FAIR TRADING COMMISSION OF SEYCHELLES GUIDELINES ON ABUSE OF DOMINANCE

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1.0. INTRODUCTION

The Fair Trading Commission guideline on abuse of dominant position will enable an enterprise to understand the procedures of the Fair Trading Commission (hereinafter referred to as "the Commission") in assessing the conduct of dominant enterprise(s). The guideline will also indicate certain key factors which the Commission considers are relevant in determining whether an enterprise is dominant and whether its behaviour will or may be regarded as abusive.

Holding a dominant position, jointly dominant position, a monopoly or a position of substantial market power is generally not abusive or illegal. However, some behaviour by such firms may be considered as abuses. This guideline is not a substitute of the Fair Trading Act 2022 or any Regulations and should instead be read in conjunction with the relevant legal instruments. The examples used within the guideline is for illustration and do not set a limit on the investigation and enforcement activities of the Commission. Persons in doubt with regards to how their commercial activities may be affected by the Act may wish to seek legal advice. The Commission may, from time to time, review and issue revised versions of its guidelines.

2.0. DOMINANCE

An enterprise may hold a dominant position in a market if—

(a) by itself or together with an interconnected enterprise, or any other enterprise, it occupies such a position of economic strength as will enable it to operate in the market or
(b) it holds a substantial share of the market or
(c) it has market power

According to section 125 (4) of the Fair Trading Act 2022, conducts that may constitute an abuse of dominant position includes;

a) *"directly or indirectly, imposing unfair purchase or selling prices or other unfair trading conditions;*
b) *limiting or restricting production, market access, investment, technical development, or technological progress;*
c) *applying dissimilar conditions to equivalent transactions with other trading parties;*
d) *making the conclusion of contracts subject to acceptance by other parties of supplementary conditions which by their nature or according to commercial usage have no connection with the subject-matter of the contracts;*
e) *exclusive dealing;*
f) *refusing to give a competitor access to an essential facility when it is economically feasible to do so*;
g) tied selling;
h) bundling."

3.0. EXCLUSION

According to Section 125 (5) of the Fair Trading Act 2022, an enterprise is not to be treated as abusing a dominant position-

a) "*if it is shown that its behaviour was exclusively directed to improving the production or distribution of goods or promoting technical or economic progress, and consumers were allowed a fair share of the resulting benefit;*

b) *if the effect or likely effect of its behaviour in a market is the result of its superior competitive performance; or*

c) *by reason only that the enterprise enforces or seeks to enforce any right under or existing by virtue of any copyright, patent, registered design or trademark except where the exercise of those rights-*

(i) has the effect of lessening competition substantially in a market; and
(ii) *impedes the transfer and dissemination of technology*."

4.0. CONCEPT OF DOMINANCE

The Commission uses a two-step test to assess whether the conduct of an enterprise falls under Section 125 of the Fair Trading Act 2022:

- Establishing the dominance of the enterprise
- Whether the enterprise is abusing that dominant position

This raises two questions considered below:

(i) the definition of the market in which the enterprise is alleged to be dominant (the relevant market); and
(ii) whether it is dominant within that market.

5.0. DEFINITION

Before assessing whether an enterprise is dominant, the relevant market must be determined. This relevant market will have two dimensions:

• The relevant goods or services (the relevant product market), and
• The geographic extent of the market (the relevant geographic market).

The relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer by reason of the products' characteristics, their prices, and their intended use. Product market definition starts by considering the products which the parties to an agreement produce, or the products which are subject to a complaint. Market definition provides an appropriate frame of reference for competition analysis. In order to establish which products or geographic areas are included in the relevant market, a conceptual framework known as the hypothetical monopolist test is usually employed.[1] In defining the relevant product market, the Commission is also assessing whether a hypothetical monopolist could profitably sustain prices above competitive levels. The more quickly buyers can switch, the greater the constraint on the exercise of market power. Depending on the case, products for which buyers take longer than one year to switch in response to a price increase are generally not included in the same market. The geographic market comprises the area in which firms concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogenous and

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[1] An extensive discussion on Market Definition in the context of abuse of Dominance case pp.II-6-12"Reference Document on Abuse of Dominance" Vol.1, Bureau of Competition Policy, Canada.

which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.

In some cases, a market may have been previously investigated and defined by the Commission or by another competition authority. While such precedents can provide useful insights, the market definition used in a previous case may not always be the correct one to use in subsequent cases. The application of the concepts may vary on a case-to-case basis.

The Commission may also use examples, concepts and cases from other jurisdictions as guidance in any investigation that may arise. Decisions taken in other jurisdiction has no binding precedence on the Commission.

The Commission's approach to market definition is provided in the Commission's Guidelines on relevant market and market power.

6.0 ASSESSING DOMINANCE

The definition of the relevant market in both its product and geographic dimensions allows the Commission to identify the suppliers and the customers/consumers active in that market. On that basis, the total market size and market shares for each supplier can be calculated based on their sales of the relevant products in the relevant area.

