CCM 4

Competition Commission of Mauritius Guidelines

MONOPOLY SITUATIONS AND NON-COLLUSIVE AGREEMENTS

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1. Introduction

1.1 These Guidelines deal with Sub-parts II and III of Part III of the Competition Act 2007: the restrictive practices described under 'Other restrictive agreements' and 'Monopoly situations'. Assessment of agreements referred to in Sub-part II is very similar to assessment of monopoly, and the focus is therefore on monopoly situations.

1.2 The Act creates threshold market shares below which enterprises are not considered to be in a monopoly situation. Markets shares will depend on market definition[1] and cannot be pre-judged. But given the size and relative isolation of the Mauritian economy it is reasonable to suppose that many enterprises will be above those thresholds, and therefore in a 'monopoly situation'.

1.3 The Act does not prohibit monopoly. It is not in itself any breach of the law for an enterprise to be in a monopoly situation but such enterprises have a responsibility to ensure they are not abusing or exploiting any market power this position confers upon them. The question for the CCM is whether such enterprises are engaged in conduct which restricts, prevents or distorts competition (such as using their market position to exclude rival enterprises) or otherwise exploiting the monopoly situation.

1.4 These sections of the Competition Act adopt a rather different approach from that taken in the two largest jurisdictions: the EU and the USA. There are similarities in both jurisdictions: the Article 82 prohibition (abuse of a 'dominant position') and 'Monopolization' under the Sherman Act, respectively . However, there is a key difference in approach. Both of these laws treat abuse of monopoly as an offence, to be deterred through penalties. The approach in Sub-parts II and III of Part III of the Competition Act 2007 is quite different: abuse of monopoly is treated instead as a problem to be remedied, not an offence to be penalized. Abuse of monopoly can only be identified and dealt with following a formal investigation by the CCM, which might then seek to remedy the situation but cannot impose fines or other penalties. As a result, the CCM's investigation will be more focused on the specific effects of any abuse of a monopoly situation, compared to the EU and US, and less on proving specific behaviour for which there is precedent for action.

1.5 Thus, although the guidelines and case-law from other jurisdictions can be helpful to understand the economics of abuse of monopoly, they should be read with this distinction in mind. In this area of its activities, the CCM will intervene to try to improve the workings of markets in Mauritius; it is not enforcing a 'prohibition'.

1.6 These guidelines should be read in conjunction with:

(a) *CCM 2: Market Definition and the Calculation of Market Shares*, which is relevant particularly to the calculation of market shares for the purposes of assessing whether a monopoly situation exists or a non-collusive agreement is reviewable, as well as to the assessment of dominance; and

[1] See *CCM 2: Market Definition and the Calculation of Market Shares.*

(b) *CCM 6: Remedies and Penalties*, which sets out the CCM's approach to determining remedies for monopoly situations and non-collusive agreements, among other restrictive practices.

1.7 These guidelines are not a substitute for the Act, the regulations or rules. They may be revised should the need arise. The examples in these guidelines are for illustration. They are not exhaustive, and do not set a limit on the investigation and enforcement activities of the CCM. In applying these guidelines, the facts and circumstances of each case will be considered. Persons in doubt about how they and their commercial activities may be affected by the Act may wish to seek legal advice.

2. Existence of a monopoly situation and action by the CCM

2.1 In this chapter, we set out some considerations the CCM will take into account, when deciding whether to investigate and whether to take action regarding monopoly situations.

(a) There must be a monopoly situation, as defined within the Act by reference to market shares. The CCM can only take action when market shares exceed these thresholds – below them is a 'safe harbour' within which no conduct can be investigated under the monopoly provisions[2]. This does not imply that market shares above these thresholds are necessarily problematic.

(b) To take action, the CCM must find that the conduct of an enterprise in a monopoly situation restricts, prevents or distorts competition or otherwise exploits the monopoly situation. We refer to such conduct as 'abuse of monopoly'. Where the Executive Director has reasonable grounds to believe that abuse is occurring, or will occur, he may launch an investigation.

(c) Within an investigation, the CCM will also consider whether the enterprise(s) has (have) a position of dominance. Dominance means the enterprise(s) have some market power, that by virtue of their position in the market they can act to some extent free of the constraints that competition would normally be expected to provide.

