Vertical Restraints on Trade in Competition Law

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The agreements and the consequent likely restraints on trade, in competition law can be of two types: Horizontal and Vertical. Any restraints on trade in horizontal agreements resulting in an anticompettive outcomes enumerated in sub-section (3) of Section 3 of the Act shall be presumed causing an Appreciable Adverse Effect on Competition (AAEC). After this presumption, the person concerned is free to bring before the competition agency any evidence/defences in support of his innocence or otherwise. On the other hands, a vertical agreement including a tie-in aarrangent, exclusive supply agreement, exclusive distribution agreement, refusal to deal or resale price maintenance (RPM) and can only be treated as in violation of competition law if it was causing AAEC in India. Thus, either way, India follows an 'effects' based approach' in nearly all the cases in contrast to the 'per se' approach followed in USA wherein, sometimes, what is seen is the simple language of the agreement and if this has the impact of adversly effecting competition.

The Author, who headed the Antitrust Division of the Commission in the formative years of the Commission, looks at the implications of vertical restraints and the way the Commission looks at them on the basis of the cases dealt with by the Commission and Competition Appellate Tribunal (COMPAT).

The agreements and the consequent restraints on trade, in competition law, are broadly classified in two types. The first one, popularly known as 'horizontal agreements' are amongst the enterprises at the same horizontal level of production, supply, distribution, storage, acquisition or control of goods or provision of services. The other agreements, popularly known as 'vertical agreements' are enterprises or persons at different stages or levels of the production chain in different markets in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services. The horizontal agreements mentioned herein may result in appreciable adverse affect on competition (AAEC) as a result of the effects of such an agreement falling within the mischief of any one or more of the clauses (a), (b), (c), (d) of sub-section (3) of Section 3 of the Competition Act, 2002 ('Act'). Any one alleging such an effect only has the onus of proving that, first of all, there is an agreement or arrangement amongst an enterprise or association of enterprises or person or association of persons and, secondly, that agreement results in any of the outcomes enumerated in clauses (a), (b), (c), (d) of sub-section (3) of Section 3 of the Act. Once these two steps are taken, a tentative prima facie

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case is made out and, if Hon'ble Competition Commission of India (hereinafter referred to as "Commission" of "CCI") concurs, an investigation may be directed to be caused by Director General (DG) into the matter. The onus of proving that there was either no such agreement or effect lies on the shoulder of the person who is alleged to have brought the matter before the Commission.

These days it is not uncommon to come across some persons doing various sundry assignments but sportingly an apron carrying the name of the organisation they are working for. The activities, thus being done, can vary from sweeping, electrician's job, plumber work or such other activity. These outsourced staff can, generally, be easily identified by the loosely held aprons across on which the name of the organisation or the body for whom they are working is written. This was not the scenario, in India, some four decades earlier. With opening up of the economy and realisation of the advantages of a lean government, as many hitherto considered integral functions of various departments of the Government as well as local bodies are being outsourced as possible. This is a concept which reflects the growing tendency of the big organisations including Government departments and the Governments not to get entangled in the responsibilities of having a large work force and facing all the related consequential Human Relations (HR) issues but focus on the core competencies and outsource other aspects which can be dealt by some one else at an 'arm's length'.

Emerging for the concept of the specialisation, various enterprises have now come up and grown which claim expertise in many such domains which traditionally were considered the exclusive responsibility of the Government or the local bodies or enterprise which has decided on 'out sourcing'. These areas may range from cleaning the streets to maintaining sophisticated computers. house keeping, transportation services, supply of stationery, xeroxing, printing, catering services, defence supplies, electrical and civil maintenance etc. Even this has come to pass, in the present scenario, when the outsourcing has been here for decades. Now, still much more complex issues such as defence maintenance, railway supplies, securities services, intelligence agencies, hardware maintenance, content writing for various end uses, laboratory services, diognostic techniques, lobbying with various interest groups as well as Government, catering, running of radio and TV Channels, research assignments, care of the elderly, public relations, strategic planning, nuclear consultancy, making of soft inputs for TV are all being outsourced somewhere. Thus outsourcing is not limited to any single domain. This phenomenon is seen commonly across the entire economic spectrum. Unlike in previous times,, in present day, functioning with the advent of privatisation, the Government and Private Sector alike have discovered the virtues of "plug and play". Instead of having huge responsibilities for doing the assigned tasks, the Governments and Public Sector Undertakings (PSUs) are waking up to the ground reality that they can still get their job done quite reasonably well if they keep themselves free from the issues of having a large organisation having huge HR issues and the consequential bill of salary and wages. In case of outsourced services, it becomes easy to dispense with the services once the services are being found surplus or deficient. Thus, it also contains an element of surprise and also, if the situations so warrant, the size of the Government operations does not permit continuation of certain services they can be easily dispensed with.

The above ground realties are very much different from the olden times when any enterprise had to ensure the entire array

of services itself as such specialised services as specialised service providers were not easily available. In the circumstances, unless any reasonable big organisation had all these services under one roof, it was almost impossible to effectively function.