6.1. MARKET SHARE CALCULATION

In practice, the total market size and market shares are often available from market sources, i.e., company's estimate, studies commissioned to industry consultants and/or trade associations. When this is not the case, or also when available estimates are not reliable, the Commission will usually ask each supplier 'the competitors' in the relevant market to provide its sales to calculate the total market size and market shares. The market shares of competitors in the relevant market are one measure of the competitive constraint from existing competitors.

Sales are usually the reference to calculate market shares. There are nevertheless other indications that depending on the specific products or industry in question, can offer useful information such as, in particular, capacity, the number of players in bidding markets, etc. As a rule of thumb, both volume sales and value sales provide useful information.

Data on market shares may be collected from a number of sources including:

- Information provided by enterprises themselves. Enterprises are usually asked for data on their own market shares, and to estimate the shares of their competitors;
- Regulators, National Statistics Bureau and other Agencies ;
- Market research reports.

6.2. MARKET POWER

The Commission considers it unlikely that an enterprise will be individually dominant if its share of the relevant market is below 40 percent, although dominance could be established below that figure if other relevant factors (such as the weak position of competitors in that market and high entry barriers) provides strong evidence of dominance. In certain circumstances when the enterprise does not hold a substantial share of that market, the Commission can take into consideration the market power of the enterprise.

Market power according to Section 125(6) of the Fair Trading Act 2022 refers to the ability of an enterprise to control prices, output or terms of trading, to exclude competition or to behave to an appreciable extent independently of its competitors, consumers or suppliers over a period of time. In view that the competitive price is extremely difficult to identify in practice, determining whether an enterprise enjoys market power usually requires an indirect assessment focused on certain factors.

According to Section 125(3) of the Fair Trading Act 2022, in determining whether an enterprise enjoys market power "*a market analysis has to be conducted, taking into account the following factor amongst others-*

a) the ability of the enterprise to restrict a potential competitor from entering the market;
b) the financial position of the enterprise;
c) the existence of countervailing buyer power; and
d) *the existence of barriers to entry or expansion into the market;*
e) *beneficial ownership*."

6.2.1 THE ABILITY OF THE ENTERPRISE TO RESTRICT A POTENTIAL COMPETITOR FROM ENTERING THE MARKET

Depending on the evidence obtained the Commission will conclude that an enterprise has market power if it is able to restrict/limit competition or exclude new competitors from entering the market. Exercising exclusionary power may be a way of reducing the degree of competition in the market and allowing the remaining enterprise to raise its prices. As a result, any new entrants might be deterred from entering due to the likelihood of facing an aggressive response from the remaining enterprise.
Vertical restraints may also create a barrier to entry where the supplier or manufacturer has exclusive purchasing agreements with the retailers downstream as it might restrict the ability of any new manufacturer or supplier to compete in that market.

Exclusionary conduct and vertical restraints are discussed further in section 7 of the guideline.

6.2.2 FINANCIAL POSITION OF THE ENTERPRISE

An enterprise's financial position or its financial performance may provide evidence that it possesses market power. The Commission may consider the financial position of the enterprise in comparison to its competitors in the market. Access to funds is necessary if an enterprise attempts to increase its prices above competitive levels for a sustained period. Depending on the other available evidence, the Commission might view that an enterprise has market power if it can consistently set prices above an appropriate measure of cost or persistently earned an excessive rate of profit. High prices or profits alone are not sufficient proof that an enterprise has market power. Competitive market of similar risk and rate of innovation, may suggest that market power does exist especially if those high returns did not stimulate new entry or innovation.

6.2.3 COUNTERVAILING BUYER POWER

Countervailing buyer power exists where buyers have a strong negotiating position with their suppliers, which weakens the potential market power of a supplier. Countervailing buyer power does not simply refer to the size of the buyers, i.e. the idea that large buyers can exercise buyer power, but requires the buyer to have access to alternative sources of supply. For example, a supplier would be seen as having substantial market power in a situation where the buyer has no alternative options except that supplier. Therefore, when assessing countervailing buyer power, the Commission may look at the ease buyers can switch to alternative suppliers at little cost to themselves while continuing to meet their needs.

In some sectors, the economic behaviour of enterprises (such as the prices they set or the level of services they provide) is regulated by the Government or an industry sector regulator, and an assessment of market power may need to take that into account. Although an enterprise might not face effective constraints from existing competitors, potential competitors or buyer power in the market, it may still be constrained from profitably sustaining prices above competitive levels by the Government or an industry sector regulator. However, that is not to say that market power cannot exist when there is economic regulation. It is feasible, for example, that regulation of the average price or profit level across several markets supplied by an enterprise may still allow for the enterprise to profitably sustain prices above competitive levels in (one or more of) these markets and/or to engage in exclusionary behaviour of various kinds.

6.2.4 BARRIERS TO ENTRY OR EXPANSION

In assessing dominance, the Commission also takes into consideration the level of potential competition. The Commission will generally consider that an enterprise is not in a dominant position if entry of potential competitors is likely, timely and sufficient to

deter the dominant enterprise from sustaining prices above competitive levels or restricting output (i.e. the lower the entry barriers, the more likely it will be that potential competition will prevent enterprises already within a market from profitably sustaining prices above competitive levels).

