionary act as it had the effect of impeding and preventing its downstream competitors from competing with its own downstream undertaking.[223] In

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[219] Sutherland op cit note 35 at 7-74 to 7-75.
[220] *Competition Commission and Another v British American Tobacco South Africa (Pty) Ltd* 2009 05/CR/Feb05 ZACT 46 at 98 - 99 par 300.
[221] *Competition Commission v South African Airways* supra note 19 at paras 109-111 and 136.
[222] Sutherland op cit note 35 at 7-74.
[223] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 39 para 151.

particular, this arose due to the rise in costs for traders in the post one hundred day period in the Senwes area.[224]

The second part of the enquiry can be interpreted to mean that 'actual harm' to consumer welfare need not be proven if it can be shown that the exclusionary act is substantial or significant enough to foreclose the market.[225]

The Competition Commission elaborated on four sets of evidence in establishing that Senwes' exclusionary acts were substantial or significant enough to foreclose the market.[226] First, it described evidence from traders about how the denial of the one hundred day cap to them resulted in a change in their trading patterns in the Senwes area. Secondly, it showed that there was an increase in the percentage of grain held by Senwes showing that this increase was at the expense of the traders.[227] Thirdly, it led evidence of two tenders that Senwes had won primarily because of the effects that the margin squeeze had on its downstream competitors.[228] Fourthly, evidence was led showing that Senwes won more tenders post the one hundred day cap, than it had previously.[229] The Competition Commission's case was not limited to foreclosure, but extended to include evidence of the harm that the margin squeeze had to consumer welfare. In this respect, evidence was led which showed that the margin squeeze had an effect on farmers as well as on mill door contract prices.[230] On the basis of this evidence, the Competition Commission concluded that the differential tariff imposed by Senwes had an effect of foreclosing the market as well as a harmful effect to consumer welfare.[231]

A challenge that one faces with the interpretation of section 8(c), is that all competition is by definition exclusionary.[232] It is therefore somewhat artificial to assume that all other types of abuses that are not classified under 8(c) or 8(d) are not

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[224] Supra para 145.
[225] Blignaut, du Plessis & Lurie op cit note 13 para 18.
[226] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 54 - 60 paras 213-236.
[227] Supra paras 237-246.
[228] Supra paras 247-251.
[229] Supra paras 252-256.
[230] Supra paras 257-261.
[231] Supra para 263.
[232] Sutherland op cit note 35 at 7-55.

exclusionary. To counter this, one would have to apply a balancing test in order to distinguish between that which is pro-competitive and anti-competitive.[233]

It is important to note that the exclusionary element is the element through which the margin squeeze principles find application in the Competition law dispensation. To date, it is only the Senwes decision(s) that have made a finding in respect of section 8(c).[234]

(iii)Exclusionary Act Outside of Section 8(d)

Under section 8(d), five acts are described as being exclusionary. These are (1) inducing a supplier or customer not to deal; (2) refusing to supply scarce goods to a customer when it is commercially feasible to do so; (3) selling a product on condition that separate goods, services or conditions unrelated to the product are purchased; (4) selling products below their marginal or average variable cost; or (5) buying up scarce or intermediate goods required by a competitor. It is therefore necessary as part of the enquiry to determine whether an abuse falls under section 8(d), to rule out the application of 8(c).

As mentioned above, this is a challenging exercise as all competitive conduct is inherently exclusionary.[235] This means that all conduct that falls under section 8(d) will in most if not all instances fall and section 8(c), and that some instances which should be classified under section 8(c) proper, may just as easily be classified under section 8(d).

The Competition Tribunal went through pains in determining whether a margin squeeze should best be classified under section 8(c) or 8(d)(i) as an inducement abuse. In this respect, it concluded that whereas inducement under section 8(d)(i) constitutes the process of enticing or persuading a customer not to engage a competitor a margin squeeze does not require such persuasion or enticement.[236] It thereafter made a half-hearted attempt at determining whether the conduct fell foul of section 8(d)(iii) as a

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[233] Martin Brassey *et al Competition Law* 1ed (2002) 198.
[234] Sutherland op cit note 35 at 7-75.
[235] Ibid at 7-55.
[236] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 41 paras 158-165.

tying and bundling abuse and concluded that there was no evidence that Senwes had tied or bundled storage with trading.[237]

It should be noted however, that section 8(c) requires that the exclusionary act should not fall foul of any of the provisions listed in section 8(d). It is submitted that the Competition Tribunal was required to conduct its enquiry into every provision of section 8(d). Instead it only conducted its enquiry into those provisions prosecuted by the Competition Commission i.e. sections 8(d)(i) and 8(d)(iii). This is not to say that the Competition Tribunal failed to confirm that the Senwes' alleged conduct did not fall foul of all of the provisions section 8(d),[238] however, it is clear that the Competition Tribunal did not provide justification for its conclusion that remaining provisions of section 8(d) were not applicable i.e. sections 8(d)(ii) relating to refusal to supply, 8(d)(iv) dealing with selling products below their marginal or average variable cost, or 8(d)(v) dealing with buying up scarce or intermediate goods required by a competitor.