For enhancing one's business, there can be thousand ways in which a business entity can expand its business empire. It may be through organic or inorganic ways. The organic method is simple but involves too much of extra baggage. It implies recruitment of people for doing assigned jobs and, sometimes, the people doing the same job may overlap each other to the consequent determinant of the bottom line of the organisation.

In a similar pattern, earlier Airlines used to have most of the persons working on ground duties as well as baggage handling on their roles. Now, in a large number of cases, as many functions are outsourced as much are possible. It is not uncommon to find staffs from an enterprise for handling baggage which have nothing to do with the particular Airline. Such kind of outsourcing has become very common in all the industries and sectors. If we take hospitality sector, it is quite frequently seen that the entire house keeping jobs are outsourced. This is a natural process on account of era of specialisation and advent of readymade garments which is practically eating away the jobs of the traditional players.

In such a situation, to achieve the same end result, it is naturally expected that different enterprises would be working together in vertical relationships so as to ensure that the chain of all these services leads to a package which may be visible to the outside public world or which is having some kind of continuity and linkage.

When we talk of physical goods, the manufacturer cannot having presence in all the market areas where the goods are required to be consumed. This applies to all items of daily consumption such as milk, rice etc. as well as all other conceivable consummables. In distribution arrangement, somebody who is producing goods specialises in production and engages the services of the other enterprises which are specialised in marketing for marketing and distribution. This not only reduces the headache to the enterprises which might deviate the first enterprise from areas of its core competence but also bring in efficiency. With so many vertical linkages and relationships being in business landscape, it is necessary that the business agreement have to be drafted in such a way that they do not lead to a situations where there are unfair and discriminatory conditions imposed by any dominant enterprise on another dependent enterprise. As the unfair and discriminatory conditions could potentially compromise the safe growth of the enterprise from the potential problems with the competition agencies of the land.

It is in this connection that the competition authorities worldwide have their job cut out of bringing some sense of discipline in the examination of vertical agreements having vertical restraints. However, on account of the fact that vertical agreements are likely to lead to the reduction of double marginalisation by way of giving 'certainty' to the two enterprises engaged in a vertical relationship of getting 'a margin' on his cost and not remaining too uncertain about it. This is likely to result in consequential benefit to the customer and the consumer may get things cheaper.

The other issue which vertical agreements prevent from happening is "free riding". The differentiated products, which require some kind of pre-sale experience with the product or service such as toy helicopters or automobiles with incidental consequent expenditure and resources used, it would

be better served if the infrastructure etc. needed to create that kind of ambience and experience for enhancement of sales is not used without sharing of investment by rival brand. It is for this reason that many of the showrooms are having exclusive ambience unless there is an understanding amongst both the parties, such showrooms, normally, have an exclusive relationship and duration of the agreement so that any investment made in creating an appropriate sale environment is not taken advantages of by a rival without having invested anything in the ambience and the infrastructure.

Now, let us look at the decisional practice of Competition Commission of India (CCI) whenever the vertical agreement issues have come before it. Let us state this up front, in the beginning, that the analysis of agreements falling within Section 3(4) of the Act has been a mixed bag as far as the Competition Commission of India is concerned. Perhaps, it may be slightly premature to judge these kinds of relationships in terms of the treatment given to them by CCI. If we talk, in terms of percentage, this ought to be admitted that the cases falling within sections 3(3) and 4 would far outnumber the cases falling within Section 3(4) of the Act. This trend has many reasons. Some of them being summarised below. The reasons broadly speaking are:

1. Difficult to Understand

First of all the provisions of vertical relationships and the way they have been covered in the Competition Act, 2002, sometimes, lead to an ambiguity. As an example, if we look at one of the limbs of the Section 3(4) and i.e. "refusal to deal". It really looks contradictory in terms. If somebody just goes by the perception and does not look into the fine print where definition to 'refuse the deal' has been given, it looks really contradictory that Section 3(4) talks of an agreement. How can somebody enter into an agreement when that person is refusing to deal with somebody? However, a careful look at the definition of 'refusal to deal' clarifies all the situations in which the cases would fall within the mischief of Section 3(4) of the Act.

2. Difficult to Establish

Unlike Section 3(3) of the Act where in the only requisite requirement for proving a violation is that:

(i) the entities and enterprise are in the horizontal relationships in the market place and they are engaged in identical or similar production of goods or service.

(ii) the second thing needed to be proved is that an agreement entered into between these entities is resulting in any one of the outcomes which are enumerated from clause (a) to (d) of Section 3(3) of the Act. The moment this much is done, the onus of proving its innocence shifts to the opposite party. In comparison to this, if we look at the abuse of dominant position, the first step is to establish 'dominant position' of the opposite party. Having done that, the mere requirement of the Informant is to show that any one of the conduct of Informant who is in a dominant position is leading to unfair or discriminatory conditions or resulting in anyone of the five categories of abuses which have been enumerated in section 4(2) of the Act.

