BRIDLING MARKET DOMINANCE – A VIEW FROM JAMAICA

ABSTRACT

The fact that the topic of Competition Law and Policy in the context of small economies has been occupying the minds of so many and has fueled such vibrant discussions at so many levels, suggests that there is something peculiar about small economies *vis-à-vis* competition law and policy.

In exploring the specific theme of market dominance in small states/economies, this paper will highlight some of the peculiarities of such states, focusing on Jamaica; and through that lens discuss the treatment of dominance as a policy issue and the resultant legal framework.

Whereas at the most general level, competition law seeks to ensure that domestic markets are not impeded by anti-competitive practices; and that competitive forces are allowed to determine how markets are organized, each state must determine the more specific objectives which its law must serve. Those objectives will inform the policy and the law. Like many other states, Jamaica seeks to promote efficiency and protect consumer interest, through competition law; and while the law proscribes the abuse of dominance in the market, it does not provide any structural remedies for any such abuse that may occur: it does not contain merger control provisions. This omission might be considered by some to render the law flawed, but the policy-makers were obviously operating on the accepted principle that Competition Law must fit the circumstances of the State in which it is being implemented; the view being that a small state must by necessity be more tolerant than larger states would be, of higher levels of concentration in the market, if their significant industries are to be competitive in the regional and global arenas. Our experience has led us to conclude however, that there are viable options between the positions of "all" or "none" in respect of merger policy, which will allow a small economy to enhance competition. Strict and non-discriminatory enforcement of the abuse of dominance provisions under the law will ensure the efficient allocation of resources as contemplated by the objectives of the law.

We posit that rigorous enforcement of competition law will protect the competitive process, thereby neutralizing shocks to the economy.

INTRODUCTION

A small state, as defined by the World Bank, has a population of 1.5 million or fewer[1]; and in Charles Webb's recent paper: *"Competition Law in Small Economies Compared"*, published in Volume 10 Issue 3 of the *Jersey Law Review (October 2006)* Malta with a population of 400,000 and a GDP of US$7.9 billion, was at the top of the list of the nine (9) small states selected. The question could arise as to the considerations that have resulted in Jamaica, with its population of nearly 3.0 million and a GDP of US$11.13 billion (2004 estimates), being invited to participate in this very important conference on Small States and Economic Resilience.

In recognition of the difficulties associated with defining what is a small state or a small economy as an absolute concept, discussions in the Free Trade Area of The Americas negotiations have tended to use the expression "smaller economies" rather than "small economies", the former being "a relative concept based on countries' resource bases and levels of development".[2] Accordingly, economic vulnerability, over and above population size, land mass, GDP or per capita income, has come to define a small state. To be economically vulnerable is to be ill-equipped or unable to withstand the economic effects, of natural disaster, negative shifts in trading relationships or other external shocks.

Starting with the premise that Competition Policy and Law is appropriate for even the smallest of states, however small is defined, this paper will focus on dominance in small states; the factors which facilitate such dominance, referred to by Professor Lino Briguglio and Dr Eugene Buttigieg as "ease of market dominance[3]; and the measures available for curbing it. Practical examples, where appropriate, will be drawn primarily from the Jamaican experience with using competition law to reduce the potential negative effects of being small; and the power of dominant firms to distort the market.

This presentation is structured as follows:

Section 1 outlines the major features of the market in small states

Section 2 introduces the Fair Competition Act of Jamaica and discusses how the Law is structured to deal with the matter of market adjustment

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[1] Small Economies of The Greater Caribbean And Preparedness for Globalization – Association of Caribbean Sates 9th Meeting of the Special Committee on Trade and External Economic Relations, Port of Spain, Trinidad & Tobago, July 16 – 17, 2001. (pg. 14)

[2] ibid pg. 11

[3] Lino Briguglio and Eugene Buttigieg. (Autumn 2004). *Competition Constraints in Small Jurisdictions.* Bank of Valletta Review Nº 30 (pg. 3)

Section 3 highlights viewpoints on the adequacy of competition law

Section 4 presents two case studies which compare outcomes under contrasting legislative frameworks

Section 5 concludes the paper.