It is submitted that future decisions will need to conduct a reasonable enquiry into all the provisions of section 8(d), and in particular the provisions of section 8(d)(ii). This is because there is cause to believe that this provision could potentially house a margin squeeze abuse claim if it can be shown that the upstream product is in fact scarce, and that the exclusionary pricing practices adopted by the offending firm amounts to a constructive refusal.[239]

(iv) Objective Justification

In terms of section 8(c), when it has been established that a firm has engaged in exclusionary conduct, it can only be found to have contravened the section if the anti-competitive effect of the conduct outweighs its "*…technological, efficiency or other pro-competitive gain*". For the sake of brevity and in order to be aligned with the language of the Competition Tribunal, this dissertation will refer to this phrase as 'objective justification'.[240]

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[237] Supra paras 166-167.
[238] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 42 para 168.
[239] Parr op cit note 77 at 8.
[240] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 42 para 170.

The analysis of the objective justification element actually requires an understanding of two elements, the first being that the term/phrase 'anti-competitive effect' needs to be unpacked. Secondly, the criteria for the 'technological, efficiency or other pro-competitive gain' aspect needs to be analysed.

In relation to understanding the anti-competitive aspect, it is relevant to note that the Competition Act does not define the term.[241] It has however been opined that anti-competitive conduct is merely behaviour which is what "*a particular community regards as undesirable behaviour in the context of commercial competition, and that which is undesirable varies from community to community*".[242]

Three conclusions may however be reached regarding the meaning of anti-competitive effects in the context of South African law.[243] First, the injury or unfair treatment of a competitor is not sufficient to be classified as an 'anti-competitive effect',[244] secondly, proof that consumer welfare has been affected or harmed is adequate for purposes of establishing an anti-competitive effect [245] and thirdly, the significant or substantial foreclosure to a dominant firm's competitors will create the inference of an anti-competitive effect.[246] Little has been done to expand on these broad and somewhat vague principles,[247] meaning that these principles will need to be refined by judicial scrutiny over time.

One then needs to understand the meaning of technological, efficiency or other pro-competitive gains. This is important because even if it is established that certain conduct results in an anti-competitive effect, it may still be established that there are technological, efficiency or other pro-competitive gains that justify such an effect.[248] Examples of these gains include reduced transaction costs, the servicing of previously un-serviced customers and economies of scale.[249] It is however necessary that the pro-

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[241] Sutherland op cit note 35 at 7-58.
[242] Ibid.
[243] Ibid at 7-61.
[244] *Nkosinauth Ronald Msomi t/a Minnie Cigarette Wholesalers and Others v British American Tobacco South Africa (Pty) Ltd* 49/IR/Jul02 ZACT 49 at 14 – 15 par 59.
[245] *Competition Commission v South African Airways supra* note 19 at 35 para 132.
[246] Supra paras 128-132.
[247] Sutherland op cit note 35 at 7-64.
[248] Ibid at 7-74.
[249] Ibid.

competitive effects and/or gains (efficiencies) are the direct results of the conduct being investigated i.e. without the conduct, the gains would not exist.[250]

The distinction between sections 8(c) and 8(d) also plays a role in the determination of technological, efficiency or other pro-competitive gains. Whereas section 8(c) places the onus to prove this element on the complainant, section 8(d) places the onus on the accused.[251] The Competition Tribunal showed that this does not mean that the dominant firm is absent of any requirement to show that the outcome of its conduct is objectively justifiable. On the contrary, the Competition Tribunal asserted that there is an expectation on respondents that have an objective justification to plead this point.[252] This is because it would be difficult for the complainant to comprehensively conceive of all the defences that the accused firm would raise as objective justifications and prepare responses to these hypothetical reasons. This would be impractical and unreasonable. Instead, if the accused fails to raise any objective justifications, then the complainant will be deemed to have shown that the anti-competitive conduct's effect has superseded its pro-competitive gains.[253]

In respect of the margin squeeze allegations, Senwes did not raise any formal justification for the difference in tariffs between non-traders and traders post one hundred days.[254] Senwes did however attempt to raise two defences during the course of the proceedings. The first was raised during cross examination in which it attempted to show that the differential tariff was raised due to the willingness of different categories to pay i.e. that traders could potentially have been willing to pay more.[255] The second and more complicated defence was one based on what was termed 'selecting against'. The Competition Tribunal did not consider this a pro-competitive justification for the conduct.[256]

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[250] Ibid; see also *Patensie Sitrus Beherend Beperk* supra note 48 at 30.
[251] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 42 para 171.
[252] Supra para 176.
[253] Supra para 176.
[254] Supra para 176.
[255] Supra para 179.
[256] Supra para 205.