Entry barriers are factors that allow an enterprise profitably to sustain supra-competitive prices in the long term, without being more efficient than its potential rivals. Even if there are no existing competitors, an enterprise is unlikely to be able to sustain supra-competitive prices in the long term, in the absence of entry barriers.

Even an enterprise with a large market share in a market with very low entry barriers would be unlikely to have market power. However, an enterprise with a large market share in a market protected by significant entry barriers is likely to have market power.

Entry barriers arise when an enterprise has an advantage (not solely based on superior efficiency) over potential entrants from having already entered the market and/or from special rights (e.g., to production or distribution) or privileged access to key inputs. Entry barriers may make new entry less likely or less rapid by affecting the expected sunk costs of entry and/or the expected profits for new entrants once they are in the market, or by establishing physical, geographic or legal obstacles to entry.
Barriers to entry are closely related to barriers to expansion and can be analysed similarly. The same factor which may create barriers to entry may also affect the ability of an enterprise to expand its market shares.

There are many ways in which different types of barriers can be classified, but it is useful to distinguish between the following factors which, depending on the circumstances, can contribute to barriers to entry or expansion.

- Sunk costs;
- Limited access to key inputs and distribution outlets;
- Regulation;
- Economies of scale;
- Network effects;

SUNK COSTS

Sunk costs are costs that cannot be recovered on exiting an industry and hence serve to commit a firm or firms to stay in the market. Entry will occur only if the expected profit from being in the market exceeds any sunk costs of entry. There are three important aspects of sunk costs that influence entry and exit decisions:

First, sunk costs increase the risk of entering an industry because they cannot be recouped upon exiting. **Second,** sunk costs create a cost asymmetry between

entrants and incumbents. Once costs are sunk they are no longer a portion of the opportunity costs of production, and hence, an incumbent will require a lower return on costs in order to stay in an industry than will be required to enter. **Third,** sunk costs can serve as a commitment by incumbent firms not to exit the industry. Thus, sunk costs are central to the calculations of potential entrants because if entry involves sunk costs enterprises may be deterred if they are unlikely to be recouped, and incumbent firms may be able to exploit this fact strategically in a variety of ways.

It is useful to consider the extent to which sunk costs give an incumbent an advantage over potential new entrants and to what extent sunk costs might affect entry barriers. The mere existence of sunk costs in any particular industry, however, does not necessarily mean that entry barriers are high or that competition within the market is not effective.

ACCESS TO ESSENTIAL FACILITIES

The essential facility doctrine has its antecedents in US antitrust; the first case is considered to have been the United States v/s Terminal Railroad Association of St Louis,[2] although the term was not used in that case. A facility will be viewed as an essential only where it can be demonstrated that access to it is indispensable to compete downstream or in a related market, and where duplication is impossible or extremely difficult owing to physical, geographic, economic, or legal constraints (or is highly undesirable for reasons of public policy).

The market definition will be important in determining if a particular facility is essential. An asset will not be regarded as an essential facility if other similar facilities compete within the same relevant market (i.e. if there are potential substitutes), or if the facility is not indispensable to the provision of the product in question.

The Commission's assessment of whether a particular facility is essential will be on a case-by-case basis.

Generally, if a rival does not have access to an essential facility, it cannot enter the market. The Commission will apply the essential facility doctrine with caution and recognize the importance of limits. Demanding that a dominant firm (private sector) should grant access to its facilities might be a major intervention on the part of the Commission and an excessive application of the essential facility doctrine can have harmful economic effects. This is not only because there is an element of expropriation in requiring one firm to grant access to its property to a competitor, but also because

[2] 224 US 383 (1912); the scope of essential facilities doctrine has been raised by the Department of Justice and Federal Trade Commission as amici curiae, available at http://www.ftc.gov/ogc/briefs/02-682. pdf, in a case before the Supreme Court Verizon Communications v/s Law Offices of Curtis Trinko

the prospect that a third party might be able to demand a 'free ride' on the fruits of another's investment might deter the latter from investing in the first place.

There will be circumstances in which difficulties accessing inputs or resources constitute an entry barrier without those assets or resources meeting the strict criteria required to be defined as "essential facilities".

REGULATION

Regulation may affect barriers to entry. For example, regulation may limit the number of enterprises that can operate in a market through the granting of licences. Also, licences may be restricted so that there is an absolute limit to the number of enterprises that can operate in the market. In this case, a licence can be thought of as a necessary input before production can take place and so regulation will act as an entry barrier.

Sometimes regulation sets objective standards. Where these apply equally to all enterprises, such as health and safety regulations, they might not affect the costs for new entrants any more than they affect the costs for incumbents. However, regulation can lead to entry barriers when it does not apply equally to all enterprises. For example, incumbents might lobby for standards that are relatively easy for them to meet, but harder for a new entrant to achieve.

ECONOMIES OF SCALE

Economies of scale exist where average costs fall as output rises. In the presence of large economies of scale, a potential entrant may need to enter the market on a large scale (in relation to the size of the market) to compete effectively. Large-scale entry might require relatively large sunk costs and might be more likely to attract an aggressive response from incumbents. These factors may in some circumstances constitute barriers to entry.

