THE COMPETITION APPEAL COURT OF SOUTH AFRICA

HELD IN CAPE TOWN

In the matter between 146/CAC/Sep16

MEDIA 24 PROPRIETARY LIMITED Appellant

and

THE COMPETITION COMMISSION OF SOUTH AFRICA Respondent

JUDGMENT: 19 March 2018

DAVIS JP

Introduction

[1] This appeal concerns the first application by respondent under South African law of the principle of predatory pricing as provided for in s 8 of the Competition Act 89 of 1998 ('the Act'). Predatory pricing raises complex questions of competition economics and law and hence represents a challenge for a competition authority. As Professor Motta observes:

> 'The very nature of predatory pricing, which involves low prices for a period, makes it difficult to analyse. To distinguish low prices due to a genuine and lawful competitive response to rivals from low prices due to a predatory and unlawful behaviour is far

> from an easy task in practice. Furthermore, a very cautious approach by anti-trust agencies and courts is needed to avoid the risk that firms endowed with market power keep prices high to avoid being charged with predatory behaviour.'[1]

[2] The application of predatory pricing in this case concerns three relatively small community newspapers, *Forum* and *Vista* (both owned by Media 24, the respondent) and *Gold Net News* (*GNN*), which was independently owned, all of which were published in the area around Welkom ('the Goldfields area') before and during the period January 2004 and February 2009 ('the complaint period').

[3] On 31 October 2011 respondent referred a complaint to the Tribunal in which it contended that, during the complaint period, appellant, through *Forum*, had engaged in predatory pricing in the relevant market for advertising in the Goldfields area in contravention of s 8 (d) (iv) alternatively s 8 (c) of the Act. More specifically, the respondent contended that appellant had maintained *Forum* in the Goldfields market as a 'fighting brand' to prevent and/or inhibit *GNN* as well as potential new entrants from entering or expanding within the Goldfields market. It contended that the operation of *Forum* did not make economic sense other than as a fighting brand to achieve this predatory objective.

[4] On 8 September 2015, the Tribunal held that respondent had established that appellant had priced its publication *Forum* below its average total costs; had intended to predate its competitor, *GNN*; and had the ability subsequently to recoup what it had lost during this predation period. Hence the respondent had established that appellant committed an exclusionary act in terms of s 8 (c) of the Act. The Tribunal also found that appellant's actions had an anti-competitive effect and that there was no evidence of any procompetitive gain which would outweigh this effect.

[5] In a separate decision on 6 September 2016 the Tribunal set out a series of remedies which flowed from its initial finding on the merits. Before this court, only the issue of the merits decision was debated, the question of remedies being left for later determination, if necessary.

The factual background

[1] M Motta *Competition Law: Theory and Practice* (2004) at 412.

[6] It was common cause that *Vista* started publication in 1971, with one its founders being Mr Hans Steyl. Ownership of *Vista* changed several times between 1980 and 1999. What is relevant to the present dispute is that during the complaint period, *Vista* was operated by appellant (via the Volksblad Group) which had purchased *Vista* from the Caxton Group in 1999. At the time of its purchase by appellant, *Vista* had two weekly editions, one published on Tuesdays and the other on Thursdays. In December 2001 the Tuesday edition was discontinued and thereafter it had only published one edition a week on Thursdays.

[7] *GNN* had its origins in a group called Netnuus which started in 1999, having been established by Ms Leda Joubert. In 1999 Ms Joubert appointed Mr Steyl to assist in establishing Netnuus Welkom. Although the Netnuus group failed as a newspaper group, Mr Steyl continued to publish *GNN* which he did from 2000. It operated until it exited the market in April 2009.

[8] *Forum* was established in September 1983 by respondent and was the second community newspaper to enter the Goldfields market. It ceased publication at the end of January 2010.

[9] During the complaint period, *Forum* was a free weekly newspaper distributed every Wednesday. Its editorial content covered local municipal affairs, sport and school news with a distinct focus on “soft” human interest issues. It featured exclusives not found in any of the other local newspapers. It averaged 16 pages per edition in 2004 and between 8 to 12 pages after 2005.

[10] *Vista* averaged between 48 to 56 pages per edition and was distributed on a Thursday. Its editorial coverage included local news and sport with the focus on “hard news” – municipal matters, crime, sport and the local mining industry as well as standard weekly features focussing on motoring, entertainment and the housing market.

[11] *GNN* averaged between 20 to 24 pages per edition during 2004 although its pages declined later to between 16 to 24 pages. Its editorial content was very similar to that of *Vista*, the emphasis being on “hard” local news including municipal matters, sports, crime and new relating to the mining industry. It was distributed on a Thursday even though it carried a Friday date.

[12] Advertising was crucial to the success of all three of these community newspapers. All three newspapers carried national advertisements although *Vista* enjoyed a significantly greater share than both *GNN* and *Forum*. During the relevant period, the share of classified and national advertising for the three newspapers was as follows:

	Title	2005	2006	2007	2008	2009	Period advertising
Share of classified advertising	*Vista*	73.8%	70.7%	73.0%	78.1%	87.1%	74.8%
	Forum	4.7%	5.2%	6.3%	4.9%	3.8%	5.3%
	GNN	21.6%	24.1%	20.7%	17.0%	9.1%	19.9%
Share of national advertising	*Vista*	90.3%	88.9%	84.4%	87.8%	96.0%	88.0%
	Forum	2.3%	2.1%	6.7%	1.3%	1.6%	3.2%
	GNN	7.3%	9.0%	8.9%	10.9%	2.4%	8.8%

[13] During the relevant period the following table provides the estimated prices and differentials between *Vista*, *Forum* and *GNN* (Rands per sccm[2]) so far as advertising in the respective newspapers was concerned:

Title	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Vista	R 12.15	R 13.38	R 13.83	R 14.58	R 14.54	R 14.87	R 14.02
Forum	R 8.43	R 9.16	R 9.33	R 9.60	R 9.01	R 9.83	R 9.22
GNN	R 13.81	R 15.82	R 17.2	R 16.41	R 15.85	R 17.17	R 15.98
Differential of *Forum* relative to *Vista*	-30.6%	-31.5%	-32.6%	-34.1%	-38.0%	-33.9%	-34.3%
Differential of *GNN* relative to *Vista*	19.7%	18.2%	23.0%	12.6%	9.0%	15.5%	14.0%

[14] In January 2009 Berkina Twintig (Pty) Ltd, the owner of *GNN*, lodged a complaint against the appellant with the respondent. The essence of this complaint was that, from 2004, appellant had abused its dominant position in the Goldfields to

[2] Single column per centimetre.

force *GNN* out of business by selling advertising at 'grossly discounted rates which (were) totally unrelated to production and normal overhead costs'.

[15] The complaint set out the following allegations:

1. *Vista* and *GNN* were direct competitors, with *Vista* which was in a dominant situation averaging 48 pages per week while *GNN* averaged between 24 to 28 per week.
2. *Vista* and *GNN* had more or less the same staff complement while *Forum* had a much smaller staff complement.
3. Up until 2004 *GNN*, *Vista* and *Forum* all sold at market related advertising rates with *Forum* always being cheaper due to its smaller print order but 'probably also to constitute a nuisance factor in the goldfields market'.
4. During 2005/06 *GNN* experienced a reduction in profit as a result of 'severe local advertising rate cutting by *Vista* and *Forum*'.
5. This "onslaught" by appellant intensified in the years that followed with 'continuing rate cutting'.
6. *GNN* advertisers had indicated since 2004 that *Vista*'s local single column centre metre rate was much lower than that of *GNN*.
7. *GNN* experienced increasing losses in 2007, 2008 and 2009.
8. At the date of the complaint *Vista* was continuing to sell at local rates comparable to its rates of 10 to 12 years earlier and 'nowhere near current market related rates elsewhere in the province or the country'.
9. Appellant was printing *Vista* and *Forum* at or below costs and thus subsidising these publications 'in the broader corporate sense' to enable them to sell at considerably lower local advertising rates than *GNN*.[3]

[16] On 31 October 2011 respondent referred the complaint to the Tribunal contending that appellant, through *Forum*, had engaged in below-cost pricing conduct in contravention of s 8(d) (iv), alternatively s 8(c) of the Act. In the founding affidavit the key elements of the complaint were set out thus:

> 'The Commission contends that Media 24, through *Forum*, engaged in predatory pricing in the market for advertising (including run-of-press advertising and inserts) in community newspapers in the Goldfields region of South Africa during the period

[3] The quotations indicated are from the original complaint lodged in January 2009.