(v) Additional Considerations for 8(c)

A few additional factors should be taken into consideration when applying section 8(c).

1. Administrative Penalty

The Competition Tribunal cannot impose an administrative penalty or fine for a first time contravention of section 8(c). An administrative penalty or fine can only be imposed if a dominant firm repeats conduct that had previously been found to have contravened section 8(c).[257]

2. Proof of Intention

There are conflicting views regarding whether or not intention is required when investigating an abuse of dominance under section 8(c) (or 8(d) for that matter). On the one hand it has been posited that it is necessary to establish that a dominant firm had an intention to impede or prevent a firm from entering into or expanding within a market.[258] The contrary view is held that neither intention nor proof of a dominant firm's aim is required or is sufficient to establish a claim under section 8(c).[259] This does not mean however that proof of a firm's intention or aim would be disregarded; on the contrary, it may very well strengthen a claim.[260]

Section 8(c) does not mention the requirement for intention. It is on this basis that it is submitted that the second view (i.e. that intention is not a requirement) is supported. Although Article 102 of the EC Treaty is similarly quiet on the requirement of intention, this has not stopped the European case law from featuring this element as part of an Article 102 enquiry.[261] Our courts should avoid making a similar error (particularly if relying on European case law)[262] and should instead limit the utility of an allegation of intention to that of a supportive role.

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[257] Section 59(1)(b) of the Competition Act (note 6).
[258] Blignaut, du Plessis & Lurie op cit note 13 at page 11 para 10.4.1.
[259] Sutherland op cit note 35 at 7-36 – 7-37; see also Brassey op cit note 233 at 197 referring to section 8 of the Competition Act in general.
[260] Brassey op cit note 233.
[261] See *British Airways plc v Commission* 2003 T-219/99 ECR II-5917at II-5998 para 297 which refers to the fact that "*the fact that the hoped-for result is not achieved is not sufficient to prevent a finding of abuse of a dominant position within the meaning of Article 82 EC.*"
[262] Sutherland op cit note 35 at 7-37.

3. Proof of Harm

Abuse of dominance under section 8(c) does not require that a third party be harmed by this abuse. Similarly, a dominant firm cannot be absolved of liability for a breach of this provision on the basis that it obtained the consent or waiver of the affected third party.[263] Instead, the conduct is *de facto* prohibited.

(b) Margin Squeeze Elements: the Senwes Competition Tribunal Criteria

In conjunction with satisfying the requirements of section 8(c), the Competition Tribunal set out additional criteria against which a case for margin squeeze is based. These conditions are based on the work of O'Donogue and Padilla. [264] Although mentioned above, they are reproduced below for convenience:

- the supplier of the input (or the dominant firm) is vertically integrated;
- the input is essential for downstream competition;
- the vertically integrated firm's prices would render the activities of an efficient rival uneconomic; and
- there is no objective justification for the vertically integrated firms pricing strategy.

Each of these elements will be discussed in greater detail below

(i) Vertical Integration

As mentioned above, a vertically integrated firm is one which is dominant or controls the supply of products in the upstream market and simultaneously participates in a competitive market downstream market.[265] Because of its dominance in the upstream market, the vertically integrated firm will be able to influence the price it charges at the upstream and/or downstream level so as to impede the downstream firm's ability to cover its costs.[266]

The fact that Senwes was vertically integrated was not contested and was considered common cause.[267] Unfortunately the Competition Tribunal failed to

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[263] Ibid.
[264] O'Donogue & Padilla op cit note 54 at 310.
[265] Whish op cit note 9 at 744; see also Crocioni & Veljanovski op cit note 7 at 39-40.
[266] Chares River Associates op cit note 12.
[267] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 37 para 146.

elaborate on this test or to provide criteria against which future cases can be measured.