(d) The CCM will take into account whether the conduct has or is likely to have "an adverse effect on the efficiency, adaptability and competitiveness of the economy of Mauritius, or are likely to be detrimental to the interests of consumers".

2.2 In addition, the CCM need not take action, if it believes that to do so would eliminate benefits that arise as a result of the conduct[3]. This is a question that it will address when considering appropriate remedies, and is therefore covered in *CCM 6: Remedies and Penalties.*

2.3 The four areas of investigation above define monopoly situations and conduct that might create competition problems. In this chapter, we set out the CCM's approach to these four areas of investigation.

Market share thresholds for existence of monopoly

2.4 Section 46 (1) of the Act defines a monopoly situation, by reference to market shares as follows:

46 Existence of monopoly situation

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[2] Note that there is no equivalent safe harbour for collusive agreements. Enterprises fixing prices or otherwise agreeing not to compete can be investigated and may be fined, no matter how small their markets shares. See *CCM 3: Collusive Agreements.*

[3] As defined in Section 50(4) of the Act.

(1) A monopoly situation shall exist in relation to the supply of goods or services of any description where –

(a) 30 per cent or more of those goods or services are supplied, or acquired on the market, by one enterprise; or

(b) 70 per cent or more of those goods or services are supplied, or acquired on the market, by 3 or fewer enterprises.

2.5 These market shares must be based on a definition of the relevant market(s), as set out in the CCM's guidelines on market definition[4].

2.6 In defining the relevant market in monopoly cases, the CCM will be mindful that some products may appear to be close substitutes only because of high pricing by a monopolist. It may therefore be appropriate to consider whether the market would be narrower, if substitution were assessed at competitive price levels[5].

2.7 Note that a monopoly situation might exist for a small relevant market, as defined through market definition[6]. Similarly, relevant markets can be geographically local, if products are hard to transport, in which case an enterprise which is quite small in absolute terms[7] could in principle be in a monopoly situation in that local market. Thus, even enterprises which are not 'large', may be considered to be in a monopoly situation.

2.8 The process of market definition requires careful analysis of available data and qualitative evidence, not all of which will be available prior to, or in the early stages of, an investigation. The CCM's definition of the relevant market might therefore change as it receives information and conducts analysis.

(a) Before launching an investigation, the Executive Director must have reasonable grounds to believe that the thresholds are exceeded in the market(s) under investigation. As this decision must be taken before the investigation is launched, when the CCM's information-gathering powers are not available, relevant markets at this stage will normally be defined only provisionally, for example using qualitative evidence on the similarity of products. Similarly, market share information at this stage will often be very uncertain or lacking.

(b) If in the course of an investigation, the Executive Director becomes satisfied that no monopoly situation exists, because the relevant market definition or market shares are such that the thresholds are not exceeded, he will report that to the CCM and if the CCM agrees, a clearance decision will be issued.

[4] *CCM 2: Market definition and the Assessment of Market Shares.*
[5] See paragraph 2.20 of *CCM 2: Market definition and the Assessment of Market Shares.*
[6] Medical drugs, for example, may be in a market consisting only of a single product.
[7] Such as a shop or restaurant.

(c) At the end of an investigation, if it does take remedial action, the CCM when publishing the reasons for its decision will set out its evidence that a relevant market or markets exist within which the thresholds are exceeded.

Abuse of monopoly

2.9 The existence of a monopoly situation is not in any way a breach of the Act. The CCM is not required to investigate all monopoly situations that are brought to its attention. As Section 46(2) states:

> (2) A monopoly situation shall be subject to review by the CCM where the CCM has reasonable grounds to believe that an enterprise in the monopoly situation is engaging in conduct that –
>
> (a) has the object or effect of preventing, restricting or distorting competition; or
>
> (b) in any other way constitutes exploitation of the monopoly situation.

2.10 In the remainder of this document, we refer for convenience to these two forms of conduct as 'abuse of monopoly'. An enterprise in a monopoly situation has a responsibility to consider whether its conduct might be considered an abuse under the Competition Act. Note that conduct can be abusive in its effects, even if such abuse is not its intent.

