

NATIONAL STOCK EXCHANGE vs. COMPETITION COMMISSION OF INDIA- A PRICING BATTLE BETWEEN STOCK GIANTS

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ABSTRACT

The present case review involves the ongoing legal battle between two of the largest stock exchanges in India- National Stock Exchange (NSE) and Multi Commodity Exchange (MCX-SX). MCX-SX had filed a complaint before the Competition Commission of India (CCI) alleging that NSE had abused its dominant position by practicing predatory pricing in stock exchange services in India.

Competition Commission of India (CCI) in June 2011, passed an order, holding NSE guilty of unfair pricing and abusing its dominant position in the stock market to attract more business. CCI directed NSE to levy charges in its currency derivatives segment, and also imposed a penalty of Rupees 55.5 crores on NSE. Following the order, NSE started to levy charges on all currency derivative trades from August, 2011 and challenged the order of CCI at the Competition Appellate Tribunal (COMPAT).COMPAT also upheld the order of CCI passed against NSE along with the penalty of Rupees 55.5 crores. Now NSE can file an appeal in the Supreme Court challenging COMPAT's decision within 60 days from the date of communication of the order to NSE.

The present case review first deals with the history of the case, the Director General's Report, then with overview of the decision of the CCI and COMPAT and finally presents a critical analysis of the decision of COMPAT. The authors have done a doctrinal research relying upon secondary data such as case laws, books and journals.

Keywords- Competition Law, Predatory Pricing, National Stock Exchange, Multi Commodity Exchange, Capital Market, Currency Derivative Segment.

INTRODUCTION

India's largest stock exchange, National Stock exchange (NSE) was once again found guilty of abuse of dominant position in Currency Derivative (CD) segment by the Competition

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Appellate Tribunal (COMPAT), which upheld the decision of the Competition Commission of India (CCI) which had charged NSE with a penalty of Rupees 55.5 crore which is 5% of the average annual turnover of the past three years and was also asked to cease and desist from predatory pricing policy by modifying its zero price policy and ensure that appropriate transaction costs are levied.

The Director General of the Competition Commission had carried out an investigation and had found NSE guilty of abusing its dominant position. NSE was penalized with a fine of Rupees 55.5 crores by the CCI and this was upheld by the Competition Appellate Tribunal (COMPAT) on appeal. Various economic concepts and tests were used to determine whether the NSE had abused its dominant position. But there were also various economic approaches that the CCI did not use and it could have used more rigorous standards to determine the same. The minority judgment of the CCI termed the majority opinion as adversarial in approach.

This case is of immense importance because of the fact that there have been no previous judgments, in relation to the interpretation of different services offered by the stock exchange services as a separate relevant market. Whatever may be the outcome of this legal battle, one thing is clear that the NSE versus MCX-SX matter would go down as a benchmark case in the Indian financial services industry.

BRIEF FACTS OF THE CASE

The two main parties involved in this case were the MCX-SX and NSE. Both MCX-SX and NSE are among the top three stock exchanges in India. NSE operates on all four segments: equity, F&O, wholesale debt market and currency derivative segment while MCX-SX is exchange platform for trades in currency derivative segment.

The case dates back to 2009 when MCX-SX had filed complaint under Section 19 (1) (a) of the Competition Act, 2002 before the CCI, alleging that NSE had abused its dominant position by practising predatory pricing¹ in Stock Exchange services in India, as NSE was

¹Predatory pricing is an anti-competitive practice when a dominant firm in a relevant market charges a price below its cost of production, over a long enough period of time with the intent of driving a competitor out of the market.

levying zero transaction fees only in the CD segment while charging transaction fees on the other segments. In order to stay afloat, MCX-SX had no option but to give waiver on the transaction fees in the CD segment and thereby incurring losses. It was also urged that NSE was using its dominance in the non-CD segments to enter into and protect its position in the CD segment and was also causing denial of market access to Financial Technologies of India Ltd. (FTIL) from offering its software ODIN in the Currency Derivative (CD) Segment.

The Commission considered that prima facie a case exists and referred it to the Director's General's office for investigation.