(ii) Essential Input

Storage in concrete grain silos was confirmed to be an essential input to traders in the trading market.[268] In reaching this conclusion, the Competition Tribunal looked at an alterative to the concrete silo, being the silo bag.[269] It concluded however, that silo bags were not a realistic option due to for instance suspicions of the quality of grain in the silo bag, as well as the fact that a silo certificate (a prerequisite for trading on Safex) could not be issued if grain was stored in a silo bag.[270] It is submitted that it can be inferred from the Competition Tribunal's conclusion, that an analysis of the alternatives of a particular input as well as their practicality and availability is required when determining whether a particular input is in fact essential.

There are however a number of aspects that the Competition Tribunal failed to elaborate on with respect to this test, which would assist in establishing the criteria against which future cases can be measured.[271] These criteria include determining that the essential nature of the upstream product needs to satisfy two conditions i.e. the input needs to be essential both to downstream competitors and essential to downstream competition.[272]

Two factors are taken into consideration when assessing the first of conditions. First, the inputs supplied by the vertically integrated firm must not have close substitutes. This is because a margin squeeze cannot be said to occur if the upstream product could reasonably be substituted by a comparative product. Secondly, the input must be essential in the downstream production process.[273] This essentially entails that the technical features or nature of the upstream product allows for the provision of a derivative service or downstream product.[274]

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[268] Supra.
[269] Supra paras 51-52.
[270] Supra paras 50-52.
[271] Kelly & van der Vijver op cit note 10 at 254.
[272] Crocioni & Veljanovski op cit note 7 at 40-41.
[273] Ibid at 40.
[274] *Deutsche Telekom* (European Commission decision) supra note 75 para 109.

In respect of the second condition, the input needs to be essential for downstream competition. In other words although the input may be essential for the production of a particular downstream product, there may be other products in the downstream market that do not use the input.[275]

(iii)Effect of Vertically Integrated Firm's Prices on an Efficient Competitor – Imputation Test

The Competition Tribunal adopted a two pronged approach in determining whether this element was satisfied. First, in response to an allegation by Senwes that its competitors were inefficient, the Competition Tribunal elaborated on criteria against which it found that two firms (Cargill and Dreyfus) were on a balance of probabilities efficient. The criteria included the fact that the firms had been in the market for a long period of time, the fact that the firms were among the largest in the world and the fact that the firms were also responsible for new innovations in the markets such as mill door contracts.[276] Although the criteria may be instructive when ascertaining a firm's efficiency, they are not as stand alone criteria sufficient to reach a conclusive finding of same.[277]

The court also looked at a second test being, whether Senwes' downstream trading arm could continue to operate if it was charged the same upstream prices that its rivals were charged.[278] Senwes failed to adduce any evidence to refute this allegation (despite the fact that it would have been in the best position to do so) and it was accordingly inferred by the Court that this condition was satisfied.[279]

From the above it is apparent that the courts have adopted the approach used in the European Communities. This approach is known as the imputation test and is utilised for purposes of determining the effect of a vertically integrated firm's prices on an efficient competitor. In other words, an imputation test is a test that attempts to

[275] Crocioni & Veljanovski op cit note 7 at 40.
[276] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 37-38 paras 147-148.
[277] Kelly & van der Vijver op cit note 10 at 253-254.
[278] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 38 para 149.
[279] Supra.

quantify whether a competitors downstream retail margin is reasonable.[280] The European Communities *Access Notice* ("Access Notice")[281] is the only formal recordal of the imputation test for the European Communities.[282] Although it relates to the telecommunications sector, its applicability is not limited to this sector.[283] The *Access Notice* sets out two tests being:

> '*Test 1: A price squeeze could be demonstrated by showing that the dominant company's own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant company.'*[284]
>
> *'Test 2: …a price squeeze could also be demonstrated by showing that the margin between the price charged to competitors on the downstream market (including the dominant company's own downstream operations, if any) for access and the price which the network operator charges in the downstream market is insufficient to allow a reasonably efficient service provider in the downstream market to obtain a normal profit (unless the dominant company can show that its downstream operation is exceptionally efficient).'*[285]

Although somewhat similar, the tests differ in two fundamental aspects. First, test one refers to the profitability of the vertically integrated firm's downstream operation whereas test two refers to the profitability of 'reasonably efficient service provider (read downstream competitor).[286] In both instances, the profitability is measured by determining the margin between the cost of the input supplied by the vertically integrated firm and the selling price of either the vertically integrated firm's downstream operation or of the 'reasonably efficient' downstream competitor. The second difference is that failure to comply with the first test will result in a de facto

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[280] Case Associates: Case Note 'Testing for Price Squeezes: A Critical review of Recent competition Law decisions' 2004, available at *http://www.casecon.com/data/pdfs/casenote36.pdf* accessed on 18 November 2012 at 1.