2.11 Equally, any conduct that might otherwise breach Section 46(2) is not a breach unless a monopoly situation exists.

2.12 The two forms of abuse under Section 46(2) are rather different. Part (a) refers to the prevention, restriction or distortion of competition, while part (b) refers to 'exploitation'. The CCM, following international precedent, refers to the former as 'exclusive' conduct and the latter as 'exploitative' conduct. The CCM's approach to assessing these forms of abuse is set out in Sections 3 and 4 of these Guidelines, respectively.

2.13 Public concern often focuses primarily on exploitative conduct, as it is more direct in its effects. However, it is usually more effective for a competition authority to focus on exclusive conduct, so that its interventions promote competition, rather than dealing with the *effects* of a lack of competition. It can be difficult to distinguish exploitation from the normal functioning of a market economy: high prices can indicate abuse of monopoly, but there can be other reasons too.

2.14 The CCM will be cautious about launching investigations solely on the basis of exploitative abuse, where there is no suspicion that the conduct of the monopoly enterprise itself is restricting, preventing or distorting competition. However, as noted before, Mauritius as a small, isolated economy, is likely to have more industries in a monopoly situation than would a larger, less isolated economy. Persistent, long term pricing that is well above cost levels may constitute an abuse of monopoly.

Dominance

2.15 The assessment of whether the enterprise(s) under investigation has or have a position of dominance is an important part of a monopoly investigation.

2.16 Parts (a) to (c) of Section 46(3) of the Act effectively set out this assessment :

(3) In reviewing a monopoly situation, the CCM shall take into account –

(a) the extent to which an enterprise enjoys or a group of enterprises enjoy, such a position of dominance in the market as to make it possible for that enterprise or those enterprises to operate in that market, and to adjust prices or output, without effective constraint from competitors or potential competitors;

(b) the availability or non-availability of substitutable goods or services to consumers in the short term;

(c) the availability or non-availability of nearby competitors to whom consumers could turn in the short term;[...]

2.17 In some jurisdictions, the term 'dominance' is defined by reference to market shares. In the Act, it has the broader meaning set out in part (a) above, describing enterprises with some freedom from competitive constraints, market share thresholds having been set out separately.

2.18 Parts (b) and (c) describe the two main considerations that the CCM shall take into account in making the assessment in (a), namely whether substitute products already exist in the market and whether there are competitors able to enter the market to supply such substitute products. This assessment is aimed at understanding the competitive constraints – if any – on the monopoly enterprise(s). It is not an assessment of whether there are 'enough' products for consumers to get a good deal.

2.19 Much of the assessment in (b) will have been carried out in the market definition exercise. If there are few, or no, competing products within the relevant market as defined through that exercise, then by definition there will be few or no substitute goods within the meaning of part (b). Other things being equal, an enterprise is more likely to be dominant, the fewer rivals it has in the relevant market. An enterprise in possession of a high market share may be considered more likely to be dominant than one with a smaller share. The CCM might also consider measures that summarise the *distribution* of market shares, such as the share of the top 3 or 4 suppliers combined or the HHI.

2.20 However, assessment of the number of suppliers, market shares and related indices of concentration is not determinative. In some cases, an enterprise with a high market share might not be dominant and in others enterprises even with relatively low shares of a broadly-defined market might be dominant at least in part of that market. For example, in an industry in which customers can very easily switch to essentially identical products from alternative suppliers, and those suppliers can easily

meet that increased demand, even a small number of competitors might be enough to prevent an enterprise being dominant and an enterprise holding a large market share in such an industry might have little or no market power. Similarly, in an industry experiencing rapid change, such as one with rapid technological progress, a n enterprise might temporarily posses a high market share but no sustained market power. At the other extreme, when products are quite differentiated (eg branded goods), the possessor of one such product may be dominant, even if there are other, similar, goods.

2.21 The power of large buyers might also prevent an enterprise enjoying a dominant position, even if its markmet share is high and the industry is concentrated. The CCM will consider whether market power on the buyer side protects large buyers from exploitation by suppliers who would otherwise have market power and, where relevant, whether such buyer power also protects smaller suppliers (for example, by ensuring market-wide low prices).

2.22 The test of dominance is the ability profitably to adjust prices or output, acting to some degree independently of competitive constraints. It is not simply an exercise in assessing market shares.

