

COMPETITION COMMISSION OF PAKISTAN

ENQUIRY REPORT

(Under Section 37 of the Competition Act, 2010)

**IN THE MATTER OF COMPLAINT FILED BY M/S PAKISTAN CREDIT RATING
AGENCY LIMITED AGAINST M/S JCR-VIS CREDIT RATING COMPANY LIMITED
FOR ALLEGED VIOLATION OF SECTION 3 & 4 OF THE COMPETITION ACT, 2010**

Qasim Khan | Maliha Quddus | Aqsa Suleman

Dated: July 01, 2016

Background:

1. The Competition Commission of Pakistan (the '**Commission**') received a complaint from M/s Pakistan Credit Rating Agency Limited (Herein referred to as a '**Complainant**' or 'PACRA'), on 19th April, 2016 against M/s JCR-VIS Credit Rating Company Limited ('the Respondent' or 'JCR-VIS').
2. The complaint pertained to the award of rating assignment to the Respondent, on its allegedly low/below cost bidding, for the proposed Sukuk issue of PKR 100 billion by Neelum Jhelum Hydropower Company (Private) Limited ('NJHPC' or 'the procuring entity').
3. The Commission on 20th April 2016 initiated an enquiry under Section 37(1) of the Competition Act, 2010 (hereinafter referred to as the 'Act') and appointed Mr. Qasim Khan, Deputy Director (C&TA), Ms. Maliha Quddus, Deputy Director (C&TA) and Ms. Aqsa Suleman, Management Executive Officer (C&TA)(hereinafter the 'Enquiry Committee') to investigate the matter for possible violations of the Act, and to submit a report to the Commission.
4. The Complainant alleged that the award of the rating assignment to the Respondent raised competition concerns. Both the Complainant and the Respondent participated in a bid to procure credit rating assignment for Sukuk issue of PKR 100 billion for NJHPC. JCR-VIS quoted a bid price of PKR 100 per annum for a rating assigning spanning 10 years. PACRA alleges that this 'token' bid is devoid of any legitimate business justification or commercial sense and was solely made to outbid PACRA.
5. The Complainant alleges that the Respondent is in breach of Section 4 of the Act and since the bid is so low, it also amounts to predatory pricing which is a violation of Section 3 of the Act. The Enquiry Committee wrote letters to the Respondent and NJHPC asking them to respond to the allegations made in the complaint.

6. The Complainant further contends that in the initial bid carried out for the same project, It was the Complainant who had won the bidding on account of lowest cost and requisite expertise of having rated projects of such magnitude, however owing to violations of procedural nature as alleged by the Respondent the rating mandate awarded to PACRA was cancelled and rebidding was announced that resulted in the aformentioned situation.

7. In order to gain further clarity in the matter, NJHPC was asked to furnish details in respect of both rounds of bidding. A perusal of the details thus received reveals that even though the initial bidding resulted in the rating mandate being awarded to PACRA there was a clear difference of opinion as to who was the lowest bidder among the evaluators within the procuring entity depending on whether working of certain taxes was included in the calculations or not. Even though financial experts representing the NJHPC were of the opinion that the Respondent was the lowest bidder, calculations by Wapda showed PACRA to be the lowest bidder. Even otherwise Wapda also had a certain comfort level with PACRA owing to past experience which was factored in making the final decision as evidenced in the bidding related documents. However owing to certain alleged procedural irregularities in the procurement process, a grievance redressal committee was formed and the Complainant's contract was cancelled in favor of a fresh bidding called under the PPRA rules.

8. In one of its letters before the re-bidding dated December 8, 2015, the procuring entity expressed the following to the Complainant and the Respondent: "*The earlier quote dated 29.09.2015 is quite on the higher side, therefore in view of the budgetary constraints beside national importance of the Project, we anticipate that you will provide your services at bare minimum cost*".

9. Fresh invitation to bids were then issued on 08 March 2016 in response to which JCR submitted the bid of total cost PKR 1,100. The bid amount submitted by PACRA in the fresh round was PKR 7,220,000 which was approximately 50% lower than its

earlier quoted figure when not adjusted for the General Sales Tax and roughly 60% less than that when the mentioned tax was accounted for.