[281] Official Journal of the European Communities '*Notice on the Application of Competition Rules to Access Agreements in the Telecommunications Sector – Framework, Relevant Markets and Principles*' OJ C265 1998 available at *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:c:1998:265:0002:0028:en:PDF* accessed on 18 November 2012.

[282] Crocioni & Veljanovski op cit note 7 at 50.

[283] Ibid.

[284] Access Notice op cit note 281 para 117.

[285] Access Notice op cit note 281 para 118.

[286] Crocioni & Veljanovski op cit note 7 at 50.

finding of margin squeeze (assuming all other elements have been complied with). In respect of the second test, even if it is proved that a reasonably efficient service provider could not trade profitably due to high input costs, the vertically integrated firms would still be entitled to raise the defence that its downstream operation is exceptionally efficient, thereby entitling it to charge such high input costs.

In relation to calculation of costs, it should be noted that as a general rule the costs to be used should be the lowest of either the vertically integrated firm's downstream operation or that of the downstream competitor.[287] In addition, the standard used to ascertain the costs of the 'reasonably efficient operator' (as contemplated in the second of the *Access Notice* tests) is either '*the actual costs incurred by existing firms or (2) the costs of a[n] hypothetical efficient downstream firm based on forward looking Long Run Incremental Costs (LRIC) estimates*.'[288]

These tests and in particular the second of the imputation tests, present their own challenges. For instance, whereas the costs of a vertically integrated firm's downstream operation may be known, the costs of a reasonably efficient service provider are more challenging to ascertain. It is for this reason that most competition authorities opt for the first of the two tests. In this regard, it is interesting to note that the second test (when determining the effect of a vertically integrated firm's prices on an efficient competitor) applied by the Competition Tribunal is in actual fact the first of the imputation tests described in the *Access Notice*.[289]

Another challenge of the *Access Notice* tests and in particular the second test is that the efficiency of downstream competitors could actually be counted against them.[290] In other words, the more efficient a downstream competitor is, the more difficult it would be to establish a margin squeeze due to the fact that the high input costs of the vertically integrated firm would be negated by the cost saving efficiency of the downstream competitor.

Another challenge of the *Access Notice* tests relating to the first test occurs when the vertically integrated firm incurs additional costs when it supplies its downstream

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[287] Ibid at 54.
[288] Ibid.
[289] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 38 para 149; compare with Access Notice op cit note 281 para 117.
[290] Case Associates op cit note 280 at 1.

competitors.[291] It has been suggested that these costs be included when making the relevant calculations.[292]

It is submitted that in the context of South African law, it may be beneficial to utilise the first test being the equally efficient competitor test. This is because it promotes the principle of legal certainty. In comparison to the reasonably efficient competitor test which requires a vertically integrated firm to speculate regarding its competitors costs or the costs of a 'reasonably efficient competitor', the equally efficient competitor test allows the vertically integrated firm the benefit of access to its own costs thereby enabling it to ascertain the lawfulness of its own conduct.[293] This is however, not to say that the reasonably efficient competitor test should never be considered. There may for instance be objective reasons to utilise the reasonably efficient competitor test, for instance if the vertically integrated undertaking's cost structure cannot be assessed[294] or the vertically integrated undertaking's costs are unique due to its priviledged position.[295]

The Competition Tribunal was fortunate in that the industry in respect of which the underlying margin squeeze abuse occurred, is a relatively simple industry,[296] thereby saving the Competition Tribunal from having to grapple with what can be an exceedingly complex issue. The downside to the simplicity of the Senwes industry is that the determination of the effect of vertically integrated firm's prices on efficient competitors was not dealt with in as great a depth as its complexity warrants. It is hoped that future decisions will expand on this criteria.

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[291] Ibid.
[292] Ibid.
[293] *TeliaSonera* supra note 58 para 44.
[294] Supra para 45.
[295] Supra.
[296] *Senwes Limited v Competition Commission of South Africa* supra note 145 at 33 para 62.

(iv)Objective Justification

As confirmed by the Competition Tribunal,[297] this element (also referred to as the 'efficiency defence') is similar to that considered in respect of section 8(c) above. It shall therefore not be dealt with again as this has already been discussed in detail above.

(c) Elements Not Dealt With By Senwes Decision

Although the Senwes decision defined the criteria against which it tested for a margin squeeze, there are two additional criteria or considerations that it did not deal with and that could be of significance for future cases.