2.23 In assessing (c), the CCM will consider whether competitive forces arising from possible entry are so effective as to prevent the emergence of market power in the relevant market. In markets where entry is easy, no enterprise can be found to be dominant. 'Easy entry' does not merely require there are no legal or other impediments to entering the market: the CCM must expect that entry would occur rapidly in the event of any enterprise seeking to exercise its dominance to raise prices, and thereby defeat that price rise.

2.24 The CCM's approach to assessing entry is set out in detail in its merger guidelines, and is not repeated here[8].

Adverse effects

2.25 The last part of Section 46 requires the CCM to take into account:

> "(d) evidence of actions or behaviour by an enterprise that is, or a group of enterprises that are, a party to the monopoly situation where such actions or behaviour that have or are likely to have an adverse effect on the efficiency, adaptability and competitiveness of the economy of Mauritius, or are likely to be detrimental to the interests of consumers. "

2.26 The CCM takes the view that, in most markets, free competition is an effective guarantor of the interests of consumers and is likely best to promote the efficiency, adaptability and competitiveness of the economy of Mauritius. Significant weakening of competition will therefore have adverse effects. Consequently, if the CCM finds evidence of behaviour that is preventing, restricting or distorting competition, on the part of an enterprise with market power, in a monopoly situation, it will normally expect that such behaviour will have one, or all, of the adverse effects referred to above. It will not

[8] *CCM 5: Mergers*

therefore necessarily spell out in detail the mechanisms by which consumers or the economy generally will be harmed.

2.27 However, if the CCM believes that the conduct does not, and is not expected to, result in any of the adverse effects specified in Section 46, it will not normally take action against the conduct, even if the conduct does adversely affect an enterprise's competitors. This is in line with international practice: the purpose of competition policy is to protect competition, not to protect competitors. It will not be enough for a complainant to demonstrate that his business is being harmed by some exclusive practice; there must be a significant enough effect on competition itself for consumers or the economy to be harmed.

3. Restrictive practices (1): Exclusionary abuse

3.1 In this section, we set out the approach the CCM will take to assessment of exclusive conduct. This is the conduct described in Section 46 where

"an enterprise in the monopoly situation is engaging in conduct that

(a) has the object or effect of preventing, restricting or distorting competition[...]"

3.2 Section 46 of the Act does not specify any particular forms of conduct by an enterprise in a monopoly situation that will be considered restrictive practices. There is no check-list of practices that enterprises can simply avoid. The approach is instead to consider the object or effect of the conduct on competition. There are no forms of conduct which are necessarily abusive. However, the assessment of conduct need not be made entirely from first principles. There is an established body of economic analysis and examples from authorities in other jurisdictions, on which the CCM can draw in making its assessment, although it will not regard any such examples as fixed 'precedent'.

3.3 When assessing whether conduct by an enterprise in a monopoly situation constitutes an exclusive restrictive practice, the CCM will consider the state of competition were the practice not to occur. If, even in the absence of the conduct, the CCM would not expect the market to be any more competitive, or result in better outcomes, the conduct will not be considered a restrictive practice.

3.4 The CCM is mindful of the fact that in some cases it can be very difficult to distinguish anticompetitive exclusionary conduct from the normal process of competition, in which competing enterprises seek to gain sales from one another. Excessive concern to prevent exclusionary abuse can run the risk of penalizing competitive behaviour, or – worse – discouraging that competitive behaviour in the first place. Enterprises which are successful because their prices reflect low costs, or because their products and services are valued by consumers, should not be concerned about possible competition investigations. In assessing conduct, the CCM will be concerned not to penalize vigorous competition, as to do so would harm the economy. As noted before, damage to competitors does not of itself indicate a competition problem.

Foreclosure

3.5 'Anticompetitive foreclosure' is said to occur when the conduct of a monopoly enterprise restricts or eliminates the effective access of actual or potential competitors to customers or to 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 which has the effect of foreclosure – such as incentives for customers not to buy from rivals.

3.6 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'.

3.7 All of the practices described in this section would only constitute abuse of monopoly 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.

3.8 Complete foreclosure, driving competitors out of the market, may result in a less competitive market in the future and thereby lead to higher prices to consumers and/or to 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).

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

3.10 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.

