

CHAPTER THREE

VERTICAL AGREEMENTS IN COMPETITION LAW:

THEIR BENEFITS & DETRIMENTS

3.1 The Concept of Agreement in Competition Law:

In competition laws the world over, the concept of agreement has been given a very wide definition, the fundamental rationale being that firms entering into anti-competitive agreements are unlikely to leave a trail of evidence behind, in the form of written contracts, or otherwise. Most anticompetitive agreements are, therefore, concluded in informal ways. According to the World Bank OECD Glossary of Industrial Organisation, Economics and Competition Law “*Agreement refers to an explicit or implicit arrangement between firms normally in competition with each other to their mutual benefit... Indeed, most agreements which give rise to anticompetitive practices tend to be covert arrangements that are not easily detected by competition authorities.*”¹ Thus, in most jurisdictions, the term agreement includes informal arrangements and concerted practices. For instance, Article 101(1) of the Treaty on the Functioning of the European Union [TFEU] prohibits “*agreements between undertakings, decisions by associations of undertakings and concerted practices*” which have as their object or effect the prevention, restriction or distortion of competition within the internal market.²

The definition of agreement under Section 2(b) of the Competition Act 2002, includes any “*arrangement, understanding or action in concert (i) whether or not, such arrangement, understanding or action is formal or in writing or (ii) whether or not such arrangement, understanding or action is intended to be*

¹ The World Bank OECD Glossary of Industrial Organisation, Economics and Competition Law, online version available at <http://www.oecd.org/regreform/sectors/2376087.pdf> (last accessed on 06/04/17).

² TFEU Article 101 (1) “The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market..”

*enforceable by legal proceedings.”³ As observed by the CCI in **Builders Association of India v. Cement Manufacturers’ Association and Ors.**⁴ “the definition of ‘agreement’ as given in Section 2(b) of the Act requires *inter alia* any arrangement or understanding or action in concert, whether or not formal or in writing, or intended to be enforceable by legal proceedings. The definition, being inclusive and not exhaustive, is a wide one. The understanding may be tacit and the definition covers situations where the parties act on the basis of a nod or a wink. There is rarely any direct evidence of action in concert and in such situations, the Commission has to determine whether those involved in such dealings had some form of understanding and were acting in co-operation with each other. In light of the definition of the term ‘agreement’, the Commission has to assess the evidence on the basis of benchmark of preponderance of probabilities.”⁵*

In most competition regimes, anti competitive agreements can be characterized into **horizontal** and **vertical** agreements. Some jurisdictions, like the US⁶ and the EU⁷ do not make this categorization explicitly in their legislations and the same is interpreted according to the form of the agreement. Judicial pronouncements have also recognized this distinction and separate rules govern the regulation of horizontal and vertical agreements.

³ Competition Act, 2002, § 2 (b) “agreement” includes any arrangement or understanding or action in concert,—

(i) whether or not, such arrangement, understanding or action is formal or in writing; or

(ii) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

⁴ Case No. 29 of 2010.

⁵ *Ibid* at 182.

⁶ Sherman Act, 1890, § 1. “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.”

⁷ TFEU Article 101 (1) at *supra* note 2.

In India, Section 3 of the Competition Act, 2002, deals with anti competitive agreements. Section 3 (1) provides that *“no enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India.”* Section 3(2) is declaratory in nature and states that any agreement entered into in contravention of subsection 1 is void.⁸ Sections 3(3) and 3(4) contain a list of prohibited agreements.⁹ Though the terms ‘horizontal’ and ‘vertical’ have not been used in Section 3, it is clear from the language used that subsection 3 of Section 3 refers to horizontal agreements, whereas subsection 4 refers to vertical agreements. In the **Hiranandani Hospital case**¹⁰ the CCI held that apart from horizontal and vertical agreements, there could also be other forms of

⁸ Competition Act, 2002, § 3 (1) No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India.

(2) Any agreement entered into in contravention of the provisions contained in subsection (1) shall be void.

⁹ Competition Act, 2002, § 3(3) **“Any agreement entered into between enterprises or associations of enterprises or persons or associations of persons or between any person and enterprise or practice carried on, or decision taken by, any association of enterprises or association of persons, including cartels, engaged in identical or similar trade of goods or provision of services, which—**

(a) directly or indirectly determines purchase or sale prices;

(b) limits or controls production, supply, markets, technical development, investment or provision of services;

(c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way;

(d) directly or indirectly results in bid rigging or collusive bidding, shall be presumed to have an appreciable adverse effect on competition.”