(i) Sufficient Duration

Margin squeeze cases must be of a sufficiently long duration in order to have an exclusionary effect.[298] This aspect was dealt with in the Senwes decision,[299] but was not identified as a significant element of a margin squeeze. The reason that this element is significant is that temporary or short-term changes in prices from either an upstream or downstream perspective cannot be considered as margin squeezes.[300] On this point, in *Napier Brown – British Sugar* it was held that a margin squeeze would have occurred if British Sugar had maintained its pricing policy for the long term.[301]

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[297] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 39 para 150.
[298] Crocioni & Veljanovski op cit note 7 at 41.
[299] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 58-60 paras 228-236.
[300] Crocioni & Veljanovski op cit note 7 at 41.
[301] *Napier Brown – British Sugar* supra note 80 at para 66.

(ii) Duty to Deal

The duty to deal would not apply in a regulated market which requires the vertically integrated firm to make available the upstream input to its downstream competitors. This is because the competition law duty to deal is replaced with a regulatory duty to deal.[302] The competition law concept of a duty to deal accordingly arises primarily in unregulated (or potentially semi-regulated) markets.

The *linkline*[303] decision resulted in the divergence of US and the European Union's position on margin squeeze.[304] As mentioned above, *Linkline* refers to the decision of *Trinko*,[305] in which Justice Scalia referring to the *Colgate*[306] case confirmed that the Sherman Act does not create an obligation to trade or deal, and that a private enterprise may freely exercise its discretion as to whom to interact with where there is no such duty.[307] The question arises whether South African courts should make the same considerations.

On this point, section 8(b) of the Competition Act requires a firm to give a competitor access to an essential facility. It appears that this provision may impose a, 'duty to deal' in a manner similar to that contemplated in the aforementioned US cases. With this in mind, South African courts may very well find that the enquiry into whether or not an input is essential may be extended to include an enquiry into whether or not the 'essential input' is also an 'essential facility'.

(d) Criticisms of the Margin Squeeze Concept

The margin squeeze concept has been the subject of criticism, particularly in US jurisprudence.

(i) Price Regulation

Linkline identified a number of inherent challenges to cases based on the margin squeeze cause of action. The most significant of these challenges is that these cases

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[302] J Gregory Sidak 'Abolishing the Price Squeeze as a Theory of Antitrust Liability' (2008) 4(2) *Journal of Competition Law and Economics* 279 at page 282.
[303] *Linkline* supra note 126.
[304] Kelly & van der Vijver op cit note 10 at 246.
[305] *Trinko* supra note 130.
[306] *Colgate* supra note 132.
[307] *Trinko* supra note 130 at page 8.

require courts (or competition authorities) to engage in the challenging task of monitoring both the wholesale and retail prices of products, which effectively amounts to "*aiming at a moving target*".[308] The competition authority would face challenging questions such as having to ascertain the true economic value of the upstream input, the extent to which demand affects economic value and importantly, determining what would be a reasonable mark-up on the upstream input.[309] This in effect forces competition authorities to assume the role of not only price regulators (a role which the competition authorities are not willing[310] and or well placed to assume).[311] Another challenge is that regulation may take the more complex form of supervising the terms and conditions attached to the provision of the upstream input.[312] This in turn forces competition authorities to assume the roles of industry regulators. Instead, this role should be given to industry specific regulators[313] that presumably have the resources and expertise to handle such enquiries.

The effect of these criticisms can be partially mitigated if, as discussed above, an 'equally efficient competitor' test is adopted when determining whether a margin squeeze is excluding competitors. This is based on the assumption that a competition authority assumes the role of a price regulator when it utilises the 'reasonably efficient' competitor test due to the fact that it undertakes the mammoth task of ascertaining the market related prices. In addition, whatever ruling is made when using the 'reasonably efficient' competitor test will invariably act as the benchmark against which other affected firms will have to comply. However, when using the 'equally efficient competitor' test, the competition authority not only gets to enjoy the relative simplicity of relying on the offending firm's prices but also avoids having to set a benchmark that is acceptable to the industry due to the fact that its ruling is limited to the disparity in prices between the litigating firms.

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[308] *Linkline* supra note 126 at page 13.
[309] Parr op cit note 77 at 8.
[310] Amanda Visser 'Commission "Not a Price Regulator"' BusinessDay Newspaper 6 September 2013 page 2.
[311] Kelly & van der Vijver op cit note 10 at 247.
[312] Sidak op cit note 302 at 300.
[313] Ibid at 282.