3.11 In assessing foreclosure, the CCM will normally consider whether the conduct is likely to result in increased profits for the monopoly 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[9].

Exclusive dealing

3.12 Anticompetitive foreclosure may arise through exclusive dealing – preventing competitors from selling to customers through the use of exclusive purchasing obligations or rebates.

3.13 In general, customers signing an exclusive contract with a supplier will have done so in the knowledge that they are thereby limiting their choice in the future. This is not in itself an abuse, but might be if it is expected to result in anti-competitive foreclosure. Thus, the CCM will consider the effects of any such exclusive dealing requirements on competitors.

[9] 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.

3.14 Normally, terms of any exclusive deal will be favourable to consumers signing it, as presumably they could choose not to do so. However, this does not imply that exclusive dealing will necessarily be in the interests of consumers as a whole. If the foreclosure results in an irreversible loss of competition, then the interests of future consumers might be damaged. Furthermore, for anticompetitive foreclosure it may not be necessary for all consumers to sign exclusive deals.

Incentive and discount schemes

3.15 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.

3.16 Most forms of discounting and rebate are pro-competitive, as they represent healthy price competition. Discounts of less than 100 per cent 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[10].

(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[11].

(c) Rebates only on the additional volumes above a threshold are generally not anti-competitive. 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.

3.17 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.

3.18 The key test for the CCM 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.

Vertically-integrated enterprises: refusals to deal and to buy

[10] A scheme whereby a discount is available only if 75% (or 100%) of a customer's purchases are sourced from one supplier may be anti-competitive because the effect is to squeeze rivals' sales directly, rather than simply promoting the business's own sales.

[11] This describes a situation in which, if the customer buys – say – 101 units, he receives a discount not just on the 1 unit over a threshold of 100, but on all 101 units. At even a 1% additional discount, the 'price' of that last unit in this example is less than zero, which could have anticompetitive effects.

3.19 Vertically-integrated enterprises are those which bring together buyers and sellers in a supply chain under common ownership. Vertical integration can be a considerable form of efficiency. In some industries, a high degree of vertical integration maybe essential. Sometimes, different suppliers in an industry can operate at different degrees of vertical integration without necessarily suffering a competitive disadvantage[12]. Businesses cannot, therefore, be defined as 'vertically integrated' or 'not vertically integrated'. All businesses will make arrangements internally for some activities and externally for others.

3.20 A vertically-integrated business which has a monopoly position at one level of its business, but faces (or might potentially face) competition at another, might use its market power to foreclose rivals in the competitive market and in some circumstances this could lead to consumers or the economy as a whole being worse off as a result of a loss of competition.

3.21 This could take the form of a refusal to buy or a refusal to supply.

3.22 The CCM starts from the position that any enterprise should have the right freely to choose its trading partners, especially when deciding from which source to buy. It is up to enterprises to decide for themselves what to buy in and what to produce in-house. The CCM will therefore investigate refusals to buy only where it has reasonable grounds to believe that a significant monopoly is thereby protected in an upstream business that would otherwise be competitive, yielding better value for consumers downstream.

3.23 Refusals to supply are more likely to be anti-competitive, but again the CCM will proceed with caution. In general, it is perfectly legitimate for businesses freely to decide whether to supply a potential customer or not, and on what terms. A refusal to supply is most likely to be anti-competitive only where it concerns an essential upstream input, over which a supplier exerts significant market power, without which competitors to that supplier's downstream business are at a serious disadvantage. For example, if the only local source of an input (such as lumber) were monopolized, and imports were significantly more expensive, a refusal to deal could significantly reduce competition in various downstream markets. Similarly, a refusal to provide access to an essential facility (such as a dock) might have the effect of anti-competitive exclusion downstream, and thereby constitute abuse of monopoly.

3.24 A refusal to supply is more likely to be considered as an abuse by the CCM when an existing supply arrangement has been terminated, than when a potential customer is refused for the first time. If an existing customer has made specific investments effectively committing to that source of supply, then a refusal to deal is likely to have particularly adverse effects on that customer, and might therefore be more likely to have adverse effects on competition overall.