1. FEATURES OF THE MARKET IN SMALL STATES

(i) Natural Monopolies

Professor Briguglio and Dr Buttigieg tell us that, *inter alia*, small states are likely to be characterized by natural monopolies in utilities such as electricity, fixed line telephony, gas and water.[4] These observations are, to varying degrees, true of all Caribbean States.

Notwithstanding the adoption of extensive privatization and trade liberalization measures in the late 1980s into the 1990s these sectors have remained monopolies, to a very large extent. In Jamaica, as in Barbados and Trinidad & Tobago water has not been opened up to competition. Jamaica does not have natural gas; and that sector remains a monopoly in Barbados and Trinidad & Tobago. The same is true of electricity for these states as well, while in Jamaica there is partial liberalization, allowing for limited competition in generation. In this context, the electricity produced by the bauxite companies and a few other independent producers account for 30% of electricity generation, which has to be sold to the incumbent, Jamaica Public Service Company. Whereas it is acknowledged that this arrangement provides a reliable and relatively cheap source of electricity, there is doubt as to whether the final consumer manages to benefit from privatization and the partial liberalization of the electricity sector.

Essentially, fixed line telephony remains a monopoly in all three states, but there is vibrant competition in mobile and international services. In Jamaica where the sector was liberalized on a phased basis, with full liberalization occurring in March of 2003, a licence was actually issued in 2002 for a second fixed line provider (wireless) to enter the market, but to date the lisensee has not been able to start operations. For one thing, it seems not to have had deep enough pockets to follow through; and secondly, the chosen technology was not only quite unsuitable for Jamaica's topography, but was very mature and was heading toward obsolescence.

[4] Briguglio et al (pg. 3)

Natural monopolies are characterized by factors such as large capital outlays and "relatively large overhead costs" which prevent duplication and therefore competition; they occur where the market is not large enough to sustain competition at an efficient scale; and they tend to demonstrate appreciable economies of scale and/or scope; they are an acceptable phenomenon of small markets, despite their legendary rampant rent-seeking conduct. In an effort to achieve balance, governments the world over and certainly in the Caribbean countries referred to herein, have relied on regulation of natural monopolies. In Jamaica, the organization which regulates the utilities is the Office of Utilities Regulation (OUR) - water and electricity being fully regulated; while for competition matters in telecommunications, the OUR must consult with and defer to the Fair Trading Commission (FTC). Competition in the mobile market has been legendary, due largely to forbearance by the Regulator to regulate that market. The Government's objective was to increase the level of telephone penetration in the country; and the result was that 300,000 subscribers in January 2001 became 2,745,400 by September 2005. The FTC has had to be vigilant in monitoring the advertising wars that have ensued between the incumbent and one particularly strong new entrant. Information contained in advertisements of ever evolving new services have come under heavy scrutiny, to ensure that the consumer is not misled; and competition is not distorted. Section 37 of the FCA prohibits misleading advertising; and the FTC has interpreted the section to mean that an advertisement can mislead by what it expresses as well as by what it fails to express; and by the inferences that can be drawn from by the placement of objects in relation to one another.

Rivals have sought and achieved visibility through exclusive sponsorships; and competition in this area has benefited several communities and other groupings in the society. Sports clubs and sporting activities have been probably the greatest beneficiaries, not only locally but regionally. Exclusive promotion agreements are carefully scrutinized by the FTC to maintain healthy competition. Starting out in 2000 with 100% market share in the mobile market the incumbent began to suffer loss of market share immediately upon the entry of the Irish provider – Digicel, whose market share was 60.2% as at September 2005, compared to the incumbent's 36.2%. A third provider held 3.6%.

The telecommunications sector in Jamaica clearly demonstrates that liberalization together with unimpeded competition and keen enforcement of competition law will contribute to the level of entrepreneurship; grow the economy; discipline dominant firms and enhance consumer welfare.

Unfortunately the same cannot be said of the electricity sector. By Ministerial Order dated February 2001, all aspects of the operations of the incumbent Jamaica Public Service Company were exempt from the jurisdiction of the Fair Competition Act. This means that eventhough generation was opened up to competition, the FTC cannot enforce the rules of competition against the dominant producer, which must be to the detriment of the market. The power of the Minister to grant the relevant exemption is established under Section 3(h) of the FCA, which reads:

> *"Nothing in this Act shall apply to – such other business or activity declared by the Minister by order subject to affirmative resolution."*

It must be noted too, that under its current licence the JPSCo is the sole purchaser of all new capacity generated by independent power producers. The Company also has an exclusive right for transmission, distribution/retail business.

