Counter Point - III: Anti-competitive Practices in Pharmaceutical Sector - Case No C-87/2009/DGIR of Varca Druggist and Chemist against Chemist and Druggists Association, Goa

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As done in some of the previous issues of Competition Law Reporter (CLR), continuing with the series on dissenting and separate orders of different members of the Competition Commission of India (Commission) in some of the cases, in this write up the focus is on an old case filed before erstwhile MRTPC and transferred to the Commission under the scheme, provided under the Competition Act, 2002 (the Act), to deal with such cases on repeal of MRTPC Act, 1969 and commencement of enforcement of the Act w.e.f. May 20,2009. This was followed by similar informations filed before the Commission alleging anticompetitive practices in pharmaceutical distribution and retail sector. Various studies have documented the prevalence of a number of anticompetitive practices in the pharmaceutical sector which are so deeply entrenched that even pharmaceutical giants have to succumb to them. The reason of successful perpetuation of these anticompetitive practices is that the players responsible for initiation of these practices and their continuation have not only have a wide reach across the country but are extremely well organised. Interestingly, most of these informations landed before the Commission because of the infighting amongst members of the associations responsible for these practices or when one or some of the office bearers of these associations became too domineering with other ordinary members. The author, who as the first Director General of the Commission put the competition law investigation framework in place and supervised the very first investigations, looks at the different orders passed by the Commission and its members and the way similar issues were handled in other jurisdictions worldwide.

India is a developing nation in transition. A substantial part of its huge population lives in villages and stark poverty. Strangely, the poorer a person is on the economic ladder, as a proportion of their total earnings, more he or she spends on health or to be away from sickness. Actually, the term 'health' has yet to reach them in the sense that it should. Health, for these teeming poor millions, is attending to sickness and not necessarily to promote positive health, even without the incidence of illness, for which they do not have awareness, time or resources. They have been various studies and estimates for finding out the distribution of cost of living of general population on different heads. Health or

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expenditure on health or sickness, depending on the way you look at, consumes a substantial part of the earnings of an average household. Some estimates put it at 40 % of the earnings and even more[1]. Out of this substantial expenditure on health, broadly speaking, the studies indicate that about 60-90% of total expenditure on sickness/health is actually spent on purchase of medicines/drugs[2]. The balance 10-40 % is distributed amongst various other components such as hospitalisation, consultancy etc..

First of all, the zone from drug/medicines manufacturers till the distributor is also not free from the fears of cartelisation and, from time to time, instances of actually unearthed and penalised cartelisations keeps on coming to notice[3]. This means that the price charged by drug manufacturers is not necessarily a price which was an outcome of a perfectly competitive market. Secondly, as if the first incidence of anti competitive conduct was not enough, the price mark up from the manufacturer till the last mile connectivity point of the retailer is not only substantial but, with a strong stranglehold of the all India network of distributors and retailers, distributers, is also a victim of the anti competitive conduct of their associations such as Chemists & Druggists. Association of Goa (CDAG).

Some consumer organisations have attempted to look into the margins charged by various manufacturers/ retailers/distributors, or a combination of them, in pharmaceutical sectors. Some of the outcomes of these reports are really quite mindboggling. These show that it is not uncommon for a drug manufacturer to benefit from a huge profit mark up, sometimes, of even up to 1638% on different drug formulations[4] (page 58 of the report- cost of 'Lycet' to distributors, manufactured by Lyca Labs, is Rs.1.44 whereas the MRP for this drug, according to the study, was Rs. 25/-. This gives a margin of Rs.23.56 on a cost of Rs.1.44 or a percentage mark up of ((23.56/1.44)X 100=1638%)). If any drug manufacture tries not to follow diktat of a body/ association representing druggists and pharmacists, these powerful associations have the resources, ability and the will to bring the biggest of the pharmaceutical giants on their knees.

Therefore, from the perspective of the poor millions of this country, the curse of falling sick (positive health awareness is yet to informed majority of the population) is a double whammy and sucks away a huge amount of the available money in hand and approximately an amount of 60-90% of the total health spend is given to either the druggists/ pharmacists or the person/stores selling or dealing in surgical devices.

A look at various informations received by Competition Commission of India (CCI), in last five years of existence would indicate that such a might of the CDAG and other such associations, is not only used for only threatening but can also be put into practice after any triggering event is caused by any other pharmaceutical company or any errant member of one of these associations or any retailer/ distributor who has the gumption not to become member of one of these associations. As an example, the apex body of chemist and druggists association decides the margin on which drugs would be sold at shop or retailer.