Competition Act, 2002, § 3(4) **“Any agreement amongst 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, including—**

(a) tie-in arrangement;

(b) exclusive supply agreement;

(c) exclusive distribution agreement;

(d) refusal to deal;

(e) resale price maintenance,

shall be an agreement in contravention of sub-section (1) if such agreement causes or is likely to cause an appreciable adverse effect on competition in India.”

¹⁰ Mr. Ramakant Kini V. Dr. L.H. Hiranandani Hospital (Case No.39 of 2012).

anti competitive agreements. According to the CCI, "*Section 3(3) and section 3(4) are expansions of Section 3(1) but are not exhaustive of the scope of Section 3(1). There can be various kinds of agreements among enterprises which may fall under Section 3(1) including agreements which are against the interests of consumers, affect freedom of trade and cause or are likely to cause appreciable adverse effect on competition in India*".¹¹ However, the Competition Appellate Tribunal (COMPAT) did not endorse this view as there was no evidence in this case to establish violation of Section 3 (1) independently of Section 3 (4). The COMPAT, quoting **Subhash Yadav v. Force Motor Ltd. & Ors.**¹² said that "*Section 3 deals with two kinds of agreements. Section 3(3) of the Act, deals with horizontal agreements i.e., where the parties are engaged in identical or similar trade of goods or provision of services which determines the purchase or sale price, limit or control the production, indulge in bid rigging, etc. Whereas section 3(4) of the Act, deals with vertical agreements which are tie-in-arrangement, exclusive supply agreement and refusal to deal between the parties who are at different levels of production chain in different markets.*"¹³

3.2 Horizontal Agreements:

A horizontal agreement is an agreement between actual or potential competitors.¹⁴ In India, Section 3 (3) deals with agreements entered into between persons or enterprises "*engaged in identical or similar trade of goods or provision of services*" - thus referring to agreements between competitors. Horizontal agreements are of serious concern to competition authorities as

¹¹ Ibid at 11.

¹² Case No. 32 of 2012.

¹³ Appeal No. 19 of 2014, at 32-33.

¹⁴ Two companies are treated as actual competitors if they are active on the same relevant market. A company is treated as a potential competitor of another company if, in the absence of the agreement, in case of a small but permanent increase in prices it is likely that the former, within a short period of time would enter the relevant market on which the latter is active. See Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements online version available at [http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52011XC0114\(04\)](http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52011XC0114(04)) (last accessed on 06/04/17).

these agreements have high chances of eliminating competition and creating monopolies. Horizontal agreements like price fixing, market allocation, restriction of output and collusive tendering are prohibited by competition laws the world over. According to the OECD, the aforementioned agreements are categories of conduct often described as “hard core cartels” which have no benefit whatsoever and cause harm to the consumers and the economy.¹⁵

In India, Section 2 (c) of the Competition Act, 2002, defines cartel. This section provides that “*Cartel*” includes an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services..” According to Section 3(3) of the Act, “Any agreement entered into between enterprises or associations of enterprises or persons or associations of persons or between any person and enterprise or practice carried on, or decision taken by, any association of enterprises or association of persons, **including cartels**, engaged in identical or similar trade of goods or provision of services, which— (a) directly or indirectly determines purchase or sale prices; (b) limits or controls production, supply, markets, technical development, investment or provision of services; (c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way; (d) directly or indirectly results in bid rigging or collusive bidding, shall be presumed to have an appreciable adverse effect on competition”.

Thus, Section 3 (3) shifts the onus upon the alleged cartel participants to establish that their conduct did not result in *an appreciable adverse effect on competition*. Decisions of the CCI reveal that cartel participants have rarely succeeded in rebutting this presumption.¹⁶ Further, the CCI can rely on

¹⁵See <http://www.oecd.org/competition/cartels/> (last accessed on 06/04/17).

¹⁶ See <http://globalcompetitionreview.com/chapter/1067004/india-cartels> (last accessed on 06/04/17).

circumstantial evidence to establish the existence of an agreement, since direct evidence may be difficult to obtain during cartel investigation. As observed by the CCI in the **Airlines Cartel case**,¹⁷ *“considering the fact that since the prohibition on participating in anti-competitive agreements and the penalties the offenders may incur being well known, it is normal that such activities are conducted in a clandestine manner, where the meetings are held in secret and the associated documentation reduced to a minimum. Even if the Commission discovers evidence explicitly showing unlawful conduct between enterprises such as the minutes of a meeting, it will normally be only fragmentary and sparse, so that it is often necessary to reconstruct certain details by deduction. In most cases, the existence of an anti-competitive practice or agreement must be inferred from a number of coincidences and indicia which, taken together, may, in the absence of any other plausible explanation, constitute evidence of the existence of an agreement.”*¹⁸

