Competition law smp and dominant positions

ASSIGN BUSTER

\n[toc title="Table of Contents"]\n

\n \t

1. Introduction: \n \t
2. Understanding SMP and Dominant Positions \n \t
3. Nature of Abuse of Dominant Position \n \t
4. Exclusionary Abuse Conduct and its Implications \n \t
5. Exploitative Abusive Conduct and its Implications \n

\n[/toc]\n \n

The following research paper is titled " Competition Law: SMP and Dominant Positions". Competition Law also known as Anti-trust law in various countries, is a law dealing with anti-commerce and trade related activities indulged in by firms in dominant positions. The idea behind creating Competition Law/Anti-Trust law is to restrict dominant firms from abusing the market by; eliminating competitors, creating trade barriers, unfair pricing. The following paper i. e. " Competition Law: SMP and Dominant Positions" introduces readers to the basic understanding of what Competition Law is about, its creation, history and the current scenario in the world of Competition/Anti-trust Laws. I have divided this paper into a five part series. This paper contains definitions, typified examples and Case laws sourced from various Competition/Anti-trust laws of various countries including India.

The first part is " Introduction" giving an insight to Competition Law definitions, basic meaning and importance of competition in a market, the history behind Competition/Anti-trust laws. This part also deals with formation and existence of Competition law in various countries such as The

Sherman Act, 1890 of U. S. A., Treaty of Rome in Europe, and The Competition Act, 2002 of India. The Indian perspective on Competition Law is also given as to give an insight to the readers as how Competition Law evolved in India, its late entrance into Indian jurisprudence and the current status.

The second part of this paper explains the core topic of this paper; ' Understanding SMP (Special Market Power) and Dominant position'. This part consists of what a SMP, Dominant position is and how their anti-competitive activities can destabilise a market is explained in order to facilitate understanding as to what kind of abuses the market is subjected to by dominant firms in the following parts.

The third part of the paper, explains the ' Nature of Abuses by Dominant Positions'. This topic explains as to what are the type's abuses a dominant firm indulges in order to retain its dominant position. The two categories as per Competition/Anti-trust laws; Exclusionary Abusive and Exploitative Abusive practices are introduced, which are dealt in detail in the following parts.

The fourth part of this paper and the following part handle's the core issues of this paper; types of Abuses. This part explains the concept, forms and the consequences of ' Exclusionary Abuses and its implications'. This part consists seven sub-parts explaining each with many typified examples and Anti-trust case laws from various countries such as European Union, United States of America.

The fifth and the final part of this paper deal in the second category of abuses i. e. ‘ Exploitative Abuses and its Implications’. Exploitative Abuse which mainly has got to do with ‘ Unfair Pricing’ is explained at length with an important concept “ Predatory Pricing”. This part of paper cites many interesting case laws from Indian statute’s and a recent case under the Competition Commission of India. Therefore, this Research Paper aims to give an insight to readers on Competition Law, and its relevance in today’s Competitive markets.

Introduction:

Competition Law comes under commerce and trade laws, also known as Anti-Trust law in many jurisdictions around the world, formed to protect the market from the adverse impacts arising from a competition amongst various players existing or trying to enter into a market. Competition Law protects the interests of all market players, from manufacturers to distributors to the end consumers by providing a conducive, competitive environment and control any anti-competitive behaviour such as trade and commerce restraints, price fixations, monopolies, and price discrimination emerging within markets.

Competition[1]is “ a situation in a market in which firms or sellers independently strive for the buyer’s patronage in order to achieve a particular business objective for example, profits, sales or market share”. The idea of a utopian concept called Perfect Competition[2]as defined, “ A completely efficient market situation characterized by numerous buyers and sellers, a homogeneous product, perfect information for all parties, and complete freedom to move in and out of the market.” is highly improbable to

find in the current complex market's world over. There have been two schools of thought for a dynamic and fair competitive environment; one approach is to have an absolute free and unrestricted competition, which in time will drive out all unfair practices. Second approach supports the thought, to create a free competitive environment model combined with regulations that shall prevent any subversion on free trade and competition. From observation of markets from around the world, most markets follow the second approach, i. e. free competition combined with rules and regulations that ensure free trade and prevention of any unfair competition. Free trade and competition are essentials ingredients to economic efficiency. This approach has highly contributed in attaining Economic efficiency.