DIRECTOR GENERAL'S REPORT

The Competition Act prescribes a three-step test for the determination of abuse of dominance:

1. Defining the relevant market
2. Assessing dominance in the relevant market
3. Establishing abuse of dominance.

According to DG the geographical relevant market was India and the product market was the 'services offered by the stock exchange'. The Director General while considering the relevant market came to the conclusion that stock exchange services in India including equity F&O, WDM and CD but excluding Over-the-Counter (OTC) market, constitute the relevant market in the present case.²

In foreign jurisdictions, the concept of relevant market is examined through the Small but Significant Non Transitory Increase in Price (SSNIP) Test, but the DG found that the SSNIP Test is irrelevant and not reliable in the present case.³

Once the relevant market had been defined the next step was to assess its dominance.

Competition Act provides a checklist of factors, to assess if the enterprise is enjoying dominance in the relevant market.⁴ The DG looked at the following aspects, to assess if NSE was a dominant player in the relevant market:

²National Stock Exchange of India Ltd. vs. CCI&Anr., Appeal No. 15 of 2011, at para 21.

³Supra note 2 at para 20.

1. Position of strength.
2. Ability to operate independently of competitive forces.
3. Ability to influence the competitors or consumers to its advantage.⁵

On account of the factors such as size and resource of the enterprise, size and importance of the competitors, vertical integration and dependence of consumers on NSE and presence of high entry barriers, the DG found NSE to hold a dominant position.

On the issue of abuse of dominance, the DG examined the behaviour of NSE as below:

1. Transaction fee waiver.
2. Admission fee and deposit level waivers.
3. Data feed fee waiver.
4. Exclusionary denial of integrated market watch facility.⁶

As regards the transaction fee waiver, NSE argued that the waiver was done in the CD segment to encourage larger participation, as the currency futures were at a nascent stage. But DG took note that the NSE did not have any historical precedent of waiving the transaction fee to develop a nascent market.⁷

As for the admission fee, the DG found that NSE charged fee for all the segments, except for the CD segment. NSE also does not collect any subscription charges and advance charges in respect of CD segment. The amount of deposit was also reduced, to which NSE argued that when MCS-SX commenced business, it had set a very low interest-free security deposit of only Rupees 2 Lakhs as against NSE requirement of Rupees 10 Lakhs, and this forced NSE to reduced its own deposit fee.

However, from examination of documents of NSE, the DG report observes that NSE reduced deposit structure w.e.f. November 28, 2008 which was subsequently followed by MCS-SX from January 13, 2009. Thus, as per DG report, even here it was NSE that took the first step.⁸

With regard to data feed⁹ fee waiver, it was alleged that NSE is not charging any fee in respect of its CD segment right from the beginning. The DG from the past circulars and from

⁴Section 19(4) of the Competition Act, 2002.

⁵Supra note 2 at para 22.

⁶MCS-SX Ltd. &Ors. vs. NSE &Ors., Case No. 13/2009 at para 5.16.

⁷Supra note 2 at para 31.

⁸Supra note 2 at para 32.

the minutes of the meetings of NSE found that NSE, along with its wholly-owned subsidiary DotEx, completely waived the data feed fee from the beginning.

And lastly with the issue of NSE's exclusionary denial of integrated market watch facility, it was found by DG that, Financial Technologies of India Ltd (FTIL) is engaged in the business of developing and supplying software for financial and securities market. The main software product of FTIL is ODIN, which FTIL supplies to MCX-SX and is also used by various members of NSE, BSE and Intellectual Property Companies. Omnesys, who is also in the similar business as FTIL developed a new software NOW as a substitute to ODIN used by NSE. DotEx which is a wholly-owned subsidiary of the NSE owns a stake of 26% in Omnesys.

Hence Omnesys became subsidiary of NSE. Later DotEx offered programme NOW to NSE free of cost for a year and placed ODIN on watch list across all its segments. The proposal was accepted by NSE and NSE further refused to share its CD segment Application Programme Interface Code (APIC) with FTIL, thus disabling the ODIN users from connecting to the NSE'S CD segment trading platform through their preferred mode. APIC is an essential facility to connect front end application of NOW with any other application such as ODIN, which constitutes the electronic trading platform of the stock exchanges. This has allegedly caused difficulties, as clients had been using ODIN for all other segments in the past. As a result, FTIL clients have been forced to establish a separate terminal for trading on CD segment of NSE using the newly developed NOW.¹⁰

In this regard, NSE submitted before the DG that it had placed ODIN on watch list due to complaints of its members and their constituent clients. From the statements recorded, no evidence was found to justify the claim of NSE that ODIN was put on watch list due to performance issues. Based on the facts gathered, the investigation report concluded that the actions of NSE can be considered to harm the competition as it results in exclusionary denial of integrated market watch facility.¹¹

Hence DG's report found NSE abusive on all the four counts.

