THE EFFICIENCY DEFENCE IN SOUTH AFRICAN COMPETITION LAW:
APPLICATION AND RECOMMENDATIONS

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Abstract
Chapter one: Introduction

1.1 Problem statement

The purpose of the South African Competition Act\(^1\) is to promote and maintain competition\(^2\) in the Republic of South Africa in order to enhance, among other things, the development and efficiency of the South African economy, employment, consumer welfare and the competitiveness of South African producers in international markets.\(^3\) As a result, the Competition Act prohibits market conduct that it perceives as being anti-competitive in nature, with anti-competitive conduct referring to market conduct that substantially prevents or lessens competition in a relevant market.\(^4\)

The rationale for regulating competition lies in its beneficial outcomes for economic efficiency.\(^5\) Economic efficiency also serves as the over ruling principle for the interpretation and application of the South African Competition Act.\(^6\) The importance of economic efficiency in turn, is vested in its positive impact on social welfare and in the result, economic efficiency and social welfare forms the nucleus of why the Competition Act regulates anti-competitive market conduct, the reason being that it diminishes competition and results in lower economic efficiency and social welfare.\(^7\)

In contrast to the above, economist Oliver Williamson in 1968 developed a hypothesis which came to be known as the “Williamson tradeoff.”\(^8\) In this hypothesis, Williamson theorised that anti-competitive market conduct do not always exclusively result in lower levels of economic efficiency and social welfare but rather that anti-competitive market conduct can simultaneously result in gains and losses in economic efficiency and social welfare.\(^9\) Williamson further argued that these gains could potentially be larger than the

\(^1\) 89/1998.
\(^2\) The term competition is not defined in the Competition Act 89/1998. However, chapter two contains a discussion on the meaning of competition.
\(^3\) Competition Act 89/1998: section 2.
\(^6\) Roberts 2004: 7.
\(^7\) Tongaat Hulett Group and Transvaal Suiker Bpk 83/LM/Jul00: paragraph 99; Roberts 2004: 7.
\(^8\) Trident Steel (Pty) Ltd and Dorbyl (Pty) Ltd case 89/LM/Oct00: paragraph 42.
losses.\textsuperscript{10} Therefore, competition authorities must weight the losses and gains against each other to determine the nett effect on efficiency and social welfare in the relevant market.\textsuperscript{11} If the nett effect results in increased economic efficiency and social welfare then the anti-competitive conduct must be allowed.\textsuperscript{12} Contrarily, if the nett effect results in decreased economic efficiency and social welfare then it must be prohibited.\textsuperscript{13} In Competition Law, this weighing process, the Williamson tradeoff, became known as the Efficiency Defence.\textsuperscript{14} The Efficiency Defence is a legal defence that a party, who has been convicted or is in the process of committing an anti-competitive market practice,\textsuperscript{15} can raise whereby that party must prove that the anti-competitive conduct results in efficiency gains that outweigh the anti-competitive effects thereof.\textsuperscript{16}

The first country to incorporate the Efficiency Defence into its Competition Legislation was Canada by way of section 96 of the Canadian Competition Act.\textsuperscript{17} South Africa followed suit by incorporating the Efficiency Defence into the South African Competition Act, with the formulation of the South African defence being based upon and for all practical reasons being identical to the Efficiency Defence contained in section 96 of the Canadian Competition Act.\textsuperscript{18} The South African Competition Act places the burden of proof to show that market conduct is anti-competitive on the competition authorities.\textsuperscript{19} If the competition authorities manage to displace this burden of proof, then the burden of proof shifts to the firm(s)\textsuperscript{20} committing the anti-competitive market conduct (hereafter the perpetrating parties), to show that the anti-competitive conduct has certain efficiency gains that outweigh the anti-competitive effects thereof.\textsuperscript{21} When the Efficiency Defence has been raised by the perpetrating party(ies), the competition authorities are obliged to consider the evidence provided by the perpetrating party(ies) and if the nett effect of the anti-competitive market conduct results in increased economic efficiency, then the competition

\begin{itemize}
  \item \textsuperscript{10} Williamson 1968: 21-22.
  \item \textsuperscript{11} Williamson 1968: 21-22.
  \item \textsuperscript{12} Williamson 1968: 21-22.
  \item \textsuperscript{13} Williamson 1968: 21-22.
  \item \textsuperscript{14} Trident Steel (Pty) Ltd and Dorbyl (Pty) Ltd 2000 case 89/LM/Oct00: paragraph 42-48.
  \item \textsuperscript{15} This refers to mergers where the merging parties must obtain permission from the competition authorities before they can implement their proposed merger.
  \item \textsuperscript{16} Trident Steel (Pty) Ltd and Dorbyl (Pty) Ltd 2000 case 89/LM/Oct00: paragraph 42-48.
  \item \textsuperscript{17} 1985/c-34. Trident Steel (Pty) Ltd and Dorbyl (Pty) Ltd 2000 case 89/LM/Oct00: paragraph 48.
  \item \textsuperscript{18} Trident Steel (Pty) Ltd and Dorbyl (Pty) Ltd 2000 case 89/LM/Oct00: paragraph 48.
  \item \textsuperscript{19} Tongaat Hulett Group and Transvaal Suiker Bpk 83/LM/Jul00: paragraph 99.
  \item \textsuperscript{20} In addition to a business organisation or a company, the South African Competition Act includes a natural person, a partnership and a trust as constituting a firm with regards to the interpretation and application of the Competition Act.
  \item \textsuperscript{21} Tongaat Hulett Group and Transvaal Suiker BPK 83/LM/Jul00: paragraph 99-104.
\end{itemize}
authorities are obliged to approve the anti-competitive market conduct.\textsuperscript{22}

The Efficiency Defence in South Africa consists of three separate defences, namely a
defence for efficiency gains, a defence for technological gains and a defence for any other
pro-competitive gains.\textsuperscript{23} The Efficiency Defence is thus a collective defence which consists
out of these three separate defences. In essence, the Efficiency Defence is a balancing
 provision which provides greater flexibility with regard to the interpretation and application
of the Competition Act and in the result, it should enhance the overall effectiveness of the
Competition Act in attaining its objectives because it restricts the level of competition in
circumstances where a decrease in the level of competition could potentially be beneficial
to economic efficiency and social welfare.\textsuperscript{24}

The South African Competition Act is still in its infancy\textsuperscript{25} and as a result, there are a
number of grey areas pertaining to its interpretation and application.\textsuperscript{26} One of these areas
of uncertainty surrounds the interpretation and application of the Efficiency Defence in
South African competition matters.\textsuperscript{27} These areas of uncertainty include among others, the
types of efficiencies that are valid for inclusion into the Efficiency Defence and whether the
Efficiency Defence should be applied to the benefit of consumers (consumer welfare) or
producers (total welfare).\textsuperscript{28}

There are three possible explanations for this legal uncertainty. Firstly, the South African
Competition Act provides no guidance on the interpretation and application of the
Efficiency Defence in competition matters. The only guidance provided by the Competition
Act entails the circumstances in which the Efficiency Defence can be raised and even
then, the Competition Act refrains from providing any substance to its interpretation and
application.\textsuperscript{29} Accordingly, the task to formulate the substance of the interpretation and
application of the Efficiency Defence is left exclusively to the competition authorities with
the result that it is developed slowly on a case by case basis.

\begin{flushright}
\textsuperscript{22} Tongaat Hulett Group and Transvaal Suiker BPK 83/LM/Jul00: paragraph 99-104.\\
\textsuperscript{23} Refer to sections 4(1)(a); 5(1); 8(c)-(d) and 12A(1)(a)(i) for an illustration hereof.\\
\textsuperscript{24} Neuhoff et al 2006: 54.\\
\textsuperscript{25} The Competition Act only fully came into operation 13 years ago on the 1\textsuperscript{st} of September 1999.\\
\textsuperscript{26} Sutherland 2008: 331-370; Trident steel Proprietary Ltd v Dorbyl Ltd 89/LM/Oct00: paragraph 17.\\
\textsuperscript{27} Sutherland 2008: 351-370; Trident steel Proprietary Ltd v Dorbyl Ltd 89/LM/Oct00.\\
\textsuperscript{28} Sutherland 2008: 351-370; Trident steel Proprietary Ltd v Dorbyl Ltd 89/LM/Oct00.\\
\textsuperscript{29} Refer to section 4(1)(a); 5(1); 8; 12A of the Competition Act and section 10A of the Competition
Amendment Act of 2009.
\end{flushright}
Secondly, the Efficiency Defence has to date, only been scrutinized twice, namely in the proposed merger between the Tongaat Hulett Group and Transvaal Suiker Bpk\(^{31}\) and in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd. However, in the proposed merger between the Tongaat Hulett Group and Transvaal Suiker Bpk, the scope of the Competition Tribunal's consideration of the Efficiency Defence stretched only so far as to determine the party carrying the burden of proof.\(^{33}\) Fortunately, in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd, the Competition Tribunal did attempt to formulate the substance of the Efficiency Defence as contained in the South African Competition Act. Unfortunately, the Competition Tribunal failed to adequately formulate the substance of the Efficiency Defence by leaving open a large number of questions regarding its interpretation and application.\(^{34}\) A possible explanation for this could be that this case was decided within the first year of the Competition Act becoming functional. In addition, the Competition Tribunal's decision in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd was based upon the first decision of the Canadian Competition Tribunal in the matter between the Commissioner of Competition v. Superior Propane Inc.,\(^{35}\) in which the Canadian Competition Tribunal did not have the benefit of the careful analysis eventually undertaken by the Canadian Competition Appeal Court.\(^{36}\)

The uncertainty caused by the lack of South African case law is aggravated by the lack of international case law on the interpretation and application of the Efficiency Defence.\(^{37}\)

Thirdly, the inherent complexity and controversial nature of the Efficiency Defence has resulted in courts abstaining from formulating the substance on its interpretation and application in competition matters.\(^{38}\) In fact, some jurisdictions are hesitant to even recognise efficiency as a potential defence in competition matters.\(^{39}\)

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30 2011.
31 83/LM/Jul00.
32 89/LM/Oct00.
33 The Competition Tribunal only briefly touched upon certain other elements of the efficiency defence. For more information refer to chapter five.
34 Sutherland 2007: 351-370.
35 2000 CACT 7.
36 Sutherland 2008: 354.
37 Trident steel Proprietary Ltd v Dorbyl Ltd 89/LM/Oct00: paragraph 42-48.
This legal uncertainty surrounding the Efficiency Defence has the practical consequence that interested parties have to wait for a perpetrating firms to discharge the burden of proof of the Efficiency Defence, and then for the competition authorities to weight the Efficiency Defence against any anti-competitive effects, before any legal certainty surrounding any component of its interpretation and application in South African competition matters are obtained. As a result, this legal uncertainty should increase the financial risks associated with conducting business within the South African economy since it is impossible for firms to be certain which efficiencies will be accepted in the Efficiency Defence and the manner in which these efficiency gains are to be presented.\textsuperscript{40} Contravention of the Competition Act can also result in enormous financial penalties with these penalties potentially being as high as 10 percent of the perpetrating firm's total annual turnover (sales) obtained within South Africa including exports from South Africa.\textsuperscript{41}

In contrast to legal uncertainty, legal certainty surrounding the interpretation and application of the Efficiency Defence should aid firms to determine whether certain anti-competitive market conduct will be approved following the Efficiency Defence.\textsuperscript{42} Legal certainty should also contribute to the effectiveness of the competition authorities in considering whether to uphold an Efficiency Defence since the principles for its interpretation and application would be clear.\textsuperscript{43} Legal certainty should thus contribute to the overall effectiveness of the Competition Act in promoting and maintaining competition so as to enhance the efficiency and social welfare of the South African economy.\textsuperscript{44}

Based upon the preceding paragraphs, the aim of this study is to contribute to the legal certainty surrounding the interpretation and application of the Efficiency Defence in South African competition matters by making recommendations based upon its interpretation and application in other jurisdictions. More specifically, this study will analyse the Competition Law jurisprudence found in the United States of America (hereafter the US) and in the European Union (hereafter the EU), to search for potential solutions on how the Efficiency Defence should be interpreted and applied in South African competition matters. By following this approach, this study will hopefully contribute to the establishment of legal certainty surrounding the interpretation and application of the Efficiency Defence in South

\textsuperscript{40} Renckens 2007: 150.

\textsuperscript{41} Competition Act 89/1998: section 59.

\textsuperscript{42} Renckens 2007: 150.

\textsuperscript{43} Renckens 2007: 150.

\textsuperscript{44} Renckens 2007: 150.
African competition matters. Thereby, increasing the overall effectiveness of the Competition Act in attaining efficiency and social welfare within the South African economy and also contribute to ease the financial risks associated with conducting business within the South African economy.

1.2 Object of this study

The object of this study is the interpretation and application of the Efficiency Defence in South African competition matters. The Efficiency Defence is contained in several sections of the South African Competition Act. More specifically, the Competition Act provides for the use of the Efficiency Defence in two broad categories of market conduct, namely mergers and prohibited practices. Prohibited practises are dealt with under sections 4(1)(a); 5(1) and 8(c)-(d) and mergers under section 12A(1)(a)(i). In addition, the Competition Amendment Act, which is yet to come into force, will insert a “complex monopoly conduct” provision into the Competition Act as section 10A, which will also provide for the Efficiency Defence. The Competition Amendment Act of 2009 is, however, ignored for the purposes of this study.

The sections providing for the use of the Efficiency Defence are discussed in detail in chapter three. What is of importance at this stage is that these sections, broadly speaking, have a coherent wording with regard to the Efficiency Defence. This coherent wording can be summarised as follows: market conduct will be regarded as anti-competitive and thus prohibited if it has the effect of substantially preventing or lessening competition in a market, unless the perpetrating party(ies) can prove that any technological, efficiency or other pro-competitive gains that result from that anti-competitive conduct outweigh the anti-competitive effects thereof (own emphasis).

Based upon the wording of the Efficiency Defence, the Competition Tribunal in the merger between Trident Steel Proprietary Ltd and Dorbyl Ltd, identified six issues that had to be addressed in the interpretation and application of the Efficiency Defence in South African competition matters. These issues are as follow:

45 Refer to section 4(1)(a); 5(1); 8; 12A of the Competition Act.
46 Refer to Chapter two and chapter three of the Competition Act 89/1998.
48 Refer to section 4(1)(a); 5(1); 8(c)-(d); 12A(1)(a)(i).
49 Paragraphs 59 and 78.
1. The meaning of technological and other pro-competitive gains.
2. The party carrying the burden of proof to establish the efficiency gains that will potentially result from the anti-competitive conduct.
3. The types of efficiencies that should be recognised in the Efficiency Defence.
4. The calibration of the tradeoff analysis i.e., the manner or unit in which the gains and losses must be measured, the manner in which the competition authorities must verify the claimed efficiencies, and the manner in which the gains and losses should be weighed against one another.\(^50\)
5. The welfare standard to be applied i.e., who should benefit from the efficiency gains?
6. Whether the efficiency gains must be specific to the anti-competitive market conduct. i.e., must the anti-competitive market conduct be the only means by which to obtain the efficiency gains (this is known as the merger specific requirement)?\(^51\)

In addition to these issues identified by the Competition Tribunal, Sutherland\(^52\) identified six further issues that also need be addressed, namely:

1. Whether only effects within the South African economy should be considered.
2. Whether the Efficiency Defence will be upheld even if the prohibited conduct will result in a monopoly market structure.
3. Whether the efficiency gains and losses must result or have effect within the same relevant market.
4. Whether the efficiency gains must be likely to be realised.
5. The time frame, if any, within which the efficiency gains must realised.
6. Whether the efficiency gains must be substantial.

To provide a comprehensive picture on the interpretation and application of the Efficiency Defence in South African competition matters, this study considers nine of the twelve issues. The issues not considered are the following: whether only effects within the South African economy are considered, whether the Efficiency Defence will be upheld even if the prohibited conduct will result in a monopoly market structure, and whether the efficiency gains and losses must result or have effect within the same relevant market. Although nine issues are considered in total, emphasis is placed upon the welfare standard to be applied,

\(^{50}\) Sutherland 2008: 342; Trident steel Proprietary Ltd v Dorbyl Ltd 89/LM/Oct00: paragraph 63-67.
\(^{51}\) Coate 2005: 196.
\(^{52}\) 2008: 358 and 363-364.
the burden of proof of the Efficiency Defence, the types of efficiencies that should be recognised, and the tradeoff analysis. These nine issues are considered under five headings contained in chapter four and they are as follow:

**Heading 1: The welfare standard**

Heading 1 considers the welfare standard applied in South African, US and EU competition matters and provides a recommendation on the preferable welfare standard to be applied in the South African economy. Heading 1 is dealt with in sections 4.3 and 4.8.

**Heading 2: The burden of proof**

Heading 2 considers the party carrying the burden to prove the efficiency gains that will result from the anti-competitive conduct. In so doing, heading 2 considers the party carrying the burden in South African, US and EU competition matters and provides a recommendation on the party who should preferably carry this burden in South African competition matters. Heading 2 is dealt with in section 4.4.

**Heading 3: The efficiencies recognised in the Efficiency Defence**

Heading 3 considers the types of efficiencies that are recognised under the Efficiency Defence. Heading 3 does not contain an exposition on the various gains that could potentially fall under a specific type of efficiency. Economic literature recognises four broad categories of economic efficiency, namely allocative, productive, dynamic and transactional efficiency.\(^{53}\) This study only considers these four broad categories of economic efficiency and not all the various efficiencies that could potentially result form anti-competitive market conduct. The reason being that it is an impossible task to identify all the potential efficiency gains that could potentially result form anti-competitive market conduct.\(^{54}\) Such a task will also hinder the object of this study, which is the interpretation and application of the Efficiency Defence and not merely the exclusive identification of all the various efficiency gains that could potentially result from anti-competitive market conduct. Economic literature also currently finds itself in a state of uncertainty in respect of

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\(^{53}\) Refer to section 2.2.2 for a discussion on the efficiency categories.

\(^{54}\) For an informative discussion on various gains that are distinguished internationally to fall under one of these four efficiency categories refer to Sutherland 2008: 365-370.
the various efficiency gains that could potentially result from anti-competitive market conduct. This uncertainty is the result of a lack of empirical evidence that support a number of efficiency gains that, according to literature, potentially result from anti-competitive market conduct.\footnote{For more information refer to Lipczynski \textit{et al} 2009.}

More specifically, heading 3 considers the types of efficiencies that are recognised in South African, US and EU competition matters as well as the meaning of technological and other pro-competitive gains. Heading 3 concludes with a recommendation on the types of efficiencies that should be recognised in South African competition matters as well as a recommendation on the manner in which technological and other pro-competitive gains could be interpreted in South African competition matters. Heading 3 is dealt with in section 4.5.

\textit{Heading 4: Likely, verifiable, merger specific and timely efficiencies}

Heading 4 considers the issue of whether efficiencies must be likely, verifiable, merger specific and timely in South African, US and EU competition matters and concludes with recommendations on the issues discussed hereunder. Heading 4 is dealt with in section 4.6.

\textit{Heading 5: The tradeoff analysis}

Heading 5 considers the requirements claimed efficiencies must satisfy in order to rescue anti-competitive market conduct as well as the manner in which the claimed efficiencies are weighed against the anti-competitive effects in South African, US and EU competition matters. Heading 5 also considers the different procedural approaches that can be utilised to apply the Efficiency Defence and whether the claimed efficiencies need to be substantial for them to be recognised in competition matters. Once more, heading 5 contains recommendations on the issues discussed hereunder. Heading 5 is dealt with in section 4.7.
In addition to the above mentioned issues, this study also examines the following relevant issues:

1. The importance of Competition Law.
2. The economic principles and theories sustaining Competition Law.
3. The meaning of economic efficiency, its importance and the manner in which it is measured for the purposes of Competition Law.
4. The meaning of a substantial prevention or lessening of competition and the difference between a prevention and a lessening of competition.
5. The specific sections of the Competition Act containing the Efficiency Defence provision.
6. The origin of the Efficiency Defence, various welfare standards that can be applied to the Efficiency Defence, and the different procedural approaches that can be used to implement the Efficiency Defence.

The rationale for the inclusion of these ancillary issues, is to examine the context and the economic framework within which Competition Law and the Efficiency Defence are to be applied. These ancillary issues also indicate the importance of competition for economic efficiency and in turn, also its importance for the social welfare of a country. The importance of competition for economic efficiency is neatly summed up by Ken Heyer, a senior economist at U.S. Department of Justice, as “efficiency is the goal, competition is the process.”

The above ancillary issues also provide the legal framework within which efficiencies are to be considered in terms the Competition Act. In essence, the value of these ancillary issues found in their contribution to help answer the main issues relevant to the interpretation and application of the Efficiency Defence in South African competition matters.

1.3 Methodology and value

Methodology

This study follows the comparative method of legal writing. The choosing of this method was motivated by section 1(3) of the Competition Act which states that “Any person...”

interpreting or applying this Act may consider appropriate foreign and international law.” In addition to the comparative method of legal writing, this study also includes elements of the informative, analytical and argumentative methods of legal writing. This study is informative in the sense that it delineates the interpretation and application of the Efficiency Defence in competition matters not only in South Africa but also in the US and the EU. In addition of being informative, this study is analytical in the context that it breaks the Efficiency Defence up into its various elements.

This study is argumentative in the context that it provides certain recommendations on how the South African competition authorities could amend their interpretation and application of the Efficiency Defence in order to enhance the effectiveness of the Efficiency Defence in South African competition matters. These recommendations are derived from comparing the interpretation and application of the Efficiency Defence in South Africa with its interpretation and application in the US and the EU. This study initially intended to compare the South African jurisprudence on the Efficiency Defence with its equivalents in Canada and Brazil. Canada was chosen because it was the first country to implement the Efficiency Defence and because the South African Efficiency Defence is based upon the Canadian defence. However, the South African jurisprudence on the efficiency defence is too similar to its Canadian equivalent for the comparative method of legal writing to be of any significant value within the object and scope of this study.

Brazil was chosen because of the similarities between the economic and political environments of Brazil and South Africa. More specifically, South Africa and Brazil face similar economic challenges and accordingly, it is argued that Brazilian jurisprudence should provide recommendations that are more relevant to the South African environment. Unfortunately, very little information, apart from reports published by the Organisation for Economic Cooperation and Development (hereafter OECD) and the International Competition Network (hereafter ICN), are available in English with the rest, rightfully being in Portuguese.

57 The Writing Centre on http://www.csuohio.edu/academic/writingcenter/organize.html (accessed on 22 March 2011)
58 Trident Steel Proprietary Ltd and Dorbyl Ltd 89/LM/Oct00: paragraphs 42 and 48.
Due to the shortcomings of using Canadian and Brazilian jurisprudence, this study settled upon US and EU jurisprudence. Nonetheless, Canadian jurisprudence is used where relevant and purposeful.

The Efficiency Defence as applied in the US and the EU is different to its application in South Africa.\textsuperscript{61} The Efficiency Defence in South Africa is an independent or true defence which can be used to rescue anti-competitive market conduct, whereas the Efficiency Defence in the US and the EU forms part of the analysis undertaken by their competition authorities to determine whether conduct is anti-competitive.\textsuperscript{62} Stated differently, in the US and the EU the Efficiency Defence is not a true or an independent legal defence that can be raised to save anti-competitive market conduct. In South Africa, as mentioned,\textsuperscript{63} the competition authorities have to prove that anti-competitive market conduct will result in a substantial prevention or lessening of competition and then, the perpetrating parties have to prove that their anti-competitive market conduct will result in efficiency gains that outweigh the anti-competitive effects thereof. In contrast, perpetrating parties in the US and EU can provide evidence on potential efficiency gains that the competition authorities have to take into consideration in their determination of whether the relevant market conduct will result in anti-competitive effects.\textsuperscript{64} Despite this difference, US and EU jurisprudence provides valuable guidelines along which the interpretation and application of the Efficiency Defence in South African competition matters could be developed.

\textit{Value}

This study is unique in comparison to other legal comparative writings on the application of the Efficiency Defence in South African competition matters as this study provides a detailed discussion, from an economic perspective, on the ideological economic principles upon which Competition Law is based, and the framework within which Competition Law and the Efficiency Defence are to function. In addition, this study only makes recommendations insofar as they are line with contemporary economic theory as discussed throughout this study. Contemporary economic theory thus functions as the validating criterion for any recommendations made in this study. More specifically, the

\begin{itemize}
\item \textsuperscript{61} Refer to section 5.2.
\item \textsuperscript{62} Sutherland 2008: 332.
\item \textsuperscript{63} Refer to section 1.1.
\item \textsuperscript{64} Refer to section 4.2.
\end{itemize}
rationale for using contemporary economic theory as the validating criterion is to be found in the principles upon which Competition Law is based. Competition Law is based upon economic ideas, concepts and principles and accordingly, it is the economist’s perception of competition that is applicable to Competition Law and consequently, Competition Law is sometimes referred to as “Economic Law.” Therefore, studies and recommendations on the interpretation and application of the South African Competition Act that ignore contemporary economic theory is of little to no value.

This study is also unique in that it is the only study, insofar as the author could determine, that explicitly contends that the interpretation and application of the Efficiency Defence in South African merger proceedings is equally relevant, broadly speaking, to the Efficiency Defence to be applied in non-merger proceedings and vice versa.

The value of study is thus founded upon the recommendations that are made on the interpretation of the Efficiency Defence in South African competition matters, the use of contemporary economic theory as the validating criterion, and the contention that the Efficiency Defence in merger proceedings should, broadly speaking, be analogous to the Efficiency Defence in non-merger proceedings.

1.4 Technical issues

Although the Efficiency Defence in South African competition matters has only been considered in the context of mergers. This study contends that the interpretation and application of the Efficiency Defence in merger proceedings is equally relevant to all other provisions in the Competition Act that provides for the Efficiency Defence because of the similar wording of all these provisions and more importantly, because the Competition Act and all its provision that allow for the Efficiency Defence is based upon the same economic principles. This view is supported by the OECD.

The Efficiency Defence contained in the Competition Act should not be confused with the exemption provision contained in section 10 of the Competition Act since they are two

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65 Cseres 2005: 11-12.
66 Refer to section 1.2.
67 In this context, the economic principles refer to the abuse of market power and the associated efficiency losses. For more information refer to chapter three.
different and independent functioning provisions. More specifically, the exemption provision provides exemption from the application of the Competition Act to firms who have behaved anti-competitively whereas the Efficiency Defence provides only a defence to firms who behave anti-competitively. The Efficiency Defence should also not be confused with the public interest provision contained in section 12A of the Competition Act since this provision does not deal with efficiency but with public interests such as employment. Also, the public interest provision is only applicable to merger proceedings whereas the Efficiency Defence is also applicable to non-merger proceedings. In addition and contrarily to the Efficiency Defence, the public interest provision can potentially result in the prohibition of a pro-competitive merger or the approval of an anti-competitive merger with no efficiency gains, in the event the competition authorities are of the opinion that the merger is in the public’s interest.

The Efficiency Defence is also not to be confused with the failing firm defence. The failing firm defence is a legal defence which is normally raised in merger and acquisition proceedings through which the perpetrating parties attempt to rescue an anti-competitive merger or acquisition from being prohibited, by arguing that one or all of the relevant firms will fail and thus exit the market if the merger or acquisition is to be prohibited. The failing firm defence thus deals with failing firms and not with efficiency gains that might result from a merger or acquisition. Contrary to the Efficiency Defence, the failing firm defence is also not a true defence and it is only one of the factors taken into account when determining whether a merger will be anti-competitive. To conclude, for the purposes of this study, all provisions and objectives of the Competition Act other than the Efficiency Defence, efficiency, and social welfare, are ignored, unless stated otherwise.

Unless stated otherwise, all future references in this study to the Competition Act refers to the South African Competition Act 89 of 1998 as amended by the Competition Amendment

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69 For more information refer to section 10 for the exemption provision and sections 4(1)(a); 5(1); 8(c)-(d) and 12A(1)(a)(i) for the Efficiency Defence provisions.
70 For more information refer to section 10 for the exemption provision and sections 4(1)(a); 5(1); 8(c)-(d) and 12A(1)(a)(i) for the Efficiency Defence provisions.
71 Wise 2003: 31; Also, refer to section 12A(3) for more information on the public interests to consider.
72 For an illustration of this refer to section 12A(3) and compare it with sections 4(1)(a); 5(1) and 8(c)-(d).
74 Iscor Limited and Saldanha Steel (Pty) Ltd 67/LM/Dec01: paragraphs 77.
75 Iscor Limited and Saldanha Steel (Pty) Ltd 67/LM/Dec01: paragraphs 103-104.

In South Africa, the terms “Competition Law” and “Competition Legislation” are used to describe legislation pertaining to the maintenance and promotion of competition in the economy whereas a number of other countries, most notably the US, prefer to use the terms “Antitrust Law” and “Antitrust Legislation”. In this study the terms “Competition Law” and “Competition Legislation” are used.

Lastly, in this study any reference to the EU refers to the European Community established by the Treaty on the European Union. Also, any reference to the EC refers to the European Commission.

1.5 Scope of the study

This study consists of five chapters. Chapter one is an introductory chapter containing the problem statement, the object, the methodology and scope of this study as well as some technicalities in relation to this study. The purpose of chapter one is to provide the reader with an understanding of what this study entails and the value thereof.

Chapter two examines the importance of Competition Law and the economic theories sustaining it. Chapter two also examines the relevance of these economic theories for the South African economy and thus also for the South African Competition Act. Additionally, chapter two examines the importance and relevance of economic efficiency, its relationship with social welfare and the manner in which it is measured. The purpose of chapter two is to provide the reader with a detailed discussion on the context and framework within which Competition Law and the Efficiency Defence are to function.

Chapter three examines the origin of the Efficiency Defence, various welfare standards, the three procedural approaches to the Efficiency Defence, and the relevant sections of the Competition Act authorising the use of the Efficiency Defence. Chapter three also provides discourse on the economic rationale for regulating the various market practices prohibited by these sections. Chapter three also considers what is meant with a substantial

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76 Note, the Competition Amendment Act 1 of 2009 has not come into effect and therefore it is not included in this study.


78 1957 as amended up and to 2007.
prevention and lessening of competition and whether there is a difference between a prevention of competition and a lessening of competition. The purpose of chapter three is to provide the reader with information on the circumstances in which the Efficiency Defence can be raised and the degree of anti-competitive market conduct required before the Efficiency Defence becomes applicable. Chapter three also contributes to the exposition on the context and framework within which the Efficiency Defence is to be interpreted and applied within South African competition matters.

Chapter four contains the exposition on the various issues identified as the object of this study. This exposition is structured according to the five headings identified earlier. Chapter four clearly contrasts the South African approach to the Efficiency Defence with the approaches taken in the US and EU. Based upon this comparison, chapter four provides the recommendations on the interpretation and application of the Efficiency Defence in South African competition matters.

Chapter five contains the concluding remarks of this study.
2.1 Scarce resources and the functioning of markets

2.1.1 The economising problem

Central to economics is the problem of scarcity which derives from the fact that society’s demand for goods and services is unquenchable, yet any given society has only a limited quantity of economic resources available to its disposal. Accordingly, economic resources are scarce relative to the demand thereof. This in turn implies that goods and services are limited and hence, society is forced to make decisions on the goods and/or services it is going to demand and produce.

This decision process is known as the economising problem. The economising problem resulted in economics being defined as “the social science concerned with how individuals, institutions and society make optimal choices under conditions of scarcity.” Economics is also defined as a “philosophical inquiry...which outlines how society allocates its scarce resources to achieve prosperity and well-being for its citizens.” These definitions of economics imply that economics is concerned with maximising the social welfare of a country’s citizens. Social welfare in turn is defined as the happiness of society which is measured by the total satisfaction (utility) consumers derive from consuming a particular combination of goods and services, subject to limited resources.

To govern the economising problem every country (society) requires an economic system. An economic system can be described as “a particular set of institutional arrangements and a coordinating mechanism designed to respond to the economising problem.”

79 There are 4 types of economic resources, namely “Land, which includes all natural resources used in the production of goods and services; Labour, which includes the physical and mental talents of individuals used in producing goods and services; Capital, which is defined as all manufacturing aids used in the production of goods and services and lastly entrepreneurial ability.” For more information see McConnel and Brue 2008: 4.
80 Wetzstein 2005: 2-3.
81 McConnell and Brue 2008: 10.
82 McConnell and Brue 2008: 4.
83 Wetzstein 2005: 3.
84 Wetzstein 2005: 3.
86 McConnell and Brue 2008: 29.
the economic system of a country is that country’s economic policy which determines, among other things, which goods and services are to be produced within that country and the producers thereof.\textsuperscript{87}

South Africa utilises the market or free market system as its economic system.\textsuperscript{88} The market system is characterised by “private ownership of property resources and the use of markets and prices to coordinate and direct economic activity.”\textsuperscript{89} More specifically, this economic system permits the private ownership of capital, it communicates through prices and coordinates and directs economic activity through markets.\textsuperscript{90} The market system is further characterised by the right of individuals (buyers or consumers) and firms (producers and sellers) to pursue only their own self interests and not that of others.\textsuperscript{91} The result of all these factors is the creation of the competition process wherein individual consumers and individual producers each strive to outperform one another in their endeavour to satisfy their self interests.\textsuperscript{92} More importantly, this economic system creates what is called “free competition” because it ensures that anyone who wants to participate in the economy is able and permitted to do so.\textsuperscript{93}

Of primary importance to the market system is the idea of \textit{laissez –faire}\textsuperscript{94} which entails little or no government interference within the economy.\textsuperscript{95} The reason for this limitation on government interference within the economy is the idea that if markets\textsuperscript{96} are organised solely by the market forces\textsuperscript{97} and not by government i.e., the competition process is left alone, then the most efficient market performance will be obtained and hence also the most efficient allocation (use) of the scarce economic resources.\textsuperscript{98} Government interference within the economy should thus be limited to the protection of private property and the creation of an appropriate environment for the proper functioning of the market.

\textsuperscript{88} Truu 1996: 2.
\textsuperscript{89} McConnell and Brue 2008: 29.
\textsuperscript{90} McConnell and Brue 2008: 29.
\textsuperscript{91} McConnell and Brue 2008: 29.
\textsuperscript{92} McConnell and Brue 2008: 29.
\textsuperscript{93} Oppenheimer: 1942: 307.
\textsuperscript{94} This term means “let it be.”
\textsuperscript{96} A market is defined as a mechanism that brings buyers (consumers) and sellers (producers) into contact with one another. For more information refer to McConnel and Brue 2008: 31.
\textsuperscript{97} Market demand and market supply. For more information refer to McConnell and Brue 2008: 30.
\textsuperscript{98} Fourie 2006: 335.
2.1.2 Functioning of the market system

There are several different Schools of thought relating to the functioning of the market system. Despite this, it seems as if there is broad consensus among these Schools on the functioning of the market mechanism and the role of price and competition. Stated earlier, the market system coordinates and directs economic activity to obtain the most efficient allocation of the scarce economic resources. The question, however, is how the market system go about to obtain the most efficient allocation of resources in a situation where there is little or no government interference in the economy and where every consumer and producer only strive to satisfy his/her self interests? The answer is found in the creation of markets and prices.

The market is a place where buyers and sellers meet to exchange goods and/or services and as a result the market facilitates the exchange of information between buyers and sellers regarding the different demand and supply choices they have made. These choices, regarding the types of goods and/or services requested by buyers and the way in which sellers have chosen to use their resources, in turn determines the market price for the various products and resources. The market price in turn, results in buyers and sellers revising their demand and supply decisions in accordance with this market price and as a result, this market price coordinates and directs the various choices that buyers and sellers make in the pursuit to satisfy their self interests.