From the above, it is seen that unlike the violation of the Section 3(3) or 4, it is doubly difficult to establish, even at the prima facie stage, an allegations u/s 3(4) of the Act. The allegations in information before the Competition Commission of India under the Act can be established even without a detailed in- depth study and research.

On account of the above background, the number of cases coming before CCI

wherein vertical relationships are alleged to have cost adverse effect on competition are much less in number but the cases are there. When an allegation was made about anti competitive conduct by Apple, Hon'ble CCI had observed that Airtel and Vodafone each have less than 30% market share and Apple i-Phone had in lesser at 3% of market share in smart phone in India. On this basis, they reached the conclusion that it is highly improbable that there would be an AAECC in the Indian market. (Sonam Sharma V. Apple Inc. USA, Apple India Pvt. Ltd., Vodafone Essar Ltd, Bharti Airtel Ltd.) Case No. 24/2011 dated 19.03.2013. On the other hand, they have been instances, where despite high market share, the CCI has not taken note of any adverse effect on competition in some cases. In the information of Snapdeal against Kaff Appliances, investigation was commenced by CCI while Kaff was having a market share of around 28%. Evidence of Resale Price Maintenance (RPM) and denial of warranty on sale of its product was available on the website of Snapdeal (*Ashish Ahuja* v. *Snapdeal and Sanddisk*, Case No. 17/2014 dated 19.05.2014). Thus it also depends on the market power reflected by the market share of the players involved. In the case of *Prime Mag. Subscription Services Private Limited* v. *Wiley India Pvt. Ltd. & John Wiley & Sons Ltd.*, a mandatory stipulation by the publishers to the distribution agents not to give more than 3% discount was not considered to be anti competitive on account of the market share of the book publishing market being very small, almost negligible. However, no such considerations prevailed in dissuading the Commission from directing an investigation against Hyundai for allegations of various instances which could be treated as vertical restraint and violations of Section 3(4) of the Act. Although the final outcome is still being awaited but the Commission did indeed direct investigation after prima facie view and is looking into the whole issues even at the time of writing this piece but the final decision of the Commission is still awaited. As the onus is on the Commission before any agreement under Section 3 (4) can be found to be foul of the competition law provisions, the standard of proof becomes extremely high and finding CCI in agreement with the allegation.

However, one of the leading cases which can be treated as a very important land mark case out of cases under Section 3(4) case, is now famous case of *Shamsher Singh Kataria* v. *Honda Siel Cars India Ltd. & Ors* (case no. 3/2011 dated 25/08/2014). In this case, the allegation was pertaining to the after sales market of complex durable equipment which is automobile. On account of the fact that Commission observed and agreed that the customers buying cars are unable to carry out life time-cost analysis and each competing manufacture becomes a dominant entity in their respective relevant market in the after sales market, the Hon'ble Commission held that since on all the original equipment, all the manufacturers (OEMs) had put restraints on original equipment supplies (OESs) from letting the market be freely supplied with the spare parts of the automobiles, the customers do not have the choice except to succumb to pay extremely heavy prices for the spare parts. The other option the customer has is of shifting to grey market and putting a part which he cannot be sure of but at a much cheaper price. A ground taken by all the parties was that such restrictions were necessary for checking counterfeit spares from being used on their high quality automobiles which might invite other liabilities. Further, these OEMs also claimed that the quality standards would fall drastically if such kind of thing was allowed. Not only the Commission did not agree with the defence of various car

manufactures but it also did impose a penalty on car the manufactures. Another point which should be kept in mind in these matters is that in items like automobiles, very frequently, the manufacturers offer the first product, practically, at a discount and later recoup the shortfall through spares and after sales service. This is a common phenomena. This aspect needed consideration.

Another important case which can be cited is that of Ramakant Kini wherein though discussing the provisions of Section 3(4) of the Act, the Commission did not directly find any of any violation of any other section. Therefore, a dissenting order was passed by the then Member Dr. Geeta Gauri. In this order, it was held that law has to be interpreted in a very strict manner and no case is made out either under Section 3(3) of the Act or Section 3(4) of the Act on account strict interpretation of law. Interestingly, in this particular case, Competition Commission of India did not hesitate to rely on the general over arching provisions of Section 3(1) of the Act. This could be a unique case in itself in which despite there being specific provision within Section 3 to deal with horizontal and vertical agreements an arrangement has been found to have fallen foul of competition law despite having not specifically been covered in either of the two sub sections relate to very specific situation.

Treatment of vertical agreements in EU and USA has progressively moved from the earlier 'per se' approach to the 'rule of reason' approach. Now, a large number of cases can be given to prove that in both the jurisdictions, it is now 'rule of reason' and the prosecution has to prove the matter before a cognisance can be taken of any alleged anti competitive conduct falling within the mischief of Section 3(4) of the Act.

Thus the above analysis shows that examination of issues under Section 3(4) of the Act still is an area which needed further decisions for better development of jurisprudence. It is still at a early stage. However, by the trends so far, it appears that we are also following a 'rule of reason' approach in India.