Earlier, in the **Cement Cartel case**¹⁹, the CCI held that *“parallel behaviour in prices, dispatch and supply accompanied with some other factors indicating coordinated behaviour among the firms may become a basis for establishing concerted action. Even in foreign jurisdictions, circumstantial evidences have been used and relied upon in cartel cases. Such circumstantial evidences are of no less value than direct evidence as the law makes no distinction between direct and circumstantial evidence.”*²⁰

A distinction is made between cartels and horizontal agreements relating to research and development, production, purchase, commercialization, standardization and information exchange. The latter have several economic benefits such as improving the product quality, enhancing innovation, putting downward pressure on costs, increasing investments and risk sharing

¹⁷ Express Industry Council of India v. Jet Airways (India) Ltd. and Ors. Case No. 30 of 2013.

¹⁸ Ibid at 112.

¹⁹ Builders Association of India v. Cement Manufacturers' Association and Ors. Case No. 29 of 2010.

²⁰ Ibid at 184.

advantages and are treated leniently.²¹ The Competition Act, 2002, provides that agreements entered into by way of joint ventures would not be regarded as anticompetitive if such agreements increase efficiency in production, supply, distribution, storage, acquisition or control of goods or provision of services.²² Cartels formed purely for the purpose of exports are also excluded from the provisions relating to anti-competitive agreements.²³

Further, exemption may be granted to intellectual property right holders to protect their intellectual property, by imposing reasonable conditions as may be “necessary” to protect such intellectual property rights. In the **Shamsher Kataria case**²⁴ the CCI clarified that *“the concept of protection of an IPR is qualified by the word “necessary”. So the question that one should ask is: can the IPR holder be able to protect his IPR, even if such restriction was not present?”*²⁵

²¹ According to the *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to Horizontal Co-operation Agreements*, if an agreement has the object to restrict competition, or in other words, by its very nature it has the potential to restrict competition under Article 101(1) TFEU, then it is not necessary to examine the actual or potential effects of the agreement. If, however, a horizontal co-operation agreement does not restrict competition by object, actual and potential effects must be analysed to determine whether there are appreciable restrictive effects on competition. There are four cumulative conditions which must be met for co-operation agreements to be exempted:

- the restrictive agreement must lead to economic benefits, such as improvements in the production or distribution of products or the promotion of technical or economic progress, i.e. efficiency gains.
- the restrictions must be indispensable to the attainment of the efficiency gains;
- consumers must receive a fair share of the resulting efficiency gains attained by indispensable restrictions;
- the agreement must offer the parties no possible elimination of competition in relation to a substantial part of the products in question.

Where these four criteria are met, the efficiency gains generated by an agreement can be considered to offset the restrictions of competition generated by it.

²² Competition Act, 2002, § 3(3) *“provided that nothing contained in this sub-section shall apply to any agreement entered into by way of joint ventures if such agreement increases efficiency in production, supply, distribution, storage, acquisition or control of goods or provision of services”*.

²³ Competition Act, 2002, § 3(5) Nothing contained in this section shall restrict—.(ii) the right of any person to export goods from India to the extent to which the agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export.

²⁴ Shri Shamsher Kataria V. Honda Siel Cars India Ltd. and others, Case No. 03/2011

²⁵ Ibid at 20.6.21.

3.3 Vertical Agreements:

Vertical agreements refer to agreements between firms that operate at different levels of the supply chain. In case of most goods or services, there is a chain of production before the product reaches the customer - from gathering of the raw material to processing and creating the final product, followed by the distribution and sale of the product. Vertical agreements, therefore, are an essential feature of commercial life, and in one sense a substitute for vertical integration.²⁶ The essence of vertical agreements lies in the fact, that unlike horizontal agreements, firms in a vertical arrangement are not competitors and do not operate in the same relevant market. Such agreements occur between firms engaged in related activities which are complimentary. For instance, in the **Hiranandani Hospital case**,²⁷ the COMPAT observed that a “*hospital is in a vertical relationship not only with obstetricians and other specialists for the provision of maternity services, but also with umbilical stem cell bank for collection of umbilical cord stem cells.*”²⁸

Earlier, in the **Jefferson Parish Hospital case**²⁹ the US Supreme Court had held that the agreement between Jefferson Parish Hospital and a group of anesthesiologists to provide anesthesiology services at the hospital was a vertical tie in arrangement. Jefferson Parish Hospital had argued that the vertical arrangement enabled it to operate more efficiently. Though the case could not justified upon efficiency considerations, the Supreme Court held that Jefferson

²⁶ Overall, vertical relations may be in the form of vertical integration (that is vertical mergers or acquisitions) and vertical agreements (or restraints) between two or more independent firms. This research focuses on vertical agreements between independent companies, in the absence of vertical integration. See H. H. Paul Lugard, *Vertical Restraints under EC Competition law: A Horizontal Approach*, 17 (3) E.C.L.R., 170-171 (1996).