Stated differently, the market brings buyers and sellers together and allows them to communicate with one another on the goods and/or services that are available (supplied) and the goods and/or services that are requested (demanded). This potential demand

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99 McConnell and Brue 2008: 29.
100 These include the Neo-Classical, Chicago, Austrian and Schumpeterian Schools of thought.
101 Singleton 1986: 1-78.
102 Singleton 1986: 1-78.
103 Refer to section 2.1.1.
104 Fourie 2006: 335.
106 Arnold 2008: 166. Refer to footnote 18.
107 Arnold 2008: 166.
and supply for the various goods and services in turn determines the market price thereof.\textsuperscript{110} The market price in turn, determines the total quantity demanded (market demand) for that goods and/or services and also the total market supply thereof and in the result, the market system use of prices to coordinate and direct the use of the scarce economic resources by using the market as a communication instrument.\textsuperscript{111}

The market price also keeps firms accountable to consumers (this is known as consumer sovereignty) because it determines the quantity demanded and hence also the quantity of the goods and/or services firms can sell.\textsuperscript{112} Consumer sovereignty exists because consumers generally have the freedom to decide upon the goods and services they want to consume and, given the market price and their budget constraints, consumers are also free to determine the exact quantity of these goods and/or service they want to consume.\textsuperscript{113}

Consumer sovereignty coupled with a firm’s incentive to obtain and maximise profits result in competition between the different firms producing identical and/or substitutable goods and/or services with each of them striving to increase their respective profits.\textsuperscript{114} This process of competing among competitors where each strive to increase their respective profits is known as the competition process.\textsuperscript{115} More specifically, the competition process refers to the process whereby firms strive to outdo their competitors so as to satisfy their self interests, which is, \textit{ceteris paribus}, to maximise their profits.\textsuperscript{116} If for example, a firm were to ask a price higher than the market price, then that firm will lose sales to other firms.\textsuperscript{117} Accordingly, the competition process ensures that firms need to maximise their efficiency if they want to provide their products at the competitive market price.\textsuperscript{118} If not, they face losing sales (profits) to other more efficient firms and in the result, the competition process functions as the regulating mechanism which ensures efficient market performance and hence it is argued that the competition process is essential for the market system to achieve optimal efficiency.\textsuperscript{119}

\begin{thebibliography}{99}
\bibitem{110} Arnold 2008: 166.
\bibitem{111} McTeer 2002: chapter 2.
\bibitem{112} Wetzstein 2005: 19.
\bibitem{113} Wetzstein 2005: 19.
\bibitem{114} Wetzstein 2005: 19.
\bibitem{115} Arnold 2008: 166.
\bibitem{116} Arnold 2008: 169.
\bibitem{117} McConnell and Brue 2008: 31; McTeer 2002: 3-5.
\bibitem{118} Wetzstein 2005: 19.
\bibitem{119} McConnell and Brue 2008: 31; McTeer 2002: 3-5.
\end{thebibliography}
In short, the market system utilises markets and prices to coordinate and direct the use of the scarce economic resources, with the competition process regulating the market system to ensure that it results in the most efficient allocation of the scarce economic resources.\textsuperscript{120} This efficient use (allocation) of the scarce economic resources is called allocative efficiency and it is discussed in section 2.2.2 together with other forms of economic efficiency.\textsuperscript{121}

\subsection*{2.1.3 Market power and market failure}

\textit{Market power}

Of central importance to Competition Law is the concept of market power.\textsuperscript{122} Industrial Organisation or Industrial Economics defines market power as the ability of a firm or a group of firms acting together to increase the price of any specific product or a group of products, by restricting output, from what the price would have been in a competitive market and as a result, they increase their respective profits from what it would have been under conditions of competition.\textsuperscript{123} In Competition Law, market power is generally defined as "the power of a firm to control prices, or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers."\textsuperscript{124}

Both these definitions of market power indicate that market power refers to the ability or situation where a firm(s) can act independently from the pressures of the competition process. In other words, market power refers to the situation where a firm is unconstrained by the competition process, which enables that firm to influence the proper functioning of the market system.\textsuperscript{125} It is held that firms in competitive markets\textsuperscript{126} are constrained, by the competition process, from interfering with the proper functioning of the market system and therefore, they have no or little market power whereas firms in uncompetitive markets are unconstrained by the competition process and therefore, they do have market power which cannot be described as allocative efficiency.

\begin{itemize}
\item \textsuperscript{120} McConnell and Brue 2008: 31; McTeer 2002: 3-5.
\item \textsuperscript{121} Hesen 2006: 9.
\item \textsuperscript{122} Walker 2006: 10.
\item \textsuperscript{123} Walker 2006: 10.
\item \textsuperscript{124} Competition Act 89/1998: section 1. This definition of market power is similar to that of the EU. For more information refer to Wise 2003: 23.
\item \textsuperscript{125} Stenborg 2004: 1-2.
\item \textsuperscript{126} Competitive and uncompetitive market are discussed in section 2.3.
\end{itemize}
they can abuse to influence the proper functioning of the market system.\textsuperscript{127}

Market power can be divided into two categories, namely unilateral and multilateral or collective market power.\textsuperscript{128} Unilateral market power refers to the market power of an individual firm. Multilateral market power on the other hand refers to the collective market power of firms acting together so as to influence the functioning of the market system by restricting output and increasing prices.\textsuperscript{129}

\textit{Market failure}

From time to time the market system fails to ensure efficient market performance.\textsuperscript{130} Market failure refers to the situation where the market forces of a market no longer function properly to direct and coordinate the use of the scarce economic resources in such a way so as to ensure efficient market performance.\textsuperscript{131} In general, market failure occurs because of imperfect competition, externalities influencing the functioning of markets, the desire for public goods that can only be provided by government, asymmetrical (irregular) information.\textsuperscript{132}

Given that the market system fails from time to time, governments have been interfering within the market system for decades despite the principle of \textit{laissez-faire}.\textsuperscript{133} Fortunately, this government interference is not aimed at coordinating and directing the economic activity within markets but rather to ensure the proper functioning thereof.\textsuperscript{134} Stated differently, governments interfere within the market system to remove any threats to the proper functioning of the market system.\textsuperscript{135}

To interfere within the functioning of the market system, governments make use of what is called “Competition Policy.”\textsuperscript{136} Competition Policy can be defined as “a regulatory tool which seeks...
to address market failures by maintaining or creating the foundations for effective functioning markets.\textsuperscript{137} Competition policy itself can be divided into two categories, namely Economic Policy and Competition Law.\textsuperscript{138} Economic policies are aimed at increasing competition (business activity) within the national and international markets and consist of trade policies, deregulation and privatisation.\textsuperscript{139} Economic policies, in the context of the free market system, are thus aimed at creating a favourable environment for the implementation and functioning of the market system.\textsuperscript{140}

Competition Law on the other hand, is aimed at enhancing the efficiency of the market system and thus the economy as a whole through the maintenance and promotion of competition.\textsuperscript{141} More specifically, Competition Law regulates anti-competitive market conduct with anti-competitive market conduct referring to any market conduct that substantially prevents or lessens competition in that or any other relevant market.\textsuperscript{142} To behave anti-competitively firms require market power and as a result, the regulation of the abuse of market power lies at the heart of Competition Law.\textsuperscript{143}

Before we continue to the next section take note of the following two contentions regarding Competition Law. Firstly, Competition Law does not condemn the possession of market power\textit{ per se}, instead it regulates those situations in which a firm or a group of firms acting together obtains such a great degree of market power that it enables it/them to abuse that market power to influence the proper functioning of the competition process and hence, the efficient allocation of the scarce economic resources.\textsuperscript{144} Secondly, Competition Law does not exist nor function to protect the individual competitors, instead it exclusively aims to protect the proper functioning of the competition process to ensure efficient market performance.\textsuperscript{145} In other words, if a firm harms one of its competitors or one of its buyers, that harmful conduct will not be regulated nor prohibited by Competition Law if it does not decrease competition\textsuperscript{146} in the whole of that market.\textsuperscript{147}

\begin{itemize}
\item \textsuperscript{137} Neuhoff \textit{et al} 2006: 11.
\item \textsuperscript{138} Neuhoff \textit{et al} 2006: 11.
\item \textsuperscript{139} Neuhoff \textit{et al} 2006: 11.
\item \textsuperscript{140} Neuhoff \textit{et al} 2006: 11.
\item \textsuperscript{142} Agnew 1985: 67.
\item \textsuperscript{143} Boshoff 2008: 3; Stenborg 2003: 1.
\item \textsuperscript{144} Boshoff 2008: 3; Stenborg 2003: 1.
\item \textsuperscript{145} Neuhoff \textit{et al} 2006: 44.
\item \textsuperscript{146} The meaning of competition is discussed in section 2.3.4.
\item \textsuperscript{147} For an illustration of this refer to SASOL Oil (Pty) Ltd v Nationwide Poles 49/CAC/APRIL05.
\end{itemize}
2.2 Efficiency and social welfare

“Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident that it would be absurd to attempt to prove it. But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.”

(Adam Smith, 1776.)\(^{148}\)

Based upon this quote of Adam Smith, the following is generally acknowledged.

“Consumer welfare is greatest when society’s resources are allocated in the economy so that consumers are able to satisfy their wants as far as technological and physical constraints permit. In this way the wealth of the nation is maximised. Competition policy’s aim should be to help bring about this result...Society’s total wealth depends, of course, on achieving overall efficiency in the production and distribution of goods and services. This overall efficiency is composed of allocative efficiency and productive efficiency...Bork (1993, p.91) claims that the ‘whole task of anti-trust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare.’

(Duncan Reekie, 2000.)\(^{149}\)

2.2.1 The importance of efficiency and the purpose of Competition Law

For the field of Competition Law to be of any use, it requires the ability to make normative statements (value judgements or prescriptive rules).\(^{150}\) To obtain this ability, a criterion (standard) is required to serve as a benchmark against which all normative statements from the field of Competition Law can be evaluated against.\(^{151}\) This criterion is economic efficiency for the reason that economic efficiency is objective (purposeful) in nature.\(^{152}\) Efficiency has also been said to be the scientific backbone of economics.\(^{153}\) The criterion for economic efficiency in turn is value with value referring to the benefit (satisfaction)

\(^{148}\) As cited in Reekie 2000: 20.
\(^{149}\) Reekie 2000: 20.
\(^{150}\) Cseres 2005: 16.
\(^{151}\) Cseres 2005: 16.
\(^{152}\) Cseres 2005: 16.
obtained from consuming a particular product or resource.\textsuperscript{154} Therefore, economic efficiency refers to the “relationship between the value of the benefit relative to the cost incurred in obtaining the benefit.”\textsuperscript{155}

In general, the principal objective of Competition Law is to improve the efficiency of an economy i.e., to improve the utilization of the scarce economic resources.\textsuperscript{156} This is also the case in South Africa with economic efficiency being the overruling principle for the application of the Competition Act.\textsuperscript{157} Additionally, it is argued that economic efficiency is obtained by means of competition and therefore, Competition Law is often cited as having the purpose of maintaining and promoting competition.\textsuperscript{158} This is also the case in South Africa, with the Competition Act citing the maintenance and promotion of competition as its exclusive purpose.\textsuperscript{159}

For the purposes of this study, economic efficiency is classified by four types of economic efficiencies, namely allocative, productive, dynamic and transactional efficiency.\textsuperscript{160} These efficiencies will now be discussed.

\subsection*{2.2.2 Types of economic efficiency}

\subsubsection*{2.2.2.1 Allocative efficiency and social welfare}

As discussed in beginning of this chapter, the economising problem resulted in economics being defined as “the social science concerned with how individuals, institutions and society make optimal choices under conditions of scarcity” and as a “philosophical inquiry...which outlines how society allocates its scarce resources to achieve prosperity and well-being for its citizens.”\textsuperscript{161} These definitions of economics imply that economics is concerned with maximising the social welfare of a country’s citizens.\textsuperscript{162} The meaning of social welfare is subjective and accordingly, there is no true

\begin{footnotesize}
\begin{enumerate}
\item[154] Cseres 2005: 16.
\item[155] Cseres 2005: 16.
\item[157] CUTS 2002: 12.
\item[159] Competition Act 89/1998: section 2.
\item[160] Hesen 2006: 23.
\item[161] Refer to section 2.1.1.
\item[162] Wetzstein 2005: 3.
\end{enumerate}
\end{footnotesize}
(universal) definition for social welfare. However, according to economic theory social welfare will be maximised when it is not possible to reallocate the scarce economic resources and its output without making any agent (consumer or producer) worse off i.e., the scarce economic resources are allocated in such a way that any change in the allocation thereof will result in at least one agent being made worse off. This position is referred to as pareto optimality, pareto efficiency or the socially efficient allocation of economic resources (allocative efficiency for short). Furthermore, a pareto improvement is obtained when one or more agents are made better off without any other agents being made worse off and hence, social welfare is taken to improve with pareto improvements.

Despite the lack of a universal meaning for social welfare, the branch of welfare economics can be defined as “that branch of study which endeavours to formulate propositions by which we may rank, on the scale of better or worse, alternative economic situations open to society.” In other words, welfare economics strives to obtain the most efficient use of society’s scarce economic resources in order to maximise social welfare.

Based upon the preceding paragraphs, social welfare can be described as “whatever is good or whatever ought to be maximised” within the context of the allocation of society’s scarce economic resources. Since it is virtually impossible to measure society’s welfare, the preferences (consumer tastes or consumer wants) of society is used as an indication of its welfare. Social welfare can thus be defined as the happiness of society which is measured by the total utility (benefit or satisfaction) consumers derive from consuming a particular combination of goods and services subject to the scarce economic resources. In other words, “whatever is good or whatever ought to be maximised” should be interpreted in the context of the utility (benefit) derived from the consumption of goods and/or services.

Allocative efficiency thus requires that economic resources are allocated in such a way to ensure that the goods and/or services that are produced are those that are valued most

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166 Yew-Kwang 1979: 3; Wetzstein 2005: 163.
168 Bohm 1987: xi.
highly by consumers.\textsuperscript{173} The market price ($P_m$) of any good or service in turn, is taken to be indicative of the value society places upon that particular good or service.\textsuperscript{174} Stated differently, the market price of a good or service is taken to be equal to the utility (benefit) society derives from consuming that particular good or service.\textsuperscript{175} For allocative efficiency to be obtained, the value society places upon an extra (marginal) unit of a good or a service must be equal to the cost of producing that marginal unit i.e., marginal benefit (MB) should equal marginal cost (MC).\textsuperscript{176}

As mentioned in the preceding paragraph, the price of a good is taken to indicate the value of that product to society and therefore $P_m=MB$.\textsuperscript{177} Allocative efficiency and pareto efficiency thus exists when the marginal benefit obtained by society from consuming a marginal unit of a product is equal to the costs to society of producing that product i.e., when $P_m(MB)=MC$.\textsuperscript{178} If $P_m>MC$, it indicates that the value society places upon a marginal unit of that good or service exceeds the cost of producing that marginal unit.\textsuperscript{179} This indicates that the industry output of that good or service is too low because the cost of producing that product is lower than the benefit society receives from consuming that product.\textsuperscript{180} As a result, allocative efficiency and social welfare will be increased by producing more of that good or service up to the point where $P_m=MC$.\textsuperscript{181} Contrary, if $P_m<MC$, then society values an additional unit of that good or service less than the cost of producing that marginal unit.\textsuperscript{182} This indicates that the industry output for that good or service is too high.\textsuperscript{183} As a result allocative efficiency and social welfare can be increased by producing less of that good or service until $P_m=MC$.\textsuperscript{184}

\begin{thebibliography}{99}
\bibitem{173} Hesen 2006: 9; Neuhoff et al 2006: 54.
\bibitem{174} Weber 2008: 2; Whish 1993: 1; Reekie 1989: 21.
\bibitem{175} Inferred from Lypczynski 2009: 63; Wetzstein 2005: 302; McConnel and Brue 2008: 418.
\bibitem{177} Wetzstein 2005: 302.
\bibitem{178} Wetzstein 2005: 302.
\bibitem{180} Wetzstein 2005: 299-302.
\bibitem{182} Lypczynski 2009: 63.
\bibitem{183} Lypczynski 2009: 63.
\end{thebibliography}
At this stage, take note that allocative efficiency will automatically change if there is any change in $P_m$ or in $MC$. Also note that Competition Law regards the development of new or improved products and services as well as the improvement in the quality of goods and services as increased allocative efficiency and social welfare because consumers receive increased utility (benefit) from these developments.\textsuperscript{185}

2.2.2.2 Productive efficiency

Productive efficiency can be defined as producing the maximum possible quantity of output at the lowest possible cost using the least possible quantity of inputs.\textsuperscript{186} Productive efficiency can be divided into two categories, namely “technical efficiency” and “cost efficiency.”\textsuperscript{187} Technical efficiency refers to the situation where a firm is using the minimum quantity of inputs to produce the maximum quantity of output that is technologically possible to produce with the given quantity of inputs.\textsuperscript{188} Cost efficiency on the other hand, refers to the situation where a firm is producing its level of output at the lowest possible cost.\textsuperscript{189} For example, if 14 tons of sweet corn represents the maximum output per hectare of an irrigated field and the lowest possible cost to obtain that 14 tons is R7000. A farmer will not be productive efficient if it costs him/her R7000 to produce 14 tons of sweet corn but he requires more than one hectare to produce that output. In this example, the farmer is cost efficient but not technical efficient.

Allocative and productive efficiencies are referred to as static efficiencies as it assumes that the products in the market and the production methods used to produce these products are fixed at a specific point in time.\textsuperscript{190} Static efficiency thus ignores the innovation of improved and/or new products and methods of production brought about by competition.\textsuperscript{191} Stated differently, in a static competitive model firms do not compete against one another in terms of new or improved products or services.\textsuperscript{192}

\begin{footnotesize}
\begin{enumerate}
\item Renckens 2007: 154; Bork 1993: 91.
\item Lipczynski et al 2009: 64.
\item Smit 2005: 4; Lee 1986: 81.
\item McCartney 2004: 2.
\end{enumerate}
\end{footnotesize}
2.2.2.3 Dynamic efficiency

Dynamic efficiency specifically refers to the innovation of improved and/or new products and methods of production which increase productive efficiency.\textsuperscript{193} Stated differently, dynamic efficiency refers to the development of new or improved products and technological advances brought about by research and development and entrepreneurial creativity.\textsuperscript{194} In a dynamic competitive model firms do not compete against one another in terms price but rather in terms of unique products or innovation.\textsuperscript{195} Accordingly, in a dynamic competitive market, producers respond to consumer wants (preferences) through innovation and other technological advances.\textsuperscript{196}

2.2.2.4 Transactional efficiency

In addition to allocative, productive and dynamic efficiency, transactional cost savings have also been identified as a source of efficiency.\textsuperscript{197} This is called transactional efficiency and it is defined as the minimization of the costs associated with conducting and concluding transactions.\textsuperscript{198} More specifically, it is argued that firms “design business practices, contracts, and organizational forms to minimize transaction costs and, in particular, to mitigate information costs and reduce their exposure to opportunistic behaviour or hold-ups.”\textsuperscript{199} It is also contended that the competition process will force firms to search for the lowest possible manner in which to conclude their transactions.\textsuperscript{200} Transactional efficiencies are generally indistinguishable from allocative, productive and dynamic efficiencies because it generally serves as a facilitator in achieving allocative, productive and dynamic efficiency.\textsuperscript{201} To date,\textsuperscript{202} competition authorities have been reluctant to specifically acknowledge that transactional efficiencies are relevant to competition matters.\textsuperscript{203} Accordingly, in this study little attention is given to transactional efficiencies compared to allocative, productive and dynamic efficiencies.

\textsuperscript{193} McCartney 2004: 2; Coate and Rodriguez 1997: 104.
\textsuperscript{194} Hesen 2006: 9.
\textsuperscript{196} Neuhoff et al 2006: 54.
\textsuperscript{197} Kolasky and Dick 2003: 249.
\textsuperscript{198} Kolasky and Dick 2003: 249.
\textsuperscript{199} Kolasky and Dick 2003: 249.
\textsuperscript{200} Kolasky and Dick 2003: 249.
\textsuperscript{201} Kolasky and Dick 2003: 208.
\textsuperscript{202} Kolasky and Dick 2003: 242-251.
\textsuperscript{203} Kolasky and Dick 2003: footnotes 3 and 8.
2.2.3 Measuring economic efficiency

As discussed in the preceding paragraphs, efficiency (value or benefit versus cost) is the backbone of economics and in the result economics is concerned with maximising social welfare with social welfare being defined as the utility derived from consuming different combinations of goods and services.\(^\text{204}\) It has also been discussed that the economic efficiency of a country refers to the social welfare of its citizens.\(^\text{205}\) The most widely used measure for economic efficiency and social welfare is that of the consumer surplus.\(^\text{206}\) The consumer surplus measure, measures economic efficiency and consumer welfare in terms of money.\(^\text{207}\) The relevance for this measure is found in the purpose of Competition Law which is to promote and maintain competition to increase the economic efficiency of a country.\(^\text{208}\) The consumer surplus measure is also widely used in Competition Law, especially in merger proceedings.\(^\text{209}\)

2.2.3.1 The consumer and producer surplus

\textit{Consumer surplus}

The consumer surplus is calculated as the difference between the maximum price consumers are willing to pay for a specific quantity of a product and the price they actually pay for that quantity of a product.\(^\text{210}\) The maximum amount a consumer is willing to pay for a product is derived from the benefit that consumer gains from consuming that product.\(^\text{211}\) Points on the demand curve represents the benefit society obtains from consuming the corresponding quantity of that product and therefore, the demand curve represents the maximum price consumers are willing to pay for the corresponding level of output.\(^\text{212}\) The Consumer surplus is delineated by the area underneath the demand curve and the area above the market price, with the market price being the borderline thereof.\(^\text{213}\)

\(^\text{204}\) Refer to section 2.2.1 and 2.2.2.1.
\(^\text{205}\) Refer to section 2.2.1 and 2.2.2.1.
\(^\text{207}\) Mishan 1981: 140.
\(^\text{208}\) Refer to section 2.5.1.
\(^\text{209}\) This will become exceedingly clear in chapter three and four.
\(^\text{211}\) McConnel and Brue 2008: 354.
\(^\text{212}\) Refer to section 2.5.4.2.1.
**Producer surplus**

The producer surplus on the other hand, is the difference between the minimum price producers are willing to sell their products for and the price they actually receive by selling their products.\(^{214}\) Points on the supply curve represents the marginal cost associated with producing the corresponding level of output and therefore, the supply curve represents the minimum price producers are willing to sell their produce for.\(^{215}\) The producer surplus is delineated by the area above the supply curve and underneath the market price, with the market price being the borderline thereof.\(^{216}\) The consumer and producer surplus is illustrated by figure 1.

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**Figure 1.**\(^{217}\)

In figure 1, \(P_c\) represents the market price of the relevant product, \(Q_c\) represents the quantity produced at the market price of \(P_c\) and the downward and upward sloping curves

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\(^{214}\) Lipczynski et al 2009: 65.

\(^{215}\) Mishan 1981: 146-147.


\(^{217}\) This figure is based upon the illustration by Saleeth on http://www.tutebox.com/2395/business/economics/consumer-surplus-and-producer-surplus/ (accessed 24 July 2011)
illustrate the market demand and market supply curves, respectively. The consumer surplus is represented by area ABPc and it represents the difference between the maximum price consumers are willing to pay for the product and the actual market price they pay. The producer surplus on the other hand, is illustrated by area CBPc and it represents the difference between the minimum price producers are willing to sell their produce for and the actual market price they receive.

2.2.3.2 Total efficiency and total welfare

Given that the demand curve represents society's marginal benefit derived from the consumption of a particular quantity of a good and/or service and given that the supply curve represents the marginal cost to society for producing a specific quantity of a particular product, the consumer and producer surpluses can be used to determine the total efficiency of a country. The total efficiency and total social welfare of a country is obtained by the sum of the consumer and producer surpluses. Therefore, any change in either the consumer and/or the producer surplus will have an effect upon the total efficiency and social welfare of a country. In figure 1, total efficiency and social welfare is represented by the area ABC.

Note that any change in the market price, market demand and/or the market supply curve will cause the consumer and/or the producer surpluses to change and hence also the total efficiency and social welfare of the market and country. Also, note that the demand curve represents the preferences of society and in the result any change in society's preferences will cause the demand curve to shift either upwards or downwards. Additionally, the supply curve represents the marginal cost to the producer for producing the corresponding quantity of output and in the result any change in the producer's marginal cost will cause

221 Wetzstein 2005: 306.
222 Wetzstein 2005: 306.
225 Refer to figure 1.
226 Mishan 1981: 146-147.
the supply curve to shift either upwards or downwards.\(^{227}\)

### 2.3 Theories sustaining Competition Law

Although the Schools of thought mentioned earlier\(^{228}\) may have consensus on the functioning of the market system and competition as the regulating mechanism which ensures efficient market performance, they vary significantly with regard to the meaning of competition, the manner in which competition ensures the efficient functioning of the market system and the meaning of efficient markets.\(^{229}\) The most relevant School for the purposes of this study is the Neo-Classical School and consequently, their views on the functioning of the competition process and the meaning of efficient market performance are discussed in the following sections.

#### 2.3.1 The Neo-Classical School

According to the Neo-Classical School, the level of competition in a market is determined by the market's structure i.e., the effectiveness of competition as the regulating mechanism is determined by a market's structure.\(^{230}\) Hence, the performance (efficiency) of a market is determined by the structure of that market.\(^{231}\) The Neo-Classical School is of the opinion that markets can, broadly speaking, take on one of four types of structures, namely that of the perfectly competitive, oligopoly, monopolistic competition and the monopoly market structure with each of these structures having different levels of competition and performance.\(^{232}\)

In essence, the Neo-Classical School views markets as being in a state of equilibrium determined by their relevant market structure.\(^{233}\) More specifically, the market equilibrium is the end result of a market's structure expressed in terms of efficiency (performance).\(^{234}\) The Neo-Classical School thus views markets as already having obtained their optimum

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\(^{227}\) Mishan 1981: 146-147.

\(^{228}\) Refer to section 2.1.2.

\(^{229}\) Singleton 1986: 1-78.

\(^{230}\) Kirzner 1997: 63.

\(^{231}\) Lipczynski et al 2009: 57.

\(^{232}\) Kirzner 1997: 63.

\(^{233}\) Kirzner 1997: 63.

\(^{234}\) Lipczynski et al 2009: 57.
efficiency as determined by their relevant market structures. This view of markets is in effect a static view of markets seeing that all demand and supply decisions are held to have been made.

To come back to the four market structures, the perfectly competitive market structure and the monopoly market structure are extreme opposites of one another and they also form the boundaries of the Neo-Classical School's ideology relating to market performance (efficiency). Accordingly, this study examines only these two market structures. The relationship between these market structures and efficient market performance is discussed in section 2.4. The purpose of examining these two structures at this point is to familiarise the reader with these structures since they are fundamental to Competition Law and used throughout this study.

2.3.1.1 The perfectly competitive market structure

The perfectly competitive market structure has the following characteristics:

1. A very large number of buyers and sellers.
2. Consumers and producers have perfect mutual knowledge regarding market conditions such as market prices, market demand and market supply.
3. A homogeneous product is produced by all the firms in that market.
4. No barriers of entry and exit i.e., easy entry into and exit from the market.
5. Firms act independently from one another and endeavour to maximise profits.
6. At the market price, a firm can sell as much output as it wishes i.e., the demand curve of an individual firm is perfectly elastic.

According to the Neo-Classical School, the result of these above mentioned characteristics, is that all the firms in the perfectly competitive market are price takers with no market power. This means that the market price is determined by the market through the interaction of market demand and market supply and not by the individual firms

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237 Cook 2001: 12.
238 Lipczynski et al 2009: 57.
239 Barriers to entry can broadly be defined as any obstacle that makes it difficult and sometimes impossible for firms to profitably enter into a new market, expand within a market or exit from a market. For more information refer to Carlton 2004.
themselves.\textsuperscript{241} Being a price taker implies that firms have no incentive to sell their produce at any price other than the market price.\textsuperscript{242} The reason being that it is held that a firm can sell as much output as it wishes at the market price.\textsuperscript{243} On the other hand, a firm will sell zero units of output at any price higher than the market price because it is held that consumers will simply substitute that firm's products for another firm's products.\textsuperscript{244} This substitution process is inexpensive and effortless because there is a large number of firms in the relevant market selling an identical or homogeneous product.\textsuperscript{245} The result of the perfectly competitive market is that the only way for firms to maximise their profits (which it is taken they strive to do) at any given market price is to increase their efficiency and consequently, firms in the perfectly competitive market are taken to be price minimisers and efficiency maximisers.\textsuperscript{246} Firms within the perfectly competitive market are also forced to be efficient due to the threat of potential entry into that market (potential competition).\textsuperscript{247} The reason being that the absence of barriers to entry results in new and more efficient firms entering into the perfectly competitive market if these firms are of the opinion that they are more efficient and in the result can produce their products at a lower price than the incumbent firms.\textsuperscript{248} 

Stated differently, in the perfectly competitive market, the competition process is held to constrain (regulate) the maximising behaviour of the market participants so as to ensure the most efficient market performance.\textsuperscript{249} Accordingly, it is used as the benchmark by which the efficiency (performance) of all other market structures are measured against.\textsuperscript{250}

In this context, efficient market performance refers allocative, productive and dynamic efficiency.\textsuperscript{251} However, although the Neo-Classical School acknowledges the importance of all three these efficiencies, they regard allocative efficiency as the most important type of efficiency with the highest level of consumer welfare.\textsuperscript{252} Considering that allocative efficiency is achieved when $P = MC$, the Neo-Classical School regards any increase in

\begin{flushleft}
\textsuperscript{241} Mandel 2009: 88-89. \\
\textsuperscript{242} Parkin 2007: 110-111. \\
\textsuperscript{243} Parkin 2007: 110-111. \\
\textsuperscript{244} Parkin 2007: 110-111. \\
\textsuperscript{245} Mandel 2009: 88-89. \\
\textsuperscript{246} Singleton 1986: 4. \\
\textsuperscript{247} Singleton 1986: 4-5. \\
\textsuperscript{248} Singleton 1986: 4-5. \\
\textsuperscript{249} Theron 2001: 615-616. \\
\textsuperscript{250} Witztum 2010: 157. \\
\textsuperscript{251} Lipczynski \textit{et al} 2009: 63-64. \\
\textsuperscript{252} Singleton 1986: 12. 
\end{flushleft}
Pm as a loss in allocative efficiency and hence as decreased market performance.\textsuperscript{253} This principle is illustrated with the consumer surplus measure where consumer surplus will decrease with any increase in Pm.\textsuperscript{254}

In real life no market actually achieves the position of being perfectly competitive.\textsuperscript{255} Nonetheless, the perfectly competitive market structure continues to provide a very useful benchmark that can be used to estimate and increase the efficiency of markets.\textsuperscript{256}

2.3.1.2 The Monopoly market structure

The monopoly market has the following characteristics:\textsuperscript{257}

1. There is only one seller of the relevant product.
2. The product of the monopolist is unique and there are no close substitutes for it.
3. High barriers to entry.
4. The monopolist strives to maximise its profits.

The monopoly market structure is positioned in stark contrast to the perfectly competitive market structure. In a monopoly market structure there is only one firm selling a unique product for which there are no close substitutes and consequently, the monopolist is unconstrained by the competition process i.e., the monopolist has no competitors to force him to be efficient.\textsuperscript{258} In the result, the monopolist is a price setter and not a price taker and hence it has the market power to determine the market price and total output in its market.\textsuperscript{259} This results in the inefficient use of the scare economic resources because the use thereof is coordinated and directed by the monopolist and not by the market system as regulated by the competition process i.e., the monopolist is not forced by the competition process to be efficient.\textsuperscript{260} In addition to the absence of competition, the monopoly market structure is characterised by high barriers to entry that prevent new firms from entering into the monopoly market and accordingly, potential competition also do not force the

\textsuperscript{253} Singleton 1986: 12.
\textsuperscript{254} Refer to figure 1.
\textsuperscript{255} McConnel and Brue 400.
\textsuperscript{256} Wetzstein 259.
\textsuperscript{257} Reid 1987: 130; Lipczynski \textit{et al} 2009: 60; Neuhoff \textit{et al} 2006: 36.
\textsuperscript{258} Arnold 2008: 226-228.
\textsuperscript{259} Arnold 2008: 226-228.
\textsuperscript{260} Parkin 2007: 113.
monopolist to be efficient.\textsuperscript{261}

Furthermore, because the monopolist has the market power to determine the market price or output and because the monopolist strives to maximise its profits, it is taken that a monopolist will decrease its output so as to increase the market price of the relevant product.\textsuperscript{262} The result is that it is assumed that a monopolist will always sell its produce at a higher price than he would have been able to in the perfectly competitive market.\textsuperscript{263} This higher market price and lower market output results in a loss of allocative efficiency and hence results in lower market performance with the monopolist earning an abnormal profit.\textsuperscript{264}

Based upon the preceding paragraph, the Neo-Classical School thus contends that the monopoly market structure and the corresponding absence of the competition process and the high barriers to entry results in lower market performance and enables the monopolist to survive in that market despite not maximising its efficiency and receiving an abnormal profit, which is supposed to attract new entrants.\textsuperscript{265}

2.3.2 The Structure- Conduct- Performance Paradigm

As mentioned, firms in the perfectly competitive market are constrained by the competition process from behaving in an anti-competitive manner and therefore, they have no market power.\textsuperscript{266} Contrary, the monopolist is unconstrained by the competition process and therefore, it has a strong degree of market power.\textsuperscript{267} Consequently, it is held that the perfectly competitive market will result in more efficient market performance relative to the monopoly market.\textsuperscript{268} With these two contrasting market structures in mind, economist Edward S. Mason developed the Structure- Conduct- Performance Paradigm (hereafter the SCP).\textsuperscript{269} The SCP is based upon the teachings of the Neo-Classical School of thought and it functions in the continuum between the perfectly competitive market and the monopoly

\textsuperscript{261} Singleton 1986: 6.
\textsuperscript{262} Mandel 2009: 99-101.
\textsuperscript{263} Wish 1993: 3; Walker 2006: 4-6; Reid 1987: 131.
\textsuperscript{264} Singleton 1986: 12.
\textsuperscript{265} Wish 1993: 3; Walker 2006: 4-6; Reid 1987: 131.
\textsuperscript{266} Theron 2001: 615-616.
\textsuperscript{267} Wish 1993: 3; Walker 2006: 4-6; Reid 1987: 131.
\textsuperscript{268} Theron 2001: 615-616.
\textsuperscript{269} Cook 2001: 12; López 2001: 360; Reid 1987: 11.
market, and is used to determine the nature and degree of competition in the relevant market.\textsuperscript{270} Similar to the Neo-Classical School, the SCP accepts that the nature and degree of competition in a market determines whether it is possible for firms to abuse their unilateral and/or collective market power.\textsuperscript{271} More specifically, the SCP contends that a dominant firm that is not necessarily a monopolist, will be able to abuse its unilateral market power to behave like a monopolist i.e., to decrease output and increase price.\textsuperscript{272} The SCP also contends that markets that more closely resembles the monopoly market structure will enable the firms within that market to act collectively so as to obtain and abuse their collective market power.\textsuperscript{273}

The most important concept in the SCP is that of the market structure because it is regarded as the primary variable that determines market performance.\textsuperscript{274} The SCP states that “exogenous basic conditions determine market structure and that there is a unidirectional flow of causality from market structure, through conduct, to performance.”\textsuperscript{275} Stated differently, the SCP suggests that there is a causal link, which runs from the market structure, to the market conduct of the firms in that market to the performance of that market.\textsuperscript{276} This causal link only operates in one direction, namely from market structure, to market conduct to market performance.\textsuperscript{277} In other words, a market’s structure determines the behaviour (conduct) of the firms within that market, and the conduct of that firms in turn determine their performance and ultimately also the performance of that market.\textsuperscript{278}

The structure of a market is said to refer to, among other things, the number of and size distribution of sellers and buyers (market concentration), the degree of product differentiation and barriers to entry and exit.\textsuperscript{279} The market conduct of firms on the other hand, includes among other things, their price and output strategies, independent or collusive behaviour, merger activities and promotional activities such as advertising and research and development.\textsuperscript{280} Lastly, market performance refers to the efficiency of

\textsuperscript{270} Kahn 1981: 1; Cook 2001: 12.
\textsuperscript{271} Neuhoff et al 2006: 35.
\textsuperscript{272} Audretsch et al 2001: 615.
\textsuperscript{273} Audretsch et al 2001: 615
\textsuperscript{274} Kahn 1981: 1; Audretsch et al 2001: 615.
\textsuperscript{275} Reid 1987: 11.
\textsuperscript{276} Smit 2005: 8.
\textsuperscript{277} Smit 2005: 8.
\textsuperscript{278} Smit 2005: 8.
\textsuperscript{280} Lipczynski et al 2009: 8; Du Plessis and Gilbert 2008: 2.
markets irrespective of whether it refers to allocative, productive and/or dynamic efficiency.\textsuperscript{281}

The SCP can be illustrated as follows:\textsuperscript{282}

<table>
<thead>
<tr>
<th>Structure</th>
<th>Conduct</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perfect Competition</td>
<td>Marginal cost pricing</td>
<td>Allocative efficiency and equity between firms.</td>
</tr>
<tr>
<td>Imperfect Competition</td>
<td>Pricing deviates from marginal cost</td>
<td>Inefficiency and potential monopoly profits</td>
</tr>
</tbody>
</table>

According to this illustration, the closer a market structure resembles that of the perfectly competitive market, the higher market output and the lower market price will be.\textsuperscript{283} Such markets are also said to achieve the highest levels of efficiency and social welfare.\textsuperscript{284} On the other hand, market structures that more closely resembles a monopoly market are associated with lower levels of market output and higher market prices.\textsuperscript{285} Such markets are thus said to be less efficient and provide lower levels of social welfare relative to markets more closely resembling the perfectly competitive market structure.\textsuperscript{286} In other words, according to the SCP, the further a market's structure deviates from that of the perfectly competitive market, the further that market deviates from optimum efficiency and social welfare.\textsuperscript{287}

The SCP regards market concentration as the most important structural characteristic in determining market performance.\textsuperscript{288} Market concentration\textsuperscript{289} refers to the number of firms in the relevant market and their relative size in relation to one another.\textsuperscript{290} Stated differently, market concentration refers to the extent to which a small number of firms are responsible

\textsuperscript{281} Singleton 1986: 6.  
\textsuperscript{282} Reekie 1989: 38.  
\textsuperscript{283} López 2001: 360.  
\textsuperscript{284} López 2001: 360; Reekie 2000: 12.  
\textsuperscript{285} Weis 1979: 1105; Smit 2005: 8.  
\textsuperscript{286} Weis 1979: 1105; Smit 2005: 8.  
\textsuperscript{287} López 2001: 360.  
\textsuperscript{288} Reekie 1984: 147.  
\textsuperscript{289} It is more accurate to refer to industry concentration because an industry refers to a market's supply side or productive activities whereas the term “market” refers to both the demand and the supply side. However, for simplicity, this study refers to industry concentration when it refers to market concentration. For more information refer to Lipczynski et al 2009: 190.  
\textsuperscript{290} Cook 2001: 15.
for a large proportion of the economic activity within a market.\textsuperscript{291} For example, a market in which two firms produce 90 percent of the total output in that market will have a higher level of concentration than a market in which these two firms produce only 60 percent of the total output. Take note that market concentration not only refers to the number of firms in a market but also to the difference in the size between them.\textsuperscript{292} This contention that market concentration is the most important structural characteristic stems from the following.

The SCP was developed after empirical evidence indicated that the profits of firms in relatively more concentrated markets are significantly higher than those of firms in relatively less concentrated markets.\textsuperscript{293} Like the Neo-Classical School, the SCP also contends that firms will always strive to maximise their profits.\textsuperscript{294} This empirical evidence together with the profit maximising behaviour of firms resulted in the SCP to contend that concentrated markets facilitate the collusive behaviour between firms and allow firms to abuse their unilateral and/or collective market power to restrict output and increase price to obtain abnormal or higher profits.\textsuperscript{295} More specifically, the SCP contends that concentrated markets result in the firms within those markets having unilateral market power and it provides them with the incentive and the ability to act together (collude) so as to obtain collective market power.\textsuperscript{296} Accordingly, the SCP contends that firms in concentrated (imperfect) industries have significant market power and therefore, they will behave anti-competitively by setting prices above marginal cost which results in allocative inefficiency and abnormal profits.\textsuperscript{297}

This is known as the "Collusion Hypothesis" and more specifically, this hypothesis states that a positive correlation between market concentration and the profitability of the firms within that market is an indication of collusive behaviour and/or other abuses of market power designed to restrict output and increase prices to obtain abnormal profits within that market.\textsuperscript{298} The perfectly competitive market has a large number of sellers selling a homogeneous product and therefore it is characterised as being unconcentrated whereas

\begin{itemize}
\item \textsuperscript{291} OECD 1993: 23.
\item \textsuperscript{292} Fourie and Smith 1993: 199.
\item \textsuperscript{293} Du Plessis and Gilbert 2008: 4.
\item \textsuperscript{294} Baldwin 1987: 113.
\item \textsuperscript{295} Leach 1992: 144.
\item \textsuperscript{296} Du Plessis and Gilbert 2008: 2; Weis 1979: 1105.
\item \textsuperscript{297} Reekie 1984: 149.
\item \textsuperscript{298} Lipczynski 2009: 17.
\end{itemize}
monopoly markets are characterised as being highly concentrated because one firm is responsible for the total market output.\textsuperscript{299} Hence, the closer a market resembles the monopoly market structure the more concentrated that market is taken to be.\textsuperscript{300}

As mentioned, the perfectly competitive market is also characterised by the absence of barriers to entry and as a result, the treat of potential entrants, in addition to the market structure, also disciplines firms within that market to behave efficiently.\textsuperscript{301} Based upon this contention by the Neo-Classical School, the SCP contends that concentrated (imperfect) markets are only a real threat to efficient market performance if there are entry barriers that prohibit new firms from entering into that market.\textsuperscript{302} As a result, the SCP regards barriers to entry as the single most important structural characteristic of markets.\textsuperscript{303} However, the SCP contends that concentrated market structures, within which the firms have unilateral and/or collective market power, will entice and enable these firms to collude with one another to create barriers to entry and therefore, it is stated that the SCP regards market concentration as the most important structural characteristic in determining market performance.\textsuperscript{304}

Based upon this ideology, the SCP is of the opinion that government interference within the economy (market system) is only warranted in the context of regulating market structures and restructuring imperfect market structures.\textsuperscript{305} Since the SCP assumes that all firms strive to maximise their profits, conduct can be taken as given (maximising profits and minimising losses) and therefore, competition authorities need only concentrate on market structure for the purpose of increasing market performance.\textsuperscript{306} More specifically, the SCP is of the view that Competition authorities need only assess competition matters by evaluating where the structure of the relevant market lies between the continuum of the perfectly competitive market and the monopoly market.\textsuperscript{307} In fact, the SCP contends that it is futile to regulate market conduct because firms will simply find other ways to achieve the same result of increased prices, decreased output and the creation of barriers to entry for

\textsuperscript{299} Du Plessis and Gilbert 2008: 2.
\textsuperscript{300} Du Plessis and Gilbert 2008: 2.
\textsuperscript{301} George \textit{et al} 1995: 286.
\textsuperscript{302} George \textit{et al} 1995: 286.
\textsuperscript{303} Singleton 1986: 6.
\textsuperscript{304} Reekie 1984: 147; Singleton 1986: 10.
\textsuperscript{305} Baldwin 1987: 115.
\textsuperscript{306} Lipczynski \textit{et al} 2009: 74.
as long as the imperfect market structure remains unchanged.  