2004 to 2009 in contravention of s 8(d)(iv) of the Act. Alternatively, Media 24's conduct amounts to exclusionary below-cost pricing in contravention of s 8(c) of the Act.'

[17] Respondent developed its case further by way of two supplementary founding affidavits of 26 February 2013 and 12 July 2013. Reading the three affidavits together its case can be summarised thus:

1. Appellant operated *Forum* solely as a 'fighting brand' in order to exclude *GNN* from the market;
2. *Forum*'s average revenues did not cover the average total costs of producing and publishing the paper;
3. *Forum*'s average revenues did not cover its average variable costs over a 12 month period (where all costs were considered variable and thus could have been avoided if *Forum* had ceased publication at this point); and/or
4. *Forum*'s incremental costs (calculated as *Forum*'s total revenues reduced by the proportion of its revenues which would have been diverted to *Vista* if *Forum* had exited the market) did not cover its incremental costs, calculated as the total costs that were incremental to the operation of *Forum* based on two definitions:
   (a) all costs that could have been eliminated over a period of one year; and
   (b) all *Forum*'s costs.

An overview of the Tribunal's decision

[18] In its determination of this case, the Tribunal first considered whether the appellant contravened s 8 (d) (iv) of the Act which provides that it is prohibited for a dominant firm to 'sell goods or services below their marginal or average variable costs unless the firm concerned can show technological, efficiency or other procompetitive gains which outweigh the anti-competitive effect of its act.'.

[19] Although I shall deal with the concept of average variable costs in more detail later in this judgment, suffice it to say that average variable costs ('AVC') is defined as the sum of all variable costs divided by output. This concept was incorporated into the Act. Subsequent to the introduction of the Act a further concept was

developed, in the economic literature, namely average avoidable costs ('AAC'), being the costs a firm could have avoided by not engaging in a predatory strategy. Unlike AVC, AAC includes an element of fixed costs known as product-specific fixed costs.

[20] There was a considerable debate before the Tribunal as to whether pricing below AAC could lead to liability under s 8 (d) (iv) of the Act. The Tribunal found that respondent had failed to discharge the onus of establishing that appellant had priced *Forum* below its AAC. It reasoned that neither AAC nor the lower figure of AVC exceeded the revenue earned by *Forum* during the complaint period.

[21] In essence this finding was based on two exclusions from the respondent's calculation of costs for AAC, namely opportunity costs and redeployment costs:

(i) Opportunity costs in the present context mean the profits which the appellant allegedly sacrificed by persisting with *Forum* and thereby allowing some advertisers, who would otherwise have advertised in *Vista* at higher advertising rates, to advertise in *Forum* at lower advertising rates. The calculation of these opportunity (or cannibalisation) costs would require an assessment of how many of *Forum*'s advertisers would have advertised in *Vista* if *Forum* had been closed (ie the diversion percentage) and the extra operating costs *Vista* would have incurred to accommodate those additional advertisers, the opportunity costs being the diverted revenues minus the extra operating costs.

(ii) Redeployment costs in the present context appears to be something of a misnomer. Many of the employees who did work in relation to *Forum* formed part of the pool serving Volksblad or community newspapers in general (for example, sub-editors, advertising administrators, artists and so forth). The respondent's contention was that, if *Forum* had not been kept in the marketplace, Volksblad could have reorganised its general staff so as to save some of these costs, whether by reducing staff numbers or getting certain staff to work reduced hours. The costs which could have been thus saved if *Forum* had been closed were referred to by the parties and the Tribunal as redeployment costs.

[22] As to the question of opportunity costs, the Tribunal held:

> 'The calculation of AAC, on the Commission's version, is based on too imprecise an assumption to be used as a basis to arrive at a reliable benchmark. Even if we accept that the estimate of 27% [ie as the diversion percentage] was the figure Van Eck intended to convey, this version was an estimate made out at a single moment during the complaint period. Whilst Ms van Eck, the then sales manager for the two publications in Welkom, and with a long history of selling adverts in the local market, was probably better placed than anyone else to make this estimate, it was still more an informed hunch than precise science. She had to guess what advertisers might do without knowing for certain what they would definitely do. We know both from her evidence and a later document that is in the record, that advertisers on the closure of *Forum* could, if *GNN* was still in the market, have done any of the following: moved advertising to *Vista*, moved advertising to *GNN*, advertised only once a week if they already advertised in both publications, or found some other medium for advertising, such as pamphlets.'[4]

[23] The Tribunal decided, with regard to redeployment costs, that:

> 'Making assumptions about re-deployment involves a judgment made on the business requirements of the firm. Take the costs of the various employees at Bloemfontein who spent some small portion of their week on *Forum* business. The evidence was that these employees were not dedicated to *Forum* but spent some time per week on the title and then worked on the other titles as they came to them during the course of the week.'[5]

[24] Having dismissed respondent's case under s 8 (d) (iv), the Tribunal turned to respondent's case brought under s 8 (c) which provides…… 'it is prohibited for a dominant firm to engage in an exclusionary act other than an act listed in paragraph (d) …'. Here the respondent's case was that *Forum* had priced below its average total costs ('ATC') and that further there was an intent on the part of appellant to predate. In this connection, the Tribunal found in favour of respondent, holding that appellant had operated *Forum* for the duration of the complaint period below its average total costs and that there was additional evidence, on the probabilities, which was consistent with predatory intent. The Tribunal found this evidence directly in the form of statements and in the formation and the implementation of a plan that was predatory in nature; and indirectly, in evidence of cannibalisation, operating

[4] Para 161 of the Tribunal's decision.
[5] Para 198 of the tribunals decision.

Forum for a lengthy period, notwithstanding repeated loss making and failure to achieve its budget forecasts; the timing of the closure of *Forum* shortly after the exit of *GNN*, and finally in strong evidence of recoupment.'[6]

The applicable law

[25] Before evaluating the arguments raised by appellant against the findings of the Tribunal, it is necessary to analyse more deeply the concept of predatory pricing and the related principles of economics. This analysis is required to determine the appropriate costing benchmarks for the application of both s 8(d) (iv) and s 8(c) of the Act.

[26] The animating idea behind the prohibition against predatory pricing can be stated in simple terms. A dominant firm deliberately reduces prices to a loss-making level when faced with competition from an existing competitor or a new entrant to the relevant market. The existing competitor, having been disciplined or having exited the market or a new entrant having been foreclosed, the dominant firm then raises its prices, thereby causing consumer harm.

[27] This simple description of the concept disguises the complexity of the problem. Competition on the merits includes price competition. This may lead to the elimination of competitors that are less efficient than the dominant firm. In a market economy a dominant firm has a right to compete on price. Accordingly, the doctrine of predatory pricing has to be developed by way of the creation of a boundary between not prohibiting a dominant firm from the exercise of competitive price-cutting on the one hand and not condoning unreasonable exclusionary predation on the other. In negotiating this boundary, a competition authority has to be extremely watchful not to commit either a false positive or a false negative. Either error would undermine the object of competition law and policy. If the effect of a prohibition is that a dominant firm would choose not to compete on price for fear that if it did so it would be found guilty of a predatory infringement, a vital objective of competition law, namely lower prices and a concomitant increase in consumer welfare, would be undermined.

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[6] Para 598 of the Tribunal's decision

[28] It is thus not surprising that a number of attempts have been made to formulate an appropriate test to determine when a price is predatory. In 1975 Professors Areeda and Turner[7] argued that a price should be deemed predatory under United States law where the price was pitched below a dominant firm's AVC. Responding to what they considered to be an excessively subjective intention-based test that had previously been applied, Areeda and Turner argued:

> 'These vague formulations of the offence overlooked the fact that predation in any meaningful sense cannot exist unless there is a temporary sacrifice of net revenue in the expectation of greater future gains. Indeed the classically-feared case of predation has been the deliberate sacrifice of present revenue for the purpose of driving rivals out of the market and then recouping the loss through higher profits earned in the absence of competition. Thus, predatory pricing would make little economic sense to a potential predator unless he had (1) greater financial staying power than his rivals; and (2) a very substantial prospect that the losses he incurs in the predatory campaign will be exceeded by the profits to be earned after his rivals had been destroyed.'[8]

[29] While the authors considered the question of recoupment of losses after successful predation, they did observe that 'the prospects of an adequate future payoff, therefore, will seldom be sufficient to motivate predation. Indeed, proven cases of predatory pricing have been extremely rare.'[9]

[30] Much of their article was devoted to the establishment of an adequate price-cost test to apply to a case of alleged predation without a need for evidence about intention. They found the appropriate measure to be AVC.

