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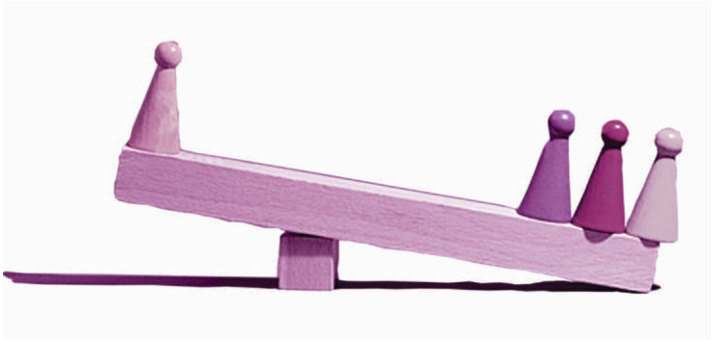
ahead of the curve

Abuse of Dominance and Vertical Agreements in India

Cheat Sheet



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A Thought Leadership Publication

We now present this Cheat Sheet to enable readers to have an overview of the systems and legal rules and regulations that are essential for business operations in India.

Content

Abuse of Dominance

Section 4 of the Competition Act, 2002 (**Act**) prohibits an abuse of a dominant position by any enterprise or "group". A dominant position is defined in the Act to mean a position of strength, enjoyed by an enterprise in the relevant market, in India, which enables it to operate independently of the competitive forces prevailing in the relevant market or affect its competitors or consumers or the relevant market in its favour.

SNEAK PEEK

- Big is not bad - prohibition only on "***abuse***" of dominant position.
- *Dominance* is a position of strength allowing an enterprise to **behave independently of competitive** forces in the relevant market or **affect its competitors or consumers in its favour.**
- Determination of dominance is a **qualitative assessment** based on the prevailing market dynamics and there is **no bright-line market share test**.
- ***Factors considered to determine dominance*** include, market share; size and resources of the enterprise; size and importance of the competitors; economic power of the enterprise; dependence of consumers on the enterprise; entry barriers; countervailing buyer power.
- The Act includes within its ambit both **exclusionary** as well as **exploitative** abuses and provides a list of prohibited conduct by dominant enterprises, including imposition of unfair or discriminatory conditions on price in purchase or sale (such as predatory pricing), limiting or restricting the production of goods, denial of market access and leveraging market position in one relevant market to enter into another relevant market.
- **A defence of 'meeting competition'** in relation to imposition of unfair and discriminatory prices or conditions is stipulated in the Act.
- Penalty upto **10% of the average turnover of past 3 years** may be imposed by the Competition Commission of India (CCI).
- The CCI is also empowered to order division of an enterprise.

Establishing abuse of dominance of an enterprise or a group under the provisions of the Act, is a three stage process comprising:

(i) Defining the relevant market;

(ii) Determining dominance in the relevant market; and

(iii) Determining abusive conduct in the relevant market.

A

The CCI's Jurisdiction

The Act prohibits abuse of dominance by an 'enterprise or group'. For the purposes of the Act, a person or a department of the government engaged in any activity relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, would constitute an ‘enterprise’. The Act is ownership-neutral and is equally applicable to both private enterprises as well as government bodies/departments, acting in their commercial capacity or when engaged in economic activities. ‘Profit motive’ is not a *sine qua non* for qualifying as an ‘enterprise’.

The Act does not recognize the concept of “collective dominance”, i.e., two or more independent entities (with no structural links) cannot be clubbed together to form an enterprise or a group for assessing dominance.

B

Defining the Relevant Market and Establishing Dominance

Dominance of an enterprise can only be established in defined relevant markets.

The relevant market comprises those goods or services in a specified area that provide a close competitive constraint on one another. The purpose of the relevant market is to identify the actual competitors of the undertakings that are capable of constraining the entity in question and of preventing it from behaving independently of effective competitive pressure.

The term ‘relevant market’ under the Act includes both the 'relevant product market' (i.e. the market comprising all those products/services which are regarded as interchangeable or substitutable) and the ‘relevant geographic market’ (i.e. the market comprising the area in which the conditions of competition for demand or supply are distinctly homogenous and distinguishable).

The factors considered for defining the relevant market are demand-side substitutability, supply-side substitutability, potential competition, etc., with demand-side substitutability (i.e. substitutability from a consumer's perspective) being the more important factor.

C

Assessment of Dominance

Under the provisions of the Act, dominance refers to the ability of an enterprise to operate independently of market forces and exploit its position of strength to affect competitors or consumers or the relevant market in its favour. While determining dominance, the CCI considers factors such as size and resources of the enterprise, size and importance of competitors, vertical integration of enterprises, dependence of consumers, entry barriers and structure of the market.

Although the CCI acknowledges that market shares are the most important criterion/yardstick in the assessment of dominance, there is no bright line market share test and the CCI has often adopted a holistic approach in concluding dominance.

D

Assessment of Abuse

The Act seeks to capture two kinds of abuse by a dominant enterprise:

(i) exclusionary abuses involving unlawful attempts to deny market access to rival enterprises, refusal to deal etc.; and

(ii) exploitative abuses involving imposition of unfair purchase or sale conditions, limiting or restricting goods or services, etc.

TYPES OF ABUSIVE CONDUCT
Imposition of unfair or discriminatory conditions or price for purchase or sale of goods or services.
Predatory pricing, which refers to sale of goods or provision of services, at a price, which is below the cost of production of the goods, or provision of services, with a view to reduce competition or eliminate the competitors.
Limiting or restricting production of goods or services, technical or scientific development;
Indulging in practices resulting in denial of market access in any manner;
Making conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts (i.e., tying and bundling); and
Using a dominant position in one relevant market to enter into or protect other relevant market (i.e., leveraging).