The SCP also regards the task of constantly policing markets as being too burdensome for competition authorities and consequently, the SCP is of the opinion that the only truly effective measures against anti-competitive conduct are the restructuring markets, divestiture and the elimination of barriers to entry. Hence, the SCP supports merger policy given that increased concentration is generally the result of mergers, especially horizontal mergers. It should be noted, however, that even though the SCP believes that concentrated markets result in allocative inefficiency, that they do not support the prohibition of mergers and anti-competitive conduct if it is conclusively proven that these practices will result in increased productive and dynamic efficiency (own emphasis).

The SCP has been subjected to various criticisms during the years despite several empirical studies validating it. These criticisms involve among others the following:

In 1982 Baumol developed the contestability theory in which he stated that if markets were to be perfectly contestable i.e., have no barriers to entry and exit, then the threat of potential competition will ensure efficient market performance regardless of the level of concentration (market structure). The contestability theory thus rejects the SCP’s claim that market concentration (imperfect market structures) always results in lower market performance.

The SCP’s reliance on market structure has also been criticised due to the Separation of Ownership and Control doctrine. According to this doctrine, firms are generally controlled by managers who do not necessarily have the same objectives as its owners with the owners’ objective being profit maximisation. Therefore, the assumption that firms will always strive to maximise their profits and minimise their costs is false. Accordingly, market conduct can’t be taken as given and hence it becomes an important determinant of

310 Singleton 1986: 12.
313 Baumol 1982.
314 Baumol 1982.
315 Lipczynski et al 2009: 76.
316 Lipczynski et al 2009: 76.
317 Lipczynski et al 2009: 76.
market performance.318

The validity of the correlation between concentration and profitability has also been severely criticised due to statistical and mathematical errors in its analysis.319 This includes the endogeneity problem between concentration and profitability which states that market structure and profitability are jointly determined and consequently, it is difficult to determine causality.320 The flawed nature of some of the profitability measures used to analyse this correlation has also been criticised.321

The SCP has also been criticized on the unidirectional flow of causality with the argument that future market structures can be determined by both market conduct and market performance.322 According to this argument, market conduct and market performance can both influence market structure. Examples of where market conduct influences market structure include, mergers and acquisitions that directly result in changes in market structure, predatory pricing, whereby firms lower the price of their products to below their production costs so as to steal customers away from their competitors, can also potentially result in changing market structures and increased market concentration.323 Examples of where market performance influences market structure include the situation where firms with high profits have the ability to expand within a market and thereby increasing concentration in that marker or where these firms can enter into other markets and thereby changing the other markets' structure and concentration.324 Based on these examples, the unidirectional flow of causality has been rejected and substituted by a multi-directional flow of causality (a feedback effect) where market structure, conduct and performance can all influence each other.325 Consequently, market structure cannot be taken to be the most important determinant of market performance.326

The most influential of all these criticisms came from the Chicago School of thought. The Chicago School views competition not with reference to market structure but rather as a

318 Lipczynski et al 2009: 76.
320 Brown and Brown 2001: 5.
322 Baldwin 1987: 117.
process that will always result in the most efficient market structure for a particular market, with some being highly concentrated and others being unconsentrated. The competition process is one in which only the most efficient firms survive with a market's structure being determined by this struggle for survival coupled with market conditions and the technical nature of the product. Accordingly, if a highly concentrated market structure is the most efficient market structure for a particular market, then this competition process (struggle for survival) will ensure that such a market structure prevails. Contrary to the Neo-Classical School, the Chicago School holds that collusion will not occur in highly concentrated markets because of the internal competition between firms and if collusion were to occur, then it will only be temporarily because the higher profits associated with collusion will attract new entrants into that market and render the collusive agreements ineffective. The competition process will thus destroy collusion and always result in the most efficient market structure by eliminating less efficient firms i.e., markets are highly contestable and market performance should be measured in terms of market conduct and market strategies and not in terms of market structure as suggested by the Neo-Classical School.

Based upon this ideology, the Chicago School emphasize that firms become large and profitable because of their superior efficiency and not because of their abuse of market power. As these more efficient firms become larger and more profitable they eliminate smaller and less efficient firms from that market and thereby increase that market's concentration. Therefore, market concentration and abnormal profits are the result of superior efficiency and not of collusion among market participants and the abuse of market power. This theory is known as the "Efficiency Hypothesis." The Chicago School thus rejects the causality of the SCP and claim that market performance (lower costs as a result of superior efficiency) determines market conduct (increased competition) which determines market structure (concentrated markets).

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327 Singleton 1986: 43.
328 Singleton 1986: 43-44.
329 Singleton 1986: 44.
330 Singleton 1986: 44.
332 Leach 1992: 144.
333 Du Plessis and Gilbert 2008: 3.
334 Leach 1992: 144.
336 Du Plessis and Gilbert 2008: 3.
As a result of all these assertions, the Chicago School is vehemently against any government interference within the economy, and the Chicago School regards government interference within the economy as nothing more than a punishment for being efficient. In fact, the Chicago School regards government interference as the only reason markets ever fail because, to the Chicago School, markets are always efficient and close to their long-run equilibriums.

2.3.3 The validity of the Structure-Conduct-Performance Paradigm in South Africa

The interpretation and application of the Competition Act was initially based upon the teachings of the SCP as illustrated by Reekie:

“The market figures in S7 of the Act of 45 and 35 per cent, are themselves, of course, arbitrary, and while the existence of a high share is not prohibited, there is at least an implied presumption of 'guilt' based on the disputed Structure: Conduct: Performance paradigm of industrial economics.”

The above mentioned criticisms of the SCP raised doubts on its validity for the South African economy and on the importance of market structure in determining market performance and hence, the importance of market structure for South African Competition matters. These criticisms, especially those of the Chicago School, eventually led to the assessment of the validity of the Collusion Hypothesis for the South African economy. This assessment was also warranted in light of the very high levels of concentration in the South African economy and the associated high prices in South Africa.

The importance of the validity of the Collusion Hypothesis is found in its influence on Competition Law. If the Collusion Hypothesis were to be valid, then Competition Law should focus exclusively upon market structure by regulating market concentration. If however, the Efficiency Hypothesis were to be valid then market concentration is of no

338 Blaug 2001: 47.
importance and the regulation of market concentration would be unjustifiable.\textsuperscript{344} Most importantly, if the Efficiency Hypothesis holds true then government interference within the functioning of the market system is only warranted to the extent that it prohibits collusive behaviour.\textsuperscript{345} In fact, market failure would then be the result of government interference aimed at regulating market structure.\textsuperscript{346}

The first author to test the validity of the SCP in South Africa was Reekie in 1984.\textsuperscript{347} His results provided an ambiguous interpretation supporting both the Collusion Hypothesis and the Efficiency Hypothesis.\textsuperscript{348} As a result, Reekie disputed the validity of the SCP for the South African economy.\textsuperscript{349} The next author to test the validity of the SCP in South Africa was Leach, in 1991.\textsuperscript{350} Leach concluded that the Efficiency Hypothesis rather than the Collusion Hypothesis were valid for the South African economy.\textsuperscript{351} However, in a later paper in 1997, Leach found the correlation between concentration and industry profitability to be consistent with both the Collusion Hypothesis and the Efficiency Hypothesis.\textsuperscript{352} Although neither Reekie nor Leach could entirely dismiss the validity of the SCP for the South African economy, they did cast significant doubt on its validity for the South African economy.

Contrarily to Reekie and Leach, other authors, most notably Fourie and Smith,\textsuperscript{353} have validated the Collusion Hypothesis for the South African economy but they too could not entirely dismiss the other hypothesis, namely the Efficiency Hypothesis.\textsuperscript{354} In 1998, Fourie and Smith published a paper in which they declared a stalemate between these two hypotheses citing various ideological and methodological differences between these two hypotheses as the reason for this stalemate and as a result, it is unknown whether the SCP is valid for the South African economy and if so, to what extent it is valid.\textsuperscript{355}

\begin{itemize}
\item \textsuperscript{344} Lipczynski 2009: 17.
\item \textsuperscript{345} Miller 1962: 65.
\item \textsuperscript{346} Blaug 2001: 47.
\item \textsuperscript{347} Du Plessis and Gilbert 2008: 5.
\item \textsuperscript{348} Reekie 1984: 154.
\item \textsuperscript{349} Reekie 1984: 154.
\item \textsuperscript{350} Du Plessis and Gilbert 2008: 5.
\item \textsuperscript{351} Leach 1992: 153.
\item \textsuperscript{352} Leach 1997: 12.
\item \textsuperscript{353} 1993; 1998 and 2001. Also, see Fourie 1996; Fedderke and Simbanegavi 2008; Fedderke \textit{et al} 2007 and Aghion \textit{et al} 2006.
\item \textsuperscript{354} Du Plessis and Gilbert 2008: 6.
\item \textsuperscript{355} Fourie and Smith 1998: 557.
\end{itemize}
As a result of these uncertainties, the South African competition authorities follow a holistic approach in which they consider all the relevant factors when assessing market power i.e., market structure, conduct and performance variables are considered. In this regard, the delineation of the relevant market in South African competition matters is very important since it includes all the potential competitive constraints (structure, conduct and performance variables) that prohibit firms from abusing their unilateral and/or collective market power to influence the proper functioning of South Africa's market system.

Nonetheless, the SCP and thus market structure remains an important consideration in South African competition matters and it continues to provide a very useful framework within which to assess the potential anti-competitive effects of conduct regulated by the Competition Act. In the merger between Santam Limited and Guardian National Insurance Company limited, the South African Competition Commission explicitly acknowledged that they continue to use the SCP, albeit in a highly augmented form in which they are hesitant to assume a unidirectional flow of causality from market structure, to market conduct, to market performance.

2.3.4 The Meaning of competition in Competition Law

The purpose of the Competition Act is to promote and maintain competition and therefore it prohibits conduct that it perceives as being anti-competitive in nature. As a result, for the Competition Act to be of any use, the term “competition” needs to be defined. In literature, competition has been defined as a process of rivalry between competitors in which they strive to win customers. In South Africa, competition has been defined in a similar manner as the following:

“In general terms competition involves the idea of a struggle between rivals endeavouring to obtain the same end. It may be said to exist whenever there is potential diversion of trade from one to another. For competition to exist the articles or services of the competitors should be related to the same purpose or must satisfy the same need.”

357 Boshoff 2006: 3.
358 Theron 2001: 621.
359 14/LM/Feb00: paragraph 45.
Although this definition may seem accurate and appropriate, closer inspection reveals that this definition is in truth, within the context of regulating the market system, slightly flawed.\textsuperscript{363} This definition does not provide for different types of competition nor does it provide for varying degrees of competition in any relevant market.\textsuperscript{364} This definition is also ineffective when determining whether specific conduct will prevent or lessen competition.\textsuperscript{365} Accordingly, this definition is problematic for competition authorities in regulating the competition process to ensure the proper functioning of the market system.\textsuperscript{366}

At this point, it is worth noting that the Competition Act does not define the term “competition.”\textsuperscript{367} At first, this may seem unusual given that competition is the purpose and hence also the relevance of the Competition Act in the South African legal system.\textsuperscript{368} The reason competition is not defined in the Competition Act is because the meaning is dependent upon the relevant market structure.\textsuperscript{369} Furthermore, as mentioned in chapter one, Competition Law is founded upon economic ideas, concepts and principles and accordingly, it is the economist’s perception of competition that is applicable to Competition Law.\textsuperscript{370}

For economists competition refers to the market structure where no firm is in a position to abuse its unilateral and/or collective market power.\textsuperscript{371} Given that competition is regarded as the regulatory mechanism which constrains firms from abusing their market power, competition refers to all the competitive constraints that prohibit firms from abusing their unilateral and/or collective market power i.e., competition refers to the environment and structural characteristics of the market within which competitors compete.\textsuperscript{372} This resulted in competition, in the context of Competition Law, to be defined as the “absence of market power”\textsuperscript{373} and as the “opposite of monopoly.”\textsuperscript{374} and accordingly, it is recommended that competition, in terms of Competition Law, should be defined with reference to those conditions that determine the degree and nature of rivalry between competitors.

\textsuperscript{363} McNulty 1968: 639-640; Land \textit{et al} 2010: 98.
\textsuperscript{364} Inferred from Neuhoff \textit{et al} 2006: 26 read with page 35.
\textsuperscript{365} Inferred from Neuhoff \textit{et al} 2006: 26.
\textsuperscript{366} Neuhoff \textit{et al} 2006: 26.
\textsuperscript{367} Competition Act 89/1998: section 1.
\textsuperscript{368} Competition Act 89/1998: section 2.
\textsuperscript{369} Neuhoff \textit{et al} 2006: 26.
\textsuperscript{370} Cseres 2005: 11-12.
\textsuperscript{371} Land \textit{et al} 2010: 98.
\textsuperscript{372} Land \textit{et al} 2010: 99.
\textsuperscript{373} Land \textit{et al} 2010: 98.
\textsuperscript{374} McNulty 1968: 639-640.
This study recommends that Competition should be defined as a dynamic process within which a diverse set of factors determine the degree and nature of the rivalry among competitors and hence market performance.\textsuperscript{375} Competition is not simply the rivalry between competitors as it also includes the business environment and the market structure within which competitors compete.

To conclude, this study contends that the concept of rivalry between competitors refers to the functioning of the market system where each firm strives to satisfy its self interest. Competition on the other hand refers to the business environment and the market structure within which this rivalry takes place.

### 2.4 Efficiency and the market models

#### 2.4.1 Allocative efficiency

##### 2.4.1.1 The perfectly competitive market

As discussed previously, in the perfectly competitive market no individual producer is in a position to abuse its market power i.e., no firm can ask any price higher than the market price.\textsuperscript{376} Additionally, it is held that the perfectly competitive firm can sell as much output as it wish at the market price.\textsuperscript{377} However, the fierce competition in that market implies that the perfectly competitive firm will sell zero units of output at any price higher than the market price.\textsuperscript{378} Since firms endeavour to obtain profit, there is no incentive for the perfectly competitive firm to ask any price lower than the market price.\textsuperscript{379} As a result, the perfectly competitive firm's price for each product sold is equal to the market price i.e., the same price is charged for all levels of output.\textsuperscript{380} Consequently, it is held that the marginal revenue (MR) of each firm is equal to the market price since every product is sold at the same market price.\textsuperscript{381} Market price is thus equal to the marginal revenue obtained from selling a marginal unit of output i.e., $P_m=MR$.\textsuperscript{382}

\textsuperscript{375} Land \textit{et al} 2010: 112.
\textsuperscript{376} Refer to section 2.2.
\textsuperscript{377} Refer to section 2.2.2.
\textsuperscript{378} Refer to section 2.2.2.1.
\textsuperscript{379} Refer to section 2.2.2.1.
\textsuperscript{380} Refer to section 2.2.2.1.
\textsuperscript{381} Cyert and Cohen 1965: 49-59.
\textsuperscript{382} Cyert and Cohen 1965: 49-59.
All firms are taken to be profit maximising firms and therefore firms will produce that level of output where MR=MC. The reason this level of output will maximise profits lays in the assumption that all firms are price takers and from the assumption that marginal cost is increasing as more output is produced. Accordingly, the gap between MR and MC will get smaller as more output is produced and hence, a firm will maximise its profits by producing that level of output where MR=MC i.e., a firm should increase its output up to the point where MC has increased so that it equals MR. Since firms in the perfectly competitive market are prohibited from asking any price other than the market price, these firms are in a position where their marginal revenue obtained by selling an additional unit of output is equal to the market price i.e., Pm=MR. Furthermore, because the firms in the perfectly competitive market will produce that level of output where MR=MC, the perfectly competitive market automatically arrives at the position where Pm=MR=MC.

The position of consumers in the perfectly competitive market is similar to that of the producers. In the perfectly competitive market, no individual consumer is in a position to influence the market price through his/her buying power. Consumers consume, within their budget constraints, that combination of goods and services from which they derive the highest utility. Given the scarcity of the economic resources, consumers are forced to choose between different combinations of goods and/or services with each combination providing varying levels of utility (benefit). Hence, consumer choices, as reflected in the prices they are prepared to pay for a product, is taken to be representative of the marginal utility or marginal benefit they receive from consuming that product. Stated differently, the aggregate market demand of all consumers is representative of their cumulative preferences. Hence, the following equation holds for the perfectly competitive market: Pm=MB.

383 Wetzstein 2005: 259-263.
384 McConnell and Brue 2008: 405.
385 McConnell and Brue 2008: 405.
386 McConnell and Brue 2008: 405.
387 McConnell and Brue 2008: 405.
388 Bohm 1987: 15.
389 Refer to section 2.5.4.
390 Refer to section 2.5.4.
391 Refer to section 2.5.4.
392 Wetzstein 2005: 299.
393 Wetzstein 2005: 299.
Given that the perfectly competitive market automatically arrives at the positions where \( P_m=MR=MC \) and where \( P_m=MB \), it is held that the perfectly competitive market automatically arrives at the position where \( P_m=MB=MR=MC \) i.e., allocative efficiency is automatically achieved by the market system.\(^{394}\) More specifically, at the point of allocative efficiency the MB society receives from consuming that product or that combination of products is equal to the cost to society to produce that product or that combination of products i.e., \( MB=MC \).\(^{395}\) To conclude, the market forces in the perfectly competitive market automatically coordinate and direct the economic activity within that market so as to produce the socially efficient quantity at the social efficient price and hence maximise social welfare.\(^{396}\)

2.4.1.2 The monopoly market

As discussed previously, in a monopoly market there is only one firm selling a unique product for which there are no close substitutes and consequently, the monopolist is unconstrained by the competition process.\(^{397}\) Accordingly, the monopolist is a price maker and not a price setter and it has the market power to determine the price or total output in that market.\(^{398}\)

Furthermore, because the monopolist is unconstrained by competition and a market price, its demand curve is downward sloping and identical to figure 1, the reason being that if the monopolist desires to increase its output it must decrease the price of all its products i.e., it cannot sell as many outputs as it desires at any given price.\(^{399}\) The monopolist is required to decrease the price if it wants to increase output, and because the price decrease is not only applicable on the additional units of output but also on the previous units of output, marginal revenue for each product is lower than the price for that product.\(^{400}\) The reason being, that marginal revenue should now be calculated by taking the marginal revenue received from selling a marginal unit and subtracting the loss incurred from also selling the

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\(^{395}\) Bohm 1987: 14-16.


\(^{397}\) Refer to section 2.2.1.2.

\(^{398}\) Refer to section 2.2.1.2.

\(^{399}\) Lipczynski et al 2009: 60-61.

\(^{400}\) Lipczynski et al 2009: 60-61; Wetzstein 2005: 379-380; McConnel and Brue 2008: 427. For more information see McConnel and Brue 2008: 427.
previous units at the now lower price. In other words, for the monopolist \( P \geq MR \), with \( P \) being the price set by the monopolist.

Firms are assumed to be profit maximising firms and the profit maximising level of output is taken to be that output where \( MR = MC \). As mentioned, since the monopolist is unconstrained by the competition process, it will charge the highest possible price at which it can sell that level of output where \( MR = MC \). Hence, the monopolist's price will always be higher than its marginal cost and marginal revenue. Also, as discussed in the preceding paragraphs, price is taken to be indicative of the value society places upon a product i.e., \( P_m = MB \). Therefore, because \( P \geq MR \) and given that the monopolist produces that level of output where \( MR = MC \), \( P(MB) > MC \) and allocative inefficiency is obtained.

As mentioned, allocative efficiency is achieved when \( P_m = MC \) and it is the same as stating that allocative efficiency will be obtained when \( MB = MC \), because \( P_m \) is indicative of \( MB \).

In the monopoly market, \( P > MC \) which means that \( MB > MC \). In other words, the marginal benefit society receives from consuming that product is higher than the cost to society to produce the corresponding quantity of that product. Stated differently, all consumers who value the product less than the new and increased price will abstain from buying that product. However, the value (MB) that some of these refraining consumers place upon that product is higher than the cost to produce that product. Therefore, allocative efficiency and social welfare will be enhanced by producing more output in that market up to the point where \( P(MB) = MC \) i.e., up to the point where the value that the most marginal consumer receives from consuming that product is equal to the MC to produce that product. Therefore, the monopoly market does not produce the socially efficient quantity at the socially efficient price which results in allocative inefficiency and social welfare losses.

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403 Refer to section 2.3.1 and 2.3.2.
404 Wish 1993: 3.
406 Refer to section 2.2.2.1.
2.4.2 Productive efficiency

2.4.2.1 The Perfectly competitive market versus the monopoly market

The profit maximising behaviour of firms led to the creation of the axiom that firms will always endeavour to achieve productive efficiency in order to maximise their profits.\textsuperscript{415} This axiom is called the Theory of the Internal Efficiency of the Firm.\textsuperscript{416} However, in 1966 economist Harvey Leibenstein developed the X-efficiency\textsuperscript{417} hypothesis.\textsuperscript{418} According to the X-Efficiency Hypothesis, a lack of competitive pressure results in various inefficiencies causing firms to become productive inefficient i.e., employees, firms and industries do not maximise their productive efficiency when the pressures of competition is low.\textsuperscript{419} Stated differently:\textsuperscript{420}

"....firms and economies do not operate on an outer-bound production possibility surface consistent with their resources. Rather they actually work on a production surface that is well within that outer bound. This means that for a variety of reasons people and organizations normally work neither as hard nor as effectively as they could."

Two possible explanations for this X-inefficiency of firms and economies are described by Comanor and Leibenstein:\textsuperscript{421}

"In the first place, the process of competition tends to eliminate high cost producers, while the existence of substantial market power often allows such firms to remain in business. This is due to the oft-noted fact that the high price-cost margins, which are established by firms with substantial market power, often serve as an umbrella which protects their high-cost rivals. Second, the process of competition, by mounting pressures on firm’s profits, tends to discipline management and employees to utilize their inputs, and to put forth effort, more energetically and more effectively than is the case where this pressure is absent."

\textsuperscript{415} McNulty 1967: 1250; Leibenstein 1975: 580; Rozen 1985: 661.
\textsuperscript{416} McNulty 1967: 1250.
\textsuperscript{417} X-efficiency refers to utilizing production inputs as efficiently as possible. Accordingly, X-efficiency refers to productive efficiency. For more information, refer to Leibenstein 1975: 582.
\textsuperscript{419} Leibenstein 1975: 580-582; Leibenstein 1966: 413; McNulty 1967: 1250; Rozen 1985: 661.
\textsuperscript{420} Leibenstein 1966: 413.
\textsuperscript{421} 1969: 304.
Competition is thus held to be a pre-requisite for productive efficiency and as a result, it is held that productive efficiency will be highest in conditions of perfect competition, the reason being that the pressure from the competition process ensures that firms need to increase their productive efficiency if they wish to stay in business in the relevant market.\footnote{Leibenstein 1966: 413; Leibenstein 1975: 604.}

To illustrate, the perfectly competitive market is characterized by a large number of buyers and sellers, low barriers to entry and exit, firms are taken to be price takers and firms are assumed to have no market power.\footnote{Refer to section 2.2.2.} As a result, firms that fail to profitably provide the product at the market price are forced to leave that market, and firms that are of the opinion that they can produce that product more efficiently than the incumbent firms will enter into that market, \textit{ceteris paribus}.\footnote{Schwartzman 1973: 756; Lee 1986: 81-82; Reid 1988: 42.} Eventually this competition process will force all firms in that market that wish to survive in that market to become productive efficient.\footnote{Schwartzman 1973: 756; Lee 1986: 81-82; Reid 1988: 42.} In addition to machinery and equipment, the competitive pressure will also increase the productive efficiency of the human capital by forcing managers and employees to become more productive efficient, \textit{ceteris paribus}.\footnote{Comanor and Leibenstein 1969: 304; Reid 1988: 42; Lee 1986: 82.}

To summarize, contrary to the perfectly competitive market, the monopoly market contains no competition and markets more closely resembling the monopoly market have lower levels of competition compared to perfectly competitive markets.\footnote{Refer to section 2.2.2.} As a result, firms in these markets tend to have significant levels of market power and this significant market power allows the monopolist to resist the competitive pressures and remain in business without having to be productive efficient.\footnote{Refer to section 2.2.2.}
2.4.3 Dynamic efficiency

2.4.3.1 The perfectly competitive market versus the monopoly market

It is contended that competition ensures dynamic efficiency because it serves as an incentive for firms to obtain and maintain a competitive advantage over their competitors by creating new products and/or services, new production and distributive methods and creating and/or entering (expanding) into new markets.\(^\text{429}\) It is also held that, in instances where innovation and technological advances can be obtained by various methods, the competition process ensures that the most efficient method(s) is chosen.\(^\text{430}\) In other words, it is held that market power results in lower levels of dynamic efficiency and therefore, monopoly markets results in dynamic inefficiency relative to perfectly competitive markets.\(^\text{431}\) More specifically, the market power of firms in the monopoly market results in these firms being able to survive in the relevant market without creating new products and/or services, new production and distributive methods and creating and/or entering (expanding) into other markets.\(^\text{432}\)

Dynamic efficiency is considered to be the most beneficial consequence of competition.\(^\text{433}\) Dynamic efficiencies also potentially have a larger influence on consumer welfare relative to static efficiencies.\(^\text{434}\) There is econometric evidence that suggests that perfect competition is not necessarily the most beneficial market structure for achieving dynamic efficiency and that some degree of market power could be necessary to achieve optimum levels of dynamic efficiency.\(^\text{435}\) Therefore, it is argued that dynamic efficiency often requires relatively large tradeoffs with competition and static efficiencies.\(^\text{436}\) As a result, competition authorities intent on increasing dynamic efficiency requires more sophisticated competition policies, and firms require relatively larger incentives (read monopoly power) to invest in research and development compared to those authorities and firms seeking only to increase static efficiency.\(^\text{437}\) In other words, competition authorities intent on increasing

\(^{434}\) Singh for UNCTAD 18 September 2002: vii.
\(^{436}\) Cseres 2005: 19.
dynamic efficiency need to effectively manage a very sophisticated balance between
dynamic efficiency, competition and static efficiency. This is discussed in more detail in
chapter three and four.

2.4.4 Transactional efficiency

2.4.4.1 The perfectly competitive market versus the monopoly market

It is held that the pressures of the competition process ensures transactional efficiency, the
reason being that it is held that faced with competition, firms are forced to seek out the
least expensive manner in which to carry out their transactions. Accordingly, it is
contended by this study that a monopolist that is not faced with competitive pressures, is
also not forced to seek out the least expensive manner in which to carry out its
transactions. Therefore, the monopolist is, ceteris paribus, not as transactional efficient as
firms faced with competitive pressures.

2.4.5 Total efficiency

2.4.5.1 The perfectly competitive market

The total efficiency obtained in the perfectly competitive market can also be illustrated
using figure 1.

In the perfectly competitive market all firms are price takers and consequently, they are
constrained from asking any price other than the market price. As a result, the marginal
revenue of all firms in the perfectly competitive market is equal to the market price. Also
discussed previously, is the axiom that profit maximising firms will produce that level of
output where MR=MC. Accordingly, in figure 1, the producers will sell Q1 quantity of
output at the market price of Pc and the market is positioned at point B where market
demand is equal to market supply. At this point, market equilibrium, the consumers'
maximum willingness to pay is equal to the producers' minimum willingness to sell

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438 Cseres 2005: 19.
440 Refer to section 2.2.1.1.
441 Refer to section 2.4.
442 Refer to section 2.4.
Accordingly, the cost to society of producing that quantity of output is equal to the benefit society receives from consuming that quantity of the product and allocative efficiency is obtained.\textsuperscript{444}

Since it is held that firms in the perfectly competitive market are productive efficient it is assumed that these firms’ marginal cost is as low as possible and hence their supply curves are positioned at the lowest possible position.\textsuperscript{445} Evidently, any change in the productive efficiency of this market will cause the supply curve to shift, which will have an effect upon both the consumer and producer surpluses.\textsuperscript{446} It has also been discussed that dynamic efficiency will be obtained within the perfectly competitive market.\textsuperscript{447} However, dynamic efficiency could alter either the preferences of consumers i.e., the demand curve or it could alter the productive efficiency of producers and thus cause the supply curve to shift.\textsuperscript{448} Nonetheless, any change in the dynamic efficiency within this market should have an effect upon the consumer and producer surpluses.

Since the perfectly competitive market results in these efficiencies, it is held that the consumer and producer surpluses are maximised within the perfectly competitive market and therefore, total efficiency and social welfare are also maximised.\textsuperscript{449} This is illustrated in figure 1 by area ABC.\textsuperscript{450} Lastly, note that any change in allocative, productive and/or dynamic efficiency should result in changes in the consumer and producer surpluses and hence also in the total efficiency and social welfare of the economy.\textsuperscript{451}

\textsuperscript{443} Smit 2005: 5.  
\textsuperscript{444} Smit 2005: 5.  
\textsuperscript{446} Refer to section 2.2.3.1.  
\textsuperscript{447} Refer to section 2.5.5.3.  
\textsuperscript{451} Mishan 1981: 146-147.
2.4.5.2 The monopoly market

The monopoly market is illustrated by figure 2.\textsuperscript{452}

Figure 2.

![Monopoly Market Diagram]

In figure 2, P\textsubscript{c} and Q\textsubscript{c} represents the market price and the corresponding market output in the perfectly competitive market.\textsuperscript{453} It is held that the monopolist will produce that quantity of output where MR=MC and that it will ask the highest price possible for that quantity of output.\textsuperscript{454} The result is that the monopolist will produce Q\textsubscript{m} quantity of output at price P\textsubscript{m}.\textsuperscript{455}

At P\textsubscript{m}, the market price is higher than the monopolist's marginal cost and therefore the marginal benefit to society from consuming that quantity of output is higher than the cost to society of producing that quantity and hence allocative efficiency is no longer obtained.\textsuperscript{456}

More specifically, at the higher market price that proportion of society who values the product less than the new higher market price are excluded from the market and therefore

\textsuperscript{452} Figure 2 was augmented to suit this discussion and obtained by combining figure 3 in Neuhoff \textit{et al} 2009: 45 with figure 3.6 in Lipczynski \textit{et al} 2009: 65.

\textsuperscript{453} Neuhoff \textit{et al} 2009: 45; Lipczynski \textit{et al} 2009: 65.

\textsuperscript{454} Refer to section 2.4.1.

\textsuperscript{455} Neuhoff \textit{et al} 2009: 45; Lipczynski \textit{et al} 2009: 65.

\textsuperscript{456} Refer to section 2.4.1.
the market is operating at a position of allocative inefficiency.\textsuperscript{457} The monopolist will also not be productive efficient and therefore, the monopolist's marginal cost will not be at its lowest possible level.\textsuperscript{458} It is also held that the monopolist is not as dynamic efficient as firms in the perfectly competitive market.\textsuperscript{459} As a result of these defects in monopoly market, it is held that total efficiency and social welfare are not maximised within the monopoly market.\textsuperscript{460}

To illustrate, in figure 2, the consumer surplus in the perfectly competitive market is represented by area ABPc and the producer surplus is represented by area ACPc. In the case of a monopoly market, the price increases from Pc to Pm and the quantity supplied decreases from Qc to Qm. The consumer surplus is now represented by area BDPm and the producer surplus by area CEDPm. Consequently, the consumer surplus is reduced by area PmPcAD and the producer surplus is increased by area PmPcFD and reduced by area FAE.

Using the consumer and producer surpluses, the question remains on what effect these changes had upon the total efficiency and social welfare of this monopoly market? By comparing the magnitude of the consumer and producer surpluses in the perfectly competitive market with their magnitude in the monopoly market, it is clear that area PmPcDF was transferred from consumers to the monopolist (the producer).\textsuperscript{461}

Total efficiency and social welfare is taken to be the sum of the consumer and the producer surplus and therefore, this transfer of surplus from consumers to the producer (monopolist) has no effect upon the total efficiency and social welfare of this monopoly market.\textsuperscript{462} However, area DEA is not transferred to either the consumers nor to the producer (monopolist) and as a result area DEA is said to be an absolute loss in efficiency and social welfare to society and the economy.\textsuperscript{463} This loss to society is called the deadweight-loss and it represents the loss in total efficiency or social welfare that results from monopoly markets.\textsuperscript{464} More specifically, the deadweight-loss is that part of the total

\textsuperscript{457} Refer to section 2.4.1.
\textsuperscript{458} Refer to section 2.4.2.
\textsuperscript{459} Refer to section 2.4.3.
\textsuperscript{460} Neuhoff et al 2009: 45; Lipczynski et al 2009: 65.
\textsuperscript{461} Neuhoff et al 2009: 45; Lipczynski et al 2009: 65.
\textsuperscript{462} Bergson 1973: 855; Posner 1975: 807-808.
\textsuperscript{463} Smit 2005: 5; Wetzstein 2005: 306.
\textsuperscript{464} Smit 2005: 5; Wetzstein 2005: 306.
decrease in surplus that is not transferred from one economic agent, say consumers, to another, say producers.\footnote{Wetzstein 2005: 306.} The deadweight-loss is also referred to as that loss in consumer and producer surpluses that result form the abuse of market power.\footnote{Gifford and Kudrle 2005: 431.}

This market performance as illustrated by the deadweight-loss in figure 2, is generally the market performance that forms the rationale for regulating monopoly market structures and the abuse of market power.\footnote{Reekie 2000: 21.} However, depending upon the welfare standard favoured by a particular competition authority, Competition Law will either seek to increase the consumer surplus or decrease the deadweight-loss.\footnote{Riziotis 2008: 105.} If the consumer surplus approach is followed then a loss in consumer surplus will be regarded as a loss in efficiency and social welfare.\footnote{Bian and McFetridge 2000: 298.} On the other hand, if the deadweight-loss approach (also called the total welfare approach) is followed, then a reduction in consumer surplus will not be regarded as a loss in efficiency provided that the loss in consumer welfare is transferred to the producers without any deadweight-loss to society.\footnote{Salop 2010: 336.} These welfare standards are discussed in detail in chapter four, with chapter five considering their relevance for the Efficiency Defence.

2.5 Closing remarks

These closing remarks serve the purpose of enlightenment by informing the reader of various other and dissimilar economic theories, explanations and opinions from those views expressed in this study. Only the three most relevant to the purpose of this study are mentioned hereunder.

2.5.1 Natural monopoly

Despite the condemnation aimed at the monopoly market structure, as discussed throughout this study, there are markets (instances) in which a monopoly market structure will result in the most efficient market performance.\footnote{Waterson 1988: 13.} These markets are known as natural
monopolies.\textsuperscript{472} A natural monopoly is said to exist when a market is characterised by decreasing average per unit costs throughout the relevant output range given by the demand function.\textsuperscript{473} In other words, the average cost of producing a marginal unit of output is continuously decreasing with each marginal unit and this decreasing average costs is applicable to all of the quantities demanded for that product in that market.\textsuperscript{474}

The result of a natural monopoly is that efficiency within that market will only be maximised when there is only one producer in that market.\textsuperscript{475} Hence, increased competition in this context will result in lower levels of efficiency and social welfare.\textsuperscript{476} This is best explained by way of an example.

Suppose that the total demand in a hypothetical market for a hypothetical product is equal to 900 units. Suppose also that the per unit average cost of production is decreasing with each marginal unit of production i.e., each subsequent marginal unit is less expensive to produce than the previous unit. Also, suppose there is only one producer in that market and that this producer provides for the total demand in that market. The result of this is that this producer will have reached the optimum efficiency in that market, relative to market demand, at the 900\textsuperscript{th} unit of output, all other things being equal.

Furthermore, suppose the competition authorities in the hypothetical market decides to increase competition in that market from one producer to three producers and also assume that all three producers provide equal quantities of that product in relation to total market demand i.e., each producer provides 300 units. The result of this will be that efficiency within that market would have decreased because each producer is now only producing 300 units and not the optimum quantity which is 900 units.

\subsection*{2.5.2 X-efficiency}

When Leibenstein introduced the X-Efficiency Hypothesis into economic literature, he also gave econometric evidence suggesting that the loss in X-efficiency, which results from monopoly markets, are likely to be larger than those losses associated with the increase in

\begin{itemize}
\item \textsuperscript{472} Mosca 2008: 317-318.
\item \textsuperscript{473} Waterson 1988: 13.
\item \textsuperscript{474} Mosca 2008: 317-318.
\item \textsuperscript{475} Waterson 1988: 13.
\item \textsuperscript{476} Mosca 2008: 317-318.
\end{itemize}
price. In other words, the losses in productive efficiency resulting from a monopoly market are likely to be higher than those losses in allocative efficiency associated with monopoly markets. This suggests that if production inefficiency where to be taken into account, the loss in efficiency and social welfare incurred by monopoly markets are substantially larger than those losses illustrated in figure 2.

However, Leibenstein’s theory of X-efficiency has been criticised by several authors questioning the validity of the X-Efficiency Hypothesis. Nonetheless, others have endorsed the X-Efficiency Hypothesis and it seems as if the X-Efficiency Hypothesis has become an established addition to economic theory and practice.

2.5.3 Contestability

In this chapter it has been stated that competition authorities almost exclusively consider market structure to determine the performance of the relevant market. However, Competition Law has been greatly influenced by Baumol's theory of contestability in which he states that if markets were to be perfectly contestable i.e., have no barriers to entry and exit, then the threat of potential competition will ensure efficient market performance regardless of concentration levels (market structure). More specifically, it is held that the threat of potential entry will constrain firms in contestable markets from abusing their market power. As a result of this theory, competition authorities nowadays explicitly considers the contestability of markets together with their structures. Accordingly, the holistic approach followed by the South Africa competition authorities, in which they consider all the factors that constrain the firm(s) ability to abuse its market power including the contestability of a market, seem to be in line with contemporary economic theory and international best practice.