[31] The question of a cost benchmark was also canvassed under European law in the case of *AKZO v The European Commission*[10] where the court declined to adopt the Areeda and Turner test according to which pricing above AVC would be presumed to be lawful. The Court of Justice established two standards to determine whether prices are predatory:

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[7] Phillip Areeda and Donald Turner 'Predatory pricing and related practices under s 2 of the Sherman Act' (1975) 88 *Harvard Law Review* 697
[8] at 698
[9] At 699.
[10] [1991] ECR – I 3359.

> ‘ATC Where a dominant firm is selling at less than ATC, but above AVC, it is guilty of predation where this is done as part of a plan to eliminate a competitor; such a pricing policy runs the risk of eliminating undertakings that are as efficient as the dominant firm but, due to their smaller financial resources, incapable of withstanding the competition waged against them
>
> AVC Where a dominant firm is selling at less than AVC, it is (rebuttably) presumed to be acting abusively since every sale would generate a loss for the dominant firm.’[11]

The corollary of these *AKZO* tests is that a firm charging prices above ATC is not guilty of predation.

[32] As Whish and Bailey note, a complicating factor in applying cost-based rules to determine whether the prices are predatory is that it may not always be appropriate to apply the standards of AVC or ATC, particularly in industries where fixed costs are very high but variable costs are very low.[12] Following these difficulties a further benchmark was developed, namely long run average incremental costs (LRAIC).[13]

> ‘LRIC is the change in total costs resulting from the production of an increment in the quantity of output, which can be the whole output of the product in question or just the incremental output associated with the exclusionary conduct. The EU Commission’s Guidance refers to LRIC as ‘the average of all the (variable and fixed) costs that a company incurs to produce a particular product. It may be more appropriate to calculate the LRIC of simply the additional output associated with exclusion. Unlike AAC, LRIC includes all product-specific fixed costs even if those costs were sunk before the period of predatory pricing, ie, LRIC includes both recoverable and sunk fixed costs.’[14]

[33] In introducing s 8 (d) (iv) into the Act, the legislature adopted the concept of AVC. Significantly, shortly before the Act became law, a further influential approach

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[11] See Richard Whish and David Bailey *Competition Law* (8th ed) at 684.
[12] Whish and Bailey at 787.
[13] In some of the literature it is referred to as LRIC
[14] Gunmar Niels, Helen Jenkins and James Kavanagh *Economics for Competition Lawyers* (2011) at 193.

was developed by William Baumol,[15] namely the cost benchmark of AAC. It is probably for this reason that s 8 (d) (iv) utilised marginal and average variable costs as benchmarks, but did not include AAC in the provision.

[34] Baumol's approach is however relevant to the application of s 8(c), which does not specify any cost benchmark for a case of predatory pricing. It requires careful analysis. Baumol contended that any individual price that is not below AAC cannot be predatory. Thus AAC, as opposed to marginal cost, is the critical test in assessing predation. He argued that a set of prices of different products of the firm can violate this test if the revenues in any combination of the firm's products fall short of the combined avoidable costs of these products. A firm's failure to maximise its profits during a relatively brief period would not of itself constitute legitimate evidence of predation. Baumol went on to suggest that ATC is a figure that is undefinable and unmeasurable in a multi-product firm and must be rejected as part of any legitimate test of predatory pricing.

[35] Baumol argued that a price can be defined as predatory, if and only if, it meets all three of the following conditions:

1. The choice of the price must have no legitimate business purpose;
2. The price must threaten the existence or the entry of rivals that are at least as efficient as the firm that has adopted the price at issue;
3. There must be a reasonable prospect of recoupment of at least whatever initial costs to the predatory firm were entailed in its adoption of the price in question.[16]

[36] In his article, Baumol dealt with the first two conditions and argued that ACC is the cost test that best guides an inquiry into predation. Of further relevance to the present dispute, is the question of opportunity costs. Here Baumol writes:

> 'Turning now to our central issue, suppose it is alleged that the price cut is predatory and that the new price should consequently be subjected to an Areeda and Turner test comparing the price with avoidable costs. Obviously the inclusion of opportunity

[15] 'Predation and the logic of average variable cost test' 1996 (39) *Journal of the Law and Economics* 49.
[16] Baumol at 52.

> cost can only increase the avoidable costs figure and make the Areeda – Turner test more difficult to pass. Should all the opportunity costs be included in the calculation? The answer, that may be unexpected to economists, is that if the Areeda – Turner test is used … to determine whether the price constitutes a threat to efficient competitors then the opportunity costs of owner – supplied input should be included, but the revenues forgone as a result of the price cut should not.
>
> The reason the cost of the owner – supplied income should be included is that any funds that our firm uses to produce its pertinent input must have their counterpart if the same output is instead produced by an efficient rival. If additional investment is required to provide that output, the rival, too, will have to provide such funds, either by borrowing or some other such means or by obtaining them from the rival's proprietors. If our firm's price does not cover the costs of its own invested funds, it is also likely to be unable to cover the rival's required investment costs, even if the rival is the more efficient supplier and can carry out its production costs with a (slightly) lower investment. In other words, a price of firm that does not cover the opportunity costs of that firm's avoidable investment can constitute a threat to a more efficient rival and should be considered to fail the generalised Areeda – Turner test.
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> In contrast, the revenue the firm F foregoes by reducing its prices has no relevance to the determination of whether the new price constitutes a threat to the presence of an efficient rival. If, in our example, the new price of $25 covers all of firm F's pertinent and avoidable input costs, both its opportunity costs and its other costs, then that price should by definition cover the corresponding costs of the lower input quantities needed by an efficient rival to produce the output in question. True, the higher revenue that the higher $30 price would have offered might also have constituted a benefit to the rival but it is irrelevant to whether the lower price, in itself, is or is not a threat to an efficient rival.'[17]

[37] Because AAC may well include some fixed costs and not only variable costs, it will generally be higher than a firm's AVC.

[38] It is also necessary to examine two decisions which were raised in argument and which were cited, in particular, by respondent as being of assistance in the exercise and in determining the appropriate cost benchmark. In *Aberdeen Journals v Office of Fair Trading,*[18] the Competition Appeal Tribunal in the United Kingdom

[17] Baumol at 70-71.
[18] [2003] CAT 11.

held that Aberdeen Journals had sold advertising in one of its newspapers at less than AVC. This was contrary to the relevant legislation. The court held that the rules are not an end in themselves and ought not to be applied mechanistically. The time period over which costs are to be calculated is important. Hence the longer the time period the more likely it is that costs will be assessed as variable rather than fixed, with the result that a failure to cover them will give rise to a presumption of predation. The longer a dominant firm prices below total costs, the easier it would be to draw an inference of intention to eliminate competition, save in exceptional circumstances. Pricing below cost would not be unlawful where there is an objective justification for it, although this would be particularly difficult to show when the pricing occurred in response to a new entrant or is part of a strategy to eliminate a competitor.

[39] Further, the court held that it was a form of recoupment for a dominant firm to engage in predatory pricing in one market so that it could protect its market share or supra-competitive profits in another market and that, in the circumstances of those cases, further evidence of the recoupment was unnecessary.

[40] In *Cardiff Bus*[19] the Office of Fair Trading (OFT) alleged that the Cardiff City Transport Services had engaged in predatory conduct against a new entrant which operated "a no frills" bus service in Cardiff. The alleged abuse was the launch of Cardiff Bus' own "no frills" service on the same routes served by the new entrant.

[41] Cardiff Bus did not deny that its new service had been loss making but it claimed that the introduction of the service had been intended to test the market for "a no frills" service. It withdrew the service when it found that there was insufficient demand therefore.

[42] The OFT considered two benchmark bases for assessing costs, namely AVC and AAC, noting that in past cases these two bases have been shown to be very similar since any cost that is variable over the period is also avoidable. However:

> 'where the dominant company makes specific investments, such as expanding capacity in order to predate, then the fixed or sunk investments made for this extra capacity will be included within AAC, causing AAC to exceed AVC.