(ii) "Ease of Dominance"

While the factors that support the existence of natural monopolies in small states are principally the usual market realities related to scale economies, there tend to be additional factors underpinning market dominance in sectors other than the utilities. This section discusses some of those factors.

Anecdotal evidence suggests for example, that factors such as strong social and family ties create barriers to entry and support dominance.

It is these factors that will allow dominant firms in a small state to remain dominant even after any superior competitive performance which they might have exhibited in their early history has disappeared. Briguglio and Buttigieg characterize "… *the poor chances of success of setting [up] new business*, in *goods and services already supplied by existing firms*"[5] as a natural barrier to entry. Where capital is scarce, for example, obtaining credit might be influenced by the aforesaid social and family ties rather than by sound business plans, thus limiting the possibilities for competition. Not least among these natural barriers to entry can be cultural allegiances to products which have taken on iconic "personalities" over time.

This situation is evident in a number of sectors in Jamaica, eg. The brewery sector. Domestic beer consumption is high and the Jamaican consumer has been exposed to many brands of beer; nonetheless the dominant brewery Red Stripe Limited remains dominant after eighty (80) years, encountering weak challenge for the first time some four (4) years ago. Beer means Red Stripe in Jamaica and to Jamaicans anywhere in the world.

Another natural barrier to entry in Jamaica is high transportation costs, given the fact that for an island, cross-border trade is largely by sea or air. This often

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[5] Briguglio et al (pg. 3)

translates into bulk buying through dominant firms, which in turn controls the distribution channels and firms are maintained in their relative positions along the distribution chain.

To the extent that interlocking relationships in small states allow business persons to have the ear of the policy makers, resulting policy decisions may tend to favour those business connections, giving rise to Government created/artificial barriers to entry. Such artificial barriers might manifest as state aid, concessions, preferential awards of contracts or tax breaks, which can amount to the picking of winners/promotion of national champions; and therefore distortion of competition. Other Government created barriers to entry which might not be peculiar to small states, include legislation such as those which address intellectual property rights and dumping. The power which resides in Agents of the Government in the granting of licences and permits may also be exerted in a manner which creates a significant barrier to entry and facilitates dominance.

2. DOMINANCE UNDER THE FAIR COMPETITION ACT (FCA)

It is important to indicate that dominance is not an offence under the Fair Competition Act (FCA). It is the abuse of that position that is punishable. A firm occupies a dominant position if

> *"... by itself or together with an interconnected company, it occupies such a position of economic strength as will enable it to operate in the market without effective constraints from its competitors or potential competitors"*.[6]

The 1945 case of *United States v Aluminium Co of America (Alcoa)*, referenced by Kovacic et al in Antitrust Law and Economics[7] provides us with as clear a picture as any of some of the possible reasons that a dominant firm[8] would need to be constrained. The learned Judge in the case suggested that monopoly power is feared because a firm holding such power can restrict output; raise prices and transfer income from customers to producers, thereby excluding rivals from the market *"... by means other than superior performance in the form of better products, prices and service."*

Fundamentally, competition law seeks to encourage, promote and maintain competition; and competition is affected by the behaviour/conduct of firms and the structure of markets. Thus competition law controls firms' behaviour by

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6 Fair Competition Act, Section 19

7 Ernest Gallhorn, William Kovacic and Stephen Calkins. *Antitrust Law and Economics (in a Nutshell).* (pg. 110). Thompson West

8 Note that in some jurisdictions, including the United States of America this concept of dominance is expressed as monopoly power

prohibiting, among other things, anti-competitive agreements and the abuse of dominance; while the application of merger control provisions prevents mergers that could result in anti-competitive levels of concentration in the market.