480 Reekie 2000: 23.
482 Baumol 1982.
483 Hay 1993: 11.
484 Stenborg 2004: 2; Hay 1993: 11.
485 Refer to section 2.3.4.
Chapter three: The Efficiency Defence in the South African Competition Act

3.1 The Williamson tradeoff

3.1.1 The origin of the Efficiency Defence

In 1968, economist Oliver Williamson developed a hypothesis which came to be known as the "Williamson tradeoff." According to this hypothesis, Williamson argued that a merger could potentially create market power, the ability to increase prices above marginal cost which results in allocative inefficiency, while simultaneously creating productive efficiencies. Williamson further argued that in some instances the gains in productive efficiencies could outweigh the losses in allocative efficiency. In other words, mergers can potentially result in higher prices and thus in allocative inefficiency and a loss in consumer welfare while simultaneously resulting in lower production costs, with these savings in production costs outweighing the losses in allocative efficiency.

Stated differently, the loss in the consumer surplus as a result of the abuse of market power obtained through a merger, can potentially be offset by an increase in the producer surplus. As discussed previously, the deadweight-loss, which measures the loss in total efficiency, is calculated with reference to the difference between the loss in the consumer surplus and the gain in the producer surplus. If the gain in the producer surplus is larger than the loss in the consumer surplus, then there is no deadweight-loss (loss in total efficiency) and hence, the anti-competitive market conduct (abuse of market power) improves the total efficiency of the economy and therefore it should be permitted. The total efficiency gain is to be found in the fact that fewer resources are now required to produce the specific product(s) and therefore these “saved” resources can now be allocated to the production of other goods and services from which consumers also derive utility.

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486 Trident Steel (Pty) Ltd and Dorbyl (Pty) Ltd 2000 case 89/LM/Oct00: paragraph 42.
490 Refer to section 2.4.5.
The Williamson tradeoff is illustrated by figure 3.

In figure 3, \( P_c \) and \( Q_c \) represents the price and quantity that prevailed in the market prior to a merger. Assuming the proposed merger results in market power, market price increases from \( P_c \) to \( P_m \) and market output decreases from \( Q_c \) to \( Q_m \). This results in a loss in the consumer surplus (allocative inefficiency), which is represented by the shaded area B. However, the merger also results in lower per unit production costs (productive efficiency) which is represented by the shaded area A. In this example, shaded area A is larger than shaded area B and consequently, it is held that this merger will result in productive efficiency gains that will offset the losses in allocative efficiency. As a result, the total efficiency and social welfare of the economy will be enhanced if the merger were to be permitted. The Williamson tradeoff specifically requires that the productive efficiency gains must be greater than the deadweight-loss for it to be taken that total efficiency and

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494 Figure obtained from Reekie 2000: 23.
495 Reekie 2000: 23.
496 Reekie 2000: 23.
social welfare will be enhanced by a merger.\textsuperscript{500}

Although the Williamson tradeoff is very attractive because of its elegance and simplicity, it has been severely criticised as being of little practical use because of the immense difficulty and complexity of practically implementing it into competition policy.\textsuperscript{501} Despite these immense difficulties, the Canadian legislator implemented this tradeoff analyses into Canadian competition policy by way of section 96 of the Canadian Competition Act\textsuperscript{502} and thereby, becoming the first country to provide a true defence for anti-competitive market conduct.\textsuperscript{503} This defence is known as the Efficiency Defence and Section 96 reads as follows:

"The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made."

The Efficiency Defence contained in the South African Competition Act, is based upon and for nearly all practical reasons identical to the Efficiency Defence contained in section 96 of the Canadian Competition Act.\textsuperscript{504}

3.1.2 The tradeoff between static and dynamic efficiencies

As mentioned, Competition Law regulates anti-competitive market conduct that results in allocative inefficiency through increased prices and decreased output.\textsuperscript{505} As a result, it is held that Competition Law in essence regulates allocative efficiency.\textsuperscript{506} In light of this and the introduction of the Williamson tradeoff, the goal of Competition Law has been defined as “the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare.”\textsuperscript{507} This statement clearly identifies the main

\textsuperscript{500} OECD 1996: 6.
\textsuperscript{501} Trident Steel (Pty) Ltd and Dorbyl (Pty) Ltd 2000 89/LM/Oct00: paragraph 43.
\textsuperscript{502} 1985/c-34
\textsuperscript{503} Trident Steel (Pty) Ltd and Dorbyl (Pty) Ltd 89/LM/Oct00: paragraph 48.
\textsuperscript{504} Tongaat Hulett Group (Pty) Ltd and Transvaal Suiker Bpk 83/LM/Jul00: footnote 18; Trident Steel (Pty) Ltd and Dorbyl (Pty) Ltd 2000 89/LM/Oct00: paragraph 42.
\textsuperscript{505} Refer to chapter two.
\textsuperscript{506} Kolasky and Dick 2003: 242.
\textsuperscript{507} Bork 1993: 91.
conflict in Competition Law brought about by the implementation of the Efficiency Defence as contemplated by Williamson, namely the conflict between allocative and productive efficiency with the Williamson tradeoff weighing allocative efficiency against productive efficiency.\textsuperscript{508} This is illustrated in the following paragraph.

If the abuse of market power results in decreased allocative efficiency, that conduct is held to be anti-competitive and thus prohibited.\textsuperscript{509} However, the perpetrating firms then have the opportunity to raise productive efficiencies (that will result from their conduct) which will enhance the efficient use of the scarce economic resources.\textsuperscript{510} If the claimed productive efficiencies outweigh the loss in allocative efficiency then the total efficiency of the economy is enhanced through the better use of the scarce economic resources and consequently, the anti-competitive conduct should be permitted.\textsuperscript{511}

Attention has recently shifted towards the attainment of dynamic efficiencies because dynamic efficiencies are reasoned to be more important than static efficiencies because they are assumed to be recurring over time whereas static efficiencies are taken to occur only once.\textsuperscript{512} It is also held that dynamic efficiencies will, over time, outweigh static efficiencies even if the static efficiencies were initially larger.\textsuperscript{513} However, dynamic efficiencies have one large drawback and that is that they are exceedingly difficult to identify and quantify and in practice, it is unlikely that static and dynamic efficiencies will be realised simultaneously.\textsuperscript{514} The reason being that dynamic efficiency requires a greater degree of market power (anti-competitive market conduct) to be realised compared to static efficiencies.\textsuperscript{515} Stated differently, a perpetrating firm that raises dynamic efficiencies as a defence will generally be accused of greater anti-competitive conduct (market power) than a perpetrating firm that raises static efficiencies as a defence because a greater degree of market power is required to achieve dynamic efficiencies and as a result, the Efficiency Defence and Competition Law also entails a tradeoff between dynamic and static efficiencies.\textsuperscript{516} More specifically, competition authorities have to balance the larger

\begin{itemize}
  \item \textsuperscript{508} Cseres 2005: 18; UNCTAD 1998: 2.
  \item \textsuperscript{509} Refer to chapter two.
  \item \textsuperscript{510} OECD 1996: 6.
  \item \textsuperscript{511} Cseres 2005: 18; UNCTAD 1998: 2.
  \item \textsuperscript{512} OECD 2007: 9.
  \item \textsuperscript{513} OECD 2007: 9.
  \item \textsuperscript{514} Cseres 2005: 18.
  \item \textsuperscript{515} UNCTAD 1998: 10.
  \item \textsuperscript{516} UNCTAD 1998: 2.
\end{itemize}
anti-competitive effects that goes with the larger dynamic efficiencies which in turn, may result in static inefficiencies, against the smaller anti-competitive effects that goes with static efficiencies which in turn, may prohibit dynamic efficiencies to be attained.

3.2 The welfare standard

3.2.1 Definition and relevance of welfare standards

As discussed previously, the purpose of Competition Law is to promote the efficiency of the economy and to improve social welfare and therefore Competition Law prohibits anti-competitive market conduct that results in decreased allocative efficiency. However, if the perpetrating parties can prove that their anti-competitive conduct also results in other efficiencies that outweigh the loss in allocative efficiency then their anti-competitive conduct will be approved. The Efficiency Defence thus consists of a weighing process whereby allocative efficiency is weighed against the other types of efficiencies, and if this weighing process indicates that the anti-competitive market conduct will result in a nett increase in efficiency then, the anti-competitive market conduct should be allowed. Needless to say, this weighing process requires that specific weights be assigned to the different types of efficiencies. These weights are determined by the applicable welfare standard and as a result, the interpretation and application of the Efficiency Defence is determined by the applicable welfare standard.

De la Mano defines the welfare standard as follows:

"The resolution of the efficiency tradeoffs that arise in merger cases often hinges upon the relative weight given to the welfare of the different groups of market participants: essentially merging firms, competitors and consumers. The rule chosen to assign such weights is referred to as the welfare standard. The choice of the relevant welfare standard is determined by whose welfare the merger enforcement agency seeks to maximise."

There are numerous welfare standards, however, this study will only consider five, namely

518 Refer to section 3.1.
519 Refer to section 3.1.
the total welfare standard, the consumer welfare standard, the price standard, the consumer surplus and resource savings standard, and the balancing weight standard. Even though five welfare standards are discussed, only the total and the consumer welfare standards are relevant of the purposes of this study. The other three welfare standards are nonetheless included in this study as they are helpful in explaining the substance of and the differences between the total welfare and the consumer welfare standards.

3.2.2 Types of welfare standards

3.2.2.1 Total welfare or total surplus standard

The total welfare or total surplus standard is used to maximise economic efficiency and it is the welfare standard utilised in terms of the Williamson tradeoff. According to this standard, anti-competitive market conduct should be allowed if it enhances the total surplus of the market (economy). In this context, the abuse of market power results in a loss in consumer surplus whereas the efficiencies raised by the perpetrating parties results in an increased producer surplus. If this increase in the producer surplus is larger than the decrease in consumer surplus then the total surplus in the market have been enhanced by the anti-competitive market conduct and hence, it should be permitted. The total welfare standard thus assigns equal weight to both consumers and producers. The reason being that it is held that even producers (shareholders) are consumers in their spare time and accordingly, there is no reason to benefit consumers to the detriment of producers. In the context of the total welfare standard, a decrease in allocative efficiency should be outweighed by gains in productive and/or dynamic efficiencies.

3.2.2.2 Consumer welfare or consumer surplus standard

On the other hand, the consumer welfare or consumer surplus standard is used to maximise consumer surplus and therefore, it assigns all the weight to consumer

524 Majumdar 2008: 144.
528 Majumdar 2008: 144.
529 De la Mano 2002: 19.
interests. According to anti-competitive market conduct will only be permitted if consumer welfare will not be decreased as a result thereof. In other words, the efficiency gains must be passed on to consumers in terms of lower prices, improved quality or increased variety in products and services. The consumer surplus standard thus weighs allocative efficiency against the market power required to attain increased dynamic and/or productive efficiencies with the understanding that in the event the market power required to increase dynamic and/or productive efficiencies results in a loss in allocative efficiency, then that anti-competitive conduct will be prohibited. More specifically, the consumer welfare or consumer surplus standard does not allow for any transfer of consumer surplus to producers whereas the total surplus standard allows for the distribution of consumer surplus to producers. However, although the consumer welfare standard generally does not allow for any transfer of consumer surplus to producers, it will become clear in the following chapter that such a transfer is allowed provided that it benefits consumers in terms of improved quality and/or new or improved products. More specifically, the consumer welfare standard will permit anti-competitive market conduct which results in increased prices and hence a loss in the consumer surplus, provided that the anti-competitive market conduct also results in new or improved goods and services or an increase in the quality of the goods and services. The consumer welfare standard will thus only allow anti-competitive market conduct insofar that it benefits consumers.

It should be noted that the term “consumer surplus” has falsely been used by supporters of the Chicago School of thought, especially by Robert Bork, to describe the total welfare standard. When these supporters of the Chicago school speak about consumers they refer to all consumers in society (including final consumers, intermediary purchasers and producers) and not only to final consumers.

530 Salop 2010: 336.
531 Salop 2010: 336.
532 De la Mano 2002: 18.
533 De la Mano 2002: 19.
534 De la Mano 2002: 19.
536 Salop 2010: 336.
537 Rosch 2007: 354.
3.2.2.3 Price standard

The price standard is similar to the consumer welfare standard with the exception that under the price standard, anti-competitive conduct will not be permitted if it results in a price increase of the relevant goods and/or services.\textsuperscript{538} The difference between the consumer welfare standard and the price standard is that the consumer welfare standard will permit anti-competitive conduct which results in increased prices, provided that the anti-competitive market conduct also results in new or improved goods and services or an increase in the quality of the goods and services.\textsuperscript{539} In other words, whereas the price standard only considers the anti-competitive market conduct's effect on prices, the consumer welfare standard also considers innovation or dynamic efficiency.\textsuperscript{540} Nonetheless, the price and consumer welfare standards are identical in the context that they only consider, contrarily to the total welfare standard, the effect of the anti-competitive market conduct upon consumer welfare.\textsuperscript{541}

According to the price standard, competition authorities have to assess whether the perpetrating parties will obtain market power through their anti-competitive market conduct so as to be able them to raise prices.\textsuperscript{542} The competition authorities will then weigh this market power against any efficiencies that will result in decreased marginal costs for the perpetrating parties.\textsuperscript{543} The anti-competitive market conduct will then only be permitted if the decrease in marginal costs is sufficient to compensate the decrease in the demand elasticity of price facing the perpetrating firms as a result of their increased market power.\textsuperscript{544} The importance of marginal costs will become clear in section 4.5.

3.2.2.4 Consumer surplus and resource savings standard

This standard is similar to the total welfare standard in that it also trades efficiencies that result in resource savings against losses in consumer surplus.\textsuperscript{545} However, contrarily to the total welfare standard, the transfer of consumer surplus to producers are added to the

\textsuperscript{538} Bian and McFetridge 2000: 298.
\textsuperscript{539} Renckens 2007: 155.
\textsuperscript{540} Renckens 2007: 155.
\textsuperscript{541} Renckens 2007: 155.
\textsuperscript{542} Gifford and Kudrle 2005: 435.
\textsuperscript{543} Gifford and Kudrle 2005: 435.
\textsuperscript{544} Gifford and Kudrle 2005: 435.
\textsuperscript{545} Gifford and Kudrle 2005: 436.
loss in the consumer surplus.\textsuperscript{546} This standard thus takes the whole loss in consumer surplus into consideration whereas the total welfare standard only considers that part of the loss in consumer surplus that is not transferred to producers.\textsuperscript{547} This standard is thus similar to the consumer welfare standard in the context that the redistribution of consumer surplus to producers are also counted as a loss. However, according to this standard, the efficiency gains do not have to benefit consumers.\textsuperscript{548}

3.2.2.5 Balancing weight standard

According to this standard, competition authorities are given the power and discretion to determine their own weights to be applied to the interests of consumers and producers.\textsuperscript{549} This standard is similar to the total welfare standard in that it starts off neutrally with respect to the weights given to consumer and producer interests.\textsuperscript{550} However, this standard then allows the competition authorities to adjust these weights on a case-by-case basis as they see fit in terms of the relevant social values.\textsuperscript{551} Generally, consumer interests are given more weight relative to producer interests.\textsuperscript{552} However, in cases where the interests of producers are more important than the interests of consumers, producer interests will be given more weight.\textsuperscript{553}

The balancing weight standard is calculated as follows:

\[ 1(A + B) - w(A + C) = 0 \]

Where:
A = that part of the consumer surplus that is redistributed from consumers to producers.
B = the efficiency gains.
W = the balancing weight.
C = the deadweight-loss.
1(A + B) = the gains to producers.

\textsuperscript{546} Gifford and Kudrle 2005: 436.
\textsuperscript{547} Gifford and Kudrle 2005: 436.
\textsuperscript{548} Gifford and Kudrle 2005: 436.
\textsuperscript{549} Commissioner of Competition v. Superior Propane Inc 2002 CACT 16: Paragraph 102-103.
\textsuperscript{550} Renckens 2007: 156.
\textsuperscript{551} Commissioner of Competition v. Superior Propane Inc 2002 CACT 16: Paragraph 102-103 and 110.
\textsuperscript{552} Renckens 2007: 156.
\textsuperscript{553} Renckens 2007: 156.
w(A + C) = losses to consumers.

For the above equation to balance, w can never be less than one and as a result, this standard is a mixture between the total and consumer welfare standards because if w = 1 then the total welfare standard is satisfied because producers and consumer interests are given equal weight. However, if w > 1 then more weight is given to consumer interests and consequently, this standard then imitates the consumer welfare standard. This standard can, however, never be identical to the consumer welfare standard because even when more weight is assigned to consumer interests, it is still possible for the raised efficiencies to outweigh consumer interests which is impossible under the consumer welfare standard.

This standard was first implemented in the case between the Commissioner of Competition v. Superior Propane Inc.\textsuperscript{554} In this case, the Canadian Competition Tribunal calculated A to equal $29.2 million, B to equal $40.5 million and C to equal $3 million.\textsuperscript{555} Adding these values into the equation, w is equal to 1.6.\textsuperscript{556} Accordingly, it was found that consumers suffer a loss that is 60 percent higher than the gains to producers.\textsuperscript{557} The Canadian Competition Tribunal then weighed the higher consumer loss against the smaller gains to producers in light of the Canadian social values and found that the 60 percent higher loss to consumers were not sufficient to prohibit the merger.\textsuperscript{558}

3.3 Treatment of efficiencies

Efficiencies can be treated in two ways, namely through an efficiency rebuttal or through an Efficiency Defence.\textsuperscript{559} In terms of an efficiency rebuttal, the perpetrating parties need to prove that their increase in market power will not result in increased prices and decreased output.\textsuperscript{560} More specifically, the perpetrating parties need to prove that the efficiencies will reverse the substantial prevention or lessening of competition so that their anti-competitive market conduct in fact, does not result in anti-competitive effects.\textsuperscript{561} As a result, it is often argued that the efficiency rebuttal is only applicable under the consumer welfare or the

\begin{thebibliography}{9}
\bibitem{554} 2002 CACT 16.
\bibitem{555} De la Mano 2002: vii.
\bibitem{556} De la Mano 2002: vii.
\bibitem{557} Ahmed 2006: 613.
\bibitem{558} Ahmed 2006: 613.
\bibitem{559} De la Mano 2002: vii.
\bibitem{560} De la Mano 2002: vii.
\bibitem{561} De la Mano 2002: vii.
\end{thebibliography}
price standards because the increased prices and decreased output that results from the conduct must be reversed by the efficiencies so that prices decrease and output increase. Under the efficiency rebuttal, efficiencies must rebut the anti-competitive effects of the increase in price and the decrease in output so that it cannot be said that the conduct is anti-competitive. Some jurisdictions, most notably the US and the EU, has what they call a pass-on requirement whereby all or a portion of the efficiency gains must be passed onto consumers in terms of lower prices and/or new or improved products and services. This pass-on requirement is analogous to an efficiency rebuttal given that consumers must benefit from the raised efficiencies to such an extent that the benefits to consumers rebut any potential anti-competitive effects of the anti-competitive market conduct.

Under an Efficiency Defence, efficiencies can be used to justify anti-competitive market conduct that results in increased prices and decreased output provided that the efficiency gains (increase in producer surplus) are larger than the loss in the consumer surplus or the deadweight-loss. In this context, efficiencies justify the anti-competitive effects that results from the abuse of market power. It is held that it is only when efficiencies are able to justify anti-competitive effects that efficiencies are used as a true defence. It is also argued that the Efficiency Defence is only applicable under a total welfare standard where a loss in consumer surplus can be justified through an increase in other efficiencies (producer surplus).

Another difference between an efficiency rebuttal and an Efficiency Defence relates to the procedural dimension. The efficiency rebuttal is used during the assessment by the competition authorities when they determine whether the relevant market conduct is anti-competitive. The Efficiency Defence in turn, is used to justify the anti-competitive effects after the conduct has been found to be anti-competitive.

563 Renckens 2007: 171.
564 Kiljaijski 2003: 652.
566 Kiljaijski 2003: 660.
570 Renckens 2007: 171.
571 Renckens 2007: 171.
572 Renckens 2007: 171.
Having stated the theoretical distinction between an efficiency rebuttal and a true Efficiency Defence, this study contends that it is the welfare standard and the procedural processes that determine whether an Efficiency Defence constitutes a true defence or not. For example, the application of an Efficiency Defence under a consumer welfare standard seems to be analogous to an efficiency rebuttal. The technical difference between these two concepts are thus of lesser importance which is supported by the fact that both an efficiency rebuttal and an Efficiency Defence considers efficiencies in the context of the market outcome that will result from the anti-competitive market conduct. Based upon these reasons, it is recommended that the theoretical difference between an efficiency rebuttal and a true Efficiency Defence is superfluous for the purposes of this study. Nonetheless, for clarity this study will clearly distinguish between these two concepts.

In addition to the difference between an efficiency rebuttal and an Efficiency Defence, there are also three principal procedural approaches which can be used to apply efficiencies in competition matters, namely a case-by-case approach, a general presumptions approach and a sequential approach. In terms of the case-by-case approach, the anti-competitive effects are weighed against the efficiency gains on a case-by-case basis. In terms of the general presumptions approach, structural indicators are used to determine the net effect of the conduct i.e., the anti-competitive effects are not weighed against the claimed efficiencies. More specifically, this approach assumes that below a certain structural thresholds efficiencies will always outweigh the anti-competitive effects whereas above a certain structural threshold, efficiencies are regarded to be incapable of outweighing the anti-competitive effects. The sequential approach is a combination between the case-by-case and the general presumptions approach whereby the general presumptions approach is used to identify problematic conduct with the problematic conduct then being considered under the case-by-case approach.

Following hereunder, is a discussion on the various sections of the South African Competition Act containing the Efficiency Defence. It will also become clear in the following sections that a true Efficiency Defence is implemented in South Africa in terms of the Competition Act.

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573 Renckens 2007: 171.
574 Röller et al 2000: 93.
575 Röller et al 2000: 94.
576 Röller et al 2000: 94.
3.4 The Efficiency Defence in the South African Competition Act

The Competition Act prohibits two kinds of practises (prohibited practices), namely restrictive agreements and the abuse of dominance.578 Restrictive agreements are further divided into two categories, namely restrictive horizontal agreements and restrictive vertical agreements.579 Horizontal agreements can be defined as agreements between competitors whereas vertical agreements can be defined as agreements between parties who are in a supplier and customer relationship.580 A restrictive agreement is presumed to exist between firms if one of them owns a significant interest in the other or if they have at least one director or substantial shareholder in common, and if any combination of these firms engage in that restrictive horizontal practice.581

Prohibited practices are further divided into two categories, namely per se and rule of reason prohibitions.582 Per se prohibitions are prohibitions for which there are no defences i.e., when a firm has committed a per se prohibited practice that firm is not allowed to raise any defences.583 The per se prohibitions relate to conduct which is perceived as to always result in anti-competitive effects and hence, is always harmful to consumers and efficiency.584

On the other hand, rule of reason prohibitions are prohibitions for which there is a defence, namely the Efficiency Defence i.e., when a firm has committed a rule of reason prohibited practise that firm will be allowed to raise efficiencies as a defence.585 The primary test regarding rule of reason prohibitions is whether the specific conduct under investigation substantially prevents or lessens competition in the relevant market.586 This burden of proof is laid upon the competition authorities.587 If proven, the contravening party(ies) will have to prove that any technological, efficiency or other pro-competitive gains resulting from that prohibited practice outweigh any anti-competitive effects thereof and that the

582 Cuts 2002: 12.
583 American National Soda Ash Corporation CHC Global (Pty) Ltd v Competition Commission 554/03: paragraph 40.
584 Neuhoff et al 2006: 16.
586 Cuts 2002: 12.
587 Tongaat Hulett Group (Pty) Ltd and Transvaal Suiker Bpk 83/LM/Jul00: paragraph 100.
prohibited conduct is reasonably necessary to achieve these gains.\textsuperscript{588}

To conclude, the Efficiency Defence is thus only applicable to rule of reason prohibitions and only to the extent that the rule of reason prohibited conduct results in a substantial prevention or lessening of competition.\textsuperscript{589}

3.4.1 Restrictive agreements

3.4.1.1 Restrictive horizontal agreements

Restrictive horizontal agreements are also referred to as collusion or cartel activities.\textsuperscript{590} Collusion refers to the situation where some or all the firms in a market conspire to act together so as to restrict the competitive pressures of the competition process.\textsuperscript{591} More specifically, collusion is aimed at eliminating competition between the various market participants.\textsuperscript{592} Several grounds have been advanced for why firms would want to collude with some arguing that firms collude to reduce uncertainty and decrease the risks associated with doing business which should result in increased efficiency.\textsuperscript{593} For the purposes of Competition Law it is argued that firms collude to collectively obtain monopoly levels of market power to earn abnormal profits by restricting output, increasing prices and preventing potential competition.\textsuperscript{594} Accordingly, it is argued that restrictive horizontal practices have the same adverse effects on efficiency and social welfare as monopolies and hence, it is prohibited by the Competition Act.\textsuperscript{595} Collusion can either be explicit or tacit with explicit collusion requiring formal agreements or direct communications whereas tacit collusion requires no formal agreements nor any direct commutation.\textsuperscript{596}

Restrictive horizontal agreements are dealt with under section 4 of the Competition Act. More specifically, collusion activities which involves price fixing, market division and collusive tendering are dealt with in section 4(1)(b) and these activities are prohibited \textit{per}
All other forms of collusion are dealt with in section 4(1)(a) which provides a rule of reason prohibition. Section 4 reads as follows:

“Section 4 Restrictive horizontal practices prohibited

(1) An agreement between, or concerted practice by, firms, or a decision by an association of firms, is prohibited if it is between parties in a horizontal relationship and if –

(a) it has the effect of substantially preventing or lessening competition in a market, unless a party to the agreement, concerted practice or decision can prove that any technological, efficiency or other pro-competitive gain resulting from it outweighs that effect or

(b) it involves any of the following restrictive horizontal practices:

(i) directly or indirectly fixing a purchase or selling price or any other trading condition;

(ii) dividing markets by allocating customers, suppliers, territories, or specific types of goods or services; or

(iii) collusive tendering.”

Numerous activities can fall within the ambit of section 4(1)(a) which include joint ventures between competitors and trade associations. Price fixing, market division and collusive tendering activities are, however, dealt with under section 4(1)(b) in terms of which the Efficiency Defence is not available.

One example of a contravention of section 4(1)(a) is the matter between the Competition Commission and Tracetec (Pty) Ltd v Netstar (Pty) Ltd and others. In this case it was found that the Vehicle Security Association of South Africa, which was the trade association of the stolen vehicle recovery market, was used by the three dominant suppliers of vehicle recovery systems to set compliant standards which effectively prevented other competitors from entering into the relevant market. Since there were no price fixing, market division nor collusive tendering this case was decided in terms of section 4(1)(a). Unfortunately, in this case the respondents did not raise the Efficiency

598 17/CR/Mar05.
599 Paragraph 315.
600 Paragraph 228.
Another activity that can easily fall within the scope of section 4 is joint ventures between competitors where information sharing between the parties of the joint venture result in price fixing, market division and/or collusive tendering, in which case section 4(1)(b) applies. Joint ventures also often result in collusive behaviour between competitors and in the event the collusive behaviour results in a substantial prevention or lessening of competition, section 4(1)(a) would be applicable in which event, the parties will have to prove that their collusive behaviour results in efficiencies, technological and other pro-competitive gains that outweigh the anti-competitive effects thereof.

3.4.1.2 Restrictive vertical agreements

Unlike horizontal agreements, vertical agreements are generally taken to have efficiency gains. Nonetheless, in certain instances vertical agreements can result in undue restrictions on competition and therefore, vertical agreements are also regulated although vertical agreements will only result in a substantial prevention or lessening of competition in the event that there is insufficient competition on two or more levels of trade. Vertical agreements are also very complex in nature and as a result these agreements are generally regulated through rule of reason prohibitions. This is also the case in South Africa, with the Competition Act regulating all vertical agreements through a rule of reason provision except for minimum resale price maintenance, which is prohibited per se.

There are numerous vertical agreements that can unduly restrict the competition process. These restrictions can generally be divided into two categories, namely inter-brand competition and intra-brand competition. Inter-brand competition refers to competition between competitors whereas intra-brand competition refers to competition between sellers of the same brand. Vertical agreements that can potentially result in a substantial

601 17/CR/Mar05.
604 EC Guidelines on Vertical Restraints 2010: 5.
605 EC Guidelines on Vertical Restraints 2010: 5.
prevention or lessening of competition include among others the following:

• Single branding agreements, which refer to agreements between buyers and suppliers in terms of which the buyer agrees not to buy any of his inputs from any other suppliers as the one with which it concluded the single branding agreement (this lessens inter-brand competition).

• Exclusive distribution agreements, which refer to agreements in terms of which a supplier undertakes to sell its products only to the distributor with whom it concluded the exclusive distribution agreement for the distribution of the suppliers products in a particular geographical area (this lessens intra-brand competition).

• Exclusive customer allocation agreements, which refers to agreements in terms of which a supplier agrees to sell its products to only one distributor for distribution to a specific class of consumers.

The restrictive vertical agreements provision is contained in section 5 of the Competition Act, with the rule of reason prohibition contained in section 5(1) and the per se prohibition contained in section 5(2) and 5(3). Section 5(1) reads as follows.

“Section 5: Restrictive vertical practices prohibited

(1) An agreement between parties in a vertical relationship is prohibited if it has the effect of substantially preventing or lessening competition in a market, unless a party to the agreement can prove that any technological, efficiency or other pro-competitive gain resulting from that agreement outweighs that effect.

(2) The practice of minimum resale price maintenance is prohibited.

(3) Despite subsection (2), a supplier or producer may recommend a minimum resale price to the reseller of a good or service provided –

(a) the supplier or producer makes it clear to the reseller that the recommendation is not binding; and

(b) if the product has its price stated on it, the words “recommended price” appear next to the stated price.”

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3.4.2 Abuse of dominance

In terms of section 7 of the Competition Act, a firm is regarded as being dominant in a specific market if that firm:

(a) has at least 45 percent market share in that market or
(b) if it has at least 35 percent, but less than 45 percent market share in that market unless that firm can show that it does not possess market power in that market or
(c) if it has less than 35 percent market share in that market but is in possession of market power within that market.

As mentioned in chapter two, the Competition Act defines market power as "the power of a firm to control prices, or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers." 611

In terms of the Competition Act, the abuse of dominance is regulated by section 8 and 9. Section 9, which deals with price discrimination by a dominant firm, does not contain a rule of reason provision and therefore, it is omitted in this study. The rule of reason provisions are contained in sections 8(c) and 8(d) and it regulates only one kind of conduct, namely exclusionary conduct by a dominant firm. 612 An exclusionary act is defined in the Competition Act as an act "that impedes or prevents a firm entering into, or expanding within, a market." 613 It is clear from this definition that an exclusionary act is an act through which a dominant firm abuses its market power to lessen the competition in the relevant market or to prevent potential competitors from entering into that market. Identical to the rule of reason provisions discussed in the preceding paragraphs, this abuse of dominance provision also requires the competition authorities to prove that the exclusionary act substantially prevents or lessens competition before the Efficiency Defence becomes applicable. 614

The rationale for regulating exclusionary conduct by a dominant firm is neatly summed up in the case between the Competition Commission v South African Airways, 615 where the

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612 Competition Act 89/1998: sections 8(c) and 8(d).
613 Section 1.
614 Competition Commission v South African Airways (Pty) Ltd 18/CR/Mar01.
615 18/CR/Mar01.
Competition Tribunal interpreted the application of the abuse of dominance provision: 616

“...In the first place we examine whether the conduct in question is exclusionary in nature...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...If the answer to that question is yes, we conclude that the conduct will have an anti-competitive effect...Whichever species of anti-competitive effect we have, consumer welfare or likely foreclosure (own emphasis).”

Clearly then, the rationale for regulating the abuse of dominance is to prohibit dominant firms from abusing their market power to prevent their competitors from expanding within the market or to prevent new firms entering into the market. 617

Section 8(c) and 8(d) reads as follow, with section 8(d) providing a few examples of exclusionary acts.

“Section 8: Abuse of dominance prohibited

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; or

(d) engage in any of the following exclusionary acts, unless the firm concerned can show technological, efficiency or other pro-competitive gains which outweigh the anti-competitive effect of its act –

(i) requiring or inducing a supplier or customer to not deal with a competitor;
(ii) refusing to supply scarce goods to a competitor when supplying those goods is economically feasible;
(iii) selling goods or services on condition that the buyer purchases separate goods or services unrelated to the object of a contract, or forcing a buyer to accept a condition unrelated to the object of a contract;
(iv) selling goods or services below their marginal or average variable cost; or
(v) buying-up a scarce supply of intermediate goods or resources required by a competitor.”

616 Paragraph 132.
617 For more information refer to paragraph 136-137.
3.4.3 Mergers

Merger are defined as acts by which “one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm.”\(^{618}\) Control on the other hand, may be obtained in any manner including the purchase or lease of shares, by obtaining an interest or assets in another firm or by an amalgamation or another form of grouping with another firm.\(^{619}\) This broad definition of mergers also provides for acquisitions.\(^{620}\)

There are three types of mergers, namely horizontal, vertical and conglomerate mergers.\(^{621}\) Horizontal mergers are defined as mergers between firms doing business in the same level of the supply chain and who sell substitutable goods or services in the same geographical area.\(^{622}\) Vertical mergers on the other hand, are mergers between parties in a vertical relationship i.e., parties in a supplier (upstream) and customer (downstream) relationship.\(^{623}\) Conglomerate mergers in turn, are mergers that are neither horizontal nor vertical mergers i.e., it is mergers where there are no economic relationships between the parties.\(^{624}\)

Mergers are prohibited because it is held that they contribute to the unilateral market power of the merged entity.\(^{625}\) In addition, mergers also increase market concentration and thereby induce the remaining firms in that market to collude so as to obtain and abuse their collective market power.\(^{626}\) These are referred to as the unilateral and coordinated effects of mergers.\(^{627}\) The unilateral effect refers to the merged entity obtaining market power through the merger by combining the individual market power of the merged entities. The coordinated effect refers to the reduction in the number of firms in that market which increases the possibility for the remaining firms to coordinate their behaviour through explicit and/or tacit collusion.\(^{628}\) Horizontal mergers in particular, are held to have

\(^{620}\) The Competition Commission on http://www.compcom.co.za/merger-thresholds/ (accessed on 24 January 2011)
\(^{621}\) Neuhoff et al 2006: 177-178.
\(^{624}\) Neuhoff et al 2006: 178.
\(^{625}\) International Competition Network (ICN) 2004: 1.
\(^{626}\) Röller et al 2000: 28.
\(^{627}\) Mncube et al 2009: 62.
\(^{628}\) Mncube et al 2009: 62.
unilateral and coordinated effects.\textsuperscript{629}

Vertical mergers on the other hand, are generally taken not to result in a substantial prevention or lessening of competition and therefore these mergers are less problematic for competition authorities.\textsuperscript{630} Nonetheless, vertical merger can also result in coordinated effects.\textsuperscript{631} The main anti-competitive effects of vertical mergers relate to unilateral effects, namely customer and input foreclosure.\textsuperscript{632} Input foreclosure occurs when the vertically integrated firm i.e., the merged entity, stops to supply the original supplier’s other downstream customers or when it increases the prices of the original supplier's products to its other downstream rivals.\textsuperscript{633} In this case, the customers have one less supplier from which they can buy their inputs from. Customer foreclosure on the other hand, occurs when the vertically integrated firm, in this case the customer, stops purchasing its inputs from other upstream suppliers.\textsuperscript{634} In this case, the other suppliers have one less customer to which they can sell their produce to. The competition concerns with input and customer foreclosure is that it provides the merged entity with market power because it reduces the foreclosed firms' ability and/or incentive to compete.\textsuperscript{635} Vertical mergers can thus also result in exclusionary effects in the same way as the abuse of dominance.\textsuperscript{636}

Conglomerate mergers seldom raise competition or market power concerns because they are mergers between firms in different markets.\textsuperscript{637} Generally, the only circumstances in which a conglomerate merger will raise competition concerns is when it is between firms operating in closely related markets i.e., when it is between potential competitors selling substitutable or complementary products.\textsuperscript{638} In such circumstances, it may be possible for a firm with substantial market power in one market to use that market power to obtain and abuse its market power in another market.\textsuperscript{639} To obtain and abuse this market power, firms generally tie and/or bundle their products with the newly acquired firm's product so as to

\textsuperscript{629} Röller \textit{et al} 2000: 28; Theron 2001: 615-616.
\textsuperscript{630} Morphet \textit{et al} 2008: 1.
\textsuperscript{632} Morphet \textit{et al} 2008: 5.
\textsuperscript{633} Blignaut \textit{et al} 2010: 5.
\textsuperscript{634} Blignaut \textit{et al} 2010: 5.
\textsuperscript{635} European Union 2008: 10.
\textsuperscript{636} Refer to section 3.4.2.
\textsuperscript{637} Budzinski and Wacker 2007: 281.
\textsuperscript{638} Budzinski and Wacker 2007: 281.
\textsuperscript{639} Budzinski and Wacker 2007: 281.
foreclose the acquired firms competitors in the newly entered market.\textsuperscript{640}

Bundling can be divided into pure and mixed bundling.\textsuperscript{641} Pure bundling is when two products are sold together in fixed quantities whereas mixed bundling refers to the situation where the two products are also sold separately but where their bundled price is cheaper than their combined individual prices.\textsuperscript{642} Tie-in on the other hand, refers to the situation where a consumer who purchase one product from a seller is required to also buy another product from that seller.\textsuperscript{643} These practises are held to potentially diminish the ability of firms in the newly entered market to compete with the new entrant and accordingly, it could potentially result in a substantial prevention or lessening of competition.\textsuperscript{644} The main competition concern with conglomerate mergers are thus the potential input and market foreclosure of the new entrant's competitors.\textsuperscript{645}

An example\textsuperscript{646} of a potentially anti-competitive conglomerate merger could be where Coca-Cola\textsuperscript{tm}, which operates say in the non-alcoholic soft-drink market, were to merge with a company in the alcoholic beverages market, say a Brandy producer. If the merged entity were to bundle or ty-in Coca-Cola\textsuperscript{tm} with this particular brand of Brandy and assuming that Brandy is generally used together with Coca-Cola\textsuperscript{tm}, it could potentially restrict the other Brandy producers to effectively compete with the new merged entity and hence foreclose the Brandy market for those firms.