[19] Decision of the Office of Fair Trading of 18 November 2008.

> Given the circumstances of this case the AAC benchmark is the most appropriate. The assessment includes the costs of restoring the buses used on the white service routes. This preparatory work would not be considered as variable cost. However it is the OFT's view that these costs were avoidable. The costs could have been avoided if Cardiff Bus had not restored the buses. Alternatively, once restored, Cardiff Bus could have recovered at least part of the costs of restoration had the white services not run or ceased to run, either by transferring these, now serviceable, buses onto other routes or leasing the buses.'

[43] The OFT confirmed that pricing below AAC would give rise to a rebuttable presumption of abuse.

> 'In the medium term, pricing below AAC is not in the economic interest of an undertaking, since by not providing the relevant output it would save more in cost than it would forego in revenue. In addition, the longer a dominant undertaking prices below AAC, the more likely it is that an equally efficient competitor would be forced to exit the market. This follows the same logic as the AKZO test as it has been applied in recent cases.'[20]

[44] In its published guidelines on its enforcement priorities, when relying on Article 82 of the EU Treaty, to deal with abusive or exclusionary conduct[21] the EU, in dealing with the appropriate benchmarks for predatory pricing, said the following:

> 'The costs benchmarks that the Commission is likely to use are average avoidable costs (AAC) and long-run average incremental costs (LRAIC). Failure to cover AAC indicates that the dominant undertaking is sacrificing profits in the short term and that an equally efficient competitor cannot serve the targeted customers without incurring a loss. LRAIC is usually above AAC because, in contrast to AAC (which only includes fixed costs if incurred during the period under examination), LRAIC includes product specific fixed cost made before the period in which allegedly abusive conduct took place. Failure to cover LRAIC indicates that the dominant undertaking is not recovering all the (attributable) fixed costs of producing the good or service in question and that an equally efficient competitor could be foreclosed from the market.'

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[20] [2009] UK CLR 332.
[21] 2009 Official Journal of the European Union.

The application of these of principles to the Act

[45] Section 8 (d)(iv) of the Act makes it clear that there are two tests which may be applied in order to determine the existence of predatory pricing, namely a cost benchmark of marginal costs and of AVC. Both of these concepts have an accepted meaning in economic literature and were incorporated by the legislature into the Act. In its interpretation of s 8(d)(iv), the Tribunal said in *Nationwide Airlines (Pty) Ltd and others v South African Airways (Pty) Ltd and others*[22]:

> 'Our approach is to limit the scope of the subsection by critically construing any evidence when considering a complaint predation under the section. Unless the record show unequivocally that a respondent is pricing below the prescribed cost levels the Tribunal should not make a finding under s 8 (d)(iv) but consider the complaint in terms of s 8(c).'

[46] This *dictum* finds further support in that s 8(d) sets out a series of detailed exclusionary forms of conduct, whereas s 8 (c) is a more expansive "catchall" in respect of other forms of exclusionary conduct, including predation in cases where the practice falls outside of s 8 (d)(iv).

[47] This leads to the question of the scope of s 8(c). Section 8 (c) provides that it is prohibited for a dominant firm to engage in an exclusionary act other than an act listed in paragraph (d) if the anti-competitive effect of that act outweighs its technological, efficiency or other procompetitive gain. An exclusionary act is defined in s 1 to be an act that impedes or prevents a firm entering into or expanding within a market.

[48] Section 8 (c) plays an important role in this case as the Tribunal employed the concept of ATC in finding that appellant breached that section.. It held that it was appropriate to adopt ATC as a benchmark in markets which were characterised by high barriers to entry.[23] It also found that ATC was a more reliable standard in dealing with a vertically integrated or multi-product firm because 'the orthodox method of costs evaluation, whether marginal costs, AVC or AAC 'can be obfuscated or frustrated

[22] Case 92/IR/Oct00 at para 102 with regard to s 8 (d)(iv).
[23] See paras 220-221 of the Tribunal decision.

due to information asymmetries' and further that a firm is 'better placed to win the cost classification debate … because it has command over the accounting choices'.[24]

[49] Significantly, there appears to be no engagement with the expert economic evidence presented in this case concerning the two central propositions adopted by the Tribunal in support of its application of ATC. Given the manner in which the Tribunal discussed how, within a short period, *GNN* had gained at least a quarter of the market from the two existing marked incumbents, the Tribunal's premise that barriers to entry were high is at odds with this evidence.

[50] If, the Tribunal had found, on the basis of clear evidence, that the relevant market was characterised by high barriers to entry, then in such a market, appellant contended that the appropriate price costs standard would not be ATC but LRAIC, which takes specific account of the sunk costs of entry. If LRAIC is applied to the costs of the dominant firm where high costs are associated with entry, then a return on these high costs could be allowed which would suffice to permit a rival to enter.

[51] To return to the purpose of predation, it is important to distinguish price competition on the merits from price behaviour which is subversive of the competitive process and which falls to be prohibited, in this case, under s 8 (c) of the Act. The EU law which seeks to preserve the integrity of a competitive process and therefore has close affiliation with the spirit and purport of the Act takes account of different cost benchmarks. But the relevant Guidance Paper refers in particular to AAC and LRAIC rather than AVC and ATC. The general thrust of the Guidance Paper is that a failure to cover AAC indicates that the dominant firm has sacrificed short term profits and that an equally efficient competitor cannot serve the customers without incurring a loss.

[52] By contrast, the Tribunal adopted the test applied in *AKZO* to show that where a dominant firm sells at less than ATC but above AVC it will be guilty of predation, where this is part of a plan for eliminating a competitor which might be as efficient as the dominant firm. In short, the Tribunal grafted onto the cost benchmark of ATC a further requirement of predatory intent. But where is this requirement of intention to be found in the wording of the Act? The *AKZO* decision notwithstanding,

[24] Para 221.

the task for the Tribunal and the Court is to interpret and then apply the wording as employed in the Act. Section 8(c) refers to an exclusionary act other than one which is listed in s 8 (d). An exclusionary act, as I have indicated earlier, is defined to mean an act that impedes or prevents a firm from entering into or expanding within a market. This is an objective test.

[53] The Tribunal and Court, if necessary, are required to examine the act of a dominant firm and determine the effect thereof; that is whether the effect thereof is to prevent another firm from entering into or expanding within the market. Intention does not appear to be part of the architecture of this section. In this connection it is relevant to recall Baumol's observation that ATC is 'a figure that is undefinable and unmeasurable in a multi-product firm and must therefore be rejected as part of any legitimate test of predatory pricing'.[25]

[54] Professor Motta develops upon this theme:[26]

> 'However, a problem with using ATC is that it would require a firm to cover all the fixed sunk costs, which is a very stringent standard. Suppose for instance that an incumbents firm makes some fixed expenditure that it expects to recover through monopoly profits. Soon afterwards, a new firm unexpectedly enters the market, with normal competition leading the incumbent to decrease its price to a level where the fixed sunk investments cannot be recovered. In this case, a price below ATC rule would find predation even if there is none. This drawback is avoided by the concept of average incremental costs (AIC), defined by Bolton et al (2000) as
>
> > "the per unit cost of producing the added output to serve the predatory sale, AIC differs from average variable costs in at least two ways. First, it is not measured over the firm's whole output, but only over that increment of output used to supply the additional predatory sales. Second, incremental cost includes not only variable costs, but any fixed costs incurred in expanding to serve the new sales. Incremental cost is a better standard than either average variable costs or full costs because it most accurately reflects the costs of making the predatory sales.
>
> Accordingly, these authors would presume illegal a price below AIC and lawful one above ATC with a grey area in between.

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[25] At 50.
[26] *Competition Policy: Theory and Practice* (2004) at 448

> To sum up, a number of different cost standards have been proposed in the literature. In particular, both average variable cost and average incremental costs at reasonable standards. Perhaps AIC better matches the concept of predation, but it might not be always easy in practice to identify precisely the costs that are sustained for a given output, and/or isolate the predatory output from total output.
>
> However, I would be cautious in finding predatory behaviour in cases where the price is above average variable costs (or average incremental costs): the possibility that a firm is charged with predatory pricing if it sets a price that allows it to recover variable costs but not total fixed costs (that is, a price above average variable cost but below average total costs) seems too strict and might encourage firms to keep prices higher than they otherwise would.
>
> Accordingly,
>
> 1. A price above average total costs should definitely be considered lawful, without exceptions.
> 2. A price below average total costs but above average variable costs should be presumed lawful, with the burden of providing the opposite on the plaintiff or the anti-trust authority.
> 3. A price below average variable costs should be presumed unlawful, with the burden of proving the opposite on the defendant.'