Submissions

10. The allegations made in the complaint and the Respondent's point wise response is as follows:

11. **Relevant Market -- PACRA:** JCR's share in the relevant market is 45%.

12. JCR: The relevant market share with respect to NJHP is the credit rating assignments for debt instruments in public sector, where the share of JCR is less than 40%. In the absence of dominant position, the issue of breach of Section 3 of the Competition Act, 2010 does not arise at all.

13. **Bid Submissions -- PACRA:** PACRA not only qualified as a lowest cost bidder in the initial bid but also for requisite expertise, professionalism, and in built efficiency based on its experience of having rated power sector entities with capacity of more than 12,000 MWs that is up to 50% of the installed capacity.

14. JCR: JCR did not receive any invitation from NJHPC in July 2015 for rating of the proposed debt instruments. JCR states that the quotation was initially sought from PACRA without considering JCR. JCR received the first request letter dated September 18, 2015 from NJHPC and no request letter was received prior to that. The deadline for submissions of bid was mentioned as September 15, 2015 prior to the issuance of such letter i.e. September 18, 2015.

15. **Bid submission without commercially sense --PACRA:** PACRA had shared its concern to NJHPC that the price quoted may result in a potential conflict to execute the assignment at par with other commercially executed assignments.

16. JCR: With respect to “Commercial sense” it is pertinent to mention that rating agencies are geared to undertake assignments that may not have any bearing on profitability. Works of significant importance including national are often undertaken without fee consideration. PACRA itself reduce its cost to 50% from its earliest bid.
17. **Violation of Competition Act--** PACRA: JCR through undercutting, quoting bid price without any legitimate business justification has in fact engaged in un fair and anti competitive practice. When PACRA was successful and duly secured the Initial bid award, apart from its expertise, because JCR had quoted higher rates, the offer of JCR for a token charge/ fee in the second round is manifestly an outright attempt to exclude other competitor in an unfair and unjust manner to secure award of the mandate and is tantamount to securing undue benefit for itself.
18. JCR: Complainant was successful in the initial bid; however, the process of this award was cancelled by the awarding agency. It further assumes that JCR had bid higher than complainant’s bid whereas it has not provided any documentary evidence in this respect. JCR is confident that its bid was lower in the initial round. In the re bid JCR chose not to undercut its own initial bid which in its estimation was a fair bid and should have been the winning bidder. With regard to predatory pricing the token price quoted to NJHPC was for the sole reason of working on a project of national importance.
19. **Lowest bidding reflects likelihood of default--**PACRA: Credit rating reflects forward looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honour financial obligation. The primary factor being captured on the rating scale is likelihood of default.
20. JCR: It appears that the complainant was compromising on 50% of the quality of the work by reducing its fee to almost 50% of its earlier quote .

Issue

21. The following are the core issues to be addressed in the Enquiry Report:
- a. Whether JCR-VIS holds a dominant position in the relevant market;
 - b. If yes, whether JCR-VIS is involved in predatory pricing with the intent of driving its competitor out of the relevant market in violation of Section 3 of the Act.
22. Although the Complainant has alleged a Section 4 violation as well, however, no evidence/material is provided to support this assertion. Furthermore during the course of the enquiry no indication of a prima facie prohibited agreement was found out. Therefore, the only issue to deal with is the likely violation of Section 3 of the Act.

Relevant Market

23. Section 2(1)(k) of the Act defines ‘relevant market’ as:

*the market which shall be determined by the Commission with reference to a **product market** and a **geographic market** and a product market comprises of all those products or services which are regarded as interchangeable or substitutable by the consumers by reason of the products’ characteristics, prices and intended uses. A geographic market comprises the area in which the undertakings concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighboring geographic areas because, in particular, the conditions of competition are appreciably different in those areas;*