3.4.3.1 The merger control mechanism

The merger control mechanism is a mechanism in terms of which the Competition Act places a compulsory pre-merger notification obligation on firms that are contemplating a merger.\textsuperscript{647} According to this compulsory pre-merger notification, firms are obliged to obtain pre-merger approval from the Competition Commission or the Competition Tribunal with the Competition Commission considering small and intermediate mergers and the

\begin{itemize}
\item \textsuperscript{640} Guidelines on the assessment of non-horizontal mergers 2008: 21.
\item \textsuperscript{641} Church 2004: 19-20.
\item \textsuperscript{642} Church 2004: 19-20.
\item \textsuperscript{643} Church 2004: 19-20.
\item \textsuperscript{644} Guidelines on the assessment of non-horizontal mergers 2008: 22.
\item \textsuperscript{645} Guidelines on the assessment of non-horizontal mergers 2008: 21.
\item \textsuperscript{646} This is example is purely hypothetical and in is in no way factual.
\item \textsuperscript{647} Competition Act 89/1998: chapter 3.
\end{itemize}
Competition Tribunal considering large mergers.\textsuperscript{648} More specifically, this pre-merger approval requires the Competition Commission and the Competition Tribunal to be notified of contemplated mergers.\textsuperscript{649} Firms are, however, only obliged to obtain pre-merger approval if the value of the contemplated merger falls within the values of the merger thresholds.\textsuperscript{650} Currently the merger thresholds are as follow.\textsuperscript{651}

### Merger thresholds as of 1 April 2009

<table>
<thead>
<tr>
<th>Thresholds</th>
<th>Combined turnover / Asset value</th>
<th>Target turnover / Asset value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower threshold</td>
<td>R 560 million</td>
<td>R 80 million</td>
</tr>
<tr>
<td>Higher threshold</td>
<td>R 6 600 million</td>
<td>R 190 million</td>
</tr>
</tbody>
</table>

These merger thresholds must be interpreted in the following manner. Mergers are divided into three size categories, namely small, intermediate and large mergers.\textsuperscript{652} A small merger is defined as a merger or a contemplated merger with a value equal to or below that of the value of the lower threshold.\textsuperscript{653} An intermediate merger is defined as a merger or a contemplated merger with a value between the values of the lower and the higher thresholds.\textsuperscript{654} A large merger is defined as a merger or contemplated merger with a value equal to or exceeding the higher threshold value.\textsuperscript{655}

Small mergers do not require pre-merger approval.\textsuperscript{656} Nonetheless, the Competition Commission has the power to require the parties to a small merger to inform the Competition Commission, in the prescribed manner and form, of all the relevant details of the merger if the Competition Commission is of the opinion that the small merger may substantially prevent or lessen competition in the relevant market.\textsuperscript{657}

\textsuperscript{648} Competition Act 89/1998: chapter 3.  
\textsuperscript{649} Competition Commission on http://www.compcom.co.za/merger-thresholds/ (accessed 24 January 2011)  
\textsuperscript{650} Competition Act 89/1998: section 13; 13A and 14A.  
\textsuperscript{651} Competition Commission on http://www.compcom.co.za/merger-thresholds/ (accessed 24 January 2011)  
\textsuperscript{652} Competition Act 89/1998: section 11(5).  
\textsuperscript{653} Competition Act 89/1998: section 11(5)(a).  
\textsuperscript{654} Competition Act 89/1998: section 11(5)(b).  
\textsuperscript{655} Competition Act 89/1998: section 11(5)(c).  
\textsuperscript{656} Competition Act 89/1998: section 13(1).  
\textsuperscript{657} Competition Act 89/1998: section 13(3).
Commission may only exercise this power within the first six months of the implementation of the small merger.658

Contrary to small mergers, intermediate and large mergers do require pre-merger approval.659 More specifically, a merger will constitute an intermediate merger if the value of that merger, in terms of the combined annual turnover of the merging firms or their combined asset value, equals or exceeds R 560 million and when the annual turnover or asset value of the targeted firm exceeds or is equal to R 80 million.660 A large merger on the other hand, will be a merger where the value of that merger, in terms of the combined annual turnover of the merging firms or their combined asset value, equals or exceeds R 6.6 billion and the turnover or asset value of the targeted firm exceeds or is equal to R 190 million.661

Upon receipt of a merger notification, the competition authorities must investigate the merger to determine whether the merger will substantially prevent or lessen competition in the relevant market.662 If the competition authorities conclude that the merger will most likely result in a substantial prevention or lessening of competition the merger will be prohibited unless, the merging parties can prove that the merger will likely result in technological, efficiency or other pro-competitive gains that is greater than and which will offset the anti-competitive effects thereof.663

3.5 Substantial prevention or lessening of competition

As discussed in the preceding paragraphs, the Efficiency Defence only becomes applicable when the competition authorities have proven that the conduct under investigation is anti-competitive because it results in a substantial prevention or lessening of competition. This section examines the meaning of a substantial prevention or lessening of competition and differentiates between a lessening and a prevention of competition. As

far as the author could determine, neither the Competition Act nor the competition authorities have distinguished between a prevention or a lessening of competition. Consequently, this distinction must be inferred from case law.

3.5.1 Prevention or lessening of competition

As discussed previously, Competition Law is aimed at enhancing the efficiency of the market system and thus the economy through the maintenance and promotion of competition. More specifically, Competition Law regulates anti-competitive market conduct with anti-competitive market conduct referring to any market conduct that substantially prevents or lessens competition in the relevant market. However, to behave anti-competitively, firms require market power and as a result, the regulation of market power is at the heart of Competition Law.

In the matter between the Competition Commission v South African Airways (Pty) Ltd, the Competition Tribunal stated that anti-competitive conduct can be manifested in two ways, namely through the exploitive abuse of market power or through the exclusionary abuse market power. Exploitive conduct refers to market conduct that results in higher prices, less product choices or lower product quality. Exploitive conduct thus refers to market conduct that results in the exploitation or abuse of consumers. Exclusionary conduct on the other hand refers to market conduct that excludes competitors from the relevant market or impedes their growth in the relevant market.

It is argued that the exclusionary abuse of market power refers to the conduct whereby firms prevent (exclude) their competitors or potential competitors to compete with them whereas an exploitive abuse of market power refers to the conduct of firms whereby they decrease output and increase price to the detriment consumers. More specifically, it is argued that an exclusionary abuse of market power refers to the extent to which firms determine or influence the structure of a market and the nature and degree of competition.

666 Boshoff 2008: 3; Stenborg 2003: 1.
667 18/CR/Mar01.
668 The Competition Commission v South African Airways (Pty) Ltd 18/CR/Mar01: paragraph 114-115.
within that market whereas an exploitive abuse of market power refers to the ability of firms to influence the performance (price and output) of a market.

Based upon the preceding paragraphs, this study recommends that the prevention of competition should refer to an exclusionary abuse of market power because the exclusionary abuse of market power relates to the ability of firms to prevent their competitors and potential competitors from competing with them. This study further recommends that a lessening of competition should refer to the exploitive abuse of market power because the exploitive abuse of market power is only possible under conditions where competition has been lessened. This distinction between a prevention and a lessening of competition is, as will become clear in the following section, rather superfluous.

3.5.2 Substantial prevention or lessening of competition

The Competition Act does not merely prohibit anti-competitive conduct that results in the exploitation of consumers or the exclusion of competitors. The Competition Act is very specific in that it only prohibits anti-competitive conduct if it substantially prevents or lessens competition in the relevant market. In this regard, the Competition Act requires the competition authorities to distinguish the trivial effects from the more serious. The seriousness of anti-competitive effects depends upon the facts of each particular case and consequently, the question on what constitutes a substantial prevention or lessening of competition is to be determined on a case-by-case basis.

Nonetheless, in their analysis of whether conduct will substantially prevent or lessen competition, the competition authorities have two tests at their disposal, namely an absolute and a relative test. According to the absolute test, competition authorities are required to determine the precise anti-competitive effects that the conduct under

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671 Neuhoff et al 2006: 51 seem to arrive at a similar conclusion by stating that “...implies that the lessening of competition, which implies a process, could be read back from the effect. In other words, if there is evidence that particular conduct has lead to higher prices (an anti-competitive effect). Then it can be inferred that this conduct has negatively impacted the competitive process and has lessened competition.”

672 Refer to the previous section.

673 SASOL Oil (Pty) Ltd v Nationwide Poles 49/CAC/APRIL05.

674 Blignaut et al 2010: 5.

675 Neuhoff et al 2006: 52.
investigation had or will have upon the complainant's sales or ability to compete i.e., under the absolute test the competition authorities only assess the impact that the anti-competitive market conduct will have upon the individual firm that complains about the anti-competitive market conduct.\textsuperscript{676}

Under the relative test on the other hand, competition authorities are required to determine the anti-competitive effects of the conduct under investigation upon competition in the entire market and not only upon the complainant.\textsuperscript{677} In the case between \textit{SASOL v Nationwide Poles}\textsuperscript{678} the Competition Appeal Court made the following remark:\textsuperscript{679}

"On the evidence, this court is not able to conclude that there is a reasonable possibility that competition has significantly been prevented or lessened. Putting the evidence in the best possible light for the respondent, respondent suffers a disadvantage by way of an additional cost or purchase of creosote pursuant to applicant's pricing policy. However, Competition Law does not protect the competitor, it protects competition. Evidence which goes no further than suggesting that one competitor may be prejudiced is insufficient to bring the impugned conduct within the scope of section 9(1)(a)."

Based upon this statement, the South African competition authorities seem to follow the relative test when determining whether there is a substantial prevention or lessening of competition.\textsuperscript{680} In other words, the competition authorities will assess the degree to which the prevention or lessening of competition in the case under consideration, influences the nature and degree of competition in the entire market and not merely its influence on the individual complainant, and only if the anti-competitive conduct under investigation has prevented or lessened competition in the entire market, will the competition authorities conclude that competition has been substantially prevented or lessened. In other words, it seems as if the competition authorities will not seek to only determine and quantify the negative effects the anti-competitive market conduct had or will have upon a complainant. Instead, the competition authorities will determine the effect that the relevant conduct had or will have upon competition in the entire relevant market.

\textsuperscript{676} Neuhoff \textit{et al} 2006: 52.
\textsuperscript{677} Neuhoff \textit{et al} 2006: 52.
\textsuperscript{678} 49/CAC/APRIL05.
\textsuperscript{679} Page 26-27.
\textsuperscript{680} Neuhoff \textit{et al} 2006: 52.
What is certain however, is that the market share of the firms under investigation, the market structure, the level of market concentration and barriers to entry are important determinants when considering whether specific conduct will result in a substantial prevention or lessening of competition.\footnote{Nationwide Poles v SASOL (Pty) Ltd 72/CR/Dec03; Citibank NA South Africa Branch and Mercantile Bank Ltd 91/LM/Nov04; Langeberg Foods International and Ashton Canning Company (Pty) Ltd 46/LM/May05; Blignaut \textit{et al} 2010: 19.} Accordingly, dominant firms in concentrated markets with high barriers to entries are very susceptible to a finding of substantial prevention or lessening of competition.\footnote{Blignaut \textit{et al} 2010: 19.} However, as mentioned previously, the South African competition authorities follow a holistic approach when assessing whether market conduct is anti-competitive i.e., if it substantially lessens or prevents competition, by considering all the potential competitive constraints (structure, conduct and performance variables) that prohibit firms from abusing their unilateral and/or collective market power.\footnote{Refer to section 2.3.3.}

In particular, it seems as if the competition authorities are especially adamant to consider the effect of import competition to constrain the abuse of market power and to consider the history and possibility of collusion between the firms in the relevant market.\footnote{Langeberg Foods International and Ashton Canning Company (Pty) Ltd 46/LM/May05.}

The refrain of the South African competition authorities to differentiate between a lessening and a prevention of competition; the fact that the South African competition authorities follow a holistic approach in which all the potential competitive constraints on the abuse of market power are considered; given that the Competition Act prohibits conduct that it perceives as being anti-competitive in nature\footnote{Iscor Ltd and Saldanha Steel (Pty) Ltd 67/LM/Dec01: paragraph 103; Distillers Corporation (SA) Ltd and Stellenbosch Farmers Winery Group Ltd 08/LM/Feb02: paragraph 210.} and given that market power is required to behave anti-competitively. It seems as if the distinction between a prevention and a lessening of competition is rather superfluous. The reason being that the competition authorities follow an approach in which they holistically determine whether the firm(s) will have the ability (market power) to influence the proper functioning of the competition process to such an extent that it will result in efficiency and welfare losses.\footnote{For more information refer to section 2.4.} In situations where a firm(s) has the ability and incentive to influence the proper functioning of the competition process, the conduct of such a firm(s) will automatically be subjected to the provisions of the Competition Act because the purpose of the Competition Act is to promote and maintain competition, regardless of whatever the conduct is classified as a
substantial prevention or lessening of competition.

To conclude, market conduct will not merely constitute a substantial prevention or lessening of competition if the competition authorities are convinced that the specific conduct will provide or enhance the market power of perpetrating parties. It is only in circumstances where such firms have an incentive and the ability to abuse their market power that the conduct can held to potentially constitute a substantial lessening or prevention of competition.
Chapter four: The application and interpretation of the Efficiency Defence

As discussed in chapter one, this study examines nine main issues and six ancillary issues. The ancillary issues were examined in the preceding three chapters with this chapter examining the main issues under the five headings listed in chapter one.

4.1 Trident Steel (Pty) Ltd and Dorbyl Ltd

To date, the only case in which the South African competition authorities interpreted the Efficiency Defence was in the proposed merger between Trident Steel (Pty) Ltd and Dorbyl Ltd. In this merger Trident Steel (Pty) Ltd, which was a subsidiary of Tristel Holdings (Pty) Ltd who was ultimately controlled by Aveng Ltd, proposed to purchase three subsidiaries of Dorbyl Ltd's Baldwin's Steel division. More specifically, Trident Steel proposed to purchase Baldwin's three flat steel decoiling and cut-to-length service centres situated at Rosslyn, Durban and Port Elizabeth. In this proposed merger the competition authorities considered all the relevant factors ranging from the market structure of the relevant market, the Improved Surface Finish (hereafter ISF) market, to all the various factors that could potentially constrain the merged entity's ability to abuse its market power.

Eventually, the Competition Tribunal concluded that the merger will result in Trident Steel being the only domestic producer of outer steel blanks for the automotive industry and that import competition would not provide effective competition for Trident Steel. Accordingly, the Competition Tribunal concluded that the proposed merger will result in a substantial prevention or lessening of competition in the ISF market and consequently, the merger was prohibited by the Competition Tribunal. The perpetrating parties on the other hand, were adamant that the proposed merger will result in efficiency gains that will be greater than and offset the anti-competitive effects thereof and therefore, they raised the Efficiency Defence which eventually resulted in the proposed merger being approved on efficiency grounds.

687 89/LM/Oct00.
688 89/LM/Oct00.
689 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 1-2.
690 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 8-39.
691 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 40.
692 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 40.
Unfortunately in applying the Efficiency Defence in this merger, the Competition Tribunal failed to adequately formulate the substance of the Efficiency Defence by failing to address various issues relating to its interpretation and application in South African competition matters. This chapter endeavours to address some of these issues by comparing the Competition Tribunal’s decision in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd with relevant US and EU jurisprudence.

4.2 Efficiencies and Competition Law in the United States and the European Union

This section does not provide a detailed comparison between South African, US and EU Competition Law. The purpose of this section is merely to provide a very brief overview of the manner in which the Efficiency Defence is incorporated into US and EU Competition Law with the reason being to provide a broad overview of the differences in the way in which efficiencies are dealt with under South African, US and EU Competition Law.

4.2.1 The United States

Competition matters in the US are regulated by Title 15 of the United States Code and it includes the Sherman Act, the Clayton Act and the Federal Trade Commission Act, all three of which are relevant to the purposes of this study. The relevant sections of these three Acts are briefly discussed hereunder.

The Sherman Act, section one: Horizontal and vertical agreements

Section one of the Sherman Act regulates all contracts, combinations or conspiracies that result in the restraint of trade or commerce. These include all concerted (cooperative) practices including, horizontal and vertical agreements that result in the restraint of trade

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693 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 92.
694 Sutherland 2007: 351-370.
699 Sherman Act 1890: section 1.
or commerce.\textsuperscript{700} To determine whether conduct results in the restraint of trade or commerce, the courts have adopted an approach whereby they determine whether the conduct is anti-competitive.\textsuperscript{701} According to this approach, the positive and negative effects of the relevant conduct are weighed against one another and if the negative effects outweigh the positive effects, the conduct is said to be anti-competitive.\textsuperscript{702} These concerted practises are, similar to the South African position, divided into two categories namely \textit{per se} and rule of reason prohibitions.\textsuperscript{703}

As is the case in South Africa, the claimant need only prove that the perpetrating parties committed a \textit{per se} prohibition for that parties to be found guilty of anti-competitive behaviour.\textsuperscript{704} In the context of \textit{per se} prohibitions, perpetrating parties thus do not have any defences at their disposal which they can use to justify their anti-competitive market conduct.\textsuperscript{705} On the other hand, the rule of reason prohibitions require the courts and the competition authorities to take all relevant circumstances in consideration when determining whether certain market conduct is anti-competitive.\textsuperscript{706} More specifically, these rule of reason prohibitions allow the perpetrating parties to provide the competition authorities with evidence of efficiency gains which the competition authorities are obligated to consider in their assessment of the effects of the prohibited conduct.\textsuperscript{707} Efficiency gains are thus considered during the assessment of the effects of the particular conduct and as a result, efficiencies is not used as a true defence which becomes applicable only after the competition authorities have found the relevant market conduct to be anti-competitive.\textsuperscript{708} The efficiency defence under the Sherman Act thus constitutes an efficiency rebuttal rather than a true Efficiency Defence as is the case in South Africa.\textsuperscript{709}

Nonetheless, efficiencies are considered under section one of the Sherman Act, and section one also regulates conduct that is similar to those regulated by section four and five of the Competition Act and as a result, it is argued that the consideration of efficiencies by the US competition authorities in their interpretation and application of section one of

\begin{thebibliography}{99}
\bibitem{700} Broder 2005: 56.
\bibitem{701} Gerber 2002: 428.
\bibitem{702} Broder 2005: 69.
\bibitem{703} Gerber 2002: 429.
\bibitem{704} Holmes 2001: 176.
\bibitem{705} Holmes 2001: 176.
\bibitem{706} Broder 2005: 69.
\bibitem{707} Holmes 2001: 186.
\bibitem{708} Holmes 2002: 186.
\bibitem{709} Gerber 2002: 429.
\end{thebibliography}
the Sherman Act is relevant for the purposes of this study.710

The Sherman Act, section two: The abuse of dominance

Abuse of dominance is regulated by section two of the Sherman Act with section two specifically regulating all market conduct that monopolise or aim to monopolise a market.711 Section two is applicable on both unilateral and collusive behaviour and not only upon collusive behaviour as is the case with section one.712 In this context, monopolisation occurs when a firm(s) posses market power and engage in conduct aimed at maintaining or enhancing that market power.713 This conduct is also referred to as exclusionary conduct.714 Once more, the abuse of dominance is a rule of reason prohibition whereby all the positive and negative effects on competition need to be considered before the conduct can be found to be anti-competitive.715 These considerations include potential efficiency gains and again, contrarily to the South Africa position, these efficiencies are considered under an efficiency rebuttal system.716 Although section two of the Sherman Act is much broader in scope than the abuse of dominance provision contained in the Competition Act, it is similar to the abuse of dominance provision contained in the Competition Act because it also regulates exclusionary conduct and provides for the consideration of efficiencies.717 Accordingly, it is held that the interpretation and application of efficiencies in terms of section two of the Sherman Act is relevant for the purposes of this study.

The Clayton act, section seven: Merger regulation

Section seven of the Clayton Act718 contains the merger control mechanism for the US and it is very similar to the merger control mechanism contained in the Competition Act. The reason being that it also regulates mergers and acquisitions, which include horizontal, vertical and conglomerate mergers, that substantially lessens competition.719 Although

711 Holmes 1890.
712 Holmes 2001: 375.
717 For a detailed discussion on section two of the Sherman Act, refer to Holmes 2002: 373-487.
718 Clayton Act section 7; Holmes 2002: 575.
section seven does not provide for the consideration of efficiencies, the courts in the US have acknowledged that efficiency gains are relevant in the analysis of determining whether a merger will result in a lessening of competition.\(^{720}\) Once more, efficiencies are considered under an efficiency rebuttal system.\(^{721}\) The decision of the US courts that efficiencies should be taken into consideration in merger proceedings has been strengthened by the Horizontal Merger Guidelines published in 1992\(^ {722}\) and 2010 by the US Department of Justice and the FTC. These guidelines specifically provide for the consideration of efficiencies in analysing the potential effects of a merger upon competition in the relevant market.\(^ {723}\) Accordingly, in the US, efficiencies are taken into account when considering whether to permit or prohibit a merger and therefore, it is held that the interpretation and application of efficiencies in terms of section seven of the Clayton Act is relevant for the purposes of this study.

The Federal Trade Commission Act

Section five of the Federal Trade Commission Act\(^ {724}\) prohibits “unfair methods of competition” and “unfair or deceptive acts or practices.” The Federal Trade Commission Act is exclusively enforced by the FTC.\(^ {725}\) Section five has been held to be applicable upon all conduct that are regulated under the Sherman and the Clayton Acts and in effect, the FTC can consider all conduct that contravenes the provisions of the Sherman and the Clayton Acts.\(^ {726}\) Accordingly, it is held that the decisions of the FTC are relevant to the purposes of this study to the extent that it considers conduct that is also regulated under the Sherman and the Clayton Acts.

4.2.2 The European Union

In the EU competition is regulated under Title VII, Chapter one, section one of the Treaty on the Functioning of the European Union. More specifically, prohibited practises are regulated under article 101 and abuse of dominance under article 102. Previously,

\(^{720}\) FTC 2010: 1.
\(^{722}\) As revised in 1997.
\(^{725}\) FTC 2010: 1.
\(^{726}\) FTC 2010: 1.
Competition in the EU was regulated under the Treaty on the European Union in terms of which, prohibited practises were regulated under article 81 and abuse of dominance under article 82. It is noted that articles 81 and 82 were transposed verbatim to articles 101 and 102 respectively, by the Treaty of Lisbon that was signed on 13 December 2007 and that entered into force on 1 December 2009.

As a result of the lack sources available to the writer at the time of writing, this study from time to time refers to article 81 instead of article 101 and to article 82 instead of article 102. For the purposes of this study, however, any reference to article 81 and 101, and 82 and 102 shall have corresponding meanings.

**Article 101: horizontal and vertical agreements**

Article 101 reads as follows:

“1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
(b) limit or control production, markets, technical development, or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

— any agreement or category of agreements between undertakings,
— any decision or category of decisions by associations of undertakings,
— any concerted practice or category of concerted practices, which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are no indispensable to the attainment of these objectives;
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.”
Article 101(1) prohibits any agreement among undertakings which results in the prevention, restriction or distortion of competition. An agreement among undertakings includes horizontal and vertical agreements.\(^{727}\) Article 101(1) also requires this prevention, restriction or distortion of competition to be appreciable or substantial.\(^{728}\) This is similar to section four and five of the Competition Act given that these sections also regulate horizontal en vertical agreements that substantially distorts (prevents or lessens) competition. When the EC considers whether an agreement prevents, restricts or distorts competition i.e., if the agreement results in anti-competitive effects, it considers whether the agreement will provide the parties with unilateral and/or collective market power.\(^ {729} \)

Article 101(1) is thus similar to sections four and five of the Competition Act, especially if one considers the holistic approach followed by the South African competition authorities in terms of which, they consider whether an agreement provides the relevant parties with the ability to abuse their market power.\(^{730}\)

Section 81(3), which is the functional equivalent to a rule of reason prohibition, requires the EC to consider all the potential competitive and anti-competitive effects of an agreement under its consideration.\(^ {731} \) Considering the potential competitive and anti-competitive effects in terms of article 81(3), the EC is obligated to consider any efficiency gains that might result from the agreement.\(^ {732} \) More specifically, article 81(3) provides the perpetrating parties with an efficiency rebuttal as the consideration of efficiencies in terms of article 81(3) forms part of the analysis undertaken by the EC to determine whether the agreement results in anti-competitive effects.\(^ {733} \) Nonetheless, the EC does consider efficiencies in terms of horizontal and vertical agreements which distorts (prevents or lessens) competition and accordingly, its interpretation and application of efficiencies in competition matters are relevant to the purposes of this study.

\(^{727}\) Korah 2004: 2-3.
\(^{728}\) Pace 2007: 80.
\(^{729}\) Pace 2007: 80.
\(^{730}\) Refer to section 4.2 and 4.3 of this study.
\(^{732}\) Pace 2007: 84-85.
\(^{733}\) Pace 2007: 85. Also refer to chapter four of this study.
Article 102: Abuse of Dominance

Section 102 reads as follows:

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
(b) limiting production, markets or technical development to the prejudice of consumers;
(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

The conduct prohibited by article 82 refers to the exploitive abuse of dominance, which refers to the situation whereby a dominant firm holds those with whom its deals with for ransom. In general, the exploitive abuse of dominance can be contrasted with the exclusionary abuse of dominance in terms of which a dominant firm behaves in a manner that forecloses the market to its rivals and/or whereby the conduct of the dominant firm prohibits its competitors from expanding within the market. The courts in the EU have, however, extended the reach of article 82 to include the exclusionary abuse of dominance.

At present, article 82 is under reform in terms of which its focus is being shifted to the protection of consumer welfare and consequently, efficiencies are becoming increasingly important to the EC in its analyses in determining whether an exclusionary abuse of market power is anti-competitive. Once more, efficiencies are considered using an efficiency rebuttal system.

In addition to providing for the consideration of efficiencies, article 102 regulates conduct that is substantially similar to the conduct regulated under sections 8(c) and 8(d) of the

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734 Pace 2007: 123.
735 Korah 2004: 121. Refer to section 3.4.2 for a distinction between an exploitive and an exclusionary abuse of dominance.
736 Pace 2007: 124.
737 Monti 2007: 208.
Competition Act (although article 102 is much broader in scope compared to sections 8(c) and 8(d)) and as a result, it is held that the consideration of efficiencies under article 102 is relevant to the purposes of this study. It is noted, however, that there is currently great uncertainty in relation to the interpretation and application of efficiencies in terms of article 101 and 102, with some courts rejecting the Efficiency Defence altogether and others accepting and applying it.\(^{738}\) The value of articles 101 and 102 for the purposes of this study is thus severely diminished due to the ambiguous application of the Efficiency Defence in competition matters considered under articles 101 and 102.

**Merger regulation**

Unfortunately, neither the Treaty on the Functioning of the European Union \(^{739}\) nor the Treaty on the European Union currently contain merger regulations. However, in the case of *Europemballage and Continental Can v Commission* the court found that mergers do fall within the jurisdiction of articles 81 and 82.\(^{740}\) This decision in *Europemballage and Continental Can v Commission* was, however, rejected by the EU member states because they felt that this decision would result in the EC’s powers being too wide.\(^{741}\) This anxiousness of the member states eventually resulted in the adoption of regulation 4064 of 1989 which became the first merger regulation of the EU.\(^{742}\) Regulation 4064 of 1989 would eventually be replaced by regulation 139 of 2004 which is the current merger regulation of the EU.\(^{743}\)

Article two of regulation 139 of 2004 defines mergers in a similar manner as the Competition Act, with regulation 139 of 2004 also including acquisitions in its definition of mergers.\(^{744}\) For a merger to be prohibited in terms of regulation 139 of 2004 it must, similar to the South African position, significantly impede competition within the relevant market.\(^{745}\) The consideration of efficiencies in merger proceedings are provided by the Guidelines on the Implementation of Regulation 139 of 2004.\(^{746}\) Once more, this consideration of

\(^{738}\) Riziotis 2008: 104.
\(^{739}\) Monti 2007: 247
\(^{742}\) Korah 2004: 338.
\(^{743}\) Korah 2004: 338.
\(^{744}\) Regulation 139/2004: article 2.
\(^{745}\) Regulation 139/2004: article 1.
\(^{746}\) Council Regulation 802 of 2004: article 9.
efficiencies is implemented using an efficiency rebuttal system. Nonetheless, efficiencies are considered in EU mergers and accordingly, the interpretation and application of efficiencies in EU merger proceedings are relevant to the purposes of this study.

4.3 The welfare standard

4.3.1 South Africa

In the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd the Competition Tribunal proposed the following welfare standard:

"where efficiencies constitute real efficiencies and there is evidence to verify them of a quantitative or qualitative nature, evidence that the efficiencies will benefit consumers, is less compelling. On the other hand, where efficiencies demonstrate less compelling economies, evidence of a pass through to consumers should be demonstrated and although no threshold for this is suggested, they need to be more than trivial, but neither is it necessary that they are wholly passed on. The test is thus one where real economies and benefit to consumers exist in an inverse relationship."

Unfortunately the Competition Tribunal omitted to expand upon this standard and as a result, it is open to various interpretations.

This statement by the Competition Tribunal indicates that in cases where the perpetrating parties have provided evidence to the competition authorities to enable these authorities to verify the raised efficiencies in a quantitative or qualitative nature, then these efficiencies need not benefit consumers. Stated differently, if the competition authorities are able to verify that the raised efficiencies will likely result in an increase in the producer surplus, then these efficiencies need not increase the consumer surplus. However, the Competition Tribunal went further in that it required the raised efficiencies to be real efficiencies. As is discussed in the following sections, real efficiencies refer to efficiencies that result in the saving of economic resources.

The Competition Tribunal then contrasted real efficiencies with pecuniary efficiencies

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748 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 81.
749 Refer to Sutherland 2008: 355-357 for a discussion on several other shortcomings of this standard proposed by the Competition Tribunal.
750 Refer to footnote for a discussion on the four types of economic resources.
which refer to redistributive savings. In other words, if it is likely that the raised efficiencies will result in the more efficient use of scarce economic resources then they do not have to benefit consumers i.e., if it is likely that the raised efficiencies are real efficiencies that result in an increase in the producer surplus, then they need not increase the consumer surplus or compensate for the loss in consumer surplus that may result from the merger. On the other hand, if it is unlikely that the raised efficiencies will result in the saving of economic resources, then consumers must benefit i.e., if it is unlikely that the raised efficiencies will result in the saving of economic resources then they are required to increase the consumer surplus.

Unfortunately, the Competition Tribunal did not indicate how the increase in the producer surplus is to be weighed against the decrease in the consumer surplus. Even more peculiar, the Competition Tribunal's statement appears to support the interpretation that the application of the Efficiency Defence in South Africa does not provide for the weighing of the gains in the producer surplus against the losses in the consumer surplus for the reason that in cases where it is likely that the raised efficiencies will result in the saving of economic resources, then the losses in the consumer surplus are irrelevant. Contrary, in cases where it is unlikely that the raised efficiencies will result in the saving of economic resources then the gains in the producer surplus are irrelevant as long as the consumer surplus increase.

Based upon the preceding interpretation, this study contends that the Competition Tribunal had the intention to apply a total welfare standard. However, the Competition Tribunal wrongly identified real productive efficiencies as the main source of total welfare (efficiency). It has to be kept in mind that total welfare is determined by both allocative and productive efficiencies even though savings in economic resources (productive efficiency) are taken to indirectly benefit consumers as these saved resources are now free to be used in the production of other goods and services from which consumers also derive utility. Accordingly, savings in economic resources not only increase the producer surplus but also contribute to total welfare.

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752 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
753 Refer to paragraph 52-62 and 81-82.
754 Refer to section 2.4.
surplus but also the aggregate consumer surplus of all consumers and as a result, real efficiencies have a dual impact upon total surplus (the sum of producer and consumer surplus). Accordingly, the “proportionality test” as the Competition Tribunal described their proposed welfare standard is nothing more than an augmented version of the total welfare standard. A discussion with a representative of the South Africa Competition Commission also confirmed the total welfare standard as the standard employed in South African competition matters.755

4.3.2 The United States

The welfare standard employed in the US is most clearly illustrated in the Horizontal Merger Guidelines.756 According to these guidelines efficiencies will be accepted if they are “cognizable.”757 As will become clear in the following paragraphs, efficiencies are regarded as cognizable if they increase consumer welfare.

The welfare standard applied in US competition matters can be deduced from the following provisions of the 2010 Horizontal Merger Guidelines, namely:

US competition authorities will not challenge a merger if the efficiencies are of a quality and magnitude that will nullify the anti-competitive effects of the proposed merger.758 More specifically, efficiencies must countervail the potential harm to consumers.759 In other words, efficiencies must maintain current prices, product quality, product variety and service delivery or it should decrease prices and/or improve product quality, product variety and service delivery.760

Efficiencies will not be regarded as cognizable efficiencies if they result in lower prices that are the result of reduced quality and/or reduced product and/or service variety.761 However, efficiencies could be regarded as cognizable efficiencies if they result in increased prices but then, the increase in price should be the result of

755 Maarten van Hoven, head of mergers and acquisition at the Competition Commission, July 2011.
increased product or service quality and/or product or service variety.\textsuperscript{762} The essence of cognizable efficiencies thus are that they must either prevent a reduction in consumer welfare or they must improve it, provided that the results are not obtained by decreasing output and/or quality and variety.\textsuperscript{763}

The preceding paragraphs clearly demonstrate that the consumer welfare standard is applied in US merger proceedings and not the price standard as one may easily be lead into thinking.\textsuperscript{764} The consumer welfare standard is also applied in non-merger proceedings and as a result, the consumer welfare standard is clearly the de facto standard applied in US competition matters.\textsuperscript{765}

4.3.3 The European Union

The welfare standard employed in the EU is clearly illustrated in the Guidelines on Horizontal Mergers.\textsuperscript{766} These guidelines determine that consumers must benefit from efficiencies for them to be considered in competition matters.\textsuperscript{767} In fact, the Guidelines on Horizontal Mergers specifically require that consumers must not “be worse off” as a result of a merger.\textsuperscript{768} In addition, efficiencies that decrease the marginal costs of the merged entity are taken to be more likely to benefit consumers and accordingly, these efficiencies are given preference over efficiencies that decrease the fixed costs of the merged entity.\textsuperscript{769} The Guidelines on Horizontal Mergers also specifically state that production cost savings that are the result of decreased output will not be regarded as efficiencies that benefit consumers.\textsuperscript{770}

The Guidelines on Horizontal Mergers goes further by stating that consumers will be better off if (1) prices decrease or (2) if the merger results in new or improved products and

\textsuperscript{762} Coate and Heimert 2009: 4.
\textsuperscript{763} Areeda and Hovenkamp 2004: 9-91; Coate and Heimert 2009: 4.
\textsuperscript{764} Neven and Röller 2005: 829.
\textsuperscript{765} Salop 2010: 340-342; Rosch 2007: 353,359 and 365. Refer to Rosch 2007: 353 footnote 1 for a discussion on various cases where the consumer welfare standard was identified as the welfare standard applied in US non-merger proceedings; Dabbah 2003: 21; Theron 2001: 616; Neven and Röller 2005: 829.
\textsuperscript{766} Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings. Hereafter, Guidelines on Horizontal Mergers.
\textsuperscript{767} Guidelines on Horizontal Mergers 2004: paragraph 77-78.
\textsuperscript{768} Guidelines on Horizontal Mergers 2004: paragraph 79.
\textsuperscript{769} Guidelines on Horizontal Mergers 2004: paragraph 80.
\textsuperscript{770} Guidelines on Horizontal Mergers 2004: paragraph 80.
services even if the new or improved products and services result in higher prices for these products and services.\textsuperscript{771}

The preceding paragraphs clearly indicate that the consumer welfare standard is applied EU competition matters. Once more, one should not be lead into thinking that the price standard is applied in EU competition matters, especially since consumers are taken to be better of in the event of higher prices that are the result of new or improved products and services.\textsuperscript{772}

The consumer welfare standard is also employed in terms of article 101 with article 101(3) (i) stating the following “consumers must receive a fair share of the benefits resulting from these (agreements).” This is supported by the Guidelines on the application of Article 101(3) of the Treaty which states the following “the objective of Article 81 is to protect competition on the market as a means of enhancing consumer welfare...”\textsuperscript{773} The consumer welfare test is also applied in terms of article 102.\textsuperscript{774} The consumer welfare standard is thus employed in all EU competition matters.\textsuperscript{775}

The question on whether South Africa should continue using the total welfare standard as applied in \textit{Trident Steel (Pty) Ltd and Dorbyl Ltd} or whether South Africa should implement the consumer welfare standard as utilised in US and EU competition matters is considered at the end of this chapter.

\textsuperscript{771} Guidelines on Horizontal Mergers 2004: paragraph 80-81.
\textsuperscript{772} Refer to section 4.2.
\textsuperscript{774} Riziotis 2008: 93-95.
\textsuperscript{775} De la Mano 2002: 27.
4.4 The onus of the Efficiency Defence

4.4.1 South Africa

As mentioned in chapter one, in the merger between the Tongaat Hulett Group and Transvaal Suiker Bpk the scope of the Competition Tribunal’s consideration of the Efficiency Defence stretched only so far as to determine the onus that is laid upon the competition authorities and the merging firms by the Efficiency Defence as contained in the Competition Act. In this case, the Competition Tribunal concluded that the onus to prove that the conduct under investigation results in anti-competitive effects are placed upon the competition authorities. Conversely, the Competition Tribunal found that the onus to prove that the prohibited conduct will result in efficiency gains that will offset the anti-competitive effects thereof rests with the perpetrating parties. More specifically, the Competition Tribunal stated that the perpetrating parties must prove, on the balance of probabilities, the existence of efficiencies that will countervail the anti-competitive effects of the prohibited conduct.

The Competition Tribunal also required the efficiency gains to be expressed in the same terms as the anti-competitive effects and that it must be proven on a balance of probability that the raised efficiencies will over compensate the prevention or lessening of competition (the anti-competitive effects). The Competition Tribunal therefore required the perpetrating parties to express and quantify the raised efficiency gains in economic welfare terms and not merely in commercial or financial terms. In addition, the Competition Tribunal noted the following:

Technically and in contrast to the efficiency defence system employed in South Africa, there is no onus as such under the efficiency rebuttal systems employed in US and EU competition matters as the burden is placed upon the competition authorities to assess both the pro-competitive and the anti-competitive effects of prohibited conduct. Nonetheless, for the purposes of this study, the term “onus” is used in relation to the efficiency rebuttal system to describe the responsibility on the perpetrating parties to provide the relevant competition authorities with the information required to determine whether conduct under investigation can potentially result in efficiency gains. It is further recorded that the distinction between an “onus” in its strict legal meaning and the responsibility placed upon perpetrating parties to provide competition authorities with the information required to determine whether conduct under investigation may potentially result in efficiency gains and losses, is beyond the scope of this study.

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776 Technically and in contrast to the efficiency defence system employed in South Africa, there is no onus as such under the efficiency rebuttal systems employed in US and EU competition matters as the burden is placed upon the competition authorities to assess both the pro-competitive and the anti-competitive effects of prohibited conduct. Nonetheless, for the purposes of this study, the term “onus” is used in relation to the efficiency rebuttal system to describe the responsibility on the perpetrating parties to provide the relevant competition authorities with the information required to determine whether conduct under investigation can potentially result in efficiency gains. It is further recorded that the distinction between an “onus” in its strict legal meaning and the responsibility placed upon perpetrating parties to provide competition authorities with the information required to determine whether conduct under investigation may potentially result in efficiency gains and losses, is beyond the scope of this study.

777 83/LM/Jul00.
778 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 100.
779 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 100.
780 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: footnote 20.
781 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 103.
782 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 103.
"An Efficiency Defence that simply equates to enhancing the commercial prospect of a successful firm is not an efficiency gain as contemplated in the Act, it cannot, in other words, countervail the anti-efficiency consequences presumed to flow from a merger that substantially lessens competition."  

As a result of the discussions in the preceding paragraphs, the Competition Tribunal in the merger between Tongaat Hulett Group and Transvaal Suiker Bpk. required the perpetrating parties to prove that the raised efficiency gains will nullify the anti-competitive effects in social welfare terms i.e., that the potential welfare gains of the raised efficiencies are larger than the potential welfare losses that may result from the merger. In the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd the Competition Tribunal confirmed its interpretation in Tongaat Hulett Group and Transvaal Suiker Bpk of the onus that is placed upon the competition authorities and the perpetrating firms as set out above.