Attaining a viable scale of production may take time and so require the new entrant to operate in the market for some time at a loss. For example, a new entrant at the manufacturing level might need to secure many distribution outlets to achieve a viable scale. If perhaps due to long-term contracts, many input suppliers or distributors are locked-in to dealing with the incumbent, the new entrant might not be able to achieve an efficient scale of production over the medium term. This could deter entry.

Even when entry is not completely deterred, entrants may take time to achieve efficient levels of production, obtain the relevant information, raise capital and build the necessary plant and machinery. In this case, even if entry occurs, the incumbent could nevertheless retain market power for a substantial period of time.

NETWORK EFFECTS

Certain markets are characterized by 'network effects', which arise where the value of a product increases with the number of other customers consuming the same product. The telecommunications sector is a good example of an industry characterized by network effects; the more customers that are connected to a particular telephone network, the more valuable the network is to each customer.[3]

Network effects may have positive effects on competition since consumers become better off as a product becomes more popular. However, network effects also give rise to the possibility of one or a small number of firms dominating a market, in particular, because there may be 'tipping effects' where all the customers in a particular market decide to opt for the product of one firm or one particular technology.

Network effects, just like economies of scale, may make new entry harder where the minimum viable scale (e.g. in terms of users of the network) is large in relation to the size of the market.

Nonetheless, the other factors that could be taken into consideration in assessing market power include;

- Bidding markets: Sometimes buyers choose their suppliers through procurement auctions or tenders. In these circumstances, even if there are only a few suppliers, competition might be intense. This is more likely to be the case where tenders are large and infrequent (so that suppliers are more likely to bid), where suppliers are not subject to capacity constraints (so that all suppliers are likely to place competitive bids), and where suppliers are not differentiated (so that for any particular bid, all suppliers are equally placed to win the contract). In these types of markets, an enterprise might have a high market share at a single point in time. However, if competition at the bidding stage is effective, this currently high market share would not necessarily reflect market power.

- Successful innovation: In a market where enterprises compete to improve the quality of their products, a persistently high market share might indicate persistently successful innovation and so would not necessarily mean that competition is not effective.

- Product differentiation: Sometimes the relevant market will contain products that are differentiated. In this case, enterprises with relatively low market shares might have a degree of market power because other products in the market are not very close substitutes.

[3] See OFT Economic Discussion Paper 3 (OFT 377) Innovation and Competition Policy (Charles River Associates, March 2002).

- Responsiveness of customers: Where enterprises have similar market shares, this does not necessarily mean that they have similar degrees of market power. This may be because their customers differ in their ability or willingness to switch to alternative suppliers.

- Price responsiveness of competitors: Sometimes an enterprise's competitors will not be in a position to increase output in response to higher prices in the market. For example, suppose an enterprise operates in a market where all enterprises have limited capacity (e.g. are at, or close to, full capacity and so are unable to increase output substantially). In this case, the enterprise would be in a stronger position to increase prices above competitive levels than an otherwise identical enterprise with a similar market share operating in a market where its competitors are not close to full capacity.

In general, market power is more likely to exist if an enterprise (or group of enterprises) has a persistently high market share. Likewise, market power is less likely to exist if an enterprise has a persistently low market share. Relative market shares can also be important. For example, a high market share might be more indicative of market power when all other competitors have very low market shares.

6.3. COLLECTIVE DOMINANCE

A dominant position may be held collectively when two or more legally independent enterprises are linked in such a way that they adopt a common policy on the market. The European Court confirmed the principle of collective dominance in the Italian Flat Glass case:

'There is nothing, in principle, to prevent two or more independent economic entities from being, on a specific market, united by such economic links that, by virtue of that fact, together they hold a dominant position vis à vis the other operators on the same market.'[4]

The links may be structural or they may be such that the enterprises adopt a common policy on the market[5]. For example, the nature of the market may be that enterprises might adopt the same pricing policy on the market without ever explicitly agreeing on the price.

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[4] Cases T-68/69 etc Società Italiano Vetro SpA v Commission, [1992] II ECR 1403, [1992] 5 CMLR 302. 10

[5] Joined Cases C-395/96 P and C-396/96 P Compagnie Maritime Belge SA and others, [2000] ECR I-1365 paragraph 45

7.0. ABUSE OF DOMINANCE

If the Commission establishes that an enterprise is dominant in the relevant market, the second part of the test is to assess whether the enterprise's behavior might be regarded as an abuse of its dominant position. The conduct of a dominant enterprise has the potential to significantly impact competitive conditions in Seychelles.

In assessing cases of alleged abuse, the Commission may consider if the dominant enterprise can objectively justify its conduct. For example, a refusal to supply might be justified by the poor creditworthiness of the buyer. However, the dominant enterprise will still have to show that it has behaved proportionately in defending its legitimate commercial interest. It should not take more restrictive measures than are necessary to do so. The Commission may also consider if the dominant enterprise is able to demonstrate any benefits arising from its conduct. It will still be necessary for a dominant enterprise to show that its conduct is proportionate to the benefits claimed. Such conduct will not be allowed if its primary purpose is to harm competition.