24. In light of this definition relevant market entails:
- a. A product market; and
 - b. A geographic market.

25. Both the Complainant and the Respondent are involved in providing credit rating services in Pakistan. In Pakistan this sector is regulated by the Securities & Exchange Commission of Pakistan (SECP) under the Credit Rating Company Rules, 1995 (the 'Rules) and Code of Conduct for Credit Rating Companies/Agencies('CRAs').
26. Under the Rules a credit rating company is defined as a company which intends to engage in or is so engaged primarily in the business of evaluation of credit risk through a recognized and formal process of assigning rating to present or proposed loan obligations of any business enterprise. CRA's provide credit ratings for different types of debts and financial obligations, for example, private loans, publicly and privately traded debt securities, preferred shares and other securities that offer a fixed or floating rate of return. These credit ratings can therefore, be divided into three categories namely: Entity, Term Finance Certificates and Funds.
27. According to the SECP the regulatory landscape on CRAs has recently experienced a shift on the global scale. Pursuant to the International Organization of Securities Commissions' (IOSCO) Code of Conduct Fundamentals for CRAs of May 2008, a number of jurisdictions have undertaken various regulatory measures to strengthen oversight on CRAs and to raise the standards for CRAs. It is also observed that globally this sector is highly concentrated with the 'big three' companies dominating the market. Therefore, this sector has high entry barriers due to the technical expertise involved and regulatory measures.
28. The instant matter pertains to the credit rating assignment for Sukuk issue of PKR 100 billion by NJHPC. It is noted that Sukuk is a form of Term Finance Certificate issued for the financing of NJHPC. It is noted that although knowledge of the hydropower/power sector and prior experience is important the relevant expertise for the rating of different categories is primarily the same.

29. A CRA with experience in rating Term Finance Certificates would have the technical expertise for this particular rating. Similarly a CRA rating entities and funds would have the expertise to deal with Term Finance Certificates. It may also be noted that a high market concentration is indicative of the fact that CRAs work across various sectors of the economy having a diverse portfolio. Therefore we consider the relevant product market as the market for credit rating services.
30. Both the entities are involved in providing their services in all the categories mentioned above throughout Pakistan. Therefore, the relevant geographic market is the whole of Pakistan.
31. Based on the findings of paragraphs 23-30 above, the relevant market is the market for provision of credit rating services in Pakistan.

Dominant Position

32. In terms of Section 2(1)(e) of the Act the
- ‘Dominant Position’ of one undertaking or several undertakings in a relevant market shall be deemed to exist if such undertaking or undertakings have the ability to behave to an appreciable extent independently of competitors, customers, consumers and suppliers and the position of an undertaking shall be presumed to be dominant if its share of the relevant market exceeds forty percent’.*
33. The relevant market has an oligopolistic market structure there can be more than one player that is dominant in the market. There are only two undertakings in the relevant market i.e. PACRA and JCR-VIS. As per the submissions made by PACRA the share of JCR-VIS is 45% and the share of PACRA therefore is 55%. Going by the assumption in Section 2(1)(e) of the Act, an undertaking is presumed to be dominant if its market share exceeds 40%.

34. The Act makes an irrebuttable presumption regarding dominance if share of the relevant market exceeds 40% . From this it can be inferred that if a single entity has a share of 40% the remaining 60% of the market could be divided in various ways among which one scenario could be where another player would have a share of above 40%. Hence under Section 2(1)(e) JCR-VIS can be considered to be dominant with a share of 45% even if PACRA's share of the market is 55%.

35. Therefore, based on the findings of paragraphs 32-34 above, it appears that JCR is dominant in the relevant market.

Is JCR-VIS involved in predatory pricing with the intent of driving its competitor out of the relevant market in violation of Section 3 of the Act.

36. Section 3(3)(f) of the Act deals with predatory pricing as is reproduced as under:

"predatory pricing driving competitors out of a market, prevent new entry, and monopolize the market";

37. Massimo Motta, the chief competition Economist and an internationally renowned Competition expert from the European Commission defines the concept of predatory pricing as follows:

"Predatory pricing occurs when a firm sets prices at a level that implies the sacrifice of profits in the short-run in order to eliminate competition and get higher profits in the long-run¹".