²⁷ Appeal No. 19 of 2014.

²⁸ Ibid at 23 (Quoting para 63).

²⁹ *Jefferson Parish Hospital Dist. No. 2 v. Hyde* 466 U.S. 2 (1984)

Parish Hospital had not engaged in unlawful tying because it did not have significant market power in the market for hospital services.³⁰

The primary reason behind competition authorities for being less concerned about vertical agreements than horizontal agreements, is that the latter is an agreement between competitors producing similar or substitutable products, where the incentive to collude and demand higher prices is greater. In vertical agreements, the product of one party is usually an input for the product of another. Exercise of market power by the upstream or the downstream firm could affect the demand for the product of the other firm. Therefore, parties to such agreements have a legitimate interest in preventing undue exercise of market power by the other.³¹

Further, there are certain conceptual differences between horizontal and vertical agreements, which courts have to focus on while examining the same. There are inherent difficulties of defining what an “agreement” is in the vertical sense, as vertical agreements do not fit into the “conspiracy theory” model in the same way as horizontal agreements do. In horizontal agreements, the players join together with a unity of purpose and design, for their common benefit. If the cartel succeeds then the participating firms stand to make far higher profits than what each firm would have made individually.³² Thus, cartelisation plans are usually not forced upon the participants and it is easier for antitrust authorities to regard such coordinated behavior as an “agreement”.

On the contrary, in vertical agreements there may not any unity of purpose at all between the manufacturer and dealer. Manufacturers may impose

³⁰ See generally David S. Evans, *Untying The Knot - The Case For Overruling Jefferson Parish*, available at <https://www.justice.gov/atr/untying-knot-case-overruling-jefferson-parish> (last accessed on 06/04/17).

³¹ See generally EU Commission Notice, *Guidelines on Vertical Restraints*, paras. 174-185 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17). See also RICHARD WHISH, *COMPETITION LAW*, 605-607 (6th Edn. 2009).

³² MARK FURSE, *COMPETITION LAW OF THE EC AND UK*, 35 (4th Edn. 2004). Also, see generally Massimo Motta, *Cartels in the European Union: Economics, Law, Practice*, available at http://www.barcelonagse.eu/tmp/pdf/motta_cartelseulaw.pdf (last accessed on 06/04/17).

vertical restraints, not in the interest of the dealers but because they feel that such restraints are required for increasing the competitive position of their brand in the market. Similarly, dealers may be happy, indifferent or unhappy about such restraints. Classically, dealers will be happy if they feel that their sales will increase, they will remain indifferent if they think that their sales will remain the same, irrespective of the restraint, and they will oppose the restraint if the sales decrease, or they lose profit, or want to enjoy the benefits of free riding. Therefore, it is difficult to categorize such situations as agreements involving “unity of purpose” in the horizontal sense of the term.

The legality or illegality of vertical agreements, unlike horizontal agreements, therefore does not turn upon the fact of agreement and it becomes important for courts to analyze the exact nature of the agreement.³³ Therefore, in vertical restraint cases, the evidence is focused towards the content of the agreement while in cases involving horizontal agreements the focus is on the fact of the agreement.³⁴

3.4 Vertical Integration and Vertical Mergers:

Vertical agreements are agreements between independent firms, at different levels of the supply chain. As an alternative to vertical agreements, firms can establish a system of vertical integration, either internally, by setting up of retail outlets, or by creating subsidiary companies which handle the distribution work. Vertical integration can also be achieved by taking over distributors operating at the downstream levels. One important reason for companies to vertically integrate would be the fact that such integration offers them a degree of immunity from competition law, as the internal affairs of a company, or groups of companies, would not be treated as “agreement” under

³³ See generally, Jean Wegman Burns, “Rethinking the “Agreement” Element in Vertical Antitrust Restraints” 51 Ohio ST. L.J. 1 [1990].