The following provides more details on how the Commission may assess certain types of conduct by dominant enterprises (whether individually or collectively dominant) that may infringe Section 125 of the Fair Trading Act 2022. The examples are not exhaustive, and conduct not covered by or referred to in this part, should not be assumed to be beyond the scope of the mentioned section above. The Commission will consider the likely effects on competition, based on the specific facts and circumstances of each case.

7.1. PREDATORY PRICING

Predatory pricing is the term used for a form of exclusive abuse in which an enterprise with market power, prices low with a specific strategy of forcing competitors out of the market, to exploit customers in the subsequent period in which competition is weakened or eliminated.

Low prices are normally evidence of effective, vigorous competition as enterprises seek to undercut one another's prices. Very vigorous competition on price is in customers' interests. If the Commission were to intervene too readily in response to accusations of predatory pricing, it might have the effect of preventing or softening, rather than promoting, competition. Worse, it might result in enterprises being reluctant to cut prices in the future, for fear of being investigated.

Because of these concerns, and because we are aware that businesses will often bring complaints of predatory pricing, with the aim of softening competition, the Commission will adopt a strict set of rules concerning the behaviour they might consider to be predatory. The intention is that competition law should protect competition and the competition process, not protect competitors.

The Commission will consider pricing to be predatory only if the pricing strategy would be unprofitable unless it results in the elimination or significant weakening of competition.

This will only be the case if three conditions are met:

a. The pricing strategy must be clearly unprofitable for the alleged predator[6] in the short term. Prices must be below average variable cost (as a simple proxy for short-run marginal cost) so that the supplier is losing money on every additional item sold.[7]

b. The pricing strategy has resulted (or is expected to result) in the exit of significant competitors, or increased marginal costs for competitors as a result of reduced scale, such that the market is less competitive than previously.[8]

c. It can be expected that any such losses can be recouped as a result of eliminated or weakened competition in the future. This requires that damage to competition is, for a significant period, irreversible. It would not be a successful predatory strategy to price low to eliminate a rival if the resulting monopoly cannot sustain high prices because rivals simply enter again.

If these conditions do not hold, the Commission will not regard low prices as predatory, whatever their effect on competitors.

7.2. PRICE DISCRIMINATION

Price discrimination refers to the practice by a supplier of selling the same product at different prices to customers, for example, according to their willingness to pay. In order to have price discrimination, two conditions must be fulfilled.

First, there must be a way to classify customers according to their effective willingness to pay a price. This classification can take place either through self-selection (e.g. quantity discounts) or by grouping customers based on observable characteristics (e.g. special prices for students, pensioners etc...)

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[6] The profitability test relates to the predator not the other enterprises in the market. An enterprise may well find itself facing prices lower than it can profitably meet if its rival has lower costs. This is not predatory pricing.
[7] This is a much stronger condition than requiring that prices be above average total cost, which is the condition for the product to be profitable overall sales. Prices could be below average cost but still above variable costs if fixed costs of production are high. At this point, the seller is making a loss but as long as prices are above variable cost, the supplier will be better off the more products are sold, and therefore it is not clearly unprofitable to hold prices at these low levels.
[8] Either effect can only be expected to occur only in industries in which economies of scale are significant, for example, those in which there are significant fixed costs of doing business.

The **second** condition for price discrimination to work is that the supplier must be in a position to impede arbitrage, i.e. the possibility for disadvantaged customers to buy from customers buying at lower prices. Often, the ability of customers to engage in arbitrage is clearly limited, due to inertia and lack of information favouring price discrimination.

It is important to appreciate that price discrimination can be positively beneficial in terms of allocative efficiency, since it may increase output.[9] Discrimination does not have to take place based on price only. For example, an enterprise that controlled the supply of a key input might supply a downstream enterprise with a poorer quality of service than it provides to its own business competing in the same downstream market (longer delivery times, for instance). If the difference in service quality were not reflected in the pricing by the upstream enterprise, the enterprise could be regarded as acting in a discriminatory way. As with the analysis for price discrimination, non-price discrimination will not necessarily be abusive. It would be abusive only where it harms (or is likely to harm) competition.

The Commission will adopt the approach that price discrimination which leads to an increase in sales should not be necessarily considered as anti-competitive, particularly taking into account that more customers will be supplied than with price uniformity. A possible result is that consumer welfare will increase (total welfare will increase in any case). However, if price discrimination results in a contraction of total sales, it has a negative effect on welfare.

7.3. RAISING RIVALS' COSTS

A form of abusive behaviour may be raising the costs of other competitors, thereby improving one's own competitive position. For example, a firm may invoke regulatory procedures – environmental permitting, land-use laws, etc. -- as a means of slowing or discouraging entry or expansion by its rivals. In discussing this sort of conduct, three conditions must be met for a firm to find it feasible and profitable to place its rivals at such a disadvantage. First, the value of the exclusion must be greater to the excluding firm than to the rival. Second, the rivals must not be able to find substitute suppliers which would restore their competitiveness. Third, the excluding firm must have some market power. (Ordover and Saloner, p. 566)

7.4. VERTICAL RESTRAINTS

Vertical restraints are restrictions imposed by either a buyer or seller operating at different stages of the production and distribution chain. Most vertical restraints are

[9] See Schmalensee 'Output and welfare implications of third-degree price discrimination' (1981) 71 American Economic Review 242

beneficial or benign, especially if there is effective competition at both the upstream and downstream levels. For example, vertical restraints can generate benefits through the promotion of efficiencies, non-price competition (to the benefit of consumers), and investment and innovation. The Commission will consider evidence of such benefits in its assessment; however, it will still be necessary for the dominant enterprise to show that its conduct is proportionate to the benefits produced.