(i) Structure Approach to Market Adjustment

In the period leading up to the enactment of the FCA, much debate centered on features of the Act that could have a negative impact on investment in the newly liberalized economy. One such feature was merger control. Critical private sector groupings took the position that given Jamaica's level of economic development; the relatively small size of many of its firms, factors which have implications for the country's competitiveness, not just at the regional level but globally, firms should be allowed to merge without being subjected to the rigours of competition oversight.

Of course, this is not a view alien to the considerations which inform Competition Law and Policy. Kovacic et al point to a number of reasons why a society might wish to leave firms "relatively free to buy or sell entire companies or specific assets:

(i) mergers can bring superior managerial or technical skill to bear on underused assets;

(ii) [they] can yield economies of scale and scope that reduce cost, improve quality, and boost output;

(iii) the possibility of a hostile takeover can discourage incumbent managers from behaving in ways that fail to maximize profits;

(iv) a merger can enable a business owner to sell his firm to someone who is already familiar with the industry and might be in a better position to pay the highest price."[9]

And the writers go further: "The prospect of a lucrative sale induces entrepreneurs to form new firms and thereby spurs competition by facilitating entry and exit"[10] they observe; and cap their arguments with the statement that "... many mergers pose few risks to competition ... where for example, the merging firms are relatively small or entry into their markets is easy."[11] In some respects, with its relatively small firms, the Jamaican economy could be seen as fitting neatly into this matrix.

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[9] *Antitrust Law and Economics*. (pg. 404)
[10] idem
[11] idem

It must be acknowledged that over the last five (5) years, Jamaica has seen a number of mergers, predominantly in the banking, insurance and media sectors; and we, at the FTC have been particularly concerned about those mergers that have occurred between banks and insurance companies. Our "gut" reaction is that consumers will be pigeonholed into using the services of specific providers, where, given choice they might have gone elsewhere. To the extent that horizontal mergers increase the level of concentration in a market, and could effectively reduce competition, they ought to come under the scrutiny of competition law. The enforcement agency must have the opportunity to analyse a merger transaction and make a determination as to whether it produces or is likely to produce efficiencies; and whether some of the gains accruing will be passed on to the consumer. Surely rigid negative assumptions about mergers are wholly undesirable. A state must determine, among other things, its own thresholds; its own competitive test; and list of factors to be weighted in determining competitive impact. Ultimately it must strike the balance that it considers desirable for its own market.

Accordingly, the FTC has presented a position paper to the relevant Minister, pointing out why the national policy regarding mergers is now ripe for review.

(ii) Conduct Remedies

In the absence of structural remedies the competition authority must be doubly vigilant in its application of the conduct remedies provided under the law, for disciplining dominant firms.

Sections 19 – 21 of the FCA specifically address the conduct of dominant firms, prohibiting, among other behviours:

- restricting the entry of persons into any market;
- eliminating any person from any market;
- imposing unfair purchase or selling prices or other uncompetitive practices;
- limiting production of goods or services to the prejudice of consumers;
- making the conclusion of agreements subject to supplementary obligations, which by their nature, or according to commercial usage, have no connection with the subject of such agreements.

An enterprise will not be treated as abusing its dominant position if it is shown that –

- its conduct was exclusively directed to improving the production or distribution of goods or to promoting technical or economic progress; and
- consumers are allowed a fair share of the resulting benefit.

Further, an enterprise would not be treated as abusing its dominant position if the only reason for the relevant conduct is to enforce an intellectual property right.

Where the Commission finds that an enterprise has abused, or is abusing a dominant position and (emphasis added) that such abuse has had, is having or is likely to have the effect of lessening competition substantially (emphasis added) in a market, the Commission shall direct the enterprise to *"take such steps as are necessary and reasonable to overcome the effects of the abuse in the market concerned."*

The Commission is enjoined, under Section 21(2) *"... to consider whether the practice is a result of superior competitive performance"* in determining whether a practice has had, is having or is likely to have the effect of lessening competition substantially.

It is therefore clear from the wording of the sections of the Act which specifically address dominance, that in enforcing the law the competition authority is expected to take great care to ensure that it promotes competition, not stifle it; that innovation and economic progress is enhanced; that creativity through the exercise of IPRs is not smothered; and that consumers benefit. Most significantly the Act supports the principle that even as it seeks to constrain the behaviour of dominant firms, competition enforcement must encourage rather than punish "superior competitive performance."