1 http://www.ijms.info/ojs/index.php/IJMS/article/view/21/v1i2a5.html#.VuXAP1N97_Q
2 http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3573605/
3 http://www.moneylife.in/article/making-a-smart-choice-thin-line-between-compliance-and-collusion/34523.html
4 http://www.cuts-ccier.org/pdf/Project-Report08Sep06.pdf

Retailers are the final point of interaction with patient/consumer for medicines and drugs as far as the last mile connectivity is concerned. If, to benefit from the competition among different retailers, some retailer decides to pass on a fraction of his margin to the customer, it may run fowl of the practices endorsed by the association. It may result in boycott of supplies from a particular pharmaceutical company or many companies to this poor retailer whose intended conduct could have precompetitive impact on market. Most of the informations in pharmaceuticals, having been brought before CCI, have come through this group. As someone or the other who was otherwise an erstwhile member of the association suddenly discovers the existence of competition law when he turns into problems on account of enforceability of the diktat of the chemist and druggist association(s).

Coming to the architecture of the structure of chemists and druggists associations, it may be noted that almost every district of the country has a chemists and druggists association. All these associations thereafter elect and are led by druggists and chemists associations (by whatever name called) as the level of state. All these state apex bodies of chemist and pharmacist association are represented in and, therefore, controlled by All India organisations of Chemists and Druggists (AIOCD). If any member defies them, the consequences through the boycott or any other measure cannot really be welcome by any business. Nearly all the cases of pharmaceutical industries, which landed before the CCI, are connected to such issues.

One such matter arose out of the complaint filed by M/s. Varca Druggists and Chemists which finally came before the Commission in the case of *Varca Druggist & Chemist & others* v. *Chemists & Druggist Association, Goa*. In this case, the Informants (retailers of drugs and medicines) had filed a complaint to the Director General (Investigation & Registrations), Monopolies and Restrictive Trade Practices Commission (MRTPC) against Chemist & Druggist Association, Goa (CDAG), an association of chemists, druggists, distributors, stockists and retailers of various pharmaceutical companies in Goa. Allegations made in the complaint related to:

1. Restrictive guidelines of CDAG-forcing pharmaceutical companies to appoint their stockists and wholesalers only from those individuals firms, who were members of CDAG,
2. Practice of pharmaceutical manufactures having to take a No Objection Certificate (NOC) from CDAG for appointing stockists or wholesalers,
3. Practice of the new wholesalers not being allowed to carry out business without taking NOC from CDAG,
4. Practice of routing the government tenders only through certain authorized stockists,
5. Practice of not refunding payment to retailers for stocks which have crossed expiry date,
6. Threatening the drug manufacturing companies with punitive actions if they do not agree to the conditions by CDAG,
7. Boycotting new entrants if they do not agree to become the members of CDAG;

Consequent upon the repeal of the Monopolies and Restrictive Trade Practices Act, 1969 ("MRTP Act"), the case was transferred to Competition Commission of India ("CCI") in terms of section 66 of the Act. As per the scheme of the Act, after forming a *prima facie* opinion that a case exists, the Commission directed the Director General ("DG") to cause an investigation. The DG carried

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out a detailed investigation and submitted a report to the Commission. In his report, DG recommended that CDAG had contravened Section 3 of the Competition Act, 2002 ("the Act") on the following counts:

1. Imposing the condition on drug manufacturers of procuring NOC for appointing new stockists and wholesalers;
2. Imposing the condition on wholesalers of procuring NOC for becoming the stockist of a drug manufacturer;
3. Not allowing the wholesalers and retailers to give discounts to their consumers;
4. Boycotting non-member retailer and wholesaler;
5. Wholesalers were not allowed to directly sell the product to the consumer;
6. Trade margins were decided by CDAG;
7. Fixing Prices for Product Information System