In addition to these possible exclusive effects, refusal to supply by an upstream monopolist may be an exploitative abuse, creating artificial

[12] For example, some sugar growers operate their own refineries, others pay for access to refineries.

scarcity of a product in order to drive up the price. See Chapter 4. Tying and bundling

3.25 If the sale of one product is conditional on the sale of another, the products are said to be 'bundled' or 'tied' together (the former term is normally used when neither product can be bought separately)[13].

3.26 Tying and bundling are normal business practices that are not by any means necessarily anticompetitive. Many products are sold jointly, or in varying combinations. Indeed, in a sense all products are 'bundles'. It would be inefficient and unworkable to try to prohibit cars being sold as 'bundles' of engine, body, wheels and tires.

3.27 However, in some cases bundling might be used anti-competitively. If an enterprise has market power in the sale of one product (for example a 100% market share), but sells another in more competitive markets, then it might 'leverage' market power to reduce competition in the second market. To the extent customers have to buy the monopolized (tying) product, they are forced in effect to buy the other (tied) product, reducing the sales of competitors for that second product. This is not in itself anti-competitive. However, if this irreparably damages those competitors or forces them out of the market, this might damage competition itself and therefore be regarded as anti-competitive foreclosure.

3.28 The CCM is more likely to find that such bundling and tying is anticompetitive, the stronger the market power of the tying product.

3.29 Market power will sometimes be particularly strong where the tying product has legal protection, for example as a result of intellectual property rights. In general, enterprises holding IP rights are free to do what they want with their property – and price it as they want. However, the CCM does not regard the general exclusion for agreements relating to IP rights as allowing 'leverage' of market power from one market to another in this manner[14].

3.30 In all cases, the CCM would examine the effects of any tying and bundling arrangements, according to the specific facts of the case. Again, a key test will be whether the tying and bundling seems to have a purpose other than anti-competitive foreclosure[15].

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[13] This might be explicit such as a food supplier requiring a supermarket to purchase its full range of foods, if the supermarket wants to carry any one of its items. Alternatively, it might simply be the way the product is packaged: buying the mobile phone handset together with a service.

[14] See discussion of Intellectual Property Rights *CCM 7: General Provisions*.

[15] If, for example, the seller realizes substantial cost savings as a result of selling two products together, or customers value the convenience associated with buying the products together, the conduct is less likely to be found to be anti-competitive.

Predatory pricing

3.31 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, in order to exploit customers in the subsequent period in which competition is weakened or eliminated.

3.32 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 CCM 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 future, for fear of being investigated.

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

3.34 The Competition Commission endorses this approach. It 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.*

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

(a) the pricing strategy must be clearly unprofitable for the alleged predator[16] 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[17];

(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[18]; and

(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

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[16] 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.

[17] 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 over all 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.

[18] 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.

to eliminate a rival, if the resulting monopoly cannot sustain high prices because rivals simply enter again.

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

4. Restrictive practices (II): Exploitative abuse

4.1 In this section, we set out the approach the CCM will take to assessment of exploitative abuse. This is the conduct described in Section 46 where

"an enterprise in the monopoly situation is engaging in conduct that [...]

(b) In any other way constitutes exploitation of the monopoly situation."

4.2 This is to be distinguished from exclusive conduct. Exploitative abuse is a monopolist benefitting from an absence of effective competition, whether or not that monopolist's own conduct created it.

4.3 In many cases, the CCM will be investigating cases in which both forms of abuse are alleged – exclusive conduct restricting, preventing or distorting competition and exploitation of the resulting lack of competition. In these circumstances, as the CCM;s remedies are likely to focus more on promoting competition by eliminating or counter-acting the exclusive conduct

4.4 There are two broad categories of exploitative abuse: unilateral market power and co-ordinated effects (or 'tacit collusion').

Unilateral market power

4.5 Enterprises in a dominant position face an economic incentive to exploit their customers. This will normally manifest itself in excessive prices, although it may also appear as reduced quality, choice or service – poor product offerings that may reduce costs or managerial effort, in a way that would not be possible for an enterprise facing competition. In the discussion that follows, 'excessive pricing' should be understood as shorthand for a poor value offering to customers more generally.

4.6 It can be very difficult for competition agencies to distinguish between normal and excessive pricing. Attempts simply to relate prices to costs can be misleading, if they fail to take account of different categories of cost, risk, the need for seasonal or other variations in prices. Furthermore, high prices can themselves stimulate competition to remove the monopolist's advantage.