A vertical restraint imposed by a dominant enterprise may be abusive where it harms (or is likely to harm) competition. Vertical restraints can take many forms, and again, it is important to note that it is the effect of the vertical restraint on competition, rather than its form, which will determine whether or not it is abusive.

A vertical restraint can be an agreement between a manufacturer and a retailer, a manufacturer and a wholesaler, a wholesaler and a retailer, a retailer and an end buyer or between two manufacturers (or wholesalers or retailers) which for the purposes of the agreement, operate at different stages in the production and distribution chain. Vertical restraints can either be imposed unilaterally by the dominant firm or made by agreement.

Vertical restraint imposed by a dominant enterprise may also affect entry and be considered as a barrier to entry. For example, a dominant manufacturer might have a series of exclusive purchasing agreements with most retailers in a particular geographic market. This might limit the ability of a new manufacturer to operate on a viable scale in that market and therefore deter entry.

7.5. FORECLOSURE

Anticompetitive foreclosure is said to occur when the conduct of a dominant (or monopoly) enterprise restricts or eliminates the effective access of actual or potential competitors to customers or supplies, to the detriment of consumers or the economy in general. Foreclosure may be of supplies: for example, when an upstream supplier refuses to sell or increases prices, to a specific downstream enterprise. It may be of customers: for example, when a downstream enterprise refuses to buy from an upstream supplier. It need not involve exclusive dealing, as in these examples, but could include conduct that has the effect of foreclosure – such as incentives for customers not to buy from rivals.

Anticompetitive foreclosure will only be held to occur if consumers or the economy more generally are harmed as a result of the effect on competition – not simply because competitors are harmed. In the remainder of this document ‘foreclosure’ should be read to mean ‘exclusion of competitors in a manner that damages consumers or the economy in general’, not simply ‘exclusion of competitors.

All of the practices described in this section would only constitute abuse of dominance if they have these effects. The practices described here should therefore not be taken to be prohibited for all businesses. In most cases, businesses' dealings with their customers or strategies to compete against their rivals will be in no way anti-competitive and are matters solely for the businesses concerned.

Complete foreclosure, driving competitors out of the market, may result in a less competitive market in the future and thereby lead to higher prices for consumers and/or less efficient production. Partial foreclosure may result in similar harm, if as a result of the foreclosure the competitor faces higher unit costs (perhaps because it cannot achieve economies of scale) or is otherwise less efficient and thereby less effective as a competitor. Foreclosure may also occur as a form of entry deterrence, preventing new competitors from coming into the market (perhaps by denying them the possibility of achieving sales sufficient to reach minimum efficient scale).

Foreclosure cannot, therefore, be expected to occur unless the industry in question exhibits economies of scale and barriers to entry or expansion.

The stronger the market power of the foreclosing enterprise, and the stronger the effect on foreclosed rivals, the more likely it is that foreclosure will be found to be anticompetitive.

In assessing foreclosure, the Commission will normally consider whether the conduct is likely to result in increased profits for the monopoly/dominant enterprise, as a result of reduced competition. Conduct which is not expected to result in higher profits is less likely to be considered to be anticompetitive foreclosure. Conduct that would only be profitable if it results in a reduction in competition is particularly likely to be considered to be anticompetitive.[10]

7.6. MARGIN SQUEEZE

The term margin squeeze (or price squeeze) is a convenient label for some forms of exclusionary abuse involving an interaction between two levels in a supply chain. This applies in particular to cases where the controller of an infrastructure facility with a dominant position seeks to "reserve to itself" parts of a related downstream market.

A margin squeeze is a form of exclusionary abuse characterized as follows:

- The firm accused of abuse operates as a vertically integrated entity over several levels of a supply chain.

[10] For example, refusing to purchase from a cheaper supplier is more likely to be considered anticompetitive than refusing to purchase from a more expensive supplier, as it is hard to see how the former conduct can be in the foreclosing enterprise's interests unless the behaviour results in a reduction in competition

- The firm holds a dominant position at one level of the supply chain — say, upstream.

- The firm faces competition or the prospect of competition, at another level of the supply chain— say, downstream.

- The firm has some influence on downstream market prices (this need not be a second dominant position).

- The relationship between the upstream price (set by the firm in a dominant position) and the prevailing price in the downstream market is such that a competitor or potential competitor is forced out of the downstream market.

A margin squeeze claim can be analyzed in two ways:

- As predatory abuse; or
- As a constructive refusal to supply.

Claiming predatory abuse in a margin squeeze situation involves showing that the prices offered by the accused firm in the potentially competitive market are so low that their object was to use the upstream dominant position to exclude one or more competitors from the downstream market.