Economic principles are the most crucial factor, which determine market activity and regulate competition. An economic principle is fair and efficient as long it strikes a balance between trade and the ethical norms to be followed for the common good of economic efficiency. Competition policy and liberal trade policy seek to achieve the same objective mentioned " Economic efficiency". Competition Law is an idea to bring that ' balance' amongst market competition and economic principles. The markets world over have suffered due to inefficient and dubious Competition policies formed by the legislators and presided over by appellate tribunals. The failure of MRTP Act (Monopolistic Restrictive Trade Practices) tribunal in India is a clear example of the inefficient laws contributing in anti-competitive activities emerging within Indian markets. Thus, Competition Law is an attempt to rectify the impaired Competition policies, facilitates market access, other competition promotion activities with an aim to punish anti-

competition activities practised by market players and also to change and control the dynamics of market.

Competition Policy[3]is defined as “ those government measures that directly affect the behaviour of enterprise and the structure of the industry” An effective Competition policy promotes the creation of a business environment, improving static and dynamic efficiency, leads to optimum and effective resource allocation, and in which the abuse of market power is barred by competition. Sound economic analysis is central to Competition policy as to take the right decisions in the right cases as it is the Competition policy of a market that shapes fundamental economic decisions on investment, consolidation and more significantly on pricing.[4]Irrespective of whether a country is developed, developing or an economy in transition, its international competitiveness is in part determined by the degree of competition or rivalry among domestic firms and therefore an effective Competition policy is essential for the creation of globally competitive industries. Trade liberalization is not sufficient to promote competition and requires effective regulations and policies for achieving efficiency.

The history of Competition Law can be traced right back to the Roman Empire. The modern Competition Law has its origins from the American antitrust statutes like Sherman Act of 1890 and Clayton Act of 1914. It won’t be wrong to say that America’s School of Jurisprudence on Economic Analysis of Law school of Jurisprudence is equal ant to Competition Law. The European Community has incorporated the provisions of Competition Law in Articles 81 and 82 of treaty of Rome; signed in 1957 and later have been further modified to the current Article 102 of EU. Subsequently most of the

major countries like China, Russia, Brazil, South Korea, and Japan have established or are in process of establishing their own Competition regimes. In 1980, less than 40 countries had Competition laws. Presently more than 100 countries have incorporated Competition Laws in their trade and economic laws.

Though Competition Law institutionally existed in many parts of the world, much before India, due to various factors such as control by foreign forces, India hadn’t developed any institutions. But conceptually India has always been profound since the ancient times on trade/economic laws and principles. In India, the Parliament passed Competition Act in 2002 and it received the President’s consent in January, 2003. The Competition Act is based on European Union Competition Law concepts and other anti-trust statutes. With certain provisions of the Act being challenged in Hon’ble Supreme Court of India and Hon’ble Chennai High Court, the bill was amended in 2006 and adopted in 2007. The government established Competition Commission of India (CCI) on 14th October, 2003. The CCI is currently chaired by Mr Dhanendra Kumar, former Executive Director, World Bank.

Competition Act, 2002 is going to provide a platform in India to develop new form of Jurisprudence and contribute to India’s growth in the 21st Century as India takes its rightfully deserving stand at G8, G20 and extended Security Council like platforms.