[55] To sum up: the question arises as to whether it is appropriate to include average total costs as an appropriate benchmark for predatory pricing under the residual exclusionary category of s 8 (c) provided that it is supplemented by the requirement of intention, it being clear from the express statutory wording of the Act that ATC cannot be employed in a predation pricing case brought under s 8(d) (iv) of the Act. Absent proof of intention, the Tribunal accepted, by implication, that ATC is an inappropriate benchmark, even for a case brought under s 8(c) of the Act. However the attempt to cure this inappropriateness by way of the further requirement of the dominant firm's predatory intention results in a test which is incongruent with the very structure of s 8, which emphasises conduct rather than intention. The latter plays no part in a s 8 case.

[56] There is, furthermore, a circularity in the use of intention to bolster a predation case based on pricing below ATC. Intention is used by the proponents of this approach to prevent a false positive that is a finding of predatory pricing where in substance the pricing represented competition on the merits. However, on analysis

intention seems unable to perform this important function. Where a firm, competing on the merits, reduces its prices, its intention is to increase its market share by taking away custom from its rivals. In a real sense, such a firm intends to 'harm' its rivals but in a way permitted by competition policy. The firm may even hope that a prolonged price war may drive its rival from the marketplace. How then does it assist the proof of predation to say that such a firm 'intends' this result, since the intention is as compatible with competition on the merits as with predation? This is another way of saying that 'fighting talk' in a firm's internal documents is an unreliable guide to proving predation. There is no escaping the conclusion that predation must focus on the likely economic effect of pricing below a particular cost measure to determine whether low prices are due to a lawful competitive response to rivals or to predation and unlawful behaviour rather than on the intention with which a pricing strategy is adopted.

[57] For all of these reasons, ATC plus intention has no place in the scheme of s 8 (c) of the Act. It follows that the benchmark of AAC must be employed when seeking to apply s 8 (c) to a case of predatory pricing as opposed to the hybrid test which the Tribunal sought to apply in the present case without any attempt to reconcile its test with the manner in which s 8 promotes an objective test.

The application of these conclusions

[58] Given the finding that, the appropriate benchmark to apply to s 8 (c) is that of AAC (which was the respondent's alternative s 8(c) case if the ATC-plus-intent test was rejected), the outcome of the appeal depends on whether the respondent established that *Forum*'s AAC exceeded its revenue during the complaint period. If that was not established, the appeal must succeed. The balance of the evidence concerning the intention of appellant which occupied a considerable portion of the record and the Tribunal's decision thereon thus is not relevant to the disposition of this dispute.

[59] For this reason, it is now necessary to examine the competing arguments with regard to the application of the benchmark of AAC and, accordingly, whether the appellant's conduct is in contravention of s 8 (c) of the Act. This, in turn, requires an

examination of the disputes between the parties regarding variable costs as well as product-specific fixed costs.

[60] A number of assessments of appellant's AAC were produced in evidence before the Tribunal. Mr Malherbe, on behalf of appellant, calculated *Forum*'s avoidable costs assuming the whole of *Forum* as the increment of output rather than a certain quantum of advertising volumes sold over the complaint period. On this basis, the avoidable costs would be those that appellant could have saved from not operating *Forum* over the complaint period. This equated to all variable costs and those fixed costs that were specific to *Forum*.

[61] Mr Malherbe concluded that the following costs were avoidable upon *Forum*'s closure:

1. all staff costs relating to employees working specifically for *Forum* (two advertising sale staff and an editor);
2. all consumable printing costs, including paper, ink, chemicals and blankets, consumed in the printing of *Forum*;
3. all distribution costs paid by National Leaflets Distributors (NLD), appellant's distribution division, to subcontractors for transporting *Forum* newspapers from the printing plant in Bloemfontein to the distribution depot in Welkom and for distributing *Forum* within the goldfields region; and

4. other operating costs including photography, stationary, entertainment, postage and promotion.

[62] Mr Malherbe contended that the following costs would have been incurred even after *Forum*'s closure and therefore there should be considered to unavoidable:

1. Common costs allocated to *Forum* from the Volksblad office in Bloemfontein and the appellant's Cape Town head office (the allocated common costs), including the printing overhead costs allocated from the Bloemfontein printing press;
2. the shared security, property and rental costs incurred at the Welkom office and allocated to *Forum* (the allocated shared costs); and
3. NLD distribution overheads and profit margins included in the NLD charges to *Forum* (this was about one-third of the amount charged by NLD to *Forum*, the

other two-thirds comprising the amounts paid to subcontractors for distributing *Forum*.

[63] On this basis, Mr Malherbe calculated that *Forum*'s avoidable costs totalled R 6 658 000 over the relevant complaint period. When this was contrasted to its turnover of R 7 554 000 over the same period, he concluded that *Forum* had earned R896 000 in revenue over avoidable costs.

[64] When testifying before the Tribunal, Mr Malherbe made three adjustments to this estimate. Firstly, he reduced the avoidable costs estimate in respect of the transport costs charged by NLD in respect of Forum the primary distribution leg between Bloemfontein and Welkom by an unavoidable portion of these costs which amounted to R 182 000.

[65] Secondly, he accepted that a small portion of the costs of printing overheads in the form of repairs and maintenance might be avoidable on the basis of wear and tear caused by the *Forum* printing run. By taking an average of maintenance costs over the complaint period and presuming that half related to wear and tear rather than scheduled maintenance, he found that this would equate to an avoidable costs component of R 16 000 for *Forum*.

[66] Thirdly, he acknowledged that there was a legitimate difference of opinion in respect of the avoidability of vehicle costs; that is the costs of the bakkie, for quality control purposes. Total vehicle costs accounted for 13% of distribution overheads. If these costs were treated wholly as avoidable, then *Forum*'s avoidable costs would increase by R 48 000. Making these adjustments, Mr Malherbe suggested that *Forum*'s revenue was in excess of avoidable costs by R 1 014 000 over the complaint period.

[67] Mr Dryden on behalf of respondent, initially modelled *Forum*'s costs on the basis of two definitions:

1. All costs that could be eliminated over a period of one year according to appellant's costs classifications; and
2. All costs of *Forum* as shown in its management accounts.

[68] Mr Dryden contended that, for two reasons, the first definition would understate the true magnitude of costs that could have been avoided during the complaint period by closing *Forum*:

(a) The complaint period lasted five years and two months during which there would have been additional scope for appellant to make changes to its business to eliminate additional costs which were unavoidable over a period of only one year;

(b) Based on the explanations provided by appellant as to how costs could be varied or eliminated, he understood that Media 24's definition of costs that could be eliminated over a one year period did not include costs that could be reallocated to alternative productive uses within Media 24 after *Forum*'s closure. In Mr Dryden's view, avoidable costs should include costs that could be eliminated or reallocated to alternative productive uses.

[69] Mr Dryden contended that the second definition overstated the true magnitude of costs that could have been avoided by closing *Forum* if any of *Forum*'s costs shown in the management accounts could not be avoided over the complaint period. Nonetheless because of the extended length of the complaint period, he considered this definition to be an appropriate scenario for analysis.

[70] By contrast to Mr Malherbe's calculations, Mr Dryden considered that the only costs which could be treated as unavoidable were:

1. The allocated common costs covering general management, advertising, administration, debtors/accounts receivable, human resources, artists and IT management;
2. rental and property costs; and
3. other small operating costs items such as, legal and pre-press costs.

On an undiscounted basis, he calculated that *Forum*'s avoidable costs amounted to R 7 884 000, which exceeded its revenue by R 330 000. (For the moment I exclude the opportunity costs which Mr Dryden likewise considered to be part of *Forum*'s AAC. I deal separately with opportunity costs later.)