This would need to rest on evidence that:

- The downstream pricing policy (considered on its own) involved a sacrifice of profits without an objective justification (e.g. promotional investment).

- Considered objectively, this sacrifice of profit could only have had as its object the elimination of a competitor from the downstream market.

- There is a risk that competitors will be eliminated as a result of the sacrifice.

- The upstream dominant position was instrumental in the elimination strategy (analyzed objectively) — for example, it might have been used to prevent some forms of downstream entry, or by funding downstream losses.

Claiming constructive refusal to supply would require evidence that supports a different set of assertions:

- The prices offered in the upstream market (under a dominant position) were higher than what could be objectively justified.

- Considered objectively, the object of these high upstream prices was to prevent one or more downstream competitors from gaining access to the upstream product.

- These competitors cannot operate competitively in the downstream market without effective access to the upstream product (as is the case, for example, if the upstream product is access to a monopoly network).

7.7. TYING AND BUNDLING

There is a variety of ways in which products can be packaged together by a single firm; these combinations are commonly categorized as tying and bundling. Tying occurs when a firm that produces two or more products requires a buyer to purchase more than one product as a condition of sale; in other words, the firm refuses to sell product A to a buyer unless that buyer purchases product B from the firm as well (and potentially products C, D, and so on).[11] Bundling typically refers to situations whereby products are sold together in fixed proportions, i.e., product A is sold in a package with product B (and potentially products C, D, and so on).[12]

Tying and bundling are ubiquitous in many, if not most, markets – cars, for example, are usually sold with four tires (a bundle of car and tires) and require service under warranty from the same manufacturer (a tie between products and service). Generally speaking, there are often strong cost efficiencies that motivate tying and bundling; it may be less costly for firms to manufacture and/or package products together, and it may be more convenient for consumers to purchase that package than search for each product. This convenience can also serve to increase demand among consumers who prefer to buy the products together. Tying and bundling may help firms achieve economies of scope, which often leads to higher quality products or lower total prices than if each product were forced to be sold separately and may also prompt firms to broaden their product offerings to maintain as complete a set of products as that of their competitors. Tying is also often used, like exclusive dealing, as a means of ensuring product quality and service levels, particularly in aftermarkets.

[11] Tying is often combined with contractual or induced exclusivity, so that the buyer must purchase all of its requirements for product B, now and potentially in the future, from the firm to purchase product A and not just a negligible amount. Tying may also be technological if a firm can use operational controls or compatibility requirements to enforce the tie, such as with software and hardware.

[12] Products A and B may or may not be available separately for sale. When products A and B are not available outside of a bundle (e.g., shoes and shoelaces), this is referred to as pure bundling. When they are available separately but the bundle is offered on more favourable terms than the sum of the individual products (e.g., fast food meal deals), this is referred to as mixed bundling.

In some cases, demand for a package of products may be sufficient such that that tie or bundle is no longer a combination of individual products, but a product market in itself.

Tying and bundling may also allow firms to engage in various forms of price discrimination. One rationale is metering demand, such as where a firm ties or bundles aftermarket products to the sale of the principal product. For instance, a firm that sells a printer may require that consumers also use that firm's aftermarket ink cartridges, either through technological restrictions or through exclusive supply arrangements. The net result is that the firm can charge more to high-demand consumers that use the printer more (i.e., require more ink cartridges). In some cases, the ability to meter can ensure that both low and high-demand consumers can purchase the principal product; if the firm can charge only a single price for its product and is unable to meter demand through tying, its profit-maximizing price may exclude low-demand consumers. If it can instead meter demand, it may be able to charge a lower price for the principal product.[13]

Aftermarket tying that creates exclusivity, such as the examples above of a car requiring service under warranty from the manufacturer and printers requiring ink cartridges from the same firm, is one of the most common forms of tying in consumer markets. As a general principle, aftermarket tying raises competition issues only under limited circumstances. While aftermarket tying may restrict third-party access to service a particular brand, a brand itself will not necessarily constitute a relevant product market if consumers see other brands and products as substitutes, and so the owner of a particular brand will not necessarily hold a dominant position. Where aftermarket tying is common across brands within a particular product market – i.e., most or all of the firms in a market engage in aftermarket tying – the Commission will examine the extent to which those firms compete for the customer in the first instance. If customers can choose between competing firms when buying the initial product and are widely aware of the subsequent aftermarket tying for that product, the Commission will consider customers as taking that condition into account when purchasing the initial product, and firms as competing amongst each other across several dimensions of competition, including aftermarkets, when attempting to capture that customer.

However, there are certain circumstances under which both tying and bundling can be anti-competitive if they can make it more difficult for non-tying/bundling rivals to compete. Theoretically, tying and bundling can be anti-competitive in two ways. First, to the extent that tying and bundling may raise the costs (or reduce the revenues) of non-bundling rivals, it may become more difficult to compete in the market(s) for standalone products, leading to the possible exclusion or disciplining of otherwise

[13] While metering can potentially improve firms' incentives to increase output and make products available, unlike the other efficiency reasons noted above, the motivation for tying in such a situation has not cost minimization, but rather the ability to efficiently capture consumer surplus at the margin. This may be associated with higher prices for at least some subset of consumers.

effective competitors. Second, by discounting a package of products, tying or bundling may constitute predatory conduct. Where that package of products is properly classified as a separate relevant product market (i.e., the bundle itself is seen as a single product, not a package of separate products), the Commission will analyze it as predatory conduct to determine whether the bundle, as a single product, is being sold below its total average avoidable cost.