Understanding SMP and Dominant Positions

Dominant positions and SMP (Special Market Power) are terms given to a firm which holds a majority of market share in any relevant markets. A firm in Dominant position enjoys the power to act and functions independently from any of its existing competitors in the market. The dominant firm can price, sell, market its products at its own terms, and create trade barriers in the market. The Dominant position allows firms to change the way market works by affecting/influencing competitors in its own favour. When Dominant Position is used to restrict and harm Competition in market, it is considered " Abuse of Dominant Position", and is primarily of two types: Exploitative abuse; Exclusionary abuse. I will be dealing later with the nature of abuse in the paper. Most of the Anti-trust/ Competition laws across world, define Dominant Positions similarly.

Now let's understand Dominant Positions with a noted argument in a renowned European Economic Community case under Article 82- Exclusionary Abuse, Commercial Solvents[5]Case held back in Luxembourg, 1974. A major supplier company wished to takeover a small manufacturing company to which it supplied raw materials, the manufacturing company dependent on the supplies from this major supplier company refused the takeover and thus was made to suffer as the Supplier Company stopped supplying raw materials. This series of events explains the idea of abuse of Market power by a firm in Dominant position in any business sector. The definition of Market Power[6], states " the power to control prices or exclude competitors from the market" and " the power to behave to an appreciable extent independently of suppliers, competitors and customers"[7]. When

assessing such Market power, the authorities look at the market share of a firm on a specific relevant market, though market share is not the only source to determine Dominance, recently it has been conferred by European Community, any firm with an excess of 70% of market share amounts to evidence of Dominant position.

Special obligations on firms with “ Dominance” or “ Market Power” are designed to protect consumers from exploitation and to ensure that competition in markets is not diminished. Acquiring Dominant position or having SMP (Special Market Power) isn’t wrong or unethical, but abuse of market power and anti-competitive activities conducted by a firm in Dominant Position tends to restrict competition. It is the abuse of market power that is considered anti-competitive, and not dominance. The Competition commissions around the world have been instituted not to merely punish anti-competitive actions by a firm in Dominance but also to change the way markets work, in limits of fairness and competitiveness.

Nature of Abuse of Dominant Position

The nature of Abuse of Dominant Positions is defined by many Competition Commissions, world over; Article 102 of the European Union anti-trust laws covers a list of Abuses practices that are done by a dominant firm though it is not an exhaustive list, and more is desired from the EU commission.

Unfair Pricing

Limited Production

Discrimination

Time

In the Indian context as per Section 4 of the Competition Act, 2003, there are broadly two kinds of prohibitions of Abuse of Dominant position:

Any actions taken by a existing firm to exploit its positions of dominance by charging higher prices, restricting quantities or generally to extract rents;

Any actions taken by an incumbent firm to protect its position of dominance by restricting the entry of other potential competitors to enter the market.

The nature of Abuse of Dominant positions though has a different nomenclature in different countries, but as per the interpretation of Competition Act 2003, EU anti-trust laws and various other anti-trust laws, broadly two categories exist;

Exclusionary Abusive practices (denial of market access, raising entry barriers)

Exploitative Abusive practices (excessive/ discriminatory pricing, predatory pricing)

Exclusionary Abuse Conduct and its Implications

Practices and conduct by firms in dominant position that raise entry barriers, thereby eliminating or reducing further competition are forms of Exclusionary abusive conduct. Exclusionary abuse aims at creating superficial barriers and restrictions in market as to make the market appear non-profitable, complex to work in. This conduct by a dominant firm, deters any new competitors from venturing into the market and thus, allowing the

dominant firm to consolidate its position. Exclusionary abusive conduct has been seen in various forms, explained with the following typified examples and cases. Since Competition Law is new in India and due to lack of relevant cases, I will be dealing the typified examples with EU case laws.

1) Rebates: The basic principle in Rebates offered are discounts granted by an undertaking in a dominant position based on a Countervailing advantage, which must be economically justified. The idea of offering Rebates is to offer such discounts to a customer that, though the product is offered at a marginally lower price, in the long term keeps the customer away from other competitors who in turn cannot offer such rebates and are forced to either exit from the market or not venture into the market at all, citing economic non- viability. Similarly, in Michelin[8], the tyre company was charged for:

a) ‘ Tying’ tyre dealers in the Netherlands to itself through the granting of selective discounts on an individual basis conditional upon sales targets and discount percentages, which were not clearly confirmed in writing and by applying to them dissimilar conditions in respect of equal ant transactions;

b) Granting an extra annual bonus on purchases of tyre for Lorries, buses and the like and on purchases of car tyres, which was conditional upon attainment of a target in respect of car tyres purchases.