[71] Before the Tribunal, a further test known as C1* less cost concessions emerged. Respondent appeared to concede that the available evidence did not

support Mr Dryden's view that printing overheads were avoidable. It then treated these costs as unavoidable along with a 15% mark-up on these costs. It also conceded that the warehousing portion of distribution costs was unavoidable, thereby reducing Mr Dryden's estimate of avoidable costs to R 7 366 000, with the result that appellant's revenues exceeded its avoidable costs by R188 000

[72] Unless opportunity costs were also included in AAC (which I discuss later), these concessions would have meant failure for respondent on the AAC test. But in argument before the Tribunal respondent came up with a further definition referred to in the proceedings as the "Commission's" definition. It now sought to classify a range of allocated common costs, including general management, advertising administration, artist/graphics and debtors/accounts receivable as avoidable. It also reclassified certain costs as unavoidable, which costs were treated as avoidable on the initial C1 * costs concession definition, including the warehousing portion of distribution costs, printing overheads and the 15% mark up on these costs.

[73] The following table illustrates the differences between the various calculations that I have described and what was added:

ZAR 000s	2004	2005	2006	2007	2008	2009	Total
Malherbe definition							6540
Add transport cost adjustment							182
Less printing wear and tear costs adjustment							-16
Less NLD vehicle costs adjustment							-48
Initial Malherbe definition	**1215**	**1251**	**1221**	**1362**	**1414**	**196**	**6658**
Add 15% uplift printing consumables	58	56	51	58	11	0	234
Add printing overheads (Paarl Coldset)	0	0	0	0	82	14	96
Add distribution overheads and NLD profit	82	84	66	61	61	9	362
Add security and other small adjustments	8	6	7	5	-12	1	15
C1* less concession definition	**1362**	**1397**	**1345**	**1485**	**1557**	**219**	**7366**
Add NLD warehouse costs	5	5	4	4	4	1	22
Add printing overheads (Volksblad)	96	112	95	98	31	0	431
Add 15% uplift printing overheads	14	17	14	15	5	0	65
C1* definition	**1478**	**1531**	**1458**	**1601**	**1596**	**220**	**7884**
Add general management	226	421	424	468	105	0	1644
Add advertising administration	89	167	143	24	0	0	423
Add artists/graphics	59	88	85	17	0	0	249
Add debtors/accounts receivable	49	93	69	2	0	0	214
Less NLD warehouse costs	-5	-5	-4	-4	-4	-1	-22
Less printing overheads	-96	-112	-95	-98	-31	0	-431
Less 15% uplift printing overheads	-14	-17	-14	-15	-5	0	-65
Commission's definition *	**1786**	**2167**	**2065**	**1997**	**1661**	**219**	**9896**

[74] It is evident from this table that respondent added four critical categories as part of *Forum*'s avoidable costs, namely general management, advertising

administration, artists/graphics and debtors/accounts receivable. These costs total R 2.53 m over the relevant complaint period. In addition, respondent added, to *Forum*'s AAC, distribution overheads and NLD profit of R362 000, a notional 15% uplift (notional NLD profit margin) of R234 000 on printing consumables and an amount of R96 000 in respect of printing overheads.[27]

[75] Manifestly, the inclusion or otherwise of these items is critical to the resolution of this case. It appears to be common cause that *Forum*'s revenue over the relevant period was R 7 554 000 which means that, based on the respondent's calculation, its avoidable costs exceeded revenue over the period by R 2 342 000. I shall deal with each of these critical items separately. For respondent to make a showing of predation, the inclusion of these items (or at least some of them) as avoidable was crucial unless respondent could show that opportunity costs needed to be included in *Forum*'s AAC. Because of the approach it followed, the Tribunal did not decide these matters.

General management costs

[76] Respondent contended that there could be little doubt that the general management costs were avoidable over a period of less than a year and were in fact probably avoided (redeployment) after *Forum*'s closure. If avoidability is assessed, as the respondent contends, over a period commensurate with the complaint period, whatever doubt there may be about the avoidability of these costs over a period of only one year would disappear.

[77] In this connection, respondent drew specific attention to the evidence of Ms Anel Coetsee, who until 31 December 2012 was employed by the Volksblad group as an accountant.

[78] Respondent referred to her evidence, in particular to Volksblad's *Forum* 12 sub-editors who reviewed 1.5 million single-column centimetres of text per year, of which 50 000 – 55 000 were contributed by *Forum*. Thus one of the sub-editors, if

[27] Initially printing costs of R 527 000 were allocated to Forum over the complaint period from Volksblad and Coldset. Respondent then conceded that there was inadequate evidence to show that the Volksblad portion of R 431 000 was avoidable.

he or she had done all of *Forum*'s work, would have spent 44% of his or her time editing *Forum*. It therefore was possible to reorganise a department to have 11 full time and one part time employees. A reorganisation of this nature could be achieved within a year. Ms Coetsee also testified that 27% of one advertising administrator's time was spent counting *Forum*'s advertisements. It was possible to rearrange the department so that one person worked part time.

[79] According to respondent, Ms Coetsee conceded that the very substantial percentage (approximately 70%) of the work of the administration department would have been redeployed to *Vista* which absorbed approximately 70% of *Forum*'s advertising revenue over the period immediately prior to and post *Forum*'s closure.

[80] Turning to the costs of graphics/artists and debtors/accounts receivable, Ms Coetsee made the same concession, accepting that *Forum*'s work could have represented 44% of one artist's employment time. On the same basis *Forum* would have occupied 17% of one debtors/accounts receivable employee's time.

[81] By contrast, appellant contended that the costs which were classified as "general management" in the management accounts comprised costs incurred for senior management and technical staff both in Cape Town and Bloemfontein as well as the costs of sub-editors.

[82] Referring to Ms Coetsee's evidence, appellant noted that she had testified that the allocated Cape Town costs included charges for common functions such as information technology, financial assistance, personnel services, the share trust, overseas offices, intranet and newspaper management.

[83] In her evidence before the Tribunal Ms Coetsee said the following in answer to a question from respondent's counsel:

> 'But why would there have been head office costs, because there would be no services to be rendered to these community newspapers? Volksblad would still have been there so it would have been the Volksblad part that they would have paid for'. She was then asked; 'But it would have been reduced, the head office cost would have been reduced?' To which she answered; 'not the head office costs itself, only the costs being allocated to Bloemfontein… that would decrease then some other

> title would have to absorb that costs because the costs would remain the same on a head office level.'

[84] A further problem with regard to the inclusion of these costs concerned the size of *Forum*. *Forum* represented a very small proportion of appellant's overall business and thus what accrued to it was a very small amount of revenue in relation to total revenue earned by the firm – 1% of the revenue of the Volksblad Group, 0.1% of the revenue of appellant's newspaper division and 0.02% of the revenue of appellant as a whole.

[85] Ms Coetsee conceded that 'I did not have anything to do with that advertising administration Cape Town'. However later in her evidence she was asked the following;

> 'and that would have been a classic instance of the relocation of resources where instead of spending that time on *Forum* and those costs in relation to *Forum* it was spent on the additional *Vista* business correct?'

To which Ms Coetsee replied;

> 'In my opinion reallocation would be to appoint somebody, all the ladies still worked on all the titles in my opinion that is not reallocation. Nobody was specifically allocated to *Forum* or to *Vista*.'

[86] Employees in this department worked in a pool which was capable of handling volume fluctuations far larger than *Forum*'s demand in the same way as editorial volumes for *Vista*'s advertising volumes alone fluctuated on a monthly basis by significantly more than the total volume of *Forum*.

[87] Turning to debtors/accounts receivable, Ms Coetsee, when her evidence is read as a whole, testified that the department serviced customers that had advertised in a number of Volksblad titles at the same time under one account for each debtor. So far as this department was concerned, she said,

> 'The closing down of *Forum* did not have an impact on the productivity of any of the people in that department… the part of their day that they spent of *Forum* (sic) was very small.'

Significantly when asked by respondent's counsel,

> 'But as a result of the closure of Forum are you saying that the amount of work in this department remained exactly the same?'

Ms Coetsee replied:

> 'Yes more or less'.

Printing overhead costs

[88] Printing overhead costs accounted for R 527 000 of the costs allocated to *Forum* over the complaint period from Volksblad and Paarl Coldset. Mr Malherbe testified that only a portion of these costs could conceivably be considered to be avoidable, being the wear and tear of the printing presses. To this end he estimated that an amount of R 16 000 over the complaint period could be considered to be part of avoidable costs.