The rationale for placing the onus of proving the Efficiency Defence on the perpetrating parties is the result of two factors. Firstly, it is extremely difficult to identify, quantify and predict efficiencies that could potentially result from a prohibited practice. Secondly, it is the perpetrating parties and not the competition authorities that are in possession of the information required to identify, quantify and predict efficiencies that could potentially result from a prohibited practice. It is thus argued that it is only practical that the onus to prove any efficiency gains be placed upon the perpetrating parties.

4.4.2 The United States

As mentioned, prohibited practices in US Competition Law are divided into two categories namely per se and rule of reason prohibitions. Per se prohibitions are prohibitions that are deemed so inherently anti-competitive that they are prohibited despite any justifications thereof and as a result, a plaintiff needs only to prove that the defendant committed the per se prohibited practice. The defendant (perpetrating firm) on the other

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783 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 104.
784 83/LM/Jul00.
785 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 51.
786 OECD 1996: 5; Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00.
787 OECD 1996: 5; Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00.
788 OECD 1996: 5; Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00.
789 Refer to section 4.2.1.
hand is prohibited from raising any efficiencies a defence i.e., there is no efficiency defence under *per se* prohibitions.\(^{791}\) All prohibitions that are not prohibited *per se* are treated as rule of reason prohibitions.\(^{792}\)

Under rule of reason prohibitions, the plaintiff has a much heavier onus to discharge since the plaintiff must prove that the prohibited practice actually harms competition in the relevant market.\(^{793}\) If the plaintiff successfully discharges his/her onus, the onus shifts to the defendant to prove that the prohibited conduct results in efficiency gains that outweigh the anti-competitive effects thereof.\(^{794}\) The onus of the Efficiency Defence is thus placed upon the perpetrating parties. In addition, section ten of the 2010 Horizontal Merger Guidelines specifically places the onus upon the perpetrating parties to substantiate any efficiency gains that might result from a merger.

The 2010 Horizontal Merger Guidelines provides the following justification for placing the onus of the Efficiency Defence upon the perpetrating parties.

> "Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims."

4.4.3 The European Union

As mentioned, the application of article 101 consists of two steps.\(^{795}\) Firstly, it must be determined whether the conduct is anti-competitive.\(^{796}\) If it is found that the conduct is anti-competitive then all pro-competitive effects need to be considered.\(^{797}\) Also mentioned previously is the fact that the consideration of pro-competitive effects is regulated under article 101(3).\(^{798}\) In terms of both article 101 and 102, the onus is placed upon the plaintiff to prove that the conduct is anti-competitive whilst the onus to prove any pro-competitive

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\(^{791}\) Holmes 2001: 175-176.  
\(^{792}\) Broder 2005: 69.  
\(^{793}\) Broder 2005: 69.  
\(^{794}\) Broder 2005: 69.  
\(^{795}\) Refer to section 4.2.2.  
\(^{796}\) Guidelines on the application of Article 81 of the EC Treaty 2004: section 2(11).  
\(^{798}\) Guidelines on the application of Article 81 of the EC Treaty 2004: section 2(33).
and efficiency gains is placed upon the perpetrating parties. 799

With regard to mergers, section 12 of the Guidelines on the Assessment of Horizontal Mergers states the following: “...The Commission analyses its possible anti-competitive effects and the relevant countervailing factors such as buyer power, the extent of entry barriers and possible efficiencies put forward by the parties.” Presumably it is for the perpetrating parties (the notifying parties) to prove the efficiency gains. This view is strengthened by section 77 and section 87 of the Horizontal Merger Guidelines.

Section 77 states that the EC will only consider substantiated efficiency claims in their overall assessment of the merger while section 87 states that it is for the notifying parties to prove that the substantiated efficiencies will likely offset the anti-competitive effects and also the degree to which the anti-competitive effects will be offset (own emphasis). Section nine of regulation 802 of 2004 on the Implementation of Council regulation 139 of 2004 also specifically places the onus on the perpetrating parties to provide the necessary information regarding any efficiency gains that will result from the merger. This is also supported by the Guidelines on Horizontal Mergers. 800

To conclude, in light of the preceding paragraphs the onus to prove the existence of efficiency gains is clearly placed upon the perpetrating parties.

4.4.4 Recommendations

Competition Law in South Africa, the US and the EU all place the onus to prove any efficiency gains upon the perpetrating parties, which is in line with the recommendations of the OECD. 801 The rationale for placing the burden to prove the existence of efficiencies upon the perpetrating firms, as discussed above, also seem very practical as it is entirely plausible that the perpetrating firms will in the majority of cases, if not in all cases, be the ones in possession of the information required to compute potential efficiency gains, and given that the assessment of potential efficiency gains is inherently difficult. 802

801 1996: 5.
Based upon the preceding paragraphs, it would be unfair and prejudice to require of the competition authorities to determine potential efficiency gains if they, in the majority of the cases, do not possess the information required to make this assessment and accordingly, it is held that the onus should be placed on the perpetrating parties to prove that their conduct will result in efficiency gains that will outweigh the anti-competitive effects thereof.\textsuperscript{803}

Based upon the preceding paragraphs, it is held that the Competition Tribunal was correct to place the onus to prove the existence of efficiencies upon the perpetrating parties, especially if one takes into consideration that the Efficiency Defence in South Africa only becomes applicable if the competition authorities have proven that the prohibited conduct is likely to result in a substantial prevention or lessening of competition.\textsuperscript{804} Even so, the competition authorities must carefully analyse and scrutinize the information relied upon by perpetrating parties as they have the incentive to overstate their claimed efficiencies and to provide information only to the extent that it supports their case.

For a very informative illustration of the difficulties to assess the realisation of potential and actual efficiency gains through anti-competitive conduct, refer to the concentration-collusion and concentration-efficiency debate between Professors Frederick Fourie and Daniel Leach which stretched between 1991 to 2001.\textsuperscript{805}

4.5 Recognised efficiencies

4.5.1 South Africa

As mentioned previously, in the merger between the Tongaat Hulett Group and Transvaal Suiker Bpk\textsuperscript{806} the Competition Tribunal held that efficiency gains must be expressed in economic welfare terms and not merely in commercial or financial terms.\textsuperscript{807} The Competition Tribunal also noted the following:

\begin{itemize}
\item \textsuperscript{803} ICN 2006: 61.
\item \textsuperscript{804} Refer to section 3.5.
\item \textsuperscript{805} See Fourie and Smith 1989; 1993; 1994; Fourie 1996; Leach 1992a; 1992b and 1997.
\item \textsuperscript{806} 83/LM/Jul00.
\item \textsuperscript{807} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 103.
\end{itemize}
"An Efficiency Defence that simply equates to enhancing the commercial prospect of a successful firm is not an efficiency gain as contemplated in the Act, it cannot, in other words, countervail the anti-efficiency consequences presumed to flow from a merger that substantially lessens competition."^{808}

and

"An efficiency gain contemplated in the Act, one that may compensate for the anti-competitive consequences of a merger that otherwise fall foul of the Act, is one that, for example, evidences new products or processes that will flow from the merger of the two companies, or that identifies new markets that will be penetrated in consequence of the merger, markets that neither firm on their own would have been able capable of entering, or that significantly enhances the intensity with which productive capacity is utilised. This is, by no means, intended to demonstrate that much that is presented as a countervailing efficiency gain falls outside the ambit and firmly into the ambit of firm level commercial gains."^{809}

In the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd the Competition Tribunal distinguished between real efficiencies and so called pecuniary efficiencies.\(^{810}\) Real efficiencies refer to savings in economic resources\(^{811}\) whereas pecuniary efficiencies refer to redistributive savings.\(^{812}\) An example of pecuniary efficiencies are tax savings or lower input costs associated with the improved bargaining power of the merged entity.\(^{813}\) These savings are redistributive in the sense that income is redistributed from the government, in the form of forgone tax income and from the supplier in the form of lower sales income, to the merged entity.\(^{814}\) These savings do not result in any savings in economic resources.\(^{815}\) Needless to say, the Competition Tribunal found that only real efficiencies will be recognised as efficiencies under the Efficiency Defence.\(^{816}\)

The Competition Tribunal then identified the types of efficiencies that, in its view, should be regarded as real efficiencies. Firstly, the Competition Tribunal identified dynamic efficiencies, which include innovation and increased product quality, and stated that these

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808 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 103.
809 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 104.
810 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
811 Refer to section 2.1.1 for a discussion on the four types of economic resources.
813 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
814 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
815 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
816 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
efficiencies are the most beneficial efficiencies and exactly those efficiencies that the competition process and the competition authorities seek to protect. However, the Competition Tribunal did acknowledge that these efficiencies are extremely difficult to prove and consequently, they are less likely to play a substantial role in the application of the Efficiency Defence.

Secondly, the Competition Tribunal identified productive efficiencies as a source of real efficiency. The Competition Tribunal noted that productive efficiencies are somewhere along the continuum between dynamic efficiencies and pecuniary efficiencies and therefore, productive efficiencies can either constitute real efficiencies or pecuniary efficiencies. Citing Sanderson, the Competition Tribunal held that productive efficiencies can be further divided into four sub-categories, namely product level, plant level, multi-plant level and fixed cost efficiencies. More specifically, plant level and therefore, multi-plant level efficiencies refer to those efficiencies that:

"flow from specialization, elimination of duplication, reduced downtime, smaller inventory requirements, or the avoidance of capital expenditures that would otherwise be required" and multi-plant level efficiencies refer to "those associated with plant specialization, rationalization of administrative and management functions, and the rationalization of research and development activities."

In other words, plant level and multi-plant level efficiencies refer to savings associated with the integration of new activities within the firm and savings obtained by the transfer of superior production techniques and know-how from one of the merging parties to the other.

Sanderson also identifies the following two productive efficiencies, namely those obtained by distribution, advertising and raising capital, and those obtained by transactional cost savings.

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817 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
818 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
819 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
820 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
821 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: footnote 41.
822 Sanderson 1997: 632.
The Competition Tribunal concluded that not all the above productive efficiencies are equally important for the purposes of the Efficiency Defence.\(^\text{825}\) The Competition Tribunal hinted that plant-level efficiencies and therefore also multi-plant level efficiencies are the productive efficiencies most likely to result in real efficiencies.\(^\text{826}\) Accordingly, it seems as if the Competition Tribunal divided productive efficiency into its two categories, namely technical efficiency and cost efficiency with real efficiency referring to the technical efficiencies and cost efficiency referring to pecuniary efficiencies.\(^\text{827}\) However, when the Competition Tribunal considered the perpetrating parties' evidence, the Competition Tribunal considered the under utilization of Trident Steel's processing lines and the level of wastage to be efficiencies that are relevant to the purposes of the Efficiency Defence.\(^\text{828}\) The Competition Tribunal eventually concluded that the increased utilization of Trident Steel's processing lines and the decrease in wastage do indeed represent real efficiencies as they "...[generate] cost savings that would add to the efficient use of Trident's plant."\(^\text{829}\) Accordingly, the Competition Tribunal acknowledged that cost efficiencies can constitute real efficiencies under certain circumstances.\(^\text{830}\) Presumably, economies of scale and scope could constitute real efficiencies under the right circumstances.

Contrary, the Competition Tribunal concluded that volume discounts, which contribute to cost efficiency as defined in 2.2.2.2, and transactional efficiencies are not considered to constitute real efficiencies as they do not result in the saving of economic resources.\(^\text{831}\)

The Competition Tribunal also acknowledged that a merger between purchasers may potentially increase the productive efficiency of their suppliers, and that these productive efficiencies may constitute real efficiencies the reason being that the increase in the efficiency of suppliers may, under certain circumstances, increase the efficiency of all entities in the purchasers' industry and as a result, increase the efficiency of the entire industry.\(^\text{832}\) The Competition Tribunal provided the parameters within which these supply efficiencies will constitute real efficiencies, namely that the supplier's increased productive

\(^{825}\) Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 56.
\(^{826}\) Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 56.
\(^{827}\) Refer to section 2.2.2.2 for a discussion on productive efficiency.
\(^{828}\) Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 84-85.
\(^{829}\) Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 85.
\(^{830}\) Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 84-85.
\(^{831}\) Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraphs 52-62 and 84-90.
\(^{832}\) Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 88.
efficiency must result in an increase in the productive efficiency of its purchasers.\textsuperscript{833} Presumably, if a merger results in productive or dynamic efficiency gains for the merged entity's suppliers, and the suppliers' increased efficiency also results in the increased productive or dynamic efficiency of its purchasers, then these supply efficiencies can be regarded as real efficiencies.

The Competition Tribunal also considered whether only savings in marginal costs will be relevant for the Efficiency Defence or whether savings in fixed costs should also be taken into consideration.\textsuperscript{834} The relevance of this question stems from the argument that only savings in marginal costs will be passed on to consumers, the reason being that firms are taken to be profit maximisers and therefore, they will ask that price where their marginal revenue is equal to their marginal costs and consequently, savings in fixed costs will not influence the pricing decisions of firms.\textsuperscript{835} Unfortunately, the Competition Tribunal omitted to address this issue.

In consideration of the preceding paragraphs, it seems as if dynamic and technical efficiencies will always be regarded as real efficiencies whereas cost efficiencies will only be regarded as real efficiencies if they result in the saving of economic resources. Transactional efficiencies on the other hand, will never be regarded as real efficiencies and therefore they are not taken into consideration under the Efficiency Defence.

4.5.2 The United States

Although, as stated previously, efficiencies are recognised as a valid "defence" in US merger proceedings it should be noted that this has not always been the case.\textsuperscript{836} For years the US competition authorities either treated efficiencies as a factor that contributed to the market power of firms or regarded the effect of efficiencies on anti-competitive conduct as neutral and therefore, there was no need or place for the Efficiency Defence and as a result, US Competition Law does not provide for the consideration of efficiencies in competition matters.\textsuperscript{837}

\textsuperscript{833} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 87-88.
\textsuperscript{834} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 60.
\textsuperscript{835} Kattan 1994: 533.
\textsuperscript{836} Kinne 1998: 7.
However, in 1997 the 1992 Horizontal Merger Guidelines were amended to provide for efficiency considerations in merger analyses. The Horizontal Merger Guidelines are jointly published by the US Department of Justice and the FTC and it sets out the analytical framework that these two institutions follow in their analyses of the economic effects of horizontal mergers. Although these guidelines are not binding on courts and although they do not supersede case law, they are extensively utilised by courts in their analyses of the economic effects of horizontal mergers. In 2010, the 1992 Horizontal Merger Guidelines as amended in 1997, were replaced by the 2010 Horizontal Merger Guidelines. Fortunately, the efficiency clause of the 1992 guidelines as amended in 1997, were transposed to the 2010 Guidelines.

The 2010 Horizontal Merger Guidelines determine that only cognizable efficiencies will be considered in merger proceedings. Cognizable efficiencies should maintain current prices, product quality, product variety and service delivery or it should decrease prices and/or improve product quality, product variety and service delivery. Efficiencies will not be regarded as cognizable efficiencies if they result in lower prices that are the result of lower quality or a reduction in product variety. Contrarily, efficiencies could be regarded as cognizable efficiencies if they result in increased prices but then the increase in price should be the result of increased product or service quality and/or product or service variety. More specifically, the Horizontal Merger Guidelines state the following with regard to the types of efficiencies that are likely to be viewed as cognizable efficiencies:

“efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the incremental cost of production, are more likely to be susceptible to verification and are less likely to result from anticompetitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.”

838 Kamerbeek 2010: 29.
839 Kamerbeek 2010: 29.
From the above wording it is clear that plant level and multi-plant level efficiencies, as discussed earlier, are the efficiencies that are most likely to be classified as being cognizable efficiencies.\textsuperscript{847} The reason these efficiencies are cognizable is that they are more likely to decrease the marginal costs of the merged entity and hence they are more likely to be passed on to consumers.\textsuperscript{848} Dynamic efficiencies are extremely important but they are very difficult to verify and hence they are given less weight than productive efficiencies and as a result, they are less likely to be classified as cognizable efficiencies.\textsuperscript{849} Efficiencies relating to procurement, management or capital costs are unlikely to ever be classified as cognizable efficiencies.\textsuperscript{850}

In addition, these cognizable efficiencies must constitute a real increase in efficiency and must not be the result of a decrease in output or the increased bargaining power of the merged entity.\textsuperscript{851} Accordingly, productive (technical and cost efficiency) and dynamic efficiencies that result in real savings in economic resources are considered to be real efficiencies and hence they are treated as potential cognizable efficiencies, whereas pecuniary efficiencies, as discussed previously, are not considered to constitute cognizable efficiencies.\textsuperscript{852} Efficiencies will also not be regarded as cognizable efficiencies if they are the result of reductions in output or service delivery.\textsuperscript{853} It is unsure whether transactional efficiencies are considered to potentially constitute real or cognizable efficiencies.\textsuperscript{854} However, taking the preceding paragraphs into consideration it seems unlikely that transactional efficiencies will constitute cognizable efficiencies.

In addition to being real efficiencies, cognizable efficiencies that result in short run cost savings are given more weight than efficiencies that result only in cost savings in the long run.\textsuperscript{855} In other words, cognizable efficiencies that result in savings in marginal costs are given more weight than efficiencies that result in savings in fixed costs. This is illustrated by footnote 15 in the 2010 Horizontal Merger Guidelines that state the following:

\begin{footnotes}
\item Kamerbeek 2010: 30.
\item Kamerbeek 2010: 30.
\item Kamerbeek 2010: 30.
\item Kinne 1998: 14.
\item FTC 2010: 40.
\item Horizontal Merger Guidelines 2010: section 10.
\item Horizontal Merger Guidelines 2010: section 10.
\end{footnotes}
"The Agencies normally give the most weight to the results of this analysis over the short term. The Agencies also may consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict. Efficiencies relating to costs that are fixed in the short term are unlikely to benefit customers in the short term, but can benefit customers in the longer run, e.g., if they make new product introduction less expensive."

Therefore, in US merger proceedings, productive and dynamic efficiencies that result in real savings in economic resources in the short run are the efficiencies that are most likely to be regarded cognizable efficiencies. The US position is thus identical to the South African position with the exception that the South African competition authorities has thus far refrained from indicating whether there is any difference to the weight assigned to efficiencies that result in marginal cost savings and those that resulted in fixed cost savings.

The argument that savings in marginal costs are more likely to be passed on to consumers is based upon contemporary economic theory. As mentioned, marginal cost refers to the additional costs associated with obtaining an additional unit of a particular good or service.\textsuperscript{856} Marginal costs are also said to be variable cost given that they change together with the level of output produced.\textsuperscript{857} Fixed costs on the other hand, are costs that do not vary with the level of output and must be paid even if output is zero.\textsuperscript{858} Fixed costs are held to be fixed in the short run and can only be avoided (changed) in the long run.\textsuperscript{859} The short run refers to a period that is too short for a firm to alter its production capacity (machinery and equipment i.e., economic capital).\textsuperscript{860} However, in the short run firms can adjust the quantities of the other economic resources they use as well as the intensity in which the firm utilise its production capacity i.e., in the short run firms can adjust their variable (marginal) costs.\textsuperscript{861} The long run on the other hand, is a period that is long enough for the firm to change its production capacity i.e., in the long run firms can adjust both their marginal and fixed costs.\textsuperscript{862} The short and long run periods are conceptual time periods

\begin{footnotesize}
\begin{enumerate}
\item Refer to section 2.4.
\item Wetzstein 2005: 221.
\item Wetzstein 2005: 221.
\item Wetzstein 2005: 221.
\item McConnell and Brue 2008: 380.
\item McConnell and Brue 2008: 380.
\item McConnell and Brue 2008: 380.
\end{enumerate}
\end{footnotesize}
and not calendar periods and therefore they vary from industry to industry.\textsuperscript{863}

Despite the scarcity of jurisprudence on the application of the Efficiency Defence in non-merger rule of reason prohibitions, the Efficiency Defence in non-merger proceedings seems to be similar to the one contained in merger proceedings.\textsuperscript{864} The non-merger Efficiency Defence also provides for the justification of anti-competitive conduct in terms of efficiencies that result in increased output and increased product variety and quality.\textsuperscript{865}

In \textit{Seagood Trading Corporation v Jerrico Incorporated} the court specifically referred to cost efficiencies and efficiencies in the distribution of goods and services as efficiencies that are relevant for the Efficiency Defence in non-merger proceedings.\textsuperscript{866} Presumably these cost efficiencies and efficiencies in the distribution of goods and services encompass productive, dynamic, transactional, real and pecuniary efficiencies. The overruling principle seems to be that the anti-competitive conduct should result in lower prices and/or increased quality and variety.\textsuperscript{867} In other words, efficiencies should benefit consumers as is the case in merger proceedings. The Efficiency Defence in non-merger proceedings thus seems to be very similar to the one contained in merger proceedings albeit that it can be interpreted to include transactional and pecuniary efficiencies.

In recent years, efficiency considerations in merger proceedings have enjoyed a great deal of attention that substantially increased their importance in competition matters and as a result, this study holds that the consideration of efficiencies in non-merger proceedings is likely to be exceedingly influenced by efficiency considerations in merger proceedings which should result in the increased convergence between the Efficiency Defence in merger and non-merger proceedings.

\textsuperscript{863} McConnel and Brue 2008: 380.
\textsuperscript{864} Refer to Holmes 2001 chapter two and three for a comprehensive discussion on efficiency considerations in non-merger competition matters.
\textsuperscript{865} Adaptive Power Solutions LLC v Hughes Missile Systems Co 9\textsuperscript{th} Circuit F.3d 947 1998: 141.
\textsuperscript{866} 11\textsuperscript{th} Circuit F.2d 924 1991: 1555.
\textsuperscript{867} Refer Holmes 2001 chapter two and three for a comprehensive discussion on efficiency considerations in non merger competition matters.
4.5.3 The European Union

As recently as 1996, the EC was of the opinion that efficiencies could not be used as a defence in mergers proceedings.\textsuperscript{868} In fact, the EC stated the following “...there is no real legal possibility of justifying an Efficiency Defence under the Merger Regulation.”\textsuperscript{869} Even more recently in 2001, efficiencies were treated as a factor that would contributed to strengthening the dominant position of a merged entity rather than a defence to show that a merger may result in efficiencies that will countervail the anti-competitive effects of the merger.\textsuperscript{870} Fortunately, this hostility towards efficiency gains brought about by mergers was diluted with the adoption of council regulation 139 of 2004\textsuperscript{871} which specifically provides for the consideration of efficiencies in merger proceedings.\textsuperscript{872} More specifically, section 76 of the Guidelines on Horizontal Mergers state the following:

“Corporate reorganisations in the form of mergers may be in line with the requirements of dynamic competition and are capable of increasing the competitiveness of industry, thereby improving the conditions of growth and raising the standard of living in the Community. It is possible that efficiencies brought about by a merger counteract the effects on competition and in particular the potential harm to consumers that it might otherwise have”

Council regulation 802 of 2004 specifically requires that efficiencies need to improve the ability and incentive of the merged entity to act pro-competitively to the benefit of consumers before such efficiencies will be considered.\textsuperscript{873} In fact, the EC will take into account any efficiency that will increase the merged entity’s ability and incentive to act pro-competitively to the benefit of consumers (own emphasis).\textsuperscript{874} Efficiencies that are taken to benefit consumers include lower prices, new products and/or services and the improvement in the quality of existing products and services.\textsuperscript{875}

Efficiencies that result in one time fixed cost savings, recurring fixed cost savings and

\textsuperscript{868} Kamerbeek 2010: 31.
\textsuperscript{869} Kamerbeek 2010: 31.
\textsuperscript{870} General Electric Company and Honeywell International Incorporated COMP/M.220: paragraph 350.
\textsuperscript{871} Council regulation on the control of concentrations between undertakings (the EC Merger Regulation).
\textsuperscript{872} Council Regulation 139 of 2004: section 29.
\textsuperscript{873} Council Regulation 802 of 2004: Section 9.
\textsuperscript{874} Guidelines on Horizontal Mergers 2004: paragraph 77.
\textsuperscript{875} Council Regulation 802 of 2004: section 9.
savings in variable costs (marginal costs) are all considered. However, efficiencies that result in marginal cost savings are taken to be more likely to benefit consumers and accordingly, these efficiencies are given preference over efficiencies that result in savings in fixed costs.

Cost savings that are the result of decreased output will not be considered as efficiencies that benefit consumers and therefore, they are not taken into consideration.

The Guidelines on Horizontal Mergers are extremely vague with regard to the Efficiency Defence and although the Guidelines predominantly focus upon productive and dynamic efficiencies it can also be interpreted to provide for the consideration of transactional efficiencies and any other cost savings under the Efficiency Defence. It seems as if any efficiency and cost saving whether it is a productive (technical and cost efficiency), transactional, dynamic, real or pecuniary efficiencies will be relevant for the Efficiency Defence if it benefits consumers in terms of lower prices and/or new or improved products and services.

The above provisions of the Horizontal Merger Guidelines are also applied in the assessment of efficiencies in the context of non-horizontal (vertical) mergers. Although the EC has finally accepted that efficiency gains could potentially offset the anti-competitive effects of mergers, it has been reluctant to approve “anti-competitive” mergers on efficiency grounds alone and it has set the burden of proof, as set out above, that has to be discharged by the merging firms extremely high.

This brings us to the Efficiency Defence in non-merger proceedings. The Efficiency Defence in terms of article 101(3) is extremely broad and it is intended to include all types of objective efficiencies. The EC distinguishes between two different “efficiencies”, namely cost efficiencies and qualitative efficiencies. Cost efficiencies include dynamic efficiencies, productive efficiencies and any synergies obtained between firms.

880 Alonso et al 2005: 335; Papandropoulos 2006: 3.
883 Pace 2007: 86.
884 Pace 2007: 86.
885 Pace 2007: 87.
Qualitative efficiencies refer to productive and dynamic efficiencies that result in new or improved products and/or services.\textsuperscript{886} Article 101(3) also provides for the consideration of transactional efficiencies.\textsuperscript{887} Identical to the Efficiency Defence in merger proceedings, consumers are also required to benefit from these efficiencies for them to be considered under the efficiency defence.\textsuperscript{888}

Contrary to the Efficiency Defence in merger proceedings, the Efficiency Defence in terms of article 101(3) does not include a consideration of the ability and incentive of the perpetrating firms to act pro-competitively to the benefit of consumers.\textsuperscript{889} In other words, it is enough to show that the relevant conduct will likely result in these efficiencies and that the efficiencies can potentially benefit consumers whereas under the Efficiency Defence in merger proceedings the merging parties specifically has to prove that they have an incentive and the ability to pass the claimed efficiencies on to consumers.\textsuperscript{890} Nonetheless, the efficiencies accepted under article 101(3) are similar to those accepted in merger proceedings.

With regards to article 102, the EC suggests that the Efficiency Defence contained in article 102 should be based upon the Efficiency Defence contained in article 101(3) with the exception that the ability and the incentive of the dominant firm to act pro-competitively to the benefit of consumers are taken into consideration as is the case in merger proceedings.\textsuperscript{891}

To summarise, the EC will consider any efficiency that results in lower prices and/or new or improved products and services if it will be passed on to consumers. Consequently, the EC does not distinguish between the different types of efficiencies nor does it distinguish between real and pecuniary efficiencies as is the case in South Africa and the US. However, the EC, similar to the US competition authorities, assigns more weight to efficiencies that result in marginal cost savings as opposed to savings in fixed costs. Nonetheless, the EC, similar to the US competition authorities, does take savings in fixed costs into account.

\textsuperscript{886} Guidelines on the application of Article 81(3) of the Treaty 2004: article 69-71.
\textsuperscript{887} Pace 2007: 86.
\textsuperscript{888} Article 81(3) of the Treaty Establishing the European Community 1957 as amended up and to 2003.
\textsuperscript{889} Monti 2007: 208.
\textsuperscript{890} Monti 2007: 208.
\textsuperscript{891} Monti 2007: 209.
4.5.4 Recommendations

The US focuses upon what they call “cognizable efficiencies” with these efficiencies referring to (1) the maintenance of current prices, product quality, product variety and service delivery or (2) the decrease in prices and/or (3) improved product quality, product variety and service delivery. These efficiencies are also required to be real efficiencies and therefore, they will not be regarded as cognizable efficiencies if they are the result of reductions in output or service delivery. The US competition authorities also place emphasis upon savings in marginal costs as opposed to savings in fixed costs although savings in fixed costs are still taken into account.

The EU also considers efficiencies that result in lower prices, new products and/or services and the improvement in the quality of existing products and services to be relevant for the Efficiency Defence. Efficiencies that result in one time fixed cost savings, recurring fixed cost savings and savings in variable costs (marginal costs) are all considered. However, efficiencies that result in marginal cost savings, similar to the US, are given preference over efficiencies that result in savings in fixed costs although savings in fixed costs are still taken into account. In essence, any efficiency and/or cost saving, whether it is a productive (technical and cost efficiency), transactional, dynamic, real or pecuniary efficiency will be relevant for the Efficiency Defence in the EU if it benefits consumers in terms of lower prices and/or new or improved products and services. Therefore, identical to the US, cost savings that are the result of decreased output will not be considered as efficiencies.

In South Africa, the emphasis is placed upon real efficiencies with dynamic and technical efficiencies always constituting real efficiencies whereas cost efficiencies will only constitute real efficiencies if they result in a saving of economic resources. There is also no evidence to suggest that different weights are assigned to savings in marginal costs as

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892 Refer to section 4.5.2.
893 Refer to section 4.5.2.
894 Refer to section 4.5.2.
895 Refer to section 4.5.3.
896 Refer to section 4.5.3.
897 Refer to section 4.5.3.
898 Refer to section 4.5.3.
899 Refer to section 4.5.3.
900 Refer to section 4.5.1
opposed to savings in fixed costs.\textsuperscript{901}

The main differences between the application of the Efficiency Defence in the US and the EU compared to South Africa are reflected in the questions below, namely:

1. Whether more weight should be assigned to savings in marginal costs as opposed to savings in fixed costs?
2. Whether cost savings that result from decreased output or increased bargaining power amount to efficiencies that should be recognised under the Efficiency Defence?
3. Whether efficiencies that result in new products and/or services and the improvement in the quality of existing products and services amount to efficiencies that should be recognised under the Efficiency Defence?
4. Whether any efficiency and cost saving whether productive (technical and cost efficiency), transactional, dynamic, real or pecuniary efficiency amount to an efficiency that should be recognised under the Efficiency Defence if it benefits consumers?

These differences will now be discussed with the aim of making recommendations on the types of efficiencies the South African competition authorities should consider under the Efficiency Defence.

1. **Should savings in marginal costs weigh more than savings in fixed costs?**

In the US and the EU efficiencies that result in marginal cost savings are given preference over efficiencies that result in savings in fixed costs while this is not the case in South Africa.\textsuperscript{902}

This study recommends that the South African competition authorities should assign more weight to efficiencies that result in savings in marginal costs compared to savings in fixed costs for the reason that these efficiencies are more likely to influence allocative efficiency through lower prices that are passed on to consumers in the short run.\textsuperscript{903} Fixed costs on the other hand are less likely to enhance allocative efficiency through lower prices passed

\textsuperscript{901} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00.
\textsuperscript{902} Refer to section 4.5.1; 4.5.2 and 4.5.3.
on to consumers in the short run. Savings in fixed costs requires longer periods to be realised and to be passed on to consumers and given that it is extremely difficult to identify, quantify and predict efficiencies, the longer period involved should, all other things being equal, result in even more difficulty and uncertainty in analysing the net effect savings in fixed costs will have upon the total welfare of a country. Therefore it seems only practical to assign more weight to efficiencies that result in savings in the short run as these efficiencies should be subject to relatively less uncertainty.

Nonetheless, savings in fixed costs are also efficiency gains and accordingly they should still be considered, albeit that they are assigned less weight, because any saving in the economic resources benefit consumers given that more resources are freed to be used to produce other goods and service from which consumers also derive utility. Fixed assets will also eventually have to be replaced with the replacement costs constituting a long run marginal cost that will decrease allocative efficiency in the long run because it will be passed on to consumers in the long run. Any reduction in fixed costs should therefore enhance allocative efficiency in the long run.

Lastly, the weight assigned to savings in marginal and fixed costs will primarily depend upon the welfare standard employed in a particular jurisdiction, with the consumer welfare standard favouring the marginal cost approach as these efficiencies are more likely to be passed onto consumers, whereas the total welfare standard should be neutral on this point because it revolves around the total efficiency of a country.

2. Should cost savings that result from decreased output or increased bargaining power amount to efficiencies that should be recognised under the Efficiency Defence

In the US and the EU, cost savings that result from decreased output or increased bargaining power is not considered under the Efficiency Defence as these cost savings are not recognised as efficiencies for the purposes of the Efficiency Defence.

905 OECD 1996: 5.
906 Refer to section 2.4.
909 Refer to section 3.2.
Although the South African competition authorities have not stated whether cost savings that result from decreased output or increased bargaining power amount to efficiencies that should be recognised under the Efficiency Defence. This study contends that such cost savings will not amount to real efficiencies as determined by the Competition Tribunal in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd and as a result, this study contends that such cost savings will not be recognised in South African Competition matters. This contention is supported by the Competition Tribunal in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd where volume discounts based upon the increased bargaining power of the merged entity were specifically rejected as constituting real efficiency gains. 910

It is thus contended that the South African approach is similar to the approach followed by the US and the EU where cost savings that result from decreased output or increased bargaining power will never amount to efficiencies that are recognised under the Efficiency Defence.

3. Should efficiencies that result in new products and/or services and the improvement in the quality of existing products and services be recognised under the Efficiency Defence?

As discussed, in the US and the EU new products and/or services and the improvement in the quality of existing products and services are considered to constitute efficiency gains even if they result in higher prices. This study recommends that this approach be followed in South Africa since new products and/or services and the improvement in the quality of existing products and services should contribute to the aggregate utility and consumer welfare of the South African society. It should be cautioned however, that the price increase and the corresponding decrease in the quantity of goods and services consumers consume should not be higher than the increase in variety and quality so as to extinguish the increase in utility and consumer welfare as a result of increased variety and quality.

The above recommendation is supported by the fact that dynamic efficiencies are regarded as real efficiencies under the South African Efficiency Defence. 911 More specifically, dynamic efficiencies are held to result in increased product variety and quality and as a result, new products and/or services and the improvement in the quality of

910 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 90.
911 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 55.
existing products and services should be regarded as real efficiencies gains since these gains are acquired through dynamic efficiencies.\textsuperscript{912}

4. Should any efficiency and cost saving whether productive (technical and cost efficiency), transactional, dynamic, real or pecuniary efficiency amount to an efficiency that should be recognised under the Efficiency Defence if it benefits consumers?

This question is divided into two parts, namely whether all efficiencies and cost savings should be recognised under the Efficiency Defence and secondly, whether efficiencies should benefit consumers before they will be recognised under the Efficiency Defence. Firstly, this study supports the South African position that only real efficiencies are recognised as efficiencies under the Efficiency Defence.\textsuperscript{913} As stated, economic resources are scarce (the economizing problem) and therefore economic systems have been developed to ensure the efficient use of these scarce resources.\textsuperscript{914} This study supports the contention that the market system, upon which the South African economy is based, results in the most efficient use of the scarce economic resources.\textsuperscript{915} This study also supports the contention that markets fail as a result of the abuse of market power, among other things, and consequently, this study contends that government intervention within the functioning of the market system is only warranted to the extent that markets fail as a result of the abuse of market power.\textsuperscript{916}

The South African competition authorities should thus only interfere within the functioning of the market system to prohibit the abuse of market power and consequently, it is recommended that only efficiencies that result in the saving of the scarce economic resources should be permitted to justify the abuse of market power i.e., only real efficiencies should be recognised as efficiencies under the Efficiency Defence.

Therefore, it is recommended that the EU approach, whereby all efficiencies and cost savings that benefit consumers are recognised as efficiencies under the Efficiency Defence, is be rejected. Accordingly, it is recommended that South Africa should adopt an approach that is similar to the US approach whereby only real efficiencies are recognised.

\textsuperscript{912} Refer to the definition of dynamic efficiencies in section 2.2.2.3.
\textsuperscript{913} Refer to section 2.1.
\textsuperscript{914} Refer to section 2.1.
\textsuperscript{915} Refer to section 2.1.
\textsuperscript{916} Refer to section 2.1.
under the Efficiency Defence. It is held that the approach recommended above is such an approach.

Secondly, the question of whether efficiencies have to benefit consumers to be recognised under the Efficiency Defence is discussed in section 4.8.

4.5.5 Technological and other pro-competitive gains

As mentioned previously, the Efficiency Defence in South Africa is a collective defence which consists of three separate defences, namely a defence for efficiency gains, a defence for technological gains and a defence for any other pro-competitive gains. The meaning of efficiency gains have been discussed in the previous sections and consequently this section only considers the meaning of technological and other pro-competitive gains.

In the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd the Competition Tribunal followed an *eiusdem generis* (of the same kind) approach to obtain a common meaning between efficiency, technological and pro-competitive gains. The Competition Tribunal concluded that technological gains refer to dynamic efficiencies and pro-competitive gains to real efficiencies.

4.5.5.1 Technological gains

It is contended that the Competition Tribunal in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd were correct to interpret technological gains as dynamic efficiencies.

Dynamic efficiency specifically refers to the innovation of improved and/or new products and/or improved or new production methods which can result in both allocative and productive efficiencies. Stated differently, dynamic efficiency refers to the development of new/improved products and technological advances brought about by research and development.

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917 Refer to section 1.1.
918 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 78.
919 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 78.
920 Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 78.
921 Refer to sections 2.2.2.3 and 2.4.3.
development and entrepreneurial creativity. In a dynamic competitive model firms do not compete against one another in terms of prices but rather in terms of unique products or innovation. In a dynamic competitive market producers thus respond to consumer wants (preferences) through innovation and other technological advances.

In addition, dynamic efficiencies are considered to be more important than static efficiencies because they are considered to be recurring over time whereas static efficiencies are taken to occur only once. Therefore, it is argued that over time dynamic efficiencies will outweigh static efficiencies even if the static efficiencies were initially larger.

To support the Competition Tribunal's interpretation, it is recommended that the term "technological gains" should be interpreted to be synonymous with the term "technological progress" as contained in economic literature. This recommendation is based upon the Competition Tribunal's decision in the merger between the Tongaat Hulett Group and Transvaal Suiker Bpk in terms of which the Competition Tribunal explicitly acknowledged the technological progress of Tongaat Hulett in terms of process innovation.

Technological progress can be defined as innovation in the production process and/or innovation in products and/or services. Technological progress is divided into two categories, namely process innovation and product/service innovations with process innovation referring to the increase in productive efficiency, and product/service innovation referring to the increase in product/service quality and/or variety. More importantly, technological progress like dynamic efficiency, is taken to constitute a real efficiency because it provides for the more efficient use of the scarce economic resources.