4.7 The CCM is not a price regulator, and the Competition Act does not require or empower it to examine all prices to test whether they are cost-related or, more broadly, fair. However, in a small and isolated economy, strong monopolies can persist without any specifically exclusionary behaviour to create or preserve that position on the part of the monopolists. In situations of substantial market power which are not expected to be eroded by entry or expansion by rivals, persistent pricing substantially in excess of cost may be considered exploitative.

4.8 In comparing prices to costs, the CCM will normally consider the returns that the enterprise is making on an asset base, valued appropriately at replacement cost, including if appropriate intangible assets such as intellectual property rights. This valuation might differ substantially from the valuation in the enterprise's own accounts, or from that using general accepted accounting principles. Assessed

against this asset base, returns *persistently* and *substantially* in excess of the cost of capital could be considered excessive profits, pointing to exploitation of a persistent monopoly.

4.9 Where appropriate, the CCM will also conduct price comparisons. If prices are persistently and significantly lower in other markets, where costs should be similar, that might indicate that in the market under investigation, they are excessive. If prices have risen from a stable level to a higher level, without any equivalent movement in costs, that might also indicate excessive pricing. Even such a price spike, however, can indicate an effective competitive response to sudden changes in demand or supply conditions.

Tacit collusion

4.10 In some markets, a small number of enterprises might collectively be dominant, in that they could keep prices high if they do not compete against one another. Any clear understanding not to compete would be a breach of the prohibition on collusive agreements[19]. However, even in the absence of such an understanding, enterprises might become aware of their mutual dependence and soften competition against one another, to maintain profits or simply in the interest of a quieter life. This situation is sometimes termed 'tacit collusion' (to distinguish it from active collusion).

4.11 In normal competitive markets, such behaviour would rapidly result in lost sales and lost profits, as the rivals to an enterprise maintaining high prices undercut those prices. Either the existing parties to the informal understanding would act on the incentive to take business from one another, or existing small suppliers or new entrants would rapidly expand sales. In order to sustain tacit collusion, therefore, it is necessary that the participating enterprises have the ability and incentive to persist with their uncompetitive behaviour, rather than undercut one another, and that new entrants or smaller fringe players have only limited scope to take market share.

4.12 For tacit collusion to be sustained, therefore, all three of the following conditions must be present in the market:

(a) It must be possible for enterprises engaged in tacit collusion to reach an implicit agreement about the price level, and to monitor compliance, becoming aware if any among them undercut it;

(b) It must be in each of the participating enterprises' interests to maintain the tacit collusion, for example through credible threats to launch a price war if one of the enterprises undercuts the collusive price ; and

(c) Constraints from rivals outside the co-ordinating group (eg fringe players or new entrants) must be weak.

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[19] See Guidelines on collusive agreements. Note that the Act provides a broad definition of 'agreement' that is not limited to explicit, written agreements.

4.13 In considering possible tacit collusion, the CCM will assess whether these three conditions are present in the market. If they are not, it will conclude that tacit collusion is not occurring. If they are, it will consider whether market outcomes show that enterprises are not competing effectively, particularly by foregoing apparently profitable opportunities to undercut one another's prices and take one another's market share. Evidence such as price-cost comparisons, the stability of market shares or stable or parallel price levels over time may be helpful in this regard, although none of these indicators is decisive as all can also occur in competitive markets.

4.14 Tacit collusion is not an 'offence' reflecting deliberate flouting of the Competition Act, as a breach of the collusive agreements prohibition might be[20]. There is no possibility of penalties under the Act for tacit collusion. Instead, it is a state of the market, reflecting a monopoly situation, that the Competition Commission would seek to remedy going forward.

[20] Although if it finds tacit collusion to be occurring, the CCM will investigate whether any of the enterprises involved have acted deliberately to create the collusive outcome – which might result in action being taken under the collusive agreements prohibition.

5. Price discrimination

5.1 Price discrimination is the practice of charging different prices to different customers for reasons unrelated to cost differentials. Price discrimination is not in itself anti-competitive and the CCM will not regard it as an abuse. Price discrimination can be an efficient way of recovering fixed costs: charging the more price sensitive customers the lowest profitable price at or close to variable cost, while charging higher prices to less price-sensitive customers to make a margin to cover fixed costs. Price discrimination is a normal business practice in a range of industries, including highly competitive ones.