[89] The Commission accepted that it lacked evidence to treat the Volksblad portion (R 431 000) as avoidable, albeit that it considered this to be a conservative approach. The commission maintained, however, that the balance of R96 000 could properly be allocated to *Forum* as an avoidable cost. By contrast, Mr Malherbe was adamant that only R 16 000 over the complaint period in respect of wear and tear could conceivable be considered to be avoidable costs. As Mr Malherbe noted, when a firm has space printing capacity, the issue of redeployment falls away, for if there were opportunities to redeploy the firm would have done so already, a point confirmed in the case of appellant's business by Mr Johannes Botha, the head of financial services of appellant which evidence remained contested.

[90] In addition, respondent included in its avoidable costs calculation a notional 15% uplift on consumable printing costs which equated to R 234 000 for the complaint period.

[91] This 15% cost uplift to *Forum*'s reported printing costs over the complaint period represented a notional cost because it was never included in *Forum*'s management accounts prior to April 2008 and was not actually charged to *Forum* by respondent's printing division. In April 2008, Paarl Coldset and its predecessor Print 24 moved from a pure cost recovery charging arrangement to a pricing model that included a 15% mark-up on costs.

[92] The change in pricing was motivated on the basis of the following considerations:

1. The mark-up was applied to ensure that charges levied to appellant's titles reflected the market price of obtaining printing services, not the costs of self provision. This would enable Paarl Coldset to obtain funds for the replacement or additional machinery;
2. The uplift would enable Paarl Coldset to recover unforeseen maintenance expenditure in a stable and consistent manner.

[93] Apart from the notional aspect of including this amount in the avoidable costs calculation, it failed to take account of the fact that prior to April 2008 maintenance costs were automatically passed on to appellant's titles when they were incurred; hence a measure of "double counting" was involved since if the 15% uplift had in fact been charged, the actual maintenance costs would not have been passed on to *Forum*.

[94] Mr Johannes Botha, Financial Manager: Shared Service in appellant told the Tribunal the following in this regard:

> 'In the years prior to the creation of Print 24 the costs for unforeseen repairs formed part of the actual costs that were allocated to the titles on a monthly basis. As *Forum* has therefore contributed to actual unforeseen repair costs during the complaint period, any retrospective addition of a margin past printing costs will double account repair costs'.

There was also the problem that to require a dominant firm to recover the costs for services provided internally on the basis of acquiring those services from a third party would cause prices to increase as dominant firms would not be able to realise efficiencies of vertical integration. Vertically integrated firms might then be required to charge double margins.

Distribution overheads

[95] *Forum* was distributed by NLD, as noted, a division of appellant. It charged all appellant's titles for distribution and transport and used contractors for this purpose. NLD's overhead costs included central overhead charges from appellant's head office in Cape Town which were allocated to each of the NLD's regional operations

including NLD Bloemfontein which was a small part of the NLD's national business. To the extent that *Forum* had any impact on NLD Bloemfontein, it would have meant losing 3.4% of its business which could not conceivably have had any impact on the overhead charges of appellant's IT system, accounting processes or the costs of senior executives in Cape Town.

[96] These costs would continue to be incurred after *Forum*'s closure. With regard to NLD's warehouse costs incurred in Bloemfontein, *Forum* never made use of this facility nor did it make use of the casual labour employed at the warehouse. In relation to NLD's staff costs, four permanent employees were responsible for the regional administration of NLD.

[97] As *Forum* made up only a very small part of NLD's Bloemfontein revenue, small fluctuations brought about by *Forum*'s existence and closure made no difference to the costs incurred in this regard. Fluctuations of revenue, which are far greater than *Forum*'s, occurred in NLD Bloemfontein on a month to month basis and even within a month. Mr Nortje, who had been the national operations manager for NLD, testified:

> 'There were also no savings other than those incurred directly in respect of contractors' charges for delivering *Forum*. The Bloemfontein infrastructure and overhead (and all the more so the national overheads) were left unaffected by the closure. For NLD (and ultimately appellant), none of its infrastructure costs and overheads were variable with a change in *Forum*'s distribution volumes, nor were any of them avoidable with the closure of *Forum*, not even in the long run. All other things being equal, these costs would continue to be incurred indefinitely.'

Allocated common costs

[98] In its final submission, respondent treated a large portion of common costs (77%) as avoidable common costs. Common costs were those allocated from Volksblad and appellant's corporate offices and covered general management advertising administration, accounts receivable, human resources, artists and IT

management. These were the so-called redeployment costs which, according to respondent, could – if *Forum* had been closed – been saved through a reorganisation or rejigging or redeployment of appellant's common staff resources.

[99] In this regard Ms Coetsee's evidence is of particular significance. She explained that Volksblad had a community's management department which comprised a general manager for community newspapers, his or her personal assistant and sub-editors for the community newspapers; 10-12 people in total. Their salaries, telephones, IT, equipment, stationery and rental expenses fell under the rubric "community's management" in the financial statements who were allocated to all the community newspapers. In the area of advertising administration, Volksblad employed about eight people and had one manager. They were responsible for statistics, measuring column centimetres sold and confirming the correct placement of advertisements in order to have invoices generated. In the Human Resources Department Volksblad had an average of three employees, being a manager, a payroll clerk and an administrative clerk. The expenses incurred in this department did not vary with *Forum*'s volumes. In this connection Ms Coetsee testified:

'MS COETZEE:	Over a year the total community newspaper group would produce approximately 1.5 million editorial centimetres.
MR UNTERHALTER:	Yes.
MS COETZEE:	And the average for *Forum* would total roundabout 50 000 / 55 000 editorial centimetres in a year.
MR UNTERHALTER:	Yes. So just again in percentage terms what did *Forum* makeup of the total editorial content of the community newspapers in a year?
MS COETZEE:	Okay, so it was 55 000 centimetres in relation to 1.5 million centimetres which would be about 3% approximately.
MR UNTERHALTER:	Now were the – were particular titles allocated to particular sub-editors?
MS COETZEE:	No, all the sub-editors worked in a pool, they weren't allocated specifically to a title.

MR UNTERHALTER: I see. Well then let me ask you the question upon the closure of *Forum* in respect of this particular category of costs of general management were the costs avoidable or unavoidable in your view, and why?

MS COETZEE: Since *Forum*, if you look at their editorial centimetres was only about 4% of the total editorial centimetres that these people had to deal with I cannot imagine that it would have any impact on the sub-editors pool.'

[100] In a memorandum to senior management dated 10 July 2006 Mr WJ Bonthuyzen, who testified on behalf of respondent, stated:

> 'The budgeted allocated costs of R 789 988 would not disappear from the Volksblad Group's expenses since most of *Forum* allocated costs consist of the following costs categories:
>
> - Printing press (used or unused hours)
> - Personnel Division
> - Administration section
> - Artists'
>
> [translation from Afrikaans]

[101] The Tribunal rejected respondent's argument for the inclusion of the redeployment costs, holding that, in a large business such as appellant's, a firm would not have undertaken reorganisation upon *Forum*'s closure, given that the common resources apportioned to *Forum* were, from the perspective of appellant's overall business, trivial. The Tribunal did not consider that the evidence extracted by respondent under cross-examination established the contrary. Forum To this respondent contended that it was unlikely that appellant would not have 'redeployed' its resources in the manner for which respondent contended: 'The Commission's case is simply that it could and indeed would likely to have done so.'

[102] This is hardly sufficient to sustain an argument that this Court should find differently to the Tribunal in this regard, based on the probabilities and in terms of the evidence so presented. Indeed under-cross examination, Mr Bonthuyzen, after being referred to the passage I have quoted from his memorandum of 10 July 2006, testified as follows:

‘MR BURGER: *Forum* … Now what is debated here, am I correct is what happens if we close *Forum*.

MR BONTHUYZEN: That’s correct ja.

MR BURGER: And what you are debating now with your staff is if we close *Forum* will there be a saving on “toegedeelde koste” on allocated costs.

MR BONTHUYZEN: That’s correct.

MR BURGER: And the conclusion you reach is the answer is no, most of those costs are going to stay.

MR BONTHUYZEN: That’s correct ja.

MR BURGER: And that will be an argument against closing *Forum*?

MR BONTHUYZEN: That’s correct.

MR BURGER: And the items you identify, which will not disappear is “rolpers tyd” now those are printing costs.

MR BONTHUYZEN: That’s correct ja.