(ii) Undermining the Consumer Welfare Approach

The theoretical implication of the margin squeeze concept could be interpreted as undermining consumer welfare. This is because requiring a vertically integrated firm to warrant that its competitor enjoys a sufficient margin, results in the substitution of an approach that favours consumer welfare for an approach that favours competitor welfare.[314] Similarly, it is impossible to simultaneously ensure a competitor maintains profitability while maintaining that the ultimate goal is to ensure consumer welfare.[315] Consumers would accordingly suffer harm when the vertically integrated firm, in light of its legitimate desire to avoid liability in terms of the margin squeeze concept, is either forced to maintain prices that are artificially high or is forced to withdraw the goods from the market in an effort to avoid liability.[316]

There is also the danger that the vertically integrated firm would be forced to effectively subsidize the operations of a less efficient competitor, thereby reducing the benefits of lower prices that would have accrued to consumers had the firms been allowed to compete without interruption.[317]

[314] Ibid at 294.
[315] Ibid.
[316] Ibid at 297.
[317] Dennis W Carlton 'Should "Price Squeeze" be a Recognised Form of Anticompetitive Conduct?' (2008) 4(2) *Journal of Competition Law and Economics* 271 at page 275.

Finally, there may be advantages to having a monopolist in a particular market. For one, the monopolist may be more efficient than its competitors which efficiency could be translated into lower prices. Secondly, the consumers may also enjoy lower prices when the monopolist not only sells its own products but also those of the competitors that it squeezed out at a lower price by virtue of the absorbed capital input costs.[318] It could accordingly be argued (subject to the many known disadvantages of monopoly power) that it may be disadvantageous to utilise the margin squeeze cause of action to restrict the activities of a vertically integrated monopolist.

(iii) Conflicting Cause of Action

In attempting to remedy the economic pressures that a downstream competitor may be facing, such firm may be tempted to request the vertically integrated firm to raise its prices. Unfortunately, such behaviour may be viewed as price fixing behaviour. The vertically integrated firm would therefore find itself in a situation in which it is forced to choose between raising its prices thereby falling foul of price fixing criteria, or maintaining its low prices thereby falling foul of margin squeeze criteria.[319]

(iv)Unnecessary Cause of Action

It has been argued that behaviour that could be classified as margin squeeze type behaviour could in some instances also be classified into a number of other categories of established abuse classifications. For instance, this could include predatory pricing,[320] price discrimination or excessive pricing.[321] This argument is, however, not entirely consistent in that it is possible to demonstrate that the elements of a margin squeeze abuse differ from those of predatory pricing, price discrimination or excessive pricing. For instance, it has been held that a margin squeeze abuse cannot be classified as predatory pricing due to the fact that a margin squeeze abuse can take

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[318] Fernando Diez 'Telecoms Regulation, Antitrust and Margin Squeeze: Widening the Already Wide Gap between US and EU Competition Policy?' 2011 available at *http://ssrn.com/abstract=1828723* accessed on 28 September 2013.
[319] Sidak op cit note 302 at 297.
[320] Michele Polo 'Price Squeeze: Lessons From the Telecom Italia Case' (2007) 3(3) *Journal of Competition Law and Economics* 453 at page 455.
[321] OECD: Policy Round Tables op cit note14 at 21.

place without having to show that the dominant firm has suffered losses and intends on recouping same.[322] Another example emanates from *Albion Water Limited v Dŵr Cymru Cyfyngedig* in which it was held that a margin squeeze cannot be compared to excessive pricing because whereas a margin squeeze relates to the relation between the prices charged at the upstream and downstream levels, excessive pricing relates to the justification of the levels of either price.[323]

There is also the danger that this cause of action could conflict with or cause uncertainty when a regulatory body has accepted an upstream or downstream price levied by the offending firm as was in the case of *Deutsche Telekom*.[324] This is unfortunate because firms will not be able to confidently rely on the decisions of a regulatory body despite the fact that they are ostensibly best placed to determine whether the proposed prices are in fact detrimental to competition within the relevant market. This could result in firms adopting a more conservative approach in favour of their competitors (and, it is submitted, to the detriment of the consumers) despite having the support of the relevant regulatory body.

(v) Deterrent to Efficiency and Innovation

A threat of a margin squeeze prosecution deters innovation and efficiency-seeking behaviour of firms. This is the case particularly when the upstream product is produced voluntarily (i.e. it is not mandated to do so by regulation) by a vertically integrated firm. Such a firm may be deterred from continuing to provide this input at the risk of incurring liability.[325] This demonstrates the necessity of ensuring that the affected firm is in fact operating efficiently before determining whether or not it was priced out of the market.

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[322] see *TeliaSonera s*upra note 58 paras 96-103.
[323] *Albion Water Limited v Water Services Regulatory Authority* supra 119 para 301.
[324] Dunne op cit note 98 at 35-36.
[325] Carlton op cit note 317 at 276.