⁹Data feed refers to providing prevailing market prices and data for the segment by the stock exchange for significant consideration. The vendors display this information on their subscriber's terminals. The data fee is a significant source of income for the stock exchanges.

¹⁰Supra note 6 at para 5.33 and 5.34.

¹¹Supra note 6 at para 5.37.

DG then analysed if NSE had engaged in predatory pricing and in this relation looked at the 2009 Regulations for determination of cost of production and report of RBI-SEBI and held that the variable cost in the present case is not zero, as claimed by the NSE, rather a better measure to determine the issue was considering average total cost or average incremental cost, which clearly showed a case of predatory pricing in the present case.¹²

On the issue of leveraging the DG report held that NSE by not charging transaction fee is subsidising activities in CD segment which is open to competition and is using its monopoly profits to leverage its position. NSE is also creating barriers for users of ODIN software by not providing APIC to its own software NOW and thus NSE has abused its position of strength in the non CD segment to protect its position in the CD segment.¹³

Accordingly the DG's report concluded that the conduct of NSE was exclusionary and foreclosed competition in the Indian capital market, specially the CD segment.¹⁴

ORDER OF COMPETITION COMMISSION OF INDIA (CCI)

After two years of investigation and inquiry, the CCI passed an order on 23-06-2011 under Section 27 of the Act and via 4:2 majority found NSE guilty.

The major issue for analysis before the CCI was whether NSE merely occupying a position of strength in the other markets, could be considered a dominant player in the Currency Derivative market wherein it occupied only 33.17% of the market share while the market share of MCX-SX in CD segment was comparatively higher than NSE. The CCI has found that the NSE holds a dominant position although it holds only the third largest market share in the relevant market. The CCI has also found that the zero pricing policy followed by NSE in one segment of business by cross subsidising from another segment of business where it is also dominant is an abuse.

In the relation of predatory pricing CCI finds that predatory price is a subset of unfair price and held that that MCX-SX operates only in the CD segment and has no other sources of income unlike the NSE and as NSE and MCX-SX are not on an equal footing in terms of

¹²Supra note 2 at para 34.

¹³Supra note 2 at para 38.

¹⁴Supra note 2 at para 39.

resources available, nationwide presence etc., the zero price policy of NSE in the relevant market is unfair and can be termed as annihilating or destructive pricing.¹⁵

The CCI in its majority decision passed by the Chairperson along with three other learned members, upheld both the allegations and found NSE to be in contravention of Section 4 (2) (a) (ii) and 4 (2) (e) of the Act and imposed a penalty of 5% of the average turnover of NSE in the last three years (2007-2010) which amounted to Rupees 55.5 crores. NSE was directed to modify its zero price policy in the relevant market and to cease and desist from unfair pricing, exclusionary conduct and unfairly using its dominant position in other markets to protect the relevant CD market with immediate effect. NSE was also directed to maintain separate account for each segment from April 1, 2012. And allow free choice amongst NOW, ODIN or any other market watch software for trading on the CD segment of NSE, by the members of NSE. The last direction was subsequently settled in a compromise before the Hon'ble Bombay High Court. For the remaining other issues, NSE appealed before the COMPAT.

The minority opinion passed by Shri Anurag Goel and Dr.GeetaGouri, dissented from the majority opinion on the aspect of abuse of dominant position by NSE in the relevant market and holding that there was no violation of Section 4 of the Act. They held that NSE is not dominant considering other players are involved and have an equal amount of market share, hence zero pricing policy was not considered amounting to predatory pricing. The minority clearly stated that a separate view could have been taken considering if MCX had other source of income or not facing losses. The role of competition authorities is not meant to be adversarial but to inquire into competition related issues was the reasoning for their dissent.¹⁶ Although they agreed to the concept of relevant market and the analysis adopted by the majority opinion.

ORDER OF COMPETITION APPELLATE TRIBUNAL (COMPAT)

The COMPAT in its order dated 5th August, 2014 upheld the order of CCI in MCX-Stock exchange Ltd. vs. National Stock Exchange of India Ltd. and found NSE as a dominant

¹⁵Supra note 6 at para 10.76.

¹⁶Dissenting order in case of MCX-SX Ltd. &Ors. vs. NSE &Ors., Case No. 13/2009.

player and guilty of abusing its dominant position in the CD segment but based its order on a different rationale.