MR BURGER: That’s not going to disappear.

MR BONTHUYZEN: No.’

Mr Burger then asked Mr Bonthuyzen about additional allocated costs:

‘MR BURGER: The next fixed costs, or allocated costs which would not disappear if you close Forum in the administrative division and again presumably you refer here to Bloemfontein and to Bellville.

MR BONTHUYZEN: Especially the Bloemfontein ja.

MR BURGER: Especially Bloemfontein yes, that’s where a 60% component is sitting, and then the artists, those would be the artists presumably employed in Bloemfontein?

MR BONTHUYZEN: In Bloemfontein and also in Welkom, because they had their own artists at a certain stage.

MR BURGER: How many artists were there in Welkom?

MR BONTHUYZEN: If I remember correct two.

MR BURGER: Two?

MR BONTHUYZEN: Ja.

MR BURGER: Now would one of them have lost his or her job if Forum closed or not?

MR BONTHUYZEN: No, not.

MR BURGER: So again that costs is not going to disappear.

MR BONTHUYZEN: That's correct ja.

MR BURGER: I see. You then propose in 2006 my proposal is that we go, we carry on with Forum in its present business configuration for the same business reasons that had been advanced in 2003 as well as the fact that the allocated costs would to a large extent not disappear (of you close it). That's what you say there.

MR BONTHUYZEN: That's correct.

MR BURGER: That's in fact what you believed at the time.

MR BONTHUYZEN: That's correct ja.'

[103] Returning to the table set out above which summarises the parties various avoidable costs estimations, it is it clear that if one excises the general management costs of R 1.64 m, the 15% uplift for printing of R 234 000 and distribution overheads, of R 362 000 together with the disputed amount of R 80 000 in respect of printing overhead costs the avoidable costs would reduce to R7.656 million, only about R 20 000 more than *Forum*'s revenue. Furthermore, the evidence did not satisfactorily establish that the further so-called redeployment costs in respect of advertising administration, artist/graphics and debtors were avoidable. If, as appears to be the case, on the probabilities, these disputed costs categories should not have been included, it would result in the overall revenue which accrued to *Forum* exceeding the average avoidable costs over the complaint period.

Opportunity costs

[104] Unsurprisingly respondent argued in favour of an approach that would include not only the costs of producing *Forum* and delivering it to market but also would include profits that could have been earned by way of an alternative course of action. This calculation would include profits foregone, which concept is variously referred to as opportunity costs or cannibalisation.

[105] The Tribunal decided to exclude opportunity costs from its calculation of AAC. It reasoned as follows:

> 'All the other costs relied on to calculate AAC are based on actual costs capable for the most part of precise determination because these costs were actually costs incurred and there are accounting entries to verify them. The opportunity costs contended for in this case are not verifiable in the same way from accounting entries. Instead they rely on estimates of 'what might have been', made at a time when the 'might have been' was subject to too many imponderables nor is the task made easier by the controversy over the correct net off cost alluded to above, an issue that we also for reasons of our broader approach need not determine. Nor is the approach cured by adopting a more conservative approach to the numbers – a 16% diversion and the Media 24 approach to the net off calculation. Once the basis to the approach is accepted to be built on unreliable foundations it does not help to construct something less ambitious but still suspect as a means of calculation on top of it.'[28]

[106] I have already indicated that key figures in the economic debate with regard to AAC, Professors Baumol and Motta, are not in favour of taking account of opportunity costs as advocated by respondent. A good reason for this reluctance can be found in *In re: IBM Peripheral EDP Devices Anti Trust Litigation. Trans America Computer Company Inc. v International Business Machines Corporation*[29]:

> 'TCC has taken this concept one step further than the decision making stage and seeks to subtract from the profits IBM predicted it would realise on a particular product the estimated profits that might have been realised on a product that could have been produced in its stead. In this fashion, TCC concludes that IBM priced below cost. But, even aside from the speculative nature of the alternative's profits, the use of the concept of opportunity costs in this fashion must be held improper as a matter of law. Such costs are not reflected in a profit and loss statement, and such a theory would restrict the manufacturer with monopoly power to always choosing the alternative predicted to produce the greatest monetary rewards. It would have to blind itself to the host of factors that influence such a decision and could quite possibly lead to a more socially desirable result. The unquantifiable risks associated with a particular alternative, technological considerations and all the non-economic influences that affect a manufacturer's social responsibilities would all have to be forgotten. Such was not the intent of the Sherman Act and it not what is meant by predatory pricing.'

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[28] At para 163.
[29] 459 F. Supp 626 at 630.

[107] The difficulty in taking account of opportunity costs, in the manner advocated by respondent, is that it can lead to an argument that requires firms to price at their most profitable, therefore creating a situation that may run counter to the purpose of the Act; in particular by ensuring that more efficient firms pass on their efficiency advantage to consumers by way of lower prices, rather than being deterred therefrom.

[108] For this reason Mr Malherbe's justification for excluding opportunity cost when testifying before the Tribunal is compelling:

> 'According to the opportunity costs view put forward by Mr Dryden, one would then have to take those opportunity – those additional super margins being earned in the monopoly market, and add them – add them to the full costs of the incumbent airline on the route for which it's now competing. And force it to price at a level that includes both the actual costs plus that rich opportunity cost that it could earn during to its market power elsewhere. (sic)
>
> This is nothing other than importing market power from one market and enforcing it in the other market by bringing to bear a price cushion that would push up prices significantly above the true costs of an equally efficient competitor.
>
> For this reason, a costs benchmark that includes an opportunity cost element cannot reliably test for exclusion. It cannot say as soon as you are pricing above my innovated cost, which includes profit margin I could have taken in another market, therefore I am capable of excluding an equally efficient competitor.'

[109] Having found that opportunity costs by way of foregone profits should not be taken into account, it becomes unnecessary to canvass the issue of diversion estimates which were hotly contested between the experts in their evidence before the Tribunal.

Conclusion

[110] For the reasons set out above, s 8 (d) (iv) of the Act is drafted in precise terms. In order for respondent to show the conduct of appellant is of a predatory nature which is sufficient to fall within the section, it had to show that appellant is a dominant firm involved in selling goods or services below their marginal or average

variable costs (‘AVC’). Once the test of ATC plus intent to predate is found to have no application in s 8 (c) of the Act, where no specific costs benchmark is mentioned, the balance of the evaluation of the evidence by this Court and the Tribunal, in its carefully considered judgment, is similar leading to a finding that the application or AAC or AVC is of no assistance to respondent in proving its case, given the amount of revenue which accrued to *Forum*.

[111] It was common cause that *Forum*’s revenue over the complaint period exceeded a conventionally assessed AVC. Accordingly, the case turned on the application of s 8 (c) of the Act and the application of AAC. The idea that a total costs standard plus intention to exclude by way of predation as an appropriate test for s 8 (c) is incongruent with s8 which focusses exclusively on the act or the conduct of the appellant as opposed to a subjective test to determine intention.

[112] This leaves AAC as an appropriate costs benchmark for a predation case based on s 8(c) of the Act. The idea of AAC as a benchmark is that a price below AAC indicates a sacrifice by the dominant firm as it would not have increased its cash profits by producing any increment during the relevant period at such prices. At a price below AAC, a dominant firm would be capable of excluding an equally efficient competitor because AAC captures all the costs that the competitor already in the market has to cover during the relevant period so as to not make a loss. It is not necessary to determine whether a price below AAC can be justified given the context of this dispute. It was for respondent to prove that *Forum*’s AAC exceeded its revenues, and this it failed to do.

[113] For all of these reasons, the appeal must be upheld and the following order is therefore made:

1. The decision of the Competition Tribunal of 8 September 2015 is set aside.

2. The complaint referred by the Competition Commission to the Tribunal on 31 October 2011 is dismissed.

3. The Competition Commission is ordered to pay the costs of this appeal, such costs to include the costs of two counsel.

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DAVIS JP

ROGERS and BOQWANA JJA agrees

Appearances

Date of hearing:	13 December 2017
Date of judgment:	19 March 2018
For the Appellant:	Adv D Unterhalter SC (as he then was) and Adv M Norton SC
Instructed by:	Werksmans Inc
For the Respondent:	Adv R Bhana SC, Adv J Wilson SC and Adv G Marriot
Instructed by:	Gildenhuys Malatji Inc