Thus, Rebates is a way to deter competition by luring customers with marginally priced goods and keep them associated with the firm for a period of time that repeated purchasing becomes highly profitable in the long run for the firm.

2) Loyalty Rebates: Any form of pre-conditioned rebates implied on a customer to purchase all goods from the dominant firm results in abuse of dominance. Loyalty rebates are a conditional offer that is given to customers in order to stop; any other competitors from selling their goods and buyers from buying goods from any other firm. This form of selling strategy abuses the competition and market, not allowing any firm to offer its products in the market, which in hand makes the dominant firm more dominant and almost all customers and market starts depending upon supplies from the dominant firm. As per the judgement in Hoffmann La Roche[9]paragraph 111 " A system on rebates on overall purchases is an abuse in that it aims at making the conclusions of contracts subject to supplementary obligations which, by their nature of according to commercial usage, have no connection with the subject of such contracts." This is a case of Fidelity Rebates under Loyalty rebates where the purchaser had not made purchases from a rival firm during the relevant reference period of time.

3) Loyalty of Inducing Volumes Rebates: The model of Loyalty of inducing Volume Rebates works on a principle where; a dominant firm uses its position that already has substantial sales to the industry customers and offers rebates on incremental sales that are designed in a manner, which cannot be matched or competed by any other smaller firms. This inability to match is because the incremental Rebates are applied to all sales and are of substantive value due to the large sales already made to the customer. Thus, customers are encouraged to purchase more from the dominant firm than they would otherwise and remain loyal to the dominant firm. This, dominant position is used in the market to close out the market to

competing or potential suppliers, which in turn maintains or strengthen the dominant position of the firm. In the famous case between South African Airways (SAA) versus Competition Commission[10], South Africa, SAA was found to have set target sales figure for travel agents and offer a basic commission till that point. However, if agents exceeded their individual target an additional " override" commission would become payable not just on the sales in excess of the target, but on all sales.

The incentive to purchase created by a quantity rebate system is therefore much greater where the discounts are calculated on total turnover achieved during a certain period then where they are calculated per transaction. Thus, the longer the reference period, the more loyalty inducing the quantity rebate system.

4) Bundling: Bundling are a form of Rebates offered on purchases of a variety of products by a dominant firm. Bundling is selling of two or more products only together in;

One bundle at one price.

Separately but at a discounted bundled price

In a case where different products offered separately by a dominant firm do not incur the desired sales, dominant firm offer the products bundled together at such high rebate prices, that buyers are forced to buy the bundled lot of products rather than buying the specific required product. Such Bundling by a dominant supplier violates Article 82 of the European Community Treaty and anti-trust laws of other nations.

5) Tying: Tying as defined, any firm in a dominant position selling one product only on the condition that the buyer also purchases another product or agrees on not purchasing tied product from any other competitor. It is selling of a certain (tying) product only in combination with a (tied) product. This form of practices results in problems where transfer of market power onto other markets where bundling/Tying company is not dominant.

In the famous Microsoft[11]case, Microsoft Corporations used its dominant position by tying up its Operating System i. e. Windows 2000 along with Windows Media Player, it was observed " a leveraging infringement, consisting in Microsoft's use of its dominant position on the client PC operating systems market to extend that dominant position to two adjacent markets, namely the markets for work group server operating systems and the market for streaming media players."

Thus, the practice of selling of a tying (product) along with a tied (product) is an infringement of competition and anti-trust laws. Tying up is another form of Exclusionary Abusive Conduct of rebate scheme, which allows the dominant firm to control and abuse the market, by selling of its variety of goods in a inseparable manner. The tying and the tied product remain for selling together.