38. The general approach with regards to predatory pricing is that prices are assumed to be predatory if they are below average variable costs. In such a case, there is no conceivable economic purpose other than the elimination of a competitor, since each item produced and sold entails a loss for the undertaking. Secondly, prices below average total costs but above average variable costs are only to be considered abusive if an intention to eliminate can be shown.

¹ Massimo Motta, Competition Policy, Cambridge University Press, Cambridge, 2004, Page 412

39. From the foregoing, it can be inferred that the onus to prove the intention of an undertaking to eliminate its competitor is only necessary when the subject pricing is between the average total cost and the average variable cost of the undertaking offering a good or a service in a market. In case, a dominant undertaking charges a price below its average variable cost, it is assumed that such a move could have no other economic purpose for that undertaking but to eliminate its competitor/competitors.

40. Examining the bidding documents available in the fresh round of bidding JCR while submitting its bid to NJHPC on 11 March 2016 noted the following:

"A bid had earlier been submitted by us already significantly below our regular fee schedule and our best possible offer; we believe a re-submission of any lower quotation may possible be interpreted as 'fee shopping', not suitable for procurement of specialized intellectual services like ratings. As an internationally affiliated and a globally active rating agency, it is important for JCR-VIS Credit Rating Company (JCR-VIS) to maintain our reputation of integrity, and we have therefore submitted a bid that reflects our business philosophy, rather than the cost to be incurred in executing this mandate.

Indeed JCR-VIS has in the past undertaken ratings in areas of national and social importance at no more than a token cost, or even on a no-fee basis, as admissible under rules and regulations governing credit rating agencies, issued by Securities & Exchange Commission of Pakistan. It is not uncommon globally, for rating agencies to issue their opinion in national or investor interest on a no-consideration basis.

It is with this background that we are pleased to submit a bid (schedule attached herewith) a token fee basis to undertake ratings of this very important infrastructure project in Pakistan."

41. The following bid schedule was submitted by JCR:

Initial Fee	Surveillance Fee (Year Wise)										Total Rs.
	1	2	3	4	5	6	7	8	9	10	
100	100	100	100	100	100	100	100	100	100	100	1100

42. By JCR's own admission it was submitting a bid that did not reflect its cost and rather it was submitting a token bid. It is noted that PKR1,100 for credit rating over a period of ten years is insufficient to cover JCR's cost and the sum is so nominal so as to assume that it is below its average variable cost. As for the JCR's claim that it has quoted such a low bid in consideration of this project bearing national importance, question arises as to why JCR did not quote such a low price or something close in the earlier bidding and whether the same was an afterthought to justify its almost free offer. Based on the standard for predation, the bid amount submitted by JCR is without any shred of doubt below its average variable cost which could have no other economic purpose but to eliminate a competitor.

43. In view of the foregoing analysis in paragraphs 36-42, the behavior of the Respondent appears to be predatory and in terms of Section 3(3)(f) read with Section 3(2) of the Act which constitutes a violation of Section 3(1) of the Act.

Conclusion:

44. Based on the findings of paragraphs 23-30 above, the relevant market is the market for provision of credit rating services in Pakistan.

45. Based on the findings of paragraphs 32-34 above, it appears that JCR is dominant in the relevant market. There are only two undertakings in the relevant market i.e. PACRA and JCR-VIS. As per the submissions made by PACRA the share of JCR-VIS is 45% and the share of PACRA therefore is 55%. Going by the presumption in Section 2(1)(e) of the Act, an undertaking is assumed to be dominant if its market share exceeds 40%.

46. Based on the findings in paragraphs 36-42 above it appears that JCR's submission of a token bid of PKR 1,100 for a rating assignment regarding a Sukuk issue of PKR 100 billion for NJHPC is predatory in terms of Section 3(3) (f) read with Section 3(2) which constitutes a violation of Section 3(1) of the Act.
47. In view of the preceding findings, it is proposed that proceedings may be initiated against the Respondent in terms of Section 30 of the Act for a *prima facie* violation of Section 3(1) of the Act.

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Enquiry Officer

Maliha Quddus
Enquiry Officer

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