To understand the allegations, it should be realised that for launching of a new drug by any drug manufacturer, the retailers or the entire distribution network should know about the product. It is only possible if new product finds its way into product information system (PIS) of the chemist and drugs association of the GOA (CDAG). It may be noted that almost all the associations maintain, in one form or the other, product information system (PIS). This is extremely critical for sale of any medicine/drug/molecule for the very simple and basic reason that to make any headway in the direction of selling any product, first the existence of that product should be known. For this reason, entering any medicine /drug into PIS is very critical entry barrier for manufacturer of any new medicine/ drug. To make an entry in PIS, the manufacturer is charged some money before it can be entered into PIS and, thereafter, launched in a particular territory. After the matter was referred to DG, the DG found, in his report that this practice of payment for including a drug in PIS as anti-competitive and held members of the executive committee to be responsible for this conduct. In addition, the DG report also found that the condition of obtaining a No Objection Certificate (NOC) from the existing distributors/retailers if a new distributor /retailer is to be appointed in the same geographical area was anti-competitive. Amongst various informations received before the Commission, this requirement of NOC has been a cause of triggering cause against the association by one or more members. One such case, where on account of not having received a NOC, a party moved the CCI against Utkal Chemist and Druggists Association was case no. 79 of 2015. In this case one M/s Kyal Agencies Pvt. Ltd. had to struggle to get an NOC for being allowed to stock the drugs and pharmaceuticals of another company.

The majority view in this case of Varca Drugs was held by four members of the Commission which, in concurrence with the report of DG, concluded that CDAG had indeed contravened the provisions of the Act. The Commission found the contravention of the provisions of the Act in the following anticompetitive practices:

1. Requirement of no-objection certificate (NOC) from CDAG before the appointment of stockists/ distributors leads to reduction of supply in the market, in contravention of Section 3 (3) (b) of the Act;

2. Fixing of trade margins for stockists/distributors amounts to fixing of price violating section 3 (3) (a) of the Act;

3. Issue of restriction on discounts to be allowed by the wholesaler to retailer, and by retailer to end consumer;

4. Fixing of Public Information System (PIS) charges leading to the fixing of prices of drugs in violation of Section 3 (3) (a) of the Act.

The majority carried out a general and broad analysis and found the above practices to be anticompetitive. Accordingly, penalty at the rate of 10% of the average of the turnover for the last two years, amounting to Rs. 2,00,000 was imposed upon CDAG. The Commission also concluded that if the practice of NOC is done away with, there would be more supply of drugs in the market and consequently more availability of the drugs to the consumers. At this point, we are confronted with a very interesting situation. Without attempting to answer the questions, some questions naturally arising in such cases are being listed below:

(a) Whether a trade association is engaged in any business? Or is it only a facilitation ground for all its members who, in turn, are engaged in business and do have individual business turnovers?

(b) Can such a trade association have a 'turnover'? Is it nor merely a sum total of some small token contributions which are a part of the receipt side of an 'Income and Expenditure Statement' to run the activities of the association such as arranging meetings, serving refreshments etc.? If these receipts are taken as proxy of ' turnover' of the association, does it not mean that automatically despite, on the face of it, imposing a penalty of any association, the Commission is virtually letting the distributers.

One of the Members, Member Geeta Gauri passed a separate concurrent order- concurrent with the majority- in which she opined that all the allegations should be looked at separately and an enquiry into whether such a conduct, on account of each of these violations separately, could have a positive impact also, in addition to the perceived negative impact on competition, should be carried out. Only after such an exercise is done and pros and cons of both the options evaluated, can the Commission reach an appropriate & definite conclusion about the overall impact on the state of competition of such practices. She had following to say about the order of the majority:

"This approach, while it may have its merits can lead to a situation where the positive activities of an association tend to get blurred by the undesirable outcomes. More significantly, it prevents identification of the precise anticompetitive effects ..." (paragraph 10)

She further individually analysed the alleged anticompetitive conducts to find out if, in reality, such conducts really have an appreciable adverse effect on competition(AAEC). On the issue of requirement of NOC, she agreed with the majority that such a requirement was indeed anticompetitive, she emphasised that such a guideline of NOC by CDAG is emanating from the MoUs signed between CDAG and various other national and state associations hence the conduct of such associations should also have been investigated. On the issue of price fixation, she has the following to say:

"The critical aspect of margin fixation being anti-competitive in the Main order was that it was leading to price fixation. In this regard, it is important to note that the margins are allowed as a percentage of MRP, but determination of MRP is vested with the manufacturing of company, and not the Association. Also, in any product where MRP is to be indicated, the margins for the

intermediate players are considered by the manufacturer and these are largely based on industry practices and do not fluctuate much over a period of time....

Having said that the system of margin fixation is conceptually different and does not imply price fixation...

In India ... NPPA regulates the pricing of scheduled drugs and monitors the pricing of non-scheduled drugs, which protects the end consumer from any adverse effect (if any) of margin fixation in the industry."

At this juncture, it is brought to the attention of the reader that though such margin fixation may not directly lead to price fixation (as also held by the Member (GG)), but the fact remains that by capping the margin, the retailers may not have any incentive to improve their services which they could offer to the end consumer. Similarly, on the issue of PIS charges, she held that PIS serves a very useful purpose of dissemination of information and leads to a significant reduction of cost and, therefore, charges for such system should not be held to be anticompetitive.