6) Refusal to Deal: Refusal by a firm in dominant position to supply to its competitors or customers any tangible, infrastructure and IP related product is Refusal to Deal. A refusal to supply to a competitor can be " First Time" refusal of supply as observed in Bronner[12], Ladbroke[13]cases or " Complete Termination" of all existing business relationship as observed in

Commercial Solvents[14], Aspen[15]case. In both these situations mentioned on Refusal to Supply a dominant firm can point-blank refuse to supply or offer supply with such pre-conditions that are so disadvantageous that results in amount to refusal to supply. Refusal to supply Competitors and Refusal to Supply Customers can both have immense Exclusionary affects, but the former and latter are of a very different nature. Now let’s understand some basic nuances of the two:-

a) Refusal to Supply to Competitors: Each firm in a dominant position or having SMP have the general duty to assist its competitors with any tangible asset or a breakthrough technology. The idea is all firms present in a market are meant to compete one-another, develop rival-technologies, assets and products. The market works on principle of innovation and advancements. Refusal to Supply to a competitor is equal ant to anti-competitive actions, when a dominant firm controls/gains access to a resource or a facility that cannot be replicated. The dominant firm aims at reserving the facility, resource to itself, disallowing any of its competitors to gain access, resulting in elimination of competitors and downsizing of the market.

b) Refusal to Supply to Customers: A dominant positioned firm’s refusal to supply to customers is a designed strategy to induce customer’s buying behaviours. Here the basic idea is to threaten/ scare the customer in order to make them accept certain trading norms as dictated by the dominant firm. A relevant example is of “ single branding”, where a dominant firm refuses; to sell or continue to sell a “ must stock” product to a supermarket chain because the customer i. e. Supermarket store also stocks a rival product. Faced with the current situation, the customer will be forced to discontinue

purchases of the rival product and buy only the “ must stock” brand i. e. dominant firm’s product. This method adopted by dominant firm also acts as a bargaining tool; to ensure customers complies with their trading and selling policies. An induced customer submitting to the demands of the dominant firm restricts and eliminates all competitors from the competition. In United Brands and Lorain Journal[16]case, the only newspaper in town refused to sell newspaper advertising to persons who also advertised on a competition radio station. This was held to be an attempt to monopolize the advertising market and a violation of Para. 2 of U. S. anti-trust law. Thus, Refusal to Supply to customers is a way to bully customers and change the buying behaviour of customers, resulting in long term losses and elimination of rival firms from the competition market.

7) Price/ Margin Squeeze: A situation in the market; when a vertically integrated dominant firm uses its control over its inputs and supplies over to downstream rivals, sets it prices at a level in order to prevent its rival firms from making a profit in downstream market, in which the dominant firm is also active. Thus the dominant firm in upstream market also dominates downstream market. Margin Squeeze occurs when difference between wholesale price and retail price of the final goods/services does not give an efficient downstream firm a reasonable profit margin. Under any anti-trust/competition law, Margin Squeeze abuse requires the following conditions to be fulfilled to prove any abusive conduct on part of the vertically integrated dominant firm:

Existence of a dominant vertically integrated firm.

The input supplied by vertically integrated firm should be essential/ non-substitutable for competitors and competition.

Input supplied constitutes substantial portion of the downstream cost.

However, the conditions are fairly demanding and emphasise that it is anti-competitive impact on downstream market that must be addressed, therefore if the downstream market is competitive; and downstream firm has choice of substitutable inputs, than even if the margins are low/negative, dominant upstream firm is not held responsible by means of margin/price squeeze.

The Competition Act 2002, under Section 4(2) (e) prohibits Price/Margin Squeeze and states “ if an enterprise of a group uses its dominant position in one relevant market to enter into, or protect other relevant market” it is a clear violation under Section 4 resulting in Price/Margin Squeeze. Further the Act does not only prohibit tactical Price/Margin squeeze by a dominant firm but also has a provision under Expose Intervention Mechanism under Section 19(4) to control Margin squeeze.