Based upon the preceding paragraphs, it is held that technological progress, for the

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922 Refer to sections 2.2.2.3 and 2.4.3.
923 Refer to sections 2.2.2.3 and 2.4.3.
924 Refer to sections 2.2.2.3 and 2.4.3.
925 Refer to sections 2.2.2.3 and 2.4.3.
926 Refer to section 2.4.3.
927 Refer to Röller et al 2000.
928 83/LM/Jul00.
929 Tongaat Hulett Group and Transvaal Suiker Bpk 83/LM/Jul00: paragraph 105.
932 Röller et al 2000: 5.
purposes of Competition Law, is synonymous with dynamic efficiency and accordingly, this study contends that the Competition Tribunal's interpretation of technological gains as dynamic efficiencies is correct.

It is further recommended that technological gains should be interpreted so as to refer to any increase in the development or innovation of technologies (dynamic efficiencies) that will contribute to productive efficiencies that result in the more efficient use of the scarce economic resources, and the development or innovation of new or improved products with improved products referring to the improvement in the quality and/or function of a product. This recommendation that new or improved products should be regarded as technological gains or dynamic efficiencies is based upon Section 10 of the US Horizontal Merger Guidelines.

This study thus concurs with the Competition Tribunal's contention, in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd, that technological gains should be interpreted so as to refer to dynamic efficiency. However, this study expands upon the Competition Tribunal's interpretation in that it is recommended that technological gains should be interpreted so as to refer to any increase in the development or innovation of technology that will contribute to productive efficiency in terms of real efficiency gains, and/or the development or innovation of new or improved products and/or services. Improved products and/or services in turn, should refer to an improvement in the quality and/or function of the particular product or service.

4.5.5.2 Pro-competitive gains

As discussed previously, anti-competitive conduct refers to conduct that results in a substantial prevention or lessening of competition and that market power is required to behave anti-competitively.\(^933\) In essence, anti-competitive conduct refers to the abuse of market power.\(^934\) Market power in South Africa is defined as “the power of a firm to control prices, or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers.”\(^935\) In the US, market power is defined as the ability of a firm to “raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or

\(^{933}\) Refer to section 2.1.3 and 3.5. \\
^{934}\) Refer to section 2.1.3 and 3.5. \\
In the EU, market power is defined as “the ability of one or more firms to profitably increase prices, reduce output, choice or quality of goods and services, diminish innovation, or otherwise influence the parameters of competition.” These definitions of market power is strengthened by the definition of market power in terms of industrial organisation or industrial economics where market power is defined as

“the ability of a firm or a group of firms acting together to increase the price of any specific product or a group of products, by restricting output, from what the price would have been in a perfectly competitive market and as a result increase their respective profits from what it would have been under conditions of perfect competition.”

Although these four definitions of market power differ to some extent they are all analogous with one another in the context that they all refer to market power as the ability of a firm or a group of firms acting together to be unconstrained by the competition process and hence act independently from the pressures of competition. Anti-competitive conduct thus refers to any conduct that would allow perpetrating firms to be unconstrained by the competition process and hence act independently from the pressures of competition.

Logic based upon linguistics dictates that if anti-competitive conduct refers to conduct that enhance the ability of a firm or a group of firms acting together to be unconstrained by the competition process, then the term “pro-competitive gains” should refer to any conduct that constraints or limits the ability of a firm or a group of firms acting together to be unconstrained by the competition process. Pro-competitive gains thus refer to conduct or effects that constrain the ability of a firm or a group of firms acting together (collusion) to abuse its/their market power to act independently from the pressures of competition. More specifically, it is recommended that pro-competitive gains should be interpreted as the constraint of collusive conduct between firms and in particular, as the constraint on the ability of a dominant firm or a non-dominant firm with market power to abuse their market power within the relevant market. It should be noted that this study recommends that pro-competitive gains should only refer to constraints upon a dominant firm or a non-dominant firm with market power given that the constraint of the ability and/or incentive of a non-
dominant competitor or a competitor without market power to compete would in itself be anti-competitive.  

This definition of pro-competitive gains is supported by the language of the US and EU Horizontal Merger Guidelines given that these guidelines prohibit conduct that results in limiting the ability and/or incentive of rival competitors to compete, whereas it permits conduct that enhance the ability and/or incentive of the merged entity to compete.  

Stated differently, pro-competitive conduct is the opposite of exclusionary conduct which refers to the abuse of market power where the abuse of market power “impedes or prevents a firm entering into or expanding within a market.” Hence, conduct that enhance the ability and/or incentive of a firm (competitor) to enter into or expand within a market should be classified as pro-competitive.  

Based upon the preceding paragraphs it is recommended that pro-competitive gains should be interpreted to mean the following:

1. Any effect (conduct) that prohibits a dominant firm and/or a non-dominant firm with market power from abusing their market power,
2. Any effect (conduct) that enhance the ability and/or incentive of a firm (competitor) to enter into or expand within the relevant market.
3. Any effect (conduct) that hinders/prevents incumbent firms from colluding with one another.

This interpretation is supported by US jurisprudence where pro-competitive effects seem to refer to conduct that “…may actually facilitate more effective competition, or at least leave competition unaffected.”  

Take note that pro-competitive gains are different from efficiency and technological gains in that pro-competitive gains directly influence the competition process itself, whereas efficiency and technological gains directly influence the total efficiency or social welfare.
of a country through the more efficient utilization of the scarce economic resources. However, pro-competitive gains should also result in the better utilization of the scarce economic resources in the same way that efficiency and technological gains may enhance the competition process. The difference is that pro-competitive gains influence the competition process directly by limiting/preventing the abuse of market power while it indirectly enhance total efficiency and social welfare as the enhanced competition process (that result form the prevention of the abuse of market power) should result in more efficient market outcomes. Efficiency and technological gains on the other hand, has a direct influence on the efficiency and social welfare of a country while indirectly enhancing the competition process by enhancing the perpetrating firm's ability to compete and forcing its competitors to respond to the perpetrating firm's increased efficiency.

This interpretation of pro-competitive gains and the distinction between pro-competitive, efficiency and technological gains is supported, in part, by Neuhoff et al., according to whom pro-competitive gains refer to any conduct or change in market structure that result in lower prices for consumers or decreased barriers to entry and as a result opens the relevant market to potential entrants.

Neuhoff et al includes lower prices as pro-competitive gains. This inclusion of lower prices as pro-competitive gains founds support in the EU and the US where lower prices for consumers is indeed regarded as pro-competitive gains. In fact, in the EU it seems as if any benefit to consumers are regarded as pro-competitive gains. However, in the US and the EU a substantial lessening of competition that results in a monopoly market or a near monopoly market will almost never be justified by pro-competitive gains, irrespective of the benefits to consumers. The reason being that Competition Law is aimed at maintaining and enhancing competition and consequently, not all benefits of consumers will justify a lessening of competition. Consequently, it cannot be said that all

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946 Refer to section 2.4.5.
947 Refer to section 2.2 and 2.5.
948 Refer to section 2.2 and 2.5.
949 2006: 55.
950 2006: 55.
952 Guidelines on Horizontal Mergers 2004: article 77.
954 Guidelines on the application of Article 81(3) of the Treaty 2004: article 105.
benefits to consumers will be regarded as pro-competitive gains.\textsuperscript{955}

According to Ngobese and Chung,\textsuperscript{956} the inclusion of pro-competitive gains into the Efficiency Defence suggests that efficiencies must be pro-competitive in effect for them to be considered in the Efficiency Defence.\textsuperscript{957} They argue that because the Efficiency Defence only becomes applicable after it has been found that the conduct will result in a substantial prevention or lessening of competition that efficiencies must result in pro-competitive effects\textsuperscript{958} for them to be capable of outweighing the anti-competitive effects.\textsuperscript{959}

This study disagrees with this interpretation that only efficiencies that result in pro-competitive effects will be considered in the Efficiency Defence for the reason that this study contends that there is a clear distinction between efficiencies and pro-competitive gains that are recognised under the Efficiency Defence. This is illustrated below.

As discussed, competition is regarded as the regulating mechanism which ensures efficient market performance.\textsuperscript{960} Also discussed is the fact that efficiency is the goal of Competition Law and competition the vehicle by which efficiency is to be achieved.\textsuperscript{961} Anti-competitive conduct hinders the competition process and ultimately results in efficiency losses for society and therefore, it is anti-competitive conduct that is prohibited by Competition Law.\textsuperscript{962} However, if it can be shown that anti-competitive conduct will result in efficiencies that will enhance total or allocative efficiency, depending upon the welfare standard utilised, then the anti-competitive conduct must be permitted (own emphasis).\textsuperscript{963} This argument clearly demonstrates that there is an actual difference between efficiencies and pro-competitive effects (gains) and that they constitute two separate elements of the Efficiency Defence.

To conclude, this study recommends that pro-competitive gains should be interpreted as

\textsuperscript{955} Take note that Neuhoff et al did not state that consumer benefits will always be regarded as pro-competitive gains.\textsuperscript{956} 2008: 17.\textsuperscript{957} 2008: 17.\textsuperscript{958} Presumably Ngobese and Chung refer to an enhancement of the competition process itself when they refer to the term pro-competitive. In other words, efficiencies must result in increased competition for it to be relevant for the purposes of the Efficiency Defence.\textsuperscript{959} 2008: 17.\textsuperscript{960} Refer to section 2.1.2.\textsuperscript{961} Refer to section 2.1.2.\textsuperscript{962} Refer to section 3.2.\textsuperscript{963} Refer to section 3.1 and chapter one.
conduct that directly increase the competition process itself i.e. conduct that prevent firms from abusing their market power.\textsuperscript{964} whereas efficiencies and technological gains should be interpreted as gains that enhances the competitiveness of individual competitors.\textsuperscript{965}

4.6 Likely, verifiable, merger specific and timely efficiencies

This section considers the questions of whether the raised efficiencies must be verifiable, likely, merger specific and the time frame within which the raised efficiencies must be realised. Merger specific efficiencies refer to efficiencies that can only practically be obtained through a merger i.e., there must no other practical manner in which the merging parties can obtain the same efficiencies within their respective business environments.\textsuperscript{966}

4.6.1 South Africa

In the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd the Competition Tribunal stated that claimed efficiencies must not be broad and speculative in nature, instead the raised efficiencies must be capable of measurement i.e., verifiable (the unit of measurement is considered in the following section).\textsuperscript{967} Accordingly, the evidence provided by the perpetrating parties must be of such a nature and quality so as to enable the competition authorities the verify the claimed efficiencies in a quantitative and qualitative manner.\textsuperscript{968}

The Competition Tribunal also acknowledged that the likelihood that the claimed efficiencies will be realised forms an integral part of the verification process.\textsuperscript{969} This consideration of the likelihood that claimed efficiencies will be realised is explicitly required in South African merger proceedings.\textsuperscript{970}

Unfortunately, the Competition Tribunal did not indicate whether the raised efficiencies

\textsuperscript{964} As defined in section 2.3.4.
\textsuperscript{965} Please note that pro-competitive gains, efficiencies and technological gains are not mutually exclusive and that efficiencies and technological gains will also ultimately result in increased competition and that pro-competitive gains should also result in more efficient competitors.
\textsuperscript{966} Coate 2005: 196.
\textsuperscript{967} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 62.
\textsuperscript{968} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 62 together with paragraph 81.
\textsuperscript{969} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 63.
\textsuperscript{970} Competition Act 89/1998: section 12A(1)(a)(i).
must be merger specific despite the Competition Act specifically requiring efficiencies to be merger specific.\textsuperscript{971}

The Competition Tribunal also failed to indicate whether the time frame within which the raised efficiencies are likely to be realised is of any relevance.

4.6.2 The United States

The US competition authorities will not consider efficiencies that are vague, speculative or that cannot be verified.\textsuperscript{972} Given that efficiencies are very difficult to verify and quantify and that the required information is generally in the possession of the perpetrating parties, the onus is placed upon the perpetrating parties to provide the competition authorities with the information necessary to reasonably verify the claimed efficiencies.\textsuperscript{973}

Efficiencies that are raised in good faith by the perpetrating parties may not necessarily materialise despite the perpetrating parties' confidence that they will and as a result, the likelihood that claimed efficiencies will be realised is an extremely important consideration in determining whether claimed efficiencies are cognizable.\textsuperscript{974}

Efficiencies will also only be considered as cognizable efficiencies if they are merger specific.\textsuperscript{975} Efficiencies will be merger specific only if there are no practical alternatives to obtain the claimed efficiencies within the particular business environment i.e., the competition authorities do not consider less restrictive alternatives that are merely theoretical.\textsuperscript{976} Therefore, the competition authorities only consider efficiencies if the anti-competitive conduct is reasonably necessary to obtain the claimed efficiencies.\textsuperscript{977}

Due to the difficulty in forecasting or predicting efficiencies and market conditions, the US competition authorities specifically considers the time frame within which the raised efficiencies are likely to be realised.\textsuperscript{978} The US competition authorities regard time as a

\textsuperscript{971} Competition Act 89/1998: section 12A(1)(a)(i).
\textsuperscript{972} Horizontal Merger Guidelines 2010: section 10.
\textsuperscripts{973} Horizontal Merger Guidelines 2010: section 10.
\textsuperscripts{974} Horizontal Merger Guidelines 2010: section 10.
\textsuperscripts{975} Roberts and Salop 2007: 14.
\textsuperscripts{976} Coate 2005: 196; Horizontal Merger Guidelines 2010: section 10.
\textsuperscripts{977} Roberts and Salop 2007: 14.
\textsuperscripts{978} Gifford and Kudrle 2005: 466.
proxy for uncertainty and they have set 24 months as the cut-off date within which the claimed efficiencies must be likely to be realised.\textsuperscript{979} As a result, all efficiencies that are likely to only be realised after 24 months are regarded as speculative in nature and hence they are not cognizable efficiencies and will not be considered.\textsuperscript{980} This time dimension is supported by the fact that the US competition authorities assign more weight to savings in marginal costs with marginal costs being short run costs.\textsuperscript{981}

Efficiencies must thus be verifiable, likely, merger specific (least restrictive method to obtain the claimed efficiencies) and timely (realised within 24 months) for them to be regarded as cognizable efficiencies.

4.6.3 The European Union

The Guidelines on Horizontal Mergers specifically state that the later efficiencies are expected to be realised, the less weight the EC will assign to them.\textsuperscript{982} More specifically, the EC will only consider those efficiencies that are timely with timeliness being defined as a period of not more than 24 months.\textsuperscript{983} Once more, this time dimension is supported by the fact that the EC assigns more weight to savings in marginal costs.\textsuperscript{984}

The Guidelines on Horizontal Mergers also require efficiencies to be likely, verifiable and merger specific.\textsuperscript{985} The EC will consider efficiencies to be verified if the perpetrating parties provided the EC with the information required to enable them to verify the likelihood that the claimed efficiencies will be realised, to the extent that the competition authorities are reasonably convinced that the claimed efficiencies are in fact likely to be realised.\textsuperscript{986} Again, it is held that the information required to verify the claimed efficiencies are solely in possession of the perpetrating parties and therefore, the burden is upon them to provide the required information to the EC to verify the claimed efficiencies.\textsuperscript{987}

\begin{itemize}
\item \textsuperscript{979} Gifford and Kudrle 2005: 466.
\item \textsuperscript{980} Gifford and Kudrle 2005: 466.
\item \textsuperscript{981} Refer to section 5.5.
\item \textsuperscript{982} Guidelines on Horizontal Mergers 2004: Article 83.
\item \textsuperscript{983} Guidelines on Horizontal Mergers 2004: Article 74.
\item \textsuperscript{984} Guidelines on Horizontal Mergers 2004: Article 80.
\item \textsuperscript{985} De la Mano 2002: 57.
\item \textsuperscript{986} Kamerbreek 2010: 33.
\item \textsuperscript{987} Kamerbreek 2010: 33.
\end{itemize}
Efficiencies must also be quantifiable and in the event that it is impossible to quantify the claimed efficiencies, then it must at be possible to foresee that the efficiencies will have a clearly identifiable positive impact upon consumers which stretches further than a marginal positive impact.\textsuperscript{988}

Efficiencies will be regarded as merger specific if they are the direct result of the merger and if they cannot be obtained by a less anti-competitive alternative.\textsuperscript{989} It is upon the perpetrating parties to prove to the EC that “there are no less anti-competitive, realistic and attainable alternative of a non-concentrative nature (for example a licensing agreement or a cooperative joint venture) or of a concentrative nature (for example a concentrative joint venture or a differently structured merger) than the notified merger which preserve the claimed efficiencies.”\textsuperscript{990} Similar to the US, the EC will not consider alternatives that are not reasonably practical within the business environment of the perpetrating parties and in this regard, the EC takes the established business practises within the relevant market into account.\textsuperscript{991}

Efficiencies must thus be verifiable, likely, merger specific (least restrictive method to obtain the claimed efficiencies) and timely (realised within 24 months) to be considered in EU competition matters.

4.6.4 Recommendations

\textit{Likelihood}

The South African approach that claimed efficiencies must be likely to be realised is in line with the approach followed in the US and the EU and accordingly, this study concurs with the South Africa position.\textsuperscript{992}

\textit{Verifiability}

In South Africa, identical to the position in the US and the EU, claimed efficiencies will not be taken into account if they are vague and speculative in nature and consequently, it is

\textsuperscript{988} Guidelines on Horizontal Mergers 2004: Article 86.  
\textsuperscript{989} Guidelines on Horizontal Mergers 2004: paragraph 85.  
\textsuperscript{990} Guidelines on Horizontal Mergers 2004: paragraph 85.  
\textsuperscript{991} Guidelines on Horizontal Mergers 2004: paragraph 85.  
\textsuperscript{992} Refer to section 4.6.1-4.6.3.
required that claimed efficiencies must be verifiable in a quantitative and qualitative manner.\textsuperscript{993} Presumably, the quantitative manner refers to the quantity of costs and/or resource savings that will result from the merger. On the other hand, it is recommended that the qualitative manner should refer to efficiencies of which the effect cannot be quantified for example new or improved products and the improvement in the quality of existing products.\textsuperscript{994} It is thus recommended that the EU approach be followed, namely that if it is impossible to quantify the effects of the claimed efficiencies, it must be possible to foresee a clearly identifiable positive impact upon total or consumer welfare (depending on the welfare standard utilised) and/or the competition process with the understanding that it must have a real and positive effect and not merely a marginal positive effect.

**Merger specific**

Although the Competition Tribunal in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd did not indicate whether claimed efficiencies must be merger specific, the Competition Act does require them to be merger specific.\textsuperscript{995} To date, neither the Competition Act nor the competition authorities have elaborated upon the exact meaning of the merger specific requirement.\textsuperscript{996}

This study recommends that a mixture between the US and the EU approaches be followed. More specifically, this study recommends that the EU approach be followed to the extent that it must be upon the perpetrating parties to prove to the South African competition authorities that "there are no less anti-competitive, realistic and attainable alternative of a non-concentrative nature (for example a licensing agreement or a cooperative joint venture) or of a concentrative nature (for example a concentrative joint venture or a differently structured merger) than the notified merger which preserve the claimed efficiencies (own emphasis)."\textsuperscript{997} This approach whereby a distinction is made between alternatives of a concentrative and a non-concentrative nature seems practical given that it should provide more legal certainty to the perpetrating parties to exactly what they need to disprove. It is also argued that the parties that operate within the relevant market should be in a much better position to disprove less restrictive

\textsuperscript{993} Refer to section 4.6.1-4.6.3.
\textsuperscript{994} This is the same interpretation of qualitative efficiencies as provided in the Guidelines on the application of Article 81(3) of the Treaty 2004/C 101/08: paragraph 69.
\textsuperscript{995} Refer to section 4.6.1.
\textsuperscript{996} As far as the author could determine.
\textsuperscript{997} Guidelines on Horizontal Mergers 2004: paragraph 85.
alternatives than the competition authorities who do not operate within the relevant market. Take note that claimed efficiencies are often obtained through the internal expansion of the perpetrating parties and that this internal expansion forms part of the alternatives of a non-concentrative nature.\textsuperscript{998} It is further recommended that the EU approach be followed whereby the established business practises within the relevant market are taken into consideration when determining the viability of alternative methods to obtain the claimed efficiencies.\textsuperscript{999}

The US approach is recommended in the context that only alternatives that are practical within the particular business environment should be considered.\textsuperscript{1000} Less restrictive alternatives that are merely theoretical should thus be excluded from viable alternatives.

\textit{Timely}

In the merger between \textit{Trident Steel (Pty) Ltd and Dorbyl Ltd}, the Competition Tribunal did not indicate whether the time frame within which the claimed efficiencies will be realised is of any significance. The Competition Act also does not provide guidance upon this issue.

This study recommends that the US and the EU approaches be followed, namely that more weight should be assigned to efficiencies that are likely to realised sooner relative to efficiencies that are likely to be realised at a later date.\textsuperscript{1001} This study also recommends that the cut-off period be set at 24 months as is the case in the EU and the US.\textsuperscript{1002} The consideration of the time frame within which the claimed efficiencies are likely to be realised as well as the cut-off period is supported by this study's recommendation that the South Africa competition authorities should assign more weight to efficiencies that result in the saving of marginal costs.\textsuperscript{1003}

\begin{itemize}
\item \textsuperscript{998} For more information refer to Sutherland 2008: 360-361.
\item \textsuperscript{999} Refer to section 4.6.3.
\item \textsuperscript{1000} Refer to section 4.6.2.
\item \textsuperscript{1001} Refer to section 4.5.2 and 4.5.3.
\item \textsuperscript{1002} Refer to section 4.6.2 and 4.6.3.
\item \textsuperscript{1003} Refer to section 4.5.4.
\end{itemize}
4.7 Tradeoff analysis

4.7.1 The Competition Act

In terms of mergers, the Competition Act determines that the efficiency gains must be “greater than and offset the effects of the prevention or lessening of competition.”\textsuperscript{1004} Neither the US nor the EU Guidelines on Horizontal Mergers contain the wording “greater than and offset.” As mentioned, the Efficiency Defence in mergers is based upon section 96 of the Canadian Competition Act which also includes the wording “greater than and offset.”\textsuperscript{1005} Therefore, this study will examine the manner in which the Canadian competition authorities have interpreted this wording.

According to the Canadian Competition Tribunal the wording “greater than and offset” should be interpreted so that the efficiency gains must not merely be larger than the anti-competitive effects but that these efficiencies must also offset the anti-competitive effects.\textsuperscript{1006} For efficiency gains to offset anti-competitive effects it is required that the efficiency gains must more than just marginally exceed the anti-competitive effects, it must substantially exceed the anti-competitive effects.\textsuperscript{1007} The Canadian Competition Tribunal also gave an example stating that a merger cannot be approved if the “savings only refer to the salaries of executives.”\textsuperscript{1008} Therefore, the wording “greater than and offset” should be interpreted to mean that the efficiency gains must decrease (minimise or lessen) the anti-competitive effects of the abuse of market power.\textsuperscript{1009} As we shall see in the following paragraphs, the extent to which the efficiency gains must offset the anti-competitive effects is determined by the relevant welfare standard.

The wording “greater than and offset” thus implies a weighing process or a tradeoff analysis whereby the anti-competitive effects are weighed or traded off against the claimed efficiencies. This is also how the South African Competition Tribunal interpreted the wording “greater than and offset” as contained in the Competition Act.\textsuperscript{1010} The Commentary on the Horizontal Merger Guidelines also indicate that this approach is utilised in merger

\textsuperscript{1004} 89/1998: section 12(1)(a)(i).
\textsuperscript{1005} 1985/c-34.
\textsuperscript{1006} Commissioner of Competition v. Superior Propane Inc 2002 CACT 16: paragraph 172.
\textsuperscript{1007} Commissioner of Competition v. Superior Propane Inc 2002 CACT 16: paragraph 173.
\textsuperscript{1008} Commissioner of Competition v. Superior Propane Inc 2002 CACT 16: paragraph 172.
\textsuperscript{1009} Commissioner of Competition v. Superior Propane Inc 2002 CACT 16: paragraph 172.
\textsuperscript{1010} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 63.
Note that the Competition Act does not use the same wording with regard to non-merger proceedings. Instead the Competition Act uses the following wording “...can prove that any technological, efficiency and other pro-competitive gain resulting from it outweighs that effect” (own emphasis). The interpretation of the wording “outweighs that effect” is beyond the scope of this study and a question for further research although this study recommends that the wording “outweigh that effect” should be interpreted to be analogous to the wording “greater than and offset” used in merger proceedings. Particularly as merger proceedings involve a weighing process whereby the efficiency gains must outweigh the anti-competitive effects for the anti-competitive conduct to be permitted. However, the wording “outweigh that effect” may require that the efficiency gains must entirely offset the anti-competitive effects whereas the wording “greater than and offset” does not indicate whether the efficiency gains must entirely offset the anti-competitive effects.

4.7.2 The tradeoff in terms of the welfare standard employed

Tradeoff analyses is depended upon the welfare standard employed in a specific jurisdiction and therefore, the tradeoff analysis is more accurately described as a welfare tradeoff. South Africa implements the total welfare or total surplus standard whereas the US and the EU implement the consumer welfare or consumer surplus standard. As a result, this study only considered these two standards with regard to the welfare tradeoff.

As mentioned previously, the abuse of market power results in increased prices and decreased output which in turn results in a loss in allocative efficiency and consumer surplus. The increase in price and the decrease in output also result in a deadweight-loss to society. For the purposes of this study the deadweight-loss is assumed to consist only of that portion of the loss in consumer surplus that has not been transferred from consumers to producers and in fact, is lost to society as a result of the increase in

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1011 2006: 49.
1012 89/1998: section 4(1)(a); 5(1) and 8(d).
1013 Riziotis 2008: 105.
1014 Refer to section 4.3.
1015 Refer to section 2.4.1 and 2.4.5.
1016 Refer to section 2.4.5.
price and the decrease in output.\textsuperscript{1017} Based upon these losses and the claimed efficiency gains, the welfare tradeoff revolves around the following four concepts, namely: consumer surplus, producer surplus, deadweight-loss and the redistribution of consumer surplus to producers. The following sections discuss the welfare tradeoff in terms of these four concepts.

4.7.2.1 The total welfare or total surplus standard (the Williamson tradeoff)

The total welfare standard is used to maximise the economic efficiency of a country and therefore it assigns equal weight to the interests of consumers and producers.\textsuperscript{1018} The redistribution of consumer surplus to producers, that results from the abuse of market power, is therefore regarded as having a neutral effect upon the total efficiency of an economy and is therefore not taken to be a loss to society.\textsuperscript{1019} For anti-competitive conduct to be permitted under this standard, the cost savings that result from the claimed efficiencies must be larger than the deadweight-loss (loss in consumer surplus not redistributed) which is only possible if total surplus (the sum of consumer and producer surplus) has increased as a result of the anti-competitive conduct.\textsuperscript{1020} This is illustrated in figure 4.

\begin{footnotesize}
\begin{enumerate}
\item Refer to section 2.4.5.
\item Refer to section 3.2.2.1.
\item Refer to section 3.2.2.1.
\item Gifford and Kudrle 2005: 431.
\end{enumerate}
\end{footnotesize}
Figure 4 illustrates prices, costs and output under a perfectly competitive and a monopoly market structure. In figure 4, the production costs of the monopolist is lower than those of the perfectly competitive firms. The cost functions of the perfectly competitive firms are illustrated by LRMC\(_1\)=LRAC\(_1\) and the monopolist's cost functions are illustrated by LRMC\(_2\)=LRAC\(_2\). The perfectly competitive market operates at points Pc and Qc and the monopoly market at points Pm and Qm. In the perfectly competitive market, consumer surplus is equal to area A+B+C and the producer surplus is equal to zero. In the monopoly market, consumer surplus is equal to area A and the producer surplus is equal to area B+D. Area C represents the deadweight-loss to society and is equal to that part of the consumer surplus that is lost to society and not redistributed to producers. Comparing the sum of the consumer and producer surplus' (total welfare) in the perfectly competitive market with its sum in the monopoly market, it is held that the monopoly

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1021 Image obtained from Lyczynski et al 2009: 596.
1022 Lyczynski et al 2009: 596.
1023 Lyczynski et al 2009: 596.
1024 Lyczynski et al 2009: 596.
1025 Lyczynski et al 2009: 596.
1026 Lyczynski et al 2009: 596.
1027 Lyczynski et al 2009: 596.
1028 Lyczynski et al 2009: 596.
market has a higher level total welfare than the perfectly competitive market. The efficiency gains have thus resulted in an increase in total surplus with the reason being that is taken that area A+B+D is larger than area A+B+C. More specifically, the efficiency gains (area D) are taken to be larger than area C, the deadweight-loss and as a result total surplus has increased and consequently the anti-competitive conduct will be permitted under the total welfare standard.

Note that the redistribution of area B, from consumers to producers, is not taken to be loss to society under the total welfare standard. Importantly, it is the difference between LRMC₁=LRAC₁ and LRMC₂=LRAC₂ (the cost functions) that will determine whether anti-competitive conduct is likely to result in an increase in total welfare. The larger the cost advantage of the monopolist, the more likely it is that the anti-competitive conduct will be permitted under a total welfare standard. Relatively large efficiency gains should thus always result in anti-competitive conduct to be permitted under the total welfare standard. However, Williamson demonstrated that even a modest reduction in costs will be sufficient to offset a large increase in price, even in conditions where the price elasticity of demand is equal to two. Efficiency gains (productive efficiencies) that result in relatively small cost savings should thus be sufficient to justify anti-competitive conduct (loss in allocative efficiency) under the total welfare standard. The total welfare standard thus clearly weighs allocative efficiency against productive and dynamic efficiencies.

4.7.2.2 The consumer welfare or consumer surplus standard

The consumer welfare standard is used to maximise consumer surplus (welfare) and therefore it assigns all the weight to consumer interests and none to producer interests. This standard also regards the redistribution of consumer surplus to producers as a loss to consumers under the consumer surplus standard.
More specifically, the redistribution of consumer surplus is added to the deadweight-loss to form the total loss in allocative efficiency. Anti-competitive conduct will thus only be permitted in terms of this standard if there is no loss in consumer surplus. In other words, after considering the anti-competitive effects and accounting for the efficiency gains, the post merger profit maximising price must be lower than the pre-merger price. This will only occur if the anti-competitive conduct results in decreasing the marginal costs of the perpetrating party to such an extent that the decrease in marginal costs is sufficient to compensate the decrease in the price elasticity of demand that results from the anti-competitive conduct. Efficiency gains that result from anti-competitive conduct must thus be greater in magnitude to satisfy the consumer surplus standard than they need to be to satisfy the total welfare standard. In terms of the consumer welfare standard allocative efficiency is weighed against productive efficiencies that decrease the marginal costs of the perpetrating parties.

Although the US and the EU utilise the consumer welfare standard, they have augmented this standard to allow for the loss in consumer surplus or allocative efficiency under certain circumstances. These circumstances involve increases in price and decreases in output which results in new or improved products and/or the improved quality of existing products. The essence is that these losses in consumer surplus or allocative efficiency must be beneficial to consumers. More specifically, these new or improved products and/or improved quality must contribute to consumer welfare. The consumer surplus standard employed in the US and the EU thus provides not only for the weighing of allocative and productive efficiencies but also for the weighing of allocative efficiency against dynamic efficiencies.

1039 Refer to section 3.2.2.2.
1041 De la Mano 2002: 19.
1043 In this context, the profit maximising level of output (where marginal cost is equal to marginal revenue) will result in lower post merger prices than pre-merger prices. For more information refer to Gifford and Kudrle 2005: 435.
1045 Refer to section 5.3.
1046 Kiljanski 2003: 659.
4.7.2.3 The redistribution of consumer surplus

The redistribution of consumer surplus is of paramount importance in any tradeoff analysis given that the redistributed area will always be greater than the deadweight-loss. Consequently, if the whole distribution of consumer surplus to producers are regarded as a loss in allocative efficiency, then the relevant standard will be very hard to satisfy as demonstrated by Fisher and Lande.

"As the percentage increase in price or the elasticity of demand decreases, the redistribution effect becomes dramatically larger than the deadweight-loss. Since the elasticity of demand and the probable percentage price increase are interrelated, in most mergers fitting the Williamsonian conditions the redistribution effect is likely to be between approximately four and forty times the deadweight-loss."

This analysis of Fisher and Lande was calculated using various combinations of price increases and price elasticities of demand and it indicated that efficiency gains will generally have to be between four to 40 times larger than the deadweight-loss to compensate a standard where the whole redistribution are taken to be a loss in allocative efficiency. Even when the deadweight-loss is relatively small and the efficiency gains substantial, the efficiency gains will only rarely be sufficient to satisfy such a standard. The consumer welfare standard thus clearly requires a much greater magnitude of efficiencies to justify anti-competitive conduct compared to the total welfare standard.

4.7.3 The application of the welfare standard

4.7.3.1 South Africa

In the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd, the Competition Tribunal utilised the total welfare standard to conclude that the claimed efficiencies did indeed, in their opinion, offset the potential anti-competitive effects of the proposed merger and therefore the merger was approved. Unfortunately, the Competition Tribunal did not
clearly indicate the manner in which it weighed (applied the total welfare standard) the anti-competitive effects against the claimed efficiencies.\textsuperscript{1055} The Competition Tribunal only indicated that they used a discretionary approach.\textsuperscript{1056} This approach and the Tribunal’s rationale for using this approach is discussed in the following paragraph.

In the merger between \textit{Trident Steel (Pty) Ltd} and \textit{Dorbyl Ltd}, the Competition Tribunal differentiated between a formulaic approach and a discretionary approach.\textsuperscript{1057} In terms of the formulaic approach the tradeoff is done in the same way an economist would do in a classroom demonstration of the Williamson’s tradeoff.\textsuperscript{1058} In terms of this formulaic approach, the claimed efficiencies and the deadweight-loss are calculated in terms of a mathematical formula and then compared to one another.\textsuperscript{1059} If the claimed efficiencies are larger than the deadweight-loss then the prohibited conduct should be permitted.\textsuperscript{1060} Using the discretionary approach on the other hand, the competition authorities use their discretion rather than a formula to compare the losses against the claimed efficiencies.\textsuperscript{1061}

The main drawback with the formulaic approach is that the gains and losses will not always be measurable in the same units nor on the same scale.\textsuperscript{1062} The one may be quantifiable and measurable in units such as currency whereas the other may only be of a qualitative nature.\textsuperscript{1063} The main drawback with the discretionary approach is that it will result in greater uncertainty given that the perpetrating parties will have no idea how the tradeoff analyses will be conducted by the competition authorities.\textsuperscript{1064}

In the end, the Competition Tribunal indicated that a discretionary approach that takes cognisance of and implements the formulaic results is to be favoured.\textsuperscript{1065} Having stated this, the Competition Tribunal cited the following from Sanderson\textsuperscript{1066}

\textit{"Indeed it is important not to view the tradeoff analysis as an exact science, even where quantitative..."}

\textsuperscript{1055} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65.
\textsuperscript{1056} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65.
\textsuperscript{1057} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65.
\textsuperscript{1058} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65.
\textsuperscript{1059} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65.
\textsuperscript{1060} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65.
\textsuperscript{1061} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 66.
\textsuperscript{1062} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65.
\textsuperscript{1063} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65.
\textsuperscript{1064} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 66.
\textsuperscript{1065} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65.
\textsuperscript{1066} 1997: 637.
estimates are available. Discretion has been exercised at various points in time, particularly when assigning probability weights to cost savings and when quantifying anticompetitive effects. The aim of the exercise is to compare two orders of magnitude – efficiencies versus anticompetitive effects – and not to make a decision based on the fact that $n+1 > n$. Furthermore, comparing orders of magnitude generally is feasible."

In its conclusion, the Competition Tribunal also made the following statements with regard to the discretionary approach.

"Whilst this approach may be criticized for giving the competition authority too much discretion at the expense of business certainty, the alternative which is to interpret this section as a mathematical comparison of two areas on a Williamson diagram, permits an approach so clinical and rigid that it would reduce the proper exercise of a discretion to a matter of calculus."\(^{1067}\)

and

"The efficiencies the parties have claimed are in our view sufficient to be greater than and to offset any anti-competitive effect. Although we have insufficient evidence to quantify this in the form of calculations the efficiencies claimed are so overwhelming...that they will dwarf the anti-competitive effects."\(^{1068}\)

Clearly then, in South Africa, the competition authorities will use their discretion to weigh anti-competitive effects against claimed efficiencies.

4.7.3.2 The United States and the European Union

The discretionary approach to weighing the anti-competitive effects against claimed efficiencies is implemented in the US and the EU.\(^{1069}\) In particular, the US Horizontal Merger Guidelines state the following "...In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies..."\(^{1070}\) The US Horizontal Merger Guidelines also state the following "...for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market" (own emphasis).\(^{1071}\) As far as this study could determine, neither the US nor

\(^{1067}\) Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 82.

\(^{1068}\) Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 91.

\(^{1069}\) De la Mano 2002: 31, 24 and 77-78.

\(^{1070}\) Footnote 14.

\(^{1071}\) 2010: 31.
the EU utilises the formulaic approach as identified in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd.\textsuperscript{1072} Even in Canada, the Competition Appeal Court augmented the formulaic approach followed by the Competition Tribunal in the merger between Commissioner of Competition v. Superior Propane\textsuperscript{1073} (upon which the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd was based) to provide the competition authorities with greater discretion in the tradeoff analyses.\textsuperscript{1074} Although Canada still follow the formulaic approach, the competition authorities now have greater discretion in determining the particular weight to apply to consumer and producer interests and accordingly, also a greater degree of discretion in how anti-competitive effects are weighed against claimed efficiencies.

In South Africa, the US and the EU competition authorities thus use their discretion to determine whether the claimed efficiencies have satisfied the applicable welfare standard.

4.7.3.2.1 Substantial efficiencies and the sliding scale standard

In addition to being likely, verifiable, merger specific and timely, efficiencies in the US and the EU are also required to be substantial before they will be recognised under the Efficiency Defence.\textsuperscript{1075} More specifically, in both the US and the EU, the greater anti-competitive effects are the greater or more substantial claimed efficiencies need to be if it is to save an otherwise anti-competitive merger.\textsuperscript{1076} Some authors have coined this requirement as the “sliding scale standard.”\textsuperscript{1077} In the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd, the Competition Tribunal did not indicate whether this sliding scale standard is to be applied in South Africa.\textsuperscript{1078}

This study contends that the sliding scale standard is superfluous should not be incorporated into South African Competition Law for the reason that the claimed

\textsuperscript{1072} For more information refer to Pace 2007; Cseres 2005; Whish 1993; Korah 2004; Broder 2005; Holmes 2002; Dabbah 2003.
\textsuperscript{1073} 2002 CACT 16.
\textsuperscript{1074} This was done by implementing the balancing weight standard as discussed previously. For more information refer to Commissioner of Competition v. Superior Propane Inc. 2002 CACT 16.
\textsuperscript{1076} Guidelines on Horizontal Mergers 2004: article 84 and 86; Horizontal Merger Guidelines 2010: 31.
\textsuperscript{1077} De la Mano 2002: 77-78.
\textsuperscript{1078} 89/LM/Oct00. It can be argued that the welfare standard as described in paragraph 81 in this case (and discussed in section 4.3.1) represents this sliding scale standard. However, it should be remembered that paragraph 81 refers to the welfare standard and not to the requirements of efficiencies as is discussed here.
efficiencies are weighed against the anti-competitive effects. Therefore, if the anti-competitive effects are substantial then the efficiency gains evidently also have to be substantial for it offset the anti-competitive effects.