COMPAT disagreed with CCI on the definition of relevant market. CCI had held the relevant market as the currency derivatives market alone, while COMPAT held that the relevant market should be services offered by NSE independent of the product being traded because a stock exchange does not sell a product.¹⁷ Hence COMPAT widened the relevant market definition to stock exchange services.

On the issue of NSE leveraging its dominance from the non-CD segment to the CD segment, the COMPAT disagreed with the findings of the majority order passed by the CCI. Section 4 (2) (e) of the Act states that for leveraging their need to be two distinct and separate markets. But in the opinion of the COMPAT, there was only one relevant market. CCI's findings regarding violation of Section 4 (2) (e) of Competition Act, were set aside by the COMPAT.¹⁸

As regards the penalty, the COMPAT held that the penalty at 5% of the average turnover was appropriate. Further, it refused to interpret the term "turnover" narrowly stating that a multi-commodity company and several distinct relevant markets for each of them were necessary to do so.¹⁹ COMPAT upheld all other orders of CCI except on the issue of maintenance of separate segment wise accounts, as it was already held that the relevant market was the market for the service of stock exchange.

The penalty imposed on NSE by the CCI (and as upheld by the COMPAT), has been stayed by the Supreme Court by its order on Sept 23, 2014.

CRITICAL ANALYSIS OF COMPAT'S ORDER

Though the order of COMPAT brought more clarity on the concept of relevant market but CCI in its judgment reiterates the fundamental concepts of competition law, such as relevant market, dominance, abuse of dominant position, SSNIP test, monopoly leveraging. In a case

¹⁷Supra note 2 at para 50.

¹⁸Supra note 2 at para 114.

¹⁹Supra note 2 at para 123.

so complicated as this, CCI should have adopted a more comprehensive and rigorous analysis.

For finding the relevant market they could have used a more rigorous standard by following the SSNIP (small but significant and non-transitory increase in price) test which is used in both US and EU jurisdictions. The CCI departed from the use of this test without any compelling justifications.

There is a need for a cautioned approach to determine predatory pricing as there is a very thin line that exists between predatory behaviour and fair competition. In the present case, the report of the DG, as also the majority order of the CCI and the decision by the COMPAT failed to take into consideration important factors such as past behaviour of the firm, the pricing methodology used to price the product or service, the nature of the market such as two-sided markets and the market conditions. These are important factors to be considered to determine if the pricing of a company is a genuine business strategy or whether it was pursued with the objective of foreclosing competition.

Another important factor that ought to have been considered by the COMPAT was that stock exchange services being a network market, the market has natural tendencies for a certain player to emerge as the dominant operator. When a network effect is present, the value of a product or service is dependent on the number of others using it. Therefore, in such cases, 'promotional' pricing should come within the ambit of a fair competitive practice.

The COMPAT also did not consider 'fairness of price' issue and failed to consider the fact that due to competition between MCX and NSE over prices, it was the consumer that was benefitting and there was higher consumer welfare due to free services. Therefore, such a practice should not be termed as predatory in nature because it leads to short term increase in consumer welfare because the consumers are offered better products and services at competitive prices.

The minority order of the CCI is equally important it points out to the fact that NSE was ranked third by market share in the currency derivative segment behind BSE and MCX-SX. The minority agrees with NSE's argument that cross subsidization cannot constitute an abuse of dominant position as this is a widely prevalent practice in other markets also.

This ruling can have an immense impact on other companies which are not assumed to be aware of their dominant position in the market. Also following the decision of the CCI and

COMPAT, NSE has deterred from zero price policy and has start charging for its trades, which may lead to higher cost for the consumers.

CONCLUSION

This is the first case, where a major penalty has been imposed by CCI for contravention of provisions of Competition Act, 2002. This case is very important because there has been no earlier case in India or abroad, in relation to the interpretation of different services offered by the stock exchange services as a separate relevant market.

It is the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade in the markets of India but it is not to protect weaker competitors who cannot compete on the basis of merits. The current decision of COMPAT is protecting competitors who are inefficient which in turn is hurting the consumer, this is against the entire objective of Competition Law. It would be right to say that the CCI majority order and the COMPAT order had taken an adversarial approach to the issue. A more rigorous and economic-based approach should have been taken in such a case.

It seems like fate of NSE and a better clarity on the issue, now rests with the Apex Court.