One traditional concern with tying (which can hold for bundling as well) is "monopoly leveraging", where a firm with market power in one market attempts to achieve a similar position in an otherwise competitive second market by engaging in tying between two markets. This will only be considered as potentially anti-competitive if it can deter the entry or expansion of rivals in the second market.

Anti-competitive "monopoly leveraging" is possible only under certain conditions; as noted above, a necessary condition is that it artificially raises rivals' costs (or reduces rivals' revenues). For example, if the tie captures enough customers desiring both products to keep rivals from obtaining efficient scale or covering the fixed costs of serving only standalone customers, or if the tie raises rivals' costs or reduces their revenues by increasing consumer switching costs, for which consumers would have to be compensated, this theory may hold. In industries characterized by important fixed costs of production, this can also occur over time if tying discourages investment in research and development by competitors, or otherwise discourages potential dynamic innovation that would be profitable for competitors only if a larger portion of the market were contestable.

Where it appears that a firm with market power is engaging in tying for the purpose of an intended negative effect on a competitor (or competitors) without a valid business justification as discussed above, the Commission will examine the extent to which this may raise competitors' costs or reduce their revenues, with the result that competition in a market is substantially lessened or prevented.

Tying and bundling (particularly bundling) can also be viewed as direct price competition. Where it appears, a firm is selling a bundle of products primarily as a means of offering discounts to buyers, the Commission may choose to examine such conduct under a predatory standard, to avoid chilling legitimate price competition. In this case, the key issue is whether the appropriate relevant market definition is the entire set of products, or whether component products comprise separate relevant product markets. Where the bundle is determined to be a single product market, the Bureau will assess whether the total bundle, as opposed to individual products within the bundle, is below average avoidable cost. In such a case, the Commission will then examine whether this will result in a substantial lessening or prevention of competition, namely whether the bundling firm can engage in recoupment by raising the price of its bundle once its standalone competitors have been disciplined or eliminated. Where the appropriate market definition is separate products (for example, there are distinct

groups of consumers that purchase the bundle and purchase some or all of the products on a standalone basis), it may be more appropriate to assess the extent to which the bundling firm can raise the costs of rivals offering standalone products, as described above.

7.8. DISCOUNTS

Some forms of sales incentives can have similar effects to exclusive dealing requirements. Discounts and rebates which reward loyalty, for example, can induce customers to behave as if they had signed an exclusive dealing requirement.

Most forms of discounting and rebate are pro-competitive, as they represent healthy price competition. Discounts of less than 100 percent on additional sales volumes will not be considered to be anticompetitive. However:

a. Discounts relating to the share of a customer's business could be achieved by reducing purchases from rivals instead of increasing purchases from the discounting enterprise, and are therefore more likely to be considered to have foreclosure effects

b. Retrospective rebates, such as a rebate on all purchases over a year if the sales exceed a target threshold, may have foreclosure effects because they can result in very powerful incentives for a customer just below the threshold to increase purchases

c. Rebates only on the additional volumes above a threshold are generally not anticompetitive. However, a very high discount on additional volumes, so that the supplier is making a loss on those additional volumes, may be considered anti-competitive.

Such rebate schemes are not necessarily anti-competitive but might be if the effect is to foreclose rival enterprises to the detriment of consumers or the economy as a whole.

The key test for the Commission in assessing any discount scheme is whether it is profitable for the supplier, even without any effects on competitors. If a discount scheme depends for its profitability on reducing or eliminating competitors' market shares it is more likely to be found to be anticompetitive.

7.9. REFUSALS TO SUPPLY

Enterprises generally have the freedom to decide whom they will deal, or not deal with. Therefore, a refusal to supply, even by a dominant enterprise, would not normally be abuse. However, in certain circumstances, a refusal to supply by a dominant enterprise may be considered an abuse if there is evidence of (likely) substantial harm

to competition and if the behaviour cannot be objectively justified. Objective justifications might include the buyer's poor creditworthiness, or capacity constraints, for example.

A refusal to supply may constitute an abuse, for example, where a dominant enterprise stops supplying an existing buyer or withholds supplies from a new buyer, with the result of (likely) substantial harm to competition. A refusal to supply could result from a refusal to allow access to an essential facility.

As with refusals to supply in general, a refusal to allow access to an essential facility will constitute abuse only if there is evidence of (likely) substantial harm to competition and there is no objective justification for the dominant enterprise's behaviour.

In determining whether a refusal to allow access to an essential facility constitutes an abuse, and if so, on what terms access should be granted, care must be taken not to undermine the incentives for enterprises to make future investments and innovations, especially where the essential facility is a result of previous innovation.

It is not necessary for the dominant position, the abuse, and the effects of the abuse, to be in the same market.

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