The conduct of trade associations as documented elsewhere in the form of International jurisprudence is full of instances, where the effect of the conduct of the association was looked into before reaching a conclusion whether the association had acted in an anticompetitive manner-

In the very same case of *Varca drugs,* another member of the Commission, Member Dhingra also gave a concurrent order, however he passed a separate penalty order. In the separately passed penalty order, he held that:

"... An Association of enterprises in itself may not have significant turnover. That does not mean that an Association of enterprises indulging into cartel activity, highly affecting the competition should go scot free. If it is so, it will be easy for the enterprises to indulge into cartelization & escape penalty by forming an association. That could never be the intention of the legislature. .."

Based on the above arguments, he directed that since the total turnover of all the members of CDAG would be approximately Rs. 380 crores, a penalty of Rs. 20 Crores on CDAG should be imposed which CDAG would recover from its members and submit to the Commission. Here also, without attempting to answer the questions, some questions which arise are being listed below:

(a) When dealing with a serious matter such as imposing a penalty, because of violations of the Act, can an approximation be used in absence of the exact figures either having been available or found out?

(b) Is it the exclusive responsible responsibility of the agency imposing penalty to recover it when it has statutory backing, provided in the Act, or can it delegate it to the association of the people on whom penalty has been imposed upon and, thereafter, deposit with the Commission?

These are early days yet for accumulating rich experience in implementation of competition law in India. However, other jurisdictions have dealt with similar situations for much longer periods. It may be instructive as to how the other jurisdictions have dealt with similar anticompetitive conducts by associations.

The Office of Fair Trading, UK (OFT) has issued decisions that have considered the potential for anti-competitive practices on the part of trade associations. In *GISC*[5] one of the rules of the General Insurance Standards

5 Case CA98/01071/00, 13 November 2002; http://www.oft.gov.uk/advice_and_resources/resource_base/ca98/decisions/general-insurance

Council prevented its members from dealing with insurance intermediaries unless they were themselves members of GISC. After the Competition Appeal Tribunal concluded that this rule had the object and effect of restricting competition to an appreciable extent, GISC dropped the offending rule and the OFT concluded that the remaining rules did not infringe the Chapter I prohibition.

In *Northern Ireland Livestock and Auctioneers' Association (NILLA)*[6] the OFT concluded that the NILAA had infringed the Chapter I prohibition by recommending that its members introduce a standard buyer's commission to be payable by purchasers of livestock in Northern Ireland cattle markets. No penalty was imposed however due to the exceptional circumstances of the case.

In the European Union, in *French Beef* [2003] a trade association was found guilty of participating in a price-fixing cartel. Six federations entered into an agreement jointly setting a minimum price for beef and agreeing to suspend or limit imports of all types of beef into France. The European Commission (the Commission) fined the participants a total of €16.7m and one individual federation was fined €12m. There were several aggravating factors, including the fact that three of the federations were involved in acts of violence against individuals aimed at forcing them to comply. All of the federations continued to apply the agreement secretly despite a warning from the Commission.

French beef sector cartel sanctioned in April 2003 with fines totalling €16.7 million on six federations of French farmers. In the face of difficulties on European beef markets the federations had jointly set a minimum price and agreed to prevent imports from outside France. Several factors contributed to the gravity of the cartel, for example, documents found on the premises of the federations during the inspections indicated a full knowledge of the illegality of the agreement, and the federations of farmers used threats of violence against slaughterers in order to oblige them to respect the agreement. The press release accompanying the decision[7] notes that:

> "This is the first time that the Commission has imposed fines on farmers' unions. The Commission recognises the importance of trade union freedom, but it is not the job of trade unions to assist in the conclusion and implementation of agreements that disregard the rules governing law and order and, more specifically, the competition rules."

The Court confirmed this and held that a union can legitimately defend the interests of its members, but cannot use the principle of freedom of association to justify an infringement of the competition rules. The exchange of information may have an adverse effect on competition where it reduces or removes uncertainties inherent in the normal process of competition. The exchange of confidential or business-sensitive information between competitors will often form an integral part of cartel activity: most cartels require a system of information exchange to operate. Individualised (or even aggregated) market data may also help identify any companies that cheat in the cartel.