Some of the conditions imposed by enterprises, which may fall within the above list of abuses provided under the Act are:

(i) ***Price discrimination -*** Price discrimination between companies in the same circumstances may be considered abusive;

(ii) ***Predatory pricing -*** Pricing below the cost of production of the goods, or provision of services, with a view to reduce competition or eliminate the competitors, may be abusive;

(iii) ***Rebates -*** Discounts conditional on the customer obtaining all or most of its products from the dominant enterprise, or loyalty payments to customers who stock only the products of the dominant enterprise, or discounts granted according to quantities sold during a relatively long reference period, may be considered as loyalty rebates, which may be considered to unfair and discriminatory and an abuse;

(iv) ***Exclusivity agreements -*** Entering into long term exclusive agreements, having the effect of causing denial of market access to other enterprises in the relevant market, may be considered as abusive;

(v) ***Refusal to supply -*** Denial of market access through refusal to supply is an abuse;

(vi) ***Tying and Bundling -*** Tying of a product with another one by a specific contractual stipulation, or physical integration of tied product into the tying product such that it is impossible to purchase one product without the other, may raise competition concerns. Similarly, creating a package of two products and not selling one without the other, referred to as bundling, may be considered an abuse; and

(vii) ***Leveraging -*** Using dominant position in one market to enter into or protect the other relevant market is an abuse.

Statutorily, an abuse of dominance is required to be treated as a per se violation, i.e., its effects need not be established. However, the CCI has increasingly adopted an effects based approach, where it has required that the abusive conduct lead to an anti-competitive effect/distortion in the market or harm to consumers. The CCI has refrained from imposing penalty where it has found 'enough justification' for the abusive conduct.

E

Penalty

Under the Act, the CCI has the power to order the following in case of an abuse of dominance violation:

(i) direct dominant entity to discontinue abuse of dominant position;

(ii) impose penalty up to 10% of the average of the turnover for the last 3 preceding financial years;

(iii) direct modification of the agreements with abusive clauses; and

(iv) order division of a dominant enterprises.

Vertical Agreements

Section 3(1) of the Act prohibits any agreement which causes or is likely to cause an appreciable adverse effect on competition (**AAEC**) within India. One such category of anti-competitive agreements are vertical agreements, i.e., agreements between enterprises at different levels of the chain of production of goods or services, which cause or are likely to cause an AAEC. Unlike cartels (anti-competitive agreements between competitors) which are presumed to cause AAEC, the Act requires that vertical agreements must be demonstrated as having caused an AAEC. Hence, vertical agreements are not per se illegal and are analysed under the "rule of reason" approach.

A

Types of Anti-competitive Vertical Agreements

The Act identifies the following categories of vertical agreements which would be anti-competitive if seen as having caused or having the ability to cause an AAEC:

(i) ***Exclusive dealing:*** An exclusive dealing arrangement is one in which two or more enterprises agree, that one or all of them will exclusively deal with the other and refuses to deal with the third parties in respect of a commodity or class of commodities or a particular type of service or services. Such practices may raise competition law concerns if they cause market foreclosure; thereby distorting the competitive structure of the market. Exclusivity between enterprises is created by entering into exclusive supply agreements or exclusive distribution agreements.

(a) ***Exclusive distribution agreement -*** includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market, for the disposal or sale of the goods; and

(b) ***Exclusive supply agreement -*** includes any agreement restricting, in any manner, the purchaser in the course of his trade from acquiring or otherwise dealing in any goods, other than those of the seller or any other person.

(ii) ***Resale Price Maintenance:*** Resale Price Maintenance (**RPM**) refers to *"any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged".*

(a) ***Minimum RPM:*** an agreement between two parties in the distribution chain (e.g., manufacturer and retailer) to charge a specified resale price or to charge no less than a certain price; and

(b) ***Maximum RPM:*** an agreement setting the maximum price which a retailer or distributor can charge.

However, since prescribing a maximum retail price is mandated by the Legal Metrology Act, 2009 for many products, it may not be problematic under the Act as long as distributors are allowed to sell at a price below the MRP.

(iii) ***Tie-in Arrangements:*** The Act also prohibits tying and bundling arrangements, if they cause or have the ability to cause an AAEC. Tying refers to the behaviour of selling one product (the tying product) conditional on the purchase of another product (the tied product). Bundling refers to the practice of selling two unrelated products together.

(iv) ***Refusal to Deal:*** Agreements restricting or likely to restrict the person to whom goods are sold or from whom goods are bought, may also be analysed under Section 3(4) of the Act.

B

Assessment of AAEC

Section 19(3) of the Act provides the factors (positive and negative) which are used to determine whether an agreement has an AAEC under Section 3 of the Act. The negative factors are:

(a) <u>Creation of barriers to new entrants in the market:</u> For instance, if an entity has an exclusive distribution agreement for a term of 15 years with a distributor who has a stronghold in the market for distributing the entity's products, such an agreement would prevent new distributors from entering into the market;

(b) <u>Driving existing competitors out of the market:</u> The exclusive agreement mentioned above may drive out the entity's existing competitors out of the market as they will not be able to deal with the entity's distributor for a period of 15 years; and

(c) <u>Foreclosure of competition by hindering entry into the market:</u> The exclusive distribution agreement will also be considered as an act of foreclosure of competition as the exclusive distribution agreement will hinder entry into the market.

The positive factors are:

(d) Accrual of benefits to consumers;

(e) Improvements in production or distribution of goods or provisions of services; and

(f) Promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

E

Penalty

The Act prescribes penalties which may extend up to 10% of the average turnover for the last three preceding financial years upon each person or enterprise which is a party to anti¬competitive vertical agreements.

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