5.2 Price discrimination may, however, be part of a strategy that is an abuse. If some customers are charged low prices and others high prices, the low prices might be predatory, or the high prices might be part of a margin squeeze strategy against downstream competitors, or might indicate excessive pricing by an exploitative monopolist. Such pricing behaviour would be investigated by the CCM according to the guidelines on those specific abuses as set out in the previous chapters, however, not as 'price discrimination' *per se*.

6. Non-collusive agreements

6.1 Sections 44 and 45 of the Act define the second class of restrictive practice under the Act: non-collusive agreements. These agreements may be horizontal (between competing enterprises, or enterprises and their potential competitors) or vertical (between enterprises at different levels of the supply chain). These restrictive practices are treated more like monopoly situations than like collusive agreements. For example, if they generate offsetting public benefits they may be reviewed under Section 50 of the Act on the assessment of restrictive practices, which treat non-collusive agreements together with monopoly situations and mergers, rather than with collusive agreements. In addition, Section 60 of the Act treats non-collusive agreements together with monopoly situations for the assessment of remedies, so there is no scope for penalties as there is for collusive agreements.

Non-collusive horizontal agreements (Section 44)

6.2 Section 44 of the Act provides for review of a horizontal agreement that is not collusive "where –

> (a) The parties to the agreement the parties to the agreement together supply 30 per cent or more, or acquire 30 per cent or more, of goods and services of any description on the market; and
>
> (b) the CCM has reasonable grounds to believe that the agreement has the object or effect of preventing, restricting or distorting competition.

6.3 Part (a) effectively translates the monopoly situation thresholds into a collective setting. The CCM will interpret this section accordingly. The CCM will investigate agreements under this provision, and take action if necessary, if they have the object or intent of promoting behaviour among the participating enterprises, or achieving outcomes, that the CCM would find to be an abuse of monopoly if the participating enterprises were a single enterprise.

6.4 For example, agreements that had the object or effect of excluding rivals from the market[21] could be in breach of this provision, if the participating enterprises collectively had a market share of 30% or more, even if none of them individually were over that threshold. The CCM might take action to prohibit such agreements if it believes that the standards have the object or effect of creating a barrier to entry that is not justified by any public benefits assessed under Subsection (4) of Section 50 of the Act. This is similar to an exclusionary abuse under the monopoly provisions of the Act.

6.5 Only agreements found to be non-collusive will be treated in this way. An agreement to fix prices at a high level might be equivalent to an exploitative abuse of monopoly, but as a collusive agreement it would be dealt with under Section 41 and fines may be levied. Horizontal agreements that might be evaluated under Section 44 are those which potentially generate the types of public

[21] Such agreements might include, for example, the setting of technical or other standards between enterprises.

benefits set out in Section 50(4). An example of a type of agreement which might meet these criteria is an agreement between two enterprises whereby each would specialize in the manufacture of certain products in a way that allows them to exploit significant economies of scale, but which limits their ability and incentive to cooperate on prices or quantities. Another potential example is an agreement to establish a product standard.

Vertical agreements not involving resale price maintenance (section 45)

6.6 Section 45 of the Act states that "vertical agreement that does not involve resale price maintenance may be reviewed where the CCM has reasonable grounds to believe that one or more parties to the agreement is or are in a monopoly situation that is subject to review under section 46."

6.7 The CCM regards this section as clarifying that investigations of monopoly situations under Section 46 may include the review of vertical agreements concluded with parties that are not in a monopoly situation. Section 50 clarifies that the purpose of such review is to assess whether the agreement has the object or effect of preventing, restricting or distorting competition. The CCM believes that such agreements may in any case be assessed under the monopoly provisions of Section 46 as 'conduct' (that has the object or effect of preventing, restricting or distorting competition) and therefore does not expect to conduct investigations explicitly under this Section of the Act.

Competition Commission of Mauritius

7 Maupin St
Port Louis
Republic of Mauritius
Tel: (230) 211 2005
Fax: (230) 211 3107
Inquiries: info@ccm.mu
www.ccm.mu

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