6 Case CP/0504-01, 3 February 2003; http://www.oft.gov.uk/advice_and_resources/resource_base/ca98/decisions/livestock; in particular the OFT took into account the effects of the diseases BSE (bovine spongiform encephalopathy) and foot and mouth disease on the cattle industry in Northern Ireland generally and cattle auctioneers in particular, by way of increased veterinary health regulation, reduction in throughout of cattle and the temporary closure of the marts.

7 Press release IP/03/479 of 2 April 2003.

Where membership of a trade association is an essential pre-condition for admission to a particular market or profession, the membership criteria must be clear, precise, objective and legitimate

According to the European Commission in *Amino Acids* [2001]:

> 'Where an exchange of… information is an adjunct of anti-competitive practice, it is also caught by the prohibition in Article 81(1) as an integral part of that practice.'[8] Even when the information exchanged is in the public domain or relates to purely historical prices, its exchange can infringe Article 81 and/or Chapter 1 where it underpins other anti-competitive arrangements.[9]

Where membership of a trade association is an essential pre-condition for admission to a particular market or profession, the membership criteria must be clear, precise, objective and legitimate. If they are not, the trade association risks excluding competition and therefore a requirement that admission to membership is subject to approval by all or the majority of members is likely to infringe competition law where the trade association has important status in the industry, unless the rule can be shown to be objective and does not exclude otherwise capable firms from competing on that market. In the event of refusal of admission, there should be an appropriate appeal procedure.[10]

For example, in *Cauliflowers*[11] [1978], membership of a federation was a prerequisite to gaining access to auction centres and the admission of new members to the federation had to be approved by a majority of the board of directors. The European Commission held that this condition prevented new dealers from obtaining access to the auction centre and was therefore restrictive of competition as practically all the vegetables concerned were sold through auctions to which only federation members had access.

In certain circumstances, the adoption of common standards may be desirable, such as agreements on technical standards where the setting of standards is transparent and unrestricted. The parties should be free to diverge from the agreed standards or to make or market products that do not conform to the standards. The standards should be objectively justifiable, for example, use of a quality mark for consumer protection. However, such agreements may infringe competition law where they prevent parties from selling different products, limit technical development or are used to prevent imports.[12]

Industry codes of conduct that restrain competition may be anticompetitive. The US Department Of Justice challenged a professional society's prohibition in its canon of ethics of competitive bidding

8 Commission decision, *Amino acids* [2001] OJ L152/24.

9 Joined cases C-204/00 etc, *Cimenteries CBR & Ors* v *Commission* [2004] ECR

10 *Cauliflowers* [1978]. Also see *Dansk Pelsdyravlerforening* v *Commission of the European Communities (Competition)* [1992] EUECJ T-61/89 where a Danish trade association organised auctions through which the majority of the relevant products in Denmark were sold. The Court of First Instance held that the loyalty obligation imposed was so wide that it had the effect of rendering it extremely difficult for third parties to enter the market.

11 IV/28.948 - *Cauliflowers*

12 *Supra* note 5.

by its members (*National Soc. of Professional Engineers* v. *U.S.*[13]). In that case the Supreme Court held that the trial court was justified in refusing to consider the defense that the canon was justified "because it was adopted by members of a learned profession for the purpose of minimizing the risk that competition would produce inferior engineering work endangering the public safety." The Court held that "no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement," and that "the Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable."

In *Northwest Wholesale Stationers* v. *Pacific Stationery & Printing Co.*,[14] the US Supreme Court addressed the exclusion of companies seeking membership in a wholesale buying cooperative of office supply retailers. The Court noted that the cooperative "permit[ted] the participating retailers to achieve economies of scale in both the purchase and warehousing of wholesale supplies, and also ensure[d] ready access to a stock of goods that might otherwise be unavailable on short notice." The asserted reason for expelling the plaintiff – failure to comply with a cooperative rule on disclosure of a change in stock ownership – was described as a "reasonable" rule which "may well provide the cooperative with a needed means for monitoring the creditworthiness of its members." The Court held that a rule of reason analysis was appropriate:

> "[w]hen the plaintiff challenges expulsion from a joint buying cooperative, some showing must be made that the cooperative possesses market power or unique access to a business element necessary for effective competition."

The overview of the pharmaceutical sector from the perspective of competition law shows that the competition law jurisprudence is yet to firm up in India. However, going by the instances in nearly similar situations, it can be seen that there is a rich history of competition law jurisprudence in other older jurisdictions which may come handy as we move along the journey of competition law enforcement in India.

13 National Society of Professional Engineers v. United States, 435 U.S. 679 (1978).
14 472 U.S. 284 (1985)