In the United States of America, any competitor who feels threatened by a vertically dominant firm, attacks the offender under Section 2 of the Sherman Act. However, in The Supreme Court of United States of America, 2004 decision in Trinko[17]judgement, it believed that “ a margin squeeze that neither causes nor threatens the monopolization of an identifiable market cannot pass muster under Section 2. In this regard, United States anti-trust laws differ significantly from the laws of jurisdictions adopting “

abuse of dominance" as a competition law violation as compared to Article 82 of the EU commission.

The source of anti-trust's pre-Trinko in matters of Price Squeeze Jurisprudence is Judge Learned Hand's 1945 opinion in Alcoa[18]. Under Alcoa, a vertically integrated monopolist must charge downstream competitors not more than a " fair price" for its bottle neck input, and it must charge end users a retail price for its downstream product that is high enough to ensure that it is high enough to ensure that its competitors can match that price and still make a " living profit".

Exploitative Abusive Conduct and its Implications

Exploitative abuse consists of discriminatory pricing, unfair trading conditions subjected at dependent customers in order to maximise profits and retain dominant position in the market. Any biased/prejudiced selling policies by a firm which subjects its customers to pay more or influence buying behaviour in an anticompetitive manner results to direct harm to customers and Exploitative abuse. The dominant firms can also raise prices to increase profits, because customers cannot easily switch to other firms and they lose out on paying more and buying less, leading to misallocation of resources. Thus exploitative abuse can be interpreted as " earning of monopoly profits at the expense of the customers"[19]. Now I will be addressing the two main forms of Exploitative Abuse; Unfair Pricing and Unfair Trading conditions at length with the help of some Indian Commission and European Union case laws.

Unfair Pricing: The concept of Unfair Pricing works on the principle of excessive charging of an offered product, service to customers in order to make monopolistic profits and control the market share. Excessive pricing by a dominant firm in an Exploitative Abusive level is done the two stages of Predatory pricing and post-Predatory pricing. In order to understand Unfair Pricing under this perspective, let’s first understand the evil of Predatory Pricing.

Predatory Pricing- Practice of selling a product/ service at a low price usually below the profit margin levels, in order to eliminate the competing firms, create superficial barriers of entry for potentially new competitors is Predatory pricing. As per the Competition Act, 2002 under Section 4 (2) (b) Predatory Price means “ the sale of goods or provision of services, at a price which is below the cost, as maybe determined by the regulations, of production of good or provision of services, with a view to reduce competition or eliminate the competitors.” Dominant firms adopt a short-run conduct which seeks to exclude rival firms from competition on a basis other than efficiency in order to protect or acquire the market. Though the marginally low cost offered on a product/service by a dominant firm does not harm the purchasing party/ customer in a direct manner, but Predatory pricing eliminates Perfect Competition out of the market, which in turn could have been more beneficial than low cost products. The customers interest is harmed in the long run, as dominant firms tend to raise price and charge excessively one’s all competitors are driven out of the market. A very relevant case on this subject rests with the CCI (Competition Commission of India), Case no. 13/2009, MCX Stock Exchange filed information with the CCI

that NSE (National Stock Exchange), the largest stock exchange in India was abusing its dominant position by engaging in;

Predatory pricing (zero pricing),

Refusing to deal with MCX SX promoter FTIL (a supplier of software solutions to brokers).

The relevant market for which MCX SX alleged was the Stock Exchange service that consists of 4 segments; Debts, Equity, F&O (Future and Options) and CD (Currency Derivatives). The NSE entered CD (Currency Derivative) segment on 29th August, 2008 and was aware that MCX also had applied to regulators; SEBI and RBI. MCX entered CD segment on 7th October, 2008. MCX has argued that the geographical market in this case is India, and also alleged that NSE was in a dominant position as it controlled 90% of the marke