CHAPTER 5

I. CONCLUSION

South African Courts have recently had the opportunity to ascertain the applicability of the margin squeeze in South Africa when on 20 December 2006, the Competition Commission referred a case to the Competition Tribunal against Senwes following a complaint by CTH Trading (Pty) Ltd.[326]

Although a margin squeezes can take various forms, the fundamental principle behind the concept is that a margin squeeze occurs when a vertically integrated firm leverages its upstream dominance in such a manner as to put pressure on its downstream rivals profit making capacity.

Internationally, the concept is not adopted universally. Whereas the concept is generally accepted in Europe, the United Kindgom, Canada and Australia, the US has relatively recently changed its stance towards the principle and has now rejected its utility.

The case against Senwes found its way to the Constitutional Court which upheld the finding of the Competition Tribunal save that it was amended by deleting the word 'margin squeeze'. It is submitted that this aspect of the ruling is absurd and unnecessary because although the term 'margin squeeze' will no longer be recognised in South African legal jurisprudence, the principles underpinning the concept will nevertheless form part of South African Competition Law jurisprudence. In addition, it is recognised that these principles will find application under the provisions of section 8(c) of the Competition Act. It is accordingly submitted that it was unnecessary to do away with the label of 'margin squeeze' as the label does not of itself carry any weight in the adjudication of margin squeeze cases.

The principles underpinning the margin squeeze concept are that the offending firm must be shown to be vertically integrated. It must also be established that upstream input is essential for downstream competition. The vertically integrated firm's prices should render the activities of an efficient rival uneconomic and finally, there must not be an objective justification for the vertically integrated firm's pricing

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[326] *Competition Commission of South Africa v Senwes Limited* supra note 49 at 1 para 2.

strategy.[327] Additional criteria should also be taken into consideration when adjudicating a margin squeeze complaint. This criteria includes that the margin squeeze must be conducted for a sufficient duration in order to qualify as a margin squeeze. Another consideration is that courts may find it necessary to consider whether the essential input is also an 'essential facility' (i.e. whether the offending firm has a 'duty to deal') as contemplated in the Competition Act, as part of the margin squeeze inquiry.

The elements for the applicability of section 8(c) are that (i) the offending firm must be shown to be dominant as contemplated in the Competition Act; (ii) the offending firm must have engaged in exclusionary conduct; (iii) the exclusionary conduct must not be capable of being classified under section 8(d) of the Competition Act; and (iv) the exclusionary act must not be objectively justifiable. Additional criteria also need to be considered including that a first time contravention of section 8(c) does not attract an administrative penalty. Intention is also not considered as a requirement of section 8(c), although it may be considered when testing other criteria. It is also not necessary to prove harm to a third party for purposes of satisfying the requirements of section 8(c).

The additional criteria mentioned above are indicative of the fact that the various courts dealing with the Senwes case failed to adequately address the elements necessary to establish a margin squeeze. This failure was also evident in that the courts failed to adequately elaborate on a number of the established elements. For instance, when determining the effect of vertically integrated firm's prices on an efficient competitor the courts failed to elaborate on the imputation test by at the very least describing the various approaches it considered and the rational for choosing the approach that it did. The courts also failed to elaborate on whether the input needs to be essential both to downstream competitors and essential to downstream competition. This is lack of elaboration does however have with it the advantage that the courts will in future enjoy a measure of flexibility in interpreting the margin squeeze cause of action. It is also important to bear in mind that the lack of elaboration may also be attributed to the simple nature of the upstream and

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[327] O'Donogue & Padilla op cit note 54 at 310.

downstream input and markets, thereby making it unnecessary for the court to delve into much detail when critically analysing the cause of action.

The main criticism levelled against the margin squeeze cause of action is that it would require the courts to assume the role of a price and/or industry regulator. This is a role that the courts are neither willing nor well placed to assume. Other criticisms include that it would result in the undermining of the consumer welfare approach replacing it instead with a 'competitor welfare approach'. It would also place the vertically integrated firm in the conflicting position of having to choose between falling foul of price fixing allegations if it were to raise its prices to match that of its upstream competitors or falling foul of margin squeeze allegations if it retains low upstream input prices. Finally, the cause of action could also be said to be a deterrent to efficiency and innovation due the fact that there is little incentive for the vertically integrated firm to provide an upstream input (particularly if it is provided voluntarily) at the risk of incurring liability as a result of low prices, especially if such prices are obtained as a result of inherent efficiencies.

All in all, there is certainly scope for the development of the margin squeeze principle. This will be of particular necessity when it comes to elaborating on the margin squeeze principles as well as in respect of the application of the section 8(c) elements.

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