In South Africa, efficiencies will also only be considered if the anti-competitive conduct has resulted or is likely to result in a substantial prevention or lessening of competition and therefore, it can be argued that all efficiencies in South African competition matters need to be substantial for them to be able to justify the relevant anti-competitive effects.1079

This study did not consider nor have the competition authorities indicated whether the claimed efficiencies must completely offset the anti-competitive effects for it to be able to satisfy the welfare standard. If it needs not offset the anti-competitive effects completely, then it seems plausible that insubstantial efficiencies could potentially offset substantial anti-competitive effects. Ultimately though, the claimed efficiencies need to satisfy the welfare standard irrespectively of whether it is required for the claimed efficiencies to be substantial or not. The sliding scale standard and the requirement that efficiencies need to be substantial are thus superfluous.

4.7.3.3 The procedural approach to efficiencies

There are three main procedural approaches that can be utilised to implement the Efficiency Defence.1080 These are the case-by-case approach, the general presumptions approach and the sequential approach.1081 In terms of the case-by-case approach, the anti-competitive effects are weighed against the efficiency gains on a case-by-case basis.1082 In terms of the general presumptions approach, structural indicators (such as market shares and concentration) are used to determine the net effect of the conduct i.e., the anti-competitive effects are not weighed against the claimed efficiencies.1083 More specifically, this approach assumes that below certain structural thresholds efficiencies will always outweigh the anti-competitive effects whereas over a certain structural threshold efficiencies are regarded to never be able to outweigh the anti-competitive effects.1084 The

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1079 Refer to section 3.3.
1080 Refer to section 3.3.
1081 Refer to section 4.3.
1082 Refer to section 4.3.
1083 Refer to section 4.3.
1084 Refer to section 4.3.
sequential approach is a combination between the case-by-case and the general presumptions approach whereby the general presumptions approach is used to identify problematic conduct with the problematic conduct then being considered under the case-by-case approach.\footnote{Refer to section 4.3.}

The case-by-case approach has often been criticised for being too complex and difficult to implement practically because of the great degree of uncertainty involved in forecasting efficiency gains and anti-competitive effects.\footnote{Roberts and Salop 1996: 14; Fisher and Lande 1983: 1586.} Accordingly, it is argued that the case-by-case approach will be too arduous to implement.\footnote{Roberts and Salop 1996: 14; Fisher and Lande 1983: 1586.} In fact, in 1978 Judge Robert Bork considered the case-by-case analysis of efficiencies to be beyond the ability of the courts (competition authorities).\footnote{For the full discussion refer to The Antitrust Paradox: A Policy at War with Itself by Robert Bork, Basic Books 1978.} This was also acknowledged in the matter between the Commissioner of Competition v. Superior Propane where the court concurred with the following statement by Fisher and Lande\footnote{1983: 1650.} “case-by-case adjudication of efficiency gains versus effects was itself so unworkable, even under the Consumer Surplus Standard, that merger review should avoid any such analysis.”\footnote{2002 CACT 16: paragraph 384.} Recently it has been argued that competition authorities are now able to consider efficiencies on a case-by-case basis using the full advantage of economic science.\footnote{Coate 2005: 207.} Nonetheless, the weighing of efficiencies against anti-competitive effects remains a formidable task.\footnote{Coate 2005: 207.}

The general presumptions approach on the other hand, is also plagued by shortcomings. Although this approach avoids the high information costs associated with the case-by-case approach, this approach is even more prone to error because of the difficulty to determine adequate structural measures.\footnote{Renckens 2007: 171.; Röller \textit{et al} 2000: 91.} This uncertainty originates from the aggregate uncertainty surrounding the potential efficiencies to be gained from mergers in which case the structural indicators will not be perfect forecasters of the net effects that will result from mergers.\footnote{Röller \textit{et al} 2000: 91.} Presumably, the uncertainty surrounding the validity of the SCP for the South African economy will contribute to the difficulty to determine adequate structural measures.
and therefore this approach does not seem preferable for the South African economy.\textsuperscript{1095}

The sequential approach on the other hand, combines the advantages of both the case-by-case approach and the general presumptions approach by minimizing both information costs and the potential errors that may result from inadequate structural indicators.\textsuperscript{1096} This is achieved by using the general presumptions approach to identify problematic conduct with the problematic conduct then being considered under a case-by-case approach.\textsuperscript{1097} The aim of this is to limit the number of cases where the weighing of anti-competitive effects against efficiency gains are required and as a result this approach is favoured by most authors.\textsuperscript{1098}

The sequential approach which utilises the case-by-case approach, is strengthened by the contention that a case-by-case approach is the best approach to utilise in the consideration of dynamic efficiencies, precisely because these efficiencies are so inherently difficult to identify and forecast.\textsuperscript{1099} Therefore, this study recommends that the sequential approach would be ideal given that it limits the number of cases whereby dynamic efficiencies and efficiencies in general are weighed against anti-competitive effects. Fortunately, in South Africa the sequential approach is already applied to some extent given that the concept of market power is based upon market share.\textsuperscript{1100}

4.7.3.4 Recommendations

This study contends that the discretionary approach followed by the Competition Tribunal in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd is the correct approach to follow because it will allow for greater flexibility in the weighing process.\textsuperscript{1101} This flexibility should be welcomed given that efficiencies and the potential anti-competitive effects are very difficult to identify and measure, and given that tradeoff analysis is not an exact science.\textsuperscript{1102} It should be kept in mind that the discretion is applied to efficiencies that are

\textsuperscript{1095} Refer to section 2.3.3.
\textsuperscript{1096} Röller \textit{et al} 2000: 91.
\textsuperscript{1097} Renckens 2007: 171.
\textsuperscript{1098} Renckens 2007: 171.
\textsuperscript{1099} Kijanski 2007: 260; De la Mano 2002: 6.
\textsuperscript{1100} Competition Act 89/1998: section 7.
\textsuperscript{1101} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65-66.
\textsuperscript{1102} Sanderson 1996: 637. For more information regarding the difficulties to identify, measure and verify efficiencies and anti-competitive effects refer to section 4.4 and 4.6.
merger specific, likely to be realised and that have been verified. Consequently, the possibility of the competition authorities abusing their discretion to the detriment of the perpetrating parties is limited to some extent. It should also be kept in mind that the discretionary approach is based upon quantified and qualitative estimates.\textsuperscript{1103} The application of the discretionary approach is thus based upon fact and not exclusively upon the arbitrary discretion of the competition authorities. The greater flexibility provided by the discretionary approach should also make it easier for the competition authorities to adhere to the chosen welfare standard given that they can use their discretion to ensure that the effects of the applicable standard is obtained within the economy.

It is thus recommended that the South African competition authorities apply the sequential approach using their discretion in the form of the discretionary approach, and because the Efficiency Defence needs to satisfy the applicable welfare standard, this study contends that the sliding scale standard and the requirement that efficiencies need to be substantial are superfluous.

The following section considers whether the total welfare standard is the preferable standard to be applied in South Africa.

\textbf{4.8 The correct welfare standard for the South African economy}

4.8.1 The preferable standard for developing countries

In the merger between the \textit{Commissioner of Competition v. Superior Propane}, the Canadian Competition Tribunal was of the opinion that higher levels of market concentration is warranted in small economies, such as Canada, given that these economies are likely to be unable to attain economies of scale and other efficiencies due to their limited size.\textsuperscript{1104} This contention is also supported by Sanderson who suggests that although Canada may have high levels of industrial concentration that these industries may still not be operating at the minimum efficient scale due to the small size of the Canadian economy.\textsuperscript{1105} Competition Law in small economies should thus emphasise economic efficiency which may require small economies to tolerate higher levels of market

\textsuperscript{1103} Trident Steel (Pty) Ltd and Dorbyl Ltd 89/LM/Oct00: paragraph 65-67.
\textsuperscript{1104} 2002 CACT 16: paragraph 142.
\textsuperscript{1105} 1996: 624.
concentration instead of emphasising consumer welfare.\textsuperscript{1106}

This contention that smaller economies should emphasise economic efficiency and not consumer welfare and therefore, they should tolerate higher levels of market concentration may result in the belief that the total welfare standard is warranted for the South African economy\textsuperscript{1107} given that the total welfare standard promotes economic efficiency and not consumer welfare and given that the total welfare standard is more tolerable towards higher levels of market concentration.\textsuperscript{1108} As a result, it may be argued that the Competition Tribunal was correct in implementing the total welfare standard in the merger between Trident Steel (Pty) Ltd and Dorbyl Ltd.\textsuperscript{1109}

The following sections consider the appropriateness of the total welfare standard for the South African economy.

4.8.2 The South African economy and the total welfare standard

In 1996, professor Frederick Fourie published the results of his ground breaking research into the industrial concentration levels of South Africa.\textsuperscript{1110} The general conclusions of Professor Fourie are neatly summed up in table 1 note.\textsuperscript{1111}

<table>
<thead>
<tr>
<th>Distribution of CR3: 3-digit Industries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concentration Category</td>
</tr>
<tr>
<td>------------------------</td>
</tr>
<tr>
<td>CR3</td>
</tr>
<tr>
<td>0.00-0.20</td>
</tr>
<tr>
<td>0.20-0.40</td>
</tr>
<tr>
<td>0.40-0.60</td>
</tr>
<tr>
<td>0.60-0.80</td>
</tr>
<tr>
<td>0.80-1.00</td>
</tr>
</tbody>
</table>

\textsuperscript{1106} Rolf 2000: 8; Sanderson 1997: 624.

\textsuperscript{1107} According to the International Monetary Fund and the World Bank, South Africa was only the 29\textsuperscript{th} largest economy in the world for 2010 in terms of nominal GDP. Studying these estimates it is clear that South Africa is a much smaller economy than the largest and most developed economies. These reports can be found at http://www.imf.org/external/pubs/ft/weo/2011/02/weodata/weorept.aspx? and http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2 respectively.

\textsuperscript{1108} Refer to section 4.2.1 and 5.7.2.

\textsuperscript{1109} Refer to section 4.2.1 and 5.7.2.

\textsuperscript{1110} Up to 2011 this is still the most complete research done on South African industrial concentration levels.

\textsuperscript{1111} Fourie 1996: 108.

\textsuperscript{1112} The CR3 concentration measure, measures the cumulative market share of the three largest firms within an industry. Refer to Fourie 1996: 104.
These results indicate that highly concentrated industries (industries with concentration measures of 60 and higher) doubled from three in 1972 to six in 1988.\textsuperscript{1113} Although these results are on the industry level and not on the relevant market level, as required for competition analyses, these results are useful to show that the South African economy is highly concentrated with the three largest firms in more than 34 percent of the industries representing more than 40 percent of industry turnover.\textsuperscript{1114}

The high level of economic concentration in South Africa is also illustrated by the fact that in the recent past the majority of economic activity within the South African economy were controlled by only five conglomerates.\textsuperscript{1115} As recently as 1998, these five conglomerates made up 54.7 percent of the capitalisation on the Johannesburg Stock Exchange with the effect that the majority of South African markets are classified as being monopolistic in nature.\textsuperscript{1116} Unfortunately, South Africa’s integration into world markets resulted in the South African economy becoming even more concentrated than ever before.\textsuperscript{1117} The reason for this is two fold, firstly the increased trade liberalisation resulted in larger firms taking over smaller firms and secondly, firms became more focused on their primary activities and as a result, they pulled out of their secondary markets, leaving only the largest firms with little competition behind in the secondary markets.\textsuperscript{1118}

As discussed in chapter two, the SCP is based upon the teachings of the Neo-Classical school and it contends that firms always strive to maximise their profits.\textsuperscript{1119} The SCP also contends that concentrated markets facilitate collusive behaviour between firms and also allow firms to abuse their unilateral and/or collective market power to restrict output and increase prices to obtain abnormal profits.\textsuperscript{1120} Stated differently, the SCP contends that firms in concentrated industries have significant levels of market power and therefore, they will behave anti-competitively by decreasing their output and setting prices above marginal cost which results in abnormal profits and allocative inefficiency.\textsuperscript{1121} This is known as the Collusion Hypothesis and this hypothesis states that a positive correlation between market

\textsuperscript{1113} Neuhoff \textit{et al} 2006: 41.
\textsuperscript{1114} Neuhoff \textit{et al} 2006: 41.
\textsuperscript{1115} Klein 1998: 506.
\textsuperscript{1116} Klein 1998: 506.
\textsuperscript{1117} Roberts 2004: 2.
\textsuperscript{1118} Roberts 2004: 2.
\textsuperscript{1119} Baldwin 1987: 113.
\textsuperscript{1120} Leach 1992: 144.
\textsuperscript{1121} Reekie 1984: 149.
concentration and the profitability of the firms within that market is an indication of collusive behaviour and/or other abuses of market power designed to restrict output and increase profits.\textsuperscript{1122} In contrast to the Collusion Hypothesis, the Efficiency Hypothesis contends that firms become large and dominant because of their superior efficiency relative to their competitors and consequently, high levels of market concentration is the result of efficient firms.\textsuperscript{1123}

These two hypotheses can have a significant influence on competition policy. If the collusion hypotheses holds true for the South African economy, then the high concentration levels in South Africa should result in the abuse of market power through increased prices and decreased output.\textsuperscript{1124} On the other hand, if the Efficiency Hypothesis holds true for the South African economy, then the highly concentrated nature of South Africa's economy is not a cause for concern.\textsuperscript{1125} Instead, the highly concentrated nature of South Africa's economy indicates that the economy is functioning efficient.\textsuperscript{1126} These hypotheses were thoroughly tested by Fourie and Smith.\textsuperscript{1127} Fourie and Smith twice tested the validity of these hypotheses for the South African economy, once in 1993 and once more in 2001.\textsuperscript{1128} On both occasions Fourie and Smith concluded that there is a positive correlation between industry concentration and industry profitability i.e., the Collusion Hypothesis holds true for the South African economy.\textsuperscript{1129} To test the Efficiency Hypothesis, Fourie and Smith used various efficiency variables to directly test the correlation between efficiency and profitability.\textsuperscript{1130} If this correlation were to be positive then the Efficiency Hypothesis holds true as profitability is determined by efficiency.\textsuperscript{1131} However, in their 1993 paper Fourie and Smith's analyses did not indicate that there was positive correlation between profitability and efficiency.\textsuperscript{1132} In fact, their results found market concentration and efficiency to be negatively correlated with one another and consequently, Fourie and Smith rejected the Efficiency Hypothesis and accepted the Collusion Hypothesis and thus also the SCP to be valid for the South African economy.\textsuperscript{1133} Stated differently, Fourie and

\textsuperscript{1122} Lipczynski et al 2009: 17.
\textsuperscript{1123} Leach 1997: 13.
\textsuperscript{1124} Lipczynski et al 2009: 17.
\textsuperscript{1125} Lipczynski et al 2009: 17.
\textsuperscript{1126} Lipczynski et al 2009: 17.
\textsuperscript{1127} Du Plessis and Gilbert 2008: 5.
\textsuperscript{1128} Fourie and Smith 1993 and Fourie and Smith 2001.
\textsuperscript{1129} 1993: 205; 2001: 25.
\textsuperscript{1130} 1993: 198.
\textsuperscript{1131} 1993: 203.
\textsuperscript{1132} 1993: 205.
Smith's results indicate that South African firms abuse their market power to increase prices and earn abnormal profits.

The results in their 2001 paper also indicated a positive correlation between industry concentration and profitability.\(^{1134}\) The results in their 2001 paper suggested that efficiency does not directly determine profitability and therefore, Fourie and Smith once more rejected the Efficiency Hypothesis.\(^{1135}\) It should be stressed that Fourie and Smith are adamant that their results do not completely reject the Efficiency Hypothesis and that efficiency do have some influence upon industry concentration albeit in an indirect manner.\(^{1136}\) Nonetheless, their results strongly suggest that South Africa's concentrated economy is not the result of efficiency and that firms operating within the South African economy are prone to abuse their unilateral and/or collective market power.\(^{1137}\) Therefore, the South African competition authorities should be especially careful to permit anti-competitive conduct that results in increased market concentration.

To add even more weight to Fourie and Smith's conclusions are the analogous findings of various other persuasive studies that analysed the correlation between profitability and concentration and between efficiency and profitability.\(^{1138}\) What makes these studies so persuasive is that they tested these correlations using New Empirical Industrial Organization techniques that test these correlations more accurately than what was previously possible.\(^{1139}\) These studies also used higher quality and better suited data.\(^{1140}\) Fourie and Smith's findings thus seem to be holistic, objective, reliable and as a result, Fourie and Smith's findings appear credible.

In addition to the above findings, Fedderke et al.\(^{1141}\) studied the price mark-up of prices above marginal costs and they found the comparative price mark-ups in the South African manufacturing industry to be twice as high as the price mark-ups in the US manufacturer industry. The findings of Fedderke et al. strongly suggest that firms within the South African economy possess significant levels of market power and that they abuse their market power which in turn, suggests that the competition process is being hampered by the

\(^{1134}\) 2001: 25.
\(^{1135}\) 2001: 25.
\(^{1136}\) 2001: 25.
\(^{1137}\) Fourie and Smith 2001: 25; Fourie and Smith 1999: 205.
\(^{1138}\) Aghion et al 2006; Fedderke and Simbanegavi 2008 and Du Plessis and Gilbert 2008.
\(^{1139}\) Fedderke and Simbanegavi 2008: 2.
\(^{1141}\) 2007: 28.
Based upon the preceding paragraphs, this study contends that the South African economy is highly concentrated and that firms operating in the South African economy poses significant levels of market power and that they abuse their market power to increase prices and decrease allocative efficiency (through high price mark-ups) and consequently, this study caution against the implementation of the total welfare standard in South African competition matters given that it is more prone to accept increased levels of market concentration. The implementation of the total welfare standard in South Africa could thus potentially result in even higher levels of concentration in South Africa which in turn, may result in the various adverse economic consequences discussed in the preceding paragraphs for example high price mark-ups such as those identified by Fedderke et al. This caution is supported by the fact that the SCP has not been invalidated for the South African economy and therefore, it is held that the structure of South African markets do have an influence upon the conduct of the firms within that market i.e., firms in highly concentrated industries in South Africa may very well be colluding and abusing their market power. The South African competition authorities should thus be very hesitant to accept that anti-competitive market conduct that results in increased concentration levels may potentially also result in efficient market performance.

The above caution against the implementation of the total welfare standard in South Africa and tolerating high levels of concentration is especially relevant to merger policy given that increased market concentration is generally the result of increased merger activity. Moreover, numerous empirical evidence and econometric studies have shown that mergers often do not result in efficiency gains. In fact, evidence suggest that when competition authorities assume/accept that verified efficiencies will indeed materialise that these competition authorities will generally be approving welfare reducing mergers and prohibiting welfare enhancing mergers.

This contention that mergers generally do not result in efficiency gains is supported by the

1142 Refer to section 2.1 for a discussion on market power and the failure of markets.
1143 Refer to section 2.3.3 and 2.3.4.
1145 Refer to Kamberbreek 2010; Banal-Estañol et al 2006; Buccirossi et al 2006 and Lipczynski et al 2009: 514-516 for in depth discussion on the efficiency gains from mergers.
X-Efficiency Hypothesis discussed in chapter two. According to this hypothesis, a lack of competitive pressures result in various inefficiencies that cause firms with significant degrees of market power to become productive inefficient.\textsuperscript{1147} Accordingly, it can be argued that even merging firms that raise the Efficiency Defence in good faith may, in the long run, become lacklustre which may result in that merged entity becoming productive inefficient despite its claimed efficiencies. The difficulty to identify, forecast and verify efficiencies also supports this argument that mergers may not result in the claimed efficiencies.\textsuperscript{1148}

Empirical evidence also suggests that the correlation between mergers and innovation is ambiguous with the correlation being positive when market concentration is low and negative when market concentration is high.\textsuperscript{1149} In other words, dynamic efficiency decrease as market concentration increase.

Reliable and current data on concentration levels in developing countries are very scarce and economists are generally divided on the specific degree of concentration in developing countries.\textsuperscript{1150} Even so, it is generally acknowledged that developing countries have higher levels of market concentration that is the result of the abuse of market power.\textsuperscript{1151} It is also generally acknowledged that price mark-ups are higher in developing countries relative to price mark-ups in developed countries.\textsuperscript{1152} UNCTAD has laid down a conceptual framework of Competition Law for developing countries in terms of which they recommend that developing countries specifically need to control anti-competitive market structures (concentrated markets) in their economies.\textsuperscript{1153} This conceptual framework is analogous to the caution above in terms of which this study recommends that the South African competition authorities should place greater emphasize on anti-competitive market structures (concentration levels) than on the claimed efficiencies that may potentially result from anti-competitive market conduct because increased market concentration may eventually hinder the potential efficiency gains from materialising. Moreover, the general economic characteristics of developing countries, upon which the conceptual framework is based, are similar to the characteristics of the South African economy and as a result, South African competition authorities should take notice of the caution of the conceptual

\begin{footnotesize}
\textsuperscript{1147} Refer to section 2.5.5.2.1 for a discussion on the x-Efficiency Hypothesis.
\textsuperscript{1148} OECD 1996: 5.
\textsuperscript{1149} Aghion\textit{ et al} 2005: 720-721.
\textsuperscript{1150} Singh 2002: 10.
\textsuperscript{1151} UNCTAD 1998: 9.
\textsuperscript{1152} UNCTAD 1998: 9.
\textsuperscript{1153} UNCTAD 2005: ix.
\end{footnotesize}
framework against increased market concentration.  

Utilising the total welfare standard may also result in long term problems as the following statement by the Korean competition authorities indicate:

"In hindsight, it seems that if competition policy had been introduced earlier, Korea's economic development would have been achieved in a more balanced and sound manner. At the early stage of development, the negative structural effects of market concentration and the distortions of the market structure were largely overlooked. As a consequence, Korea is now confronting the very difficult task of industrial restructuring. If competition policy had been introduced before the market structure was distorted, such tasks could have been avoided."  

The caution against the implementation of the total welfare standard is also supported by the fact that competition authorities will generally have to resort to divestitures to decrease concentration levels and restore the competition process. Arguably, such divestitures will harm the international image of South Africa which may negatively influence international investments within South Africa. Some argue that it is unnecessary for competition authorities to intervene within the market structure (market concentration) because abnormal profits that result from market power and concentrated markets will attract new entrants into that market which will destroy market power and result in competitive market structures and economic efficiency i.e., competition authorities should not focus on market structure (concentration) and abnormal profits as markets will always result in the most efficient outcome. This study rejects this argument as it has often been found that potential competition and the threat of entry are not sufficient to stop firms from abusing their market power and to ensure that concentrated markets set competitive prices.  

The preceding arguments clearly caution against tolerating high levels of market concentration in South Africa and thus against the implementation of the total welfare standard in South African competition matters.

1155 World Trade Organisation 1997: 3.
1156 European Commission of Competition 2010: 217.
1157 Ezrachi and Gilo 2010: 2-3; Singleton 1986: 3.
1158 Ezrachi and Gilo 2010: 3.
4.8.3 Recommendation

Taking the following factors into consideration,

1. Mergers often do not result in efficiencies,
2. Efficiency gains are extremely difficult to identify, forecast and to verify,
3. Claimed and verified efficiencies do not always materialise,
4. The x-Efficiency Hypothesis,
5. South Africa's market are highly concentrated with firms possessing significant degrees of market power,
6. That it appears that South African firms abuse their market power and that
7. Comparative prices of manufacturing goods in South Africa are twice as high as those in the US.

This study recommends that the consumer welfare standard, as applied in the US and the EU, be applied in South African competition matters. It should be kept in mind that the competition authorities, even under the consumer welfare standard, do not prohibit or regulate the possession of market power nor do they regulate the structure of the market per se. Instead, the competition authorities regulate the abuse of market power. It should also be kept in mind that the South African competition authorities are hesitant to assume a unidirectional flow of causality from market structure, to market conduct to market performance and that they follow a holistic approach whereby they consider all those factors that might constrain perpetrating party(ies) from obtaining and abusing its/their market power. It is only when the competition authorities have concluded that the perpetrating party(ies) will indeed be able to obtain and abuse its/their market power to influence the proper functioning of the competition process that the Efficiency Defence becomes applicable. Therefore, this study recommends that this increase in market power will only be justified if the perpetrating party(ies) can show that its/their increased market power will benefit consumers through increased consumer welfare and increased allocative efficiency.

This study takes note of the argument that larger reductions in competition may be

1159 Refer to section 4.7.2.2 for a discussion on the augmented consumer welfare standard applied in the US and the EU.
1160 Neuhoff et al 2006: 43.
1161 Neuhoff et al 2006: 43.
1162 Refer to section 2.3.3
required to obtain dynamic efficiencies. Accordingly, this study recommends that a loss in allocative efficiency (through higher price mark-ups) must only be allowed if it will result in dynamic efficiencies that will benefit consumers either through new or improved goods and/or services which include the increase in the quality of existing goods and services or through new or improved production methods that will result in lower prices for consumers i.e., anti-competitive market conduct that result in decreased allocative efficiency through higher prices should only be permitted if it also result in dynamic efficiencies that will benefit consumers through greater product variety and/or increased quality.

Stated differently, this study recommends that short term losses in allocative efficiency be permitted if it will result in pro-competitive benefits, as defined in this study, that will ensure allocative efficiency in the long run. It should be kept in mind that these pro-competitive gains should result in increased competition which will ultimately benefit consumers, all other things being equal.

Some may argue that the application of the consumer welfare standard may impede the total efficiency of the economy. In light of all the literature discussed in this study, the real question to ask however, is whether this approach using the consumer welfare standard will result in greater losses in economic efficiency than those losses that will result under the total welfare standard. Based upon the literature discussed in this study, this study considers the loss in competition associated with increased concentration that may result under the total welfare standard to be more detrimental to the attainment of economic efficiency than the application of the consumer welfare standard and as a result, this study contends that the application of the consumer welfare standard in South African competition matters will result in greater efficiency gains than the application of the total welfare standard.

There has also been signs that South African producers are able to become extremely efficient within the limited capacity of the South African economy. This was illustrated in the matter between the Competition Commission and others v Mittal Steel and others. In this case it was explicitly acknowledged that Mittal Steel for many years had been one of

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1163 Refer to section 2.4.3 and 3.1.2.
1164 Refer to section 4.5.5.2 for the interpretation on pro-competitive gains.
1165 Refer to section 4.5.5.2.
1166 Refer to section 4.8.1.
1167 70/CAC/Apr07.
the lowest cost (efficient) producers of flat steel in the world.\textsuperscript{1168} In the merger between Tongaat Hulett Group and Transvaal Suiker Bpk,\textsuperscript{1169} the Competition Tribunal also explicitly acknowledged the technological progress (dynamic efficiency) of Tongaat Hulett in terms of process innovation. It should also be remembered that it has been proved that South Africa's concentrated economy is not the result of efficiency and that firms operating within the South African economy are prone to abuse their unilateral and/or collective market power.\textsuperscript{1170}

Based upon the preceding paragraphs, this study contends that South African firms do not require more concentrated markets to be able to achieve the minimum efficiency scale and to compete internationally. More specifically, this study contends that South African firms have the potential and scope to be efficient and that the South Africa economy does not, all other things being equal, require the total welfare standard to increase its efficiency. Instead, from the preceding paragraphs it appears as though the South African economy will benefit more from the implementation of the consumer welfare standard.

\textsuperscript{1168} Roberts 2007: 3-6.
\textsuperscript{1169} 83/LM/Jul00: paragraph 105.
\textsuperscript{1170} Fourie and Smith 2001: 25; Fourie and Smith 1999: 205.
Chapter five: Conclusion

This study examined and made several recommendations upon the interpretation and application of the Efficiency Defence in South African competition matters. In order to make these recommendations, this study examined the economic and legal framework within which the Efficiency Defence and Competition Law are required to function.\(^\text{1171}\) These economic and legal frameworks identified economic efficiency as the overruling principle for the interpretation and application of the Competition Act and that the Competition Act utilise competition as the vehicle by which to obtain economic efficiency. Having examined these frameworks and given the importance of efficiency for the Competition Act, this study made several recommendations regarding the interpretation and application of the Efficiency Defence in South African competition matters. Hopefully these recommendations will, at the very least, increase debate and focus on the application of the Efficiency Defence in South African competition matters and indirectly contribute to the efficiency of the South African economy, all other things being equal. The eight primary recommendations are stated below.

Firstly, it is recommended that the distinction between a prevention and a lessening of competition is superfluous given that the real question to be answered is whether the perpetrating parties will have the ability and incentive to abuse their market power, irrespective of whether the goal is to prevent or lessen competition.\(^\text{1172}\) Secondly, it is recommended that the onus to prove the existence of efficiencies that may potentially result from prohibited conduct should be placed upon the perpetrating parties. The reason for this recommendation is that the perpetrating parties are generally in possession of the information necessary to identify and quantify the efficiencies that may potentially result from prohibit conduct.

The third recommendation refers to the types of efficiencies that should be recognised under the Efficiency Defence. Currently in South Africa only real productive and real dynamic efficiencies are recognised under the Efficiency Defence. This study recommends the following with regard to real efficiencies, namely that only real efficiencies (as defined in this study) be accepted, that real efficiencies that result in marginal cost savings be

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\(^\text{1171}\) Refer to chapter two for the economic framework and to chapter three for the legal framework.

\(^\text{1172}\) For more information refer to section 3.5.
given preference over efficiencies that result in fixed cost savings, that efficiencies that result from decreased output or increased bargaining power should not be regarded as real efficiencies and that new and/or improved products and services should be regarded as real efficiencies. Fourthly, the South African competition authorities require that claimed efficiencies need to be verifiable and likely to materialise, a requirement this study concurs with. To ensure the enhancement of economic efficiency, it is recommended that the claimed efficiencies also need to be timely and merger specific i.e., the prohibit conduct must be reasonable necessary and the least restrictive manner in which to obtain the claimed efficiencies.

Fifthly, this study interpreted the meaning of the terms “technological gains” and “pro-competitive gains.” It is recommended that technological gains be interpreted to be analogous to technical progress which is analogous to dynamic efficiencies. Technological gains should thus be interpreted as dynamic efficiencies. Pro-competitive gains are recommended to be interpreted as any effect (conduct) that prevents a dominant firm or a non-dominant firm with market power from abusing its market power, any effect (conduct) that enhance the ability and/or incentive of a firm (competitor) to enter into or expand within a market, and/or any effect (conduct) that hinders the firms within a market from colluding with one another.

Sixthly, it is recommended that the sequential approach should be used in the tradeoff analyses in terms of which the actual tradeoff is done using the discretionary approach. Seventhly, given the concentrated nature of the South African economy and the associated high price mark-ups, it is recommended that the consumer welfare standard be employed in South African competition matters rather than the total welfare standard currently employed. Finally, it is recommended that these recommendations be equally applied to merger and non-merger proceedings so as to provide greater certainty surrounding the application of the Efficiency Defence in South African competition matters. This study cautions however, that further research is required to determine whether there should be any variations between the application of the Efficiency Defence in merger and non-merger proceedings.

The question that needs to be answered in applying the Efficiency Defence and the standard that needs be satisfied is whether consumers will be better off as a result of the anti-competitive conduct. Regardless of these recommendations being implemented or
not, the legal uncertainty surrounding the application and interpretation of efficiencies in South African competition matters most urgently require guidelines from the South African competition authorities, in terms of which they clearly set out their approach to the consideration, interpretation and application of efficiencies in South African competition matters. Legal uncertainty should enable competition authorities to abuse their judicial power through arbitrary decisions, and increase the risks associated with doing business in South Africa and as a result, it can be argued that legal uncertainty limits the development and efficient functioning of the South African economy to the detriment of businesses and consumers alike, all other things being equal.

South Africa also urgently require general guidelines on the application of the Competition Act in merger proceedings versus non-merger proceedings. The value of such guidelines is based in the certainty they will provide with regard to the interpretation and application of the Competition Act. Such guidelines should also make legal comparisons with other jurisdictions easier and should in turn, contribute to the development of South African Competition Law and the efficiency of the South African economy. Without such guidelines, the legal uncertainty pertaining to the interpretation and application of the Competition Act and in particular the Efficiency Defence, will most likely continue indefinitely.
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Economic efficiency is used as a proxy for the social welfare of a country's citizens and therefore it is held that if the efficiency of a country improves, so will the social welfare of its citizens. The efficiency of markets determine a country's overall efficiency and social welfare and as a result, the purpose of Competition Law has generally been to increase the efficiency of a county's markets. The efficiency of markets in turn, is increased by competition and therefore, Competition Law is generally aimed at maintaining and promoting competition, which is also the case in South Africa. Stated differently, efficiency is the purpose of Competition Law and competition the vehicle by which efficiency is enhanced.

Central to Competition Law is the concept of the “efficiency defence.” In terms of the efficiency defence, efficiencies are used to justify conduct that limits competition within a relevant market (anti-competitive conduct). The general presumption is that anti-competitive conduct is detrimental to efficiency. This is not always true and in some instances anti-competitive conduct may in fact result in increased economic efficiency. The efficiency defence is the tool used to justify anti-competitive conduct in circumstances where limiting competition will result in increased economic efficiency. Despite the obvious flexibility the efficiency defence provides to competition authorities in their quest to enhance the efficiency of an economy, most jurisdictions have been reluctant to accept efficiencies as a defence against anti-competitive conduct.

The South African Competition Act is still in its infancy and as a result, there are a number of grey areas pertaining to its interpretation and application. One of these areas of uncertainty pertains to the interpretation and application of the efficiency defence in South African competition matters. To date, the competition authorities have only once interpreted the efficiency defence and that was in the merger between Trident Steel (Pty) Ltd and Dorbyl (Pty) Ltd, more than 11 years ago.¹ This study contributes to the legal certainty pertaining to the interpretation and application of the efficiency defence in South

¹ 89/LM/Oct00.
African competition matters by making certain recommendations on its interpretation and application. These recommendations are based upon a comparison between South African, US and EU Competition Law jurisprudence. In addition, all recommendations are in line with contemporary economic theory, which functions as the validating criterion.

The principle recommendation of this study is the recommendation that the consumer welfare standard should be employed in South African competition matters instead of the total welfare standard currently employed. This recommendation is based upon the South African economic environment which includes high levels of market concentration and high price mark-ups in the manufacturing industry. The implications of using the consumer welfare standard will be that the burden of proof to discharge in the efficiency defence is much higher than it is under the total welfare standard. The reason being that under the consumer welfare standard consumers have to benefit from efficiencies for them to be able to justify anti-competitive conduct whereas it is not the case under the total welfare standard.

Keywords: Abuse of market power, competition, consumer welfare, consumer surplus, deadweight-loss, efficiency defence, social welfare, Structure Conduct Performance Paradigm, total welfare, tradeoff, weighing, welfare standard.
Doeltreffendheid word beskou as 'n aanduiding van die sosiale welvaart van 'n land se burgers. Daarom word dit beskou dat die sosiale welvaart van 'n land gesamentlik toeneem met 'n toename in die doeltreffenheid van 'n land. 'n Land se algehele doeltreffendheid en sosiale welvaart is weer op hulle beurt afhanklik van die doeltreffendheid van 'n land se markte en daarom is Mededingingsreg gewoonlik daarop gemik om die markte van 'n land te reguleer. Verder word dit aanvaar dat mededinging aanleiding gee tot 'n toename in die doeltreffendheid van markte en gevoglik is die hoofdoel van Mededingingsreg in die algemeen, soos die geval in Suid-Afrika, om mededinging te beskerm en te bevorder.

Die doeltreffendheidsverweer is 'n uitsigel in Mededingingsreg deurdat hierdie verweer dit moontlik maak vir die respondent om die doeltreffendhede wat voortspruit uit sy verbode handeling te gebruik om die verbode handeling te regverdig. Hierdie verbode handelinge is handelinge wat mededinging in die toepaslike mark beperk of belemmer (hierna beperkende handelinge). Die algemene veronderstelling is dat beperkende handelinge tot 'n afname in doeltreffendheid lei. Dit is egter nie altyd die geval nie en onder sekere omstandighede kan beperkende handelinge 'n toename in doeltrefendheid tewebring. Onder hierdie omstandighede is dit die doeltreffendheidsverweer wat toegepas word om te verseker dat 'n beperkende handeling wat tot 'n toemane in doeltreffendheid lei nie verbied word nie. Ten spyte van die buigsaamheid wat die doeltreffendheds aan mededingingsowerhede verskaf in hulle strewe na doeltreffendheid, is die meeste jurisdikties grootliks gekant teen die idee dat doeltreffendhede gebruik kan word om beperkende handelinge te regverdig.

Die Suid-Afrikaanse Wet op Mededinging het slegs 13 jaar gelede in werking getree en gevolglik bestaan daar steeds talle grys areas rondom die uitleg en toepassing daarvan. Die uitleg en toepassing van die doeltreffendheidsverweer is een van hierdie grys areas. Tot op hede is die uitleg van die doeltreffendheidsverweer nog slegs in een hofsaak oorweeg naamlik in die samesmelting tussen Trident Steel (Edms) Bpk and Dorbyl (Edms).
Bpk. Die Mededingings Tribunaal is egter erg gekritiseer vir sy uispraak in hierdie saak omdat dit versuim het om talle onsekerhede rondom die uitleg en toepassing van die doeltreffendheidsverweer aan te spreek.

Hierdie studie dra by tot die sekerheid rondom die uitleg en toepassing van die doeltreffendheidsverweer in Suid-Afrikaanse mededingings aangeleenthede deurdat hierdie studie verskeie aanbevelings maak rondom die uitleg en interpretaasie van die doeltreffendheidsverweer. Hierdie aanbevelings is verky deur die Suid-Afrikaanse regspraak met die regspraak van die V.S.A. en die E.U. te vergelyk. Verder is alle aanbevelings in hierdie studie in lyn met huidige ekonomiese teorie wat as die waarmerkings standaard daarvan dien.

Die vernaamste aanbeveling is die aanbeveling dat die verbruiker welvaarts standaard in Suid-Afrikaanse mededingings aangeleenthede toegepas moet word in plaas van die algehele welvaart standaard wat huidiglik toegepas word. Hierdie aanbeveling is gebaseer op die Suid-Afrikaanse ekonomiese omgewing wat gekenmerk word aan onder andere hoë vlakke van mark konsentrasie en buitensporige pryse in die vervaardigingsbedryf. Die vernaamste gevolg daarvan om die verbruikers welvaart standaard te gebruik is die feit dat die bewyslas wat bevredig moet word onder die verbruikers welvaart standaard aansienlik hoër is as die bewyslas wat onder die algehele welvaart standaard bevredig moet word. Die rede vir hierdie hoër bewyslas is die feit dat doeltreffendhede slegs beperkende handelinge kan regverdig onder die verbruikers welvaart standaard indien verbruikers deur die beperkende handeling bevoordeel word. Onder die algehele welvaart standaard is dit onnodig vir doeltreffendhede om verbruikers te bevoordeel.

Sleutelwoorde: Misbruik van markkrag, mededinging, verbruikers welvaart, verbruikers surplus, deadweight-loss, doeltreffendheidsverweer, sosiale welvaart, Structure- Conduct-Performance-Paradigm, algehele welvaart, tradeoff, opweging, welvaart standaard.