3. VIEWPOINTS ON THE ADEQUACY OF COMPETITION LAW

Dr Trevor Farrell, Economist speaking at a Regional Conference held in Barbados in November 2006; and hosted by The Organization of Commonwealth Caribbean Bar Associations and the Caribbean Court of Justice, expressed the view that Caribbean people, in embracing competition law and policy, need to be mindful of "Axial industries of The Caribbean" such as tourism and energy, which are replacing earlier axial industries such as banana and sugar; and went on to recommend that competition policy must determine how to defend these axial industries.

There were many listening, who felt that the learned gentleman's comments were more suited for a discussion about trade remedies than they were for competition policy; and even in the context of trade remedies one would be advised to consider the observations of Ambassador John K Veroneau, Deputy US Trade Representative in the January 2007 edition of *eJournal USA*, published by the US Department of State, entitled *"Benefits of Trade, Costs of Protectionism"*. Ambassador Veroneau says, in the Introduction to the publication: *"Each society must find a way to address the needs of those who may be dislocated by change and cushion the transition. But backsliding and erecting walls and barriers to trade is not the answer. Trade barriers protect a few at the expense of the many and countries that fail to resist protectionism actions risk slower growth, inefficient and non-competitive sectors, greater unemployment and increased inflation in the longer term."* (pg 2).

4. CASE STUDIES

This section will highlight two (2) cases: one which demonstrates how the FTC applied competition law to curb the dominance of a local icon and enhance competition. The other demonstrates how Government intervention into one market distorted the competitive process and led to chaos and disruption in the economy.

(i) As previously mentioned, Red Stripe Limited was and is the dominant brewery in Jamaica, holding in 2001 - 2002, over 90% market share – a determination with which the company disagreed, contending that the relevant market includes all alcoholic beverages and not just beer as the FTC determined.

In 2002 it came to the attention of the FTC that the Company had entered into several sales and promotional arrangements with various distribution outlets. The ensuing investigation revealed that the relevant arrangements prohibited the promotion of competing products at selected outlets; demanded sales data on competing brands; prohibited sales and promotion of competing products at sponsored events; recommended that competing products be sold at premium prices at sponsored events; and provided for post-terminate preferential treatment.

Despite its non-admission of any breach, the Company agreed to enter into a Consent Agreement with the FTC, in which it agreed, in respect of sponsorship at events, that, among other things:-

- no agreements would exceed three years or provide for an option to renew and/or for any rights of first refusal;

- notice period for termination of any agreement, without cause would be linked to the value of the sponsorship provided.

With respect to promotional arrangements at outlets the Company agreed, that, among other things:

- the number of outlets would be reduced to a number agreed by the FTC;

- duration would not exceed twelve (12) consecutive months;
- there would be no option to renew; nor would there be any right of first refusal;

- no agreement would seek to restrict or limit competing products from being displayed for sales purposes.

Dimensions of such displays were stipulated by the FTC.

As a direct result of the action taken against Red Stripe the entrant at the time has not only been able to survive in the market, but has managed to increase its annual revenue by some 200%, which could mean a significantly increased market share. It has also carved out a viable niche for itself in the hotel sector. Further, in the last year, another rival has entered the market, without having to face the barriers faced by the first entrant; and consumers have benefited from the variety now available to them.

(ii) In determining the measures that would best contribute to the growth and resilience of the Jamaican economy as it became liberalized in the early 1990s, Anti-dumping and Subsidies Laws were considered to be integral to the process. The appropriate statutory instruments were put in place; and the Anti-dumping and Subsidies Commission (ADSC) was established.

To the extent that anti-dumping laws seek to protect domestic industries from competition, those measures are often seen to be in direct conflict with the principles of competition; and never was this conflict made more stark than in 2001 when the sole producer of cement in Jamaica, Caribbean Cement Company Limited (CCCL), filed a complaint with the ADSC, alleging that since 1999 cement was being dumped into the country, resulting in injury to its production; loss of sales and market share; and therefore loss of profitability. At the end of an investigation, the Anti-dumping Commission agreed; and dumping duties of 89.79% were imposed on the relevant importer. This process repeated itself in 2002 and again in 2004, when upon the recommendation of the ADSC, the Government increased the applied tariff on cement from 15% to 40%.

The CCCL promised not to increase prices for a specified period, and only with the Government's approval.

Upon becoming aware of the matter in 2001, the FTC prepared and delivered an opinion to its Portfolio Minister, setting out its concerns and cautioning the authorities to carefully analyse from the perspective of the overall impact on competition and consumer welfare, the likely results of the measures taken. The FTC encouraged the Minister to "carefully weigh the choice of providing protection for a particular company at the cost of the consumer and wider economic objectives." It was pointed was out that CCCL's undertaking not to raise prices without the Government's approval might not be a sufficiently strong safeguard to mimic a competitive market.

Despite the caution of the FTC and the Parliamentary opposition, to persuade the Government not to intervene in the manner sought, the fifty (50) year old CCCL was afforded protection through the imposition of dumping duties, increased tariff, and a safeguard measure of 25.83%. Indeed, one poignant intervention in Parliament was *"you cannot be under supplying and expect to get protection."* [12] At the relevant time the market was demanding 900,000 metric tonnes of cement per year and CCCL was producing 700,000 metric tonnes. In 2005 CCCL's production level had improved to 844,840 metric tonnes, but the Trade Board advised that the Company would have been *"unable to keep pace with the robust demand in the construction sector…"*. By this time firms which had hitherto been importing cement had fallen out of the market. The 2007 World Cup Cricket was imminent and large construction projects were underway, e.g. a new multi-purpose stadium at which warm-up matches were to be played. New schools were being built and highways were being constructed. A crisis had emerged in the construction industry. Public sector as well as private sector construction ground to a halt; and in the middle of all that reports surfaced that CCCL had released sub-standard cement onto the market. These reports were substantiated by cracking and crumbling structures, resulting in the Company paying out J$305 million by way of compensation, as at December 2006.

In the wake of the crisis the Government, as a first step to addressing the problem, rolled back the tariff to the original 15% for three (3) months. This did very little to improve the situation: three (3) months was much too short a period to allow persons interested in resuming importation to place orders and have the product shipped to Jamaica from such far away places as Thailand. Eventually the Government was forced to remove the tariff altogether, for an indefinite period. The sector is now climbing back

[12] (March 21, 2007). *The Daily Gleaner,* pg. D4

to competitiveness, with importation increasing; but there is no guarantee that the current tariff structure will not change. As at March this year a 42.5kg bag of CCCL cement was being sold for J$464.84 while a 42.7kg bag of imported cement was being sold by one importer for J$369.00 and a 50kg bag sold by another importer for J$430.00. This translates into J$10.94 per kilo for CCCL cement; J$8.64 for one importer's and J$8.60 for cement from the second. Indeed, as at December 2005 there were ten (10) companies importing cement into the country; and consumers are benefiting from competitive prices.

The cement experience clearly demonstrates some of the dangers of picking winners and promoting national champions – which is easily pursued under anti-dumping laws. It gives muscle to the argument that effective competition is the most effective means by which a country, regardless of how small, will decide who will produce what; to whom those goods and services will be allocated; and at what price. Trade remedies ought to be resorted to as measures of very last resort; and should be used sparingly. One can only hope that the cement experience has taught some lessons which extend far beyond the specific industry; and which can inform policy approaches by other small states.

5. CONCLUSION

A dominant firm will always seek to maintain its position in a market but there needs to be a credible appreciation of the adequacy of competition law to constrain the behaviour of such a firm. Rather than relying on mechanisms which seek to protect the few at the expense of the rest of society, small states should not shirk from employing competition law and policy, to promote rivalry among firms. This in turn will maximize consumer welfare. Its enforcement must be strict, consistent, and transparent. Competition policy is a particularly useful tool in small states, where dominance is not always a result of superior competitive performance. In monitoring the behaviour of firms in the market competition law promotes efficiency, which in turn produces good quality goods and services at competitive prices. In being provided with choice, consumers are able to switch; and the producers of goods and services are forced to make the necessary adjustments. Competition policy and law is necessary support in a market economy. It offers the most objective means through which markets will be able to adjust to shocks.