³⁴ HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY – THE LAW OF COMPETITION AND ITS PRACTICE, 465 (3rd Edn. 2005).

competition law. They are treated as part of a single economic entity.³⁵ In **Viho v. Commission**,³⁶ the European Court of Justice [ECJ] confirmed that Article 81 (1) EC [now Article 101(1) TFEU] does not apply to parent subsidiary agreements, which means that vertical agreements within the same group of companies would not infringe the provisions relating to anti-competitive agreements in competition law. However, vertical integration can be an important factor for assessing the dominance of a firm in the market, and vertical mergers are also regulated by competition authorities.

According to the European Commission Guidelines³⁷ a vertical merger occurs when the manufacturer of a certain product (the “upstream firm”) merges with one of its distributors (the “downstream firm”). The guidelines further clarify that the terms “downstream” and “upstream” are used to describe the potential commercial relationship that the merging entities have with each other. Generally the commercial relationship is one where the “downstream” firm purchases the output from the “upstream” firm and uses it as an input in its own production, which it then sells on to its customers. The market where the former transaction takes place is referred to as the upstream market. The latter market is referred to as the downstream market.³⁸

Like vertical agreements, vertical mergers too are treated more leniently by competition authorities, as they have efficiency enhancing effects and are less harmful to competition. Unlike horizontal mergers, vertical mergers do not result in loss of direct competition between the merging firms. In vertical mergers, the products or the activities of the companies involved are complementary to each other. If complementary products or activities are integrated together in a single firm, it produces significant price efficiencies for

³⁵ RICHARD WHISH, *COMPETITION LAW*, 607-608 (6th Edn. 2009).

³⁶ [1997] 4 CMLR 419.

³⁷ Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings, April 2008, available at <http://ec.europa.eu/competition/mergers/legislation/nonhorizontalguidelines.pdf> (last accessed on 06/04/17).

³⁸ *Ibid* at para 4.

consumers by the internalization of double mark ups. Further, mergers involving products belonging to the same range or portfolio may give rise to customer benefits such as “one-stop shopping”. Vertical mergers, in short, create several efficiencies in the way in which the products are sold, including better coordination, better prices and better service to consumers. However, vertical mergers need to be regulated as they may give rise to two problems viz - coordinated and non coordinated effects. Coordinated effects mean that due to the vertical merger, collusion between competing firms becomes easier. Non-coordinated effects mean effects like foreclosure - for example where actual or potential rivals’ access to supplies or markets is hampered as a result of the merger.³⁹ For instance, if a dominant firm acquires sources of raw material, it could effectively deny raw materials to other suppliers, thereby foreclosing the market.

In competition law, mergers are treated as separate and distinct from agreements, and the analysis of vertical mergers differs from the analysis of vertical agreements, which is the subject of this research. To explain briefly, in case of mergers, the task of the competition authority is to assess the future behavior of the firm in the market, rather than the existing or earlier behavior. To carry out such inquiry, the competition authority uses various economic tools such as the Herfindahl Hirschman (HHI) index⁴ to determine market concentration and then identifies the potential adverse effects, including the entry barriers that could be created as a result of the merger. Further, in case of a merger, timely completion of the inquiry is crucial so that the proposed merger is not held up. Most competition laws provide for a time limit for completing the merger inquiry, and if not completed within the stipulated time, the merger may deem to have been approved. Lastly, unlike other provisions of competition law, in case of mergers, structural remedies such as prohibiting the merger (in rare cases, even ordering a de-merger) or allowing the merger with certain modifications like the divestiture of an operation, are favoured, rather than

³⁹ Ibid at paras 12-19.

behavioral remedies.⁴⁰ The law on mergers in competition law is complex, and a detailed discussion on the same is outside the scope of this research. This discussion is limited to the extent of understanding why firms may try to evade competition law by using the merger route to create the same effect as that of an anticompetitive vertical agreement. In order to prevent such effect, competition laws of most countries have provisions to oversee and regulate vertical mergers.

3.5 Categories of Vertical Agreements and their Benefits:

Vertical agreements can be broadly categorized into the following kinds:⁴¹

- **Exclusive Distribution Agreement** – Where a manufacturer sells his products to one, or a select number of distributors, for resale in a particular territory. These distributors are usually granted exclusive right to sell the products within a defined territory or to a specific group of customers and are prevented from actively selling into other exclusively allocated territories.⁴²

The EU guidelines on Vertical Restraints point out that exclusive distribution may create several efficiencies, especially in situations where considerable investments are required to be made by the distributors in advertising, building up the brand image and protecting the brand. This is particularly required for complex products - for “experience products” where the buyer learns about the attributes of the product after buying and consuming or “credence products” where the qualities are difficult to

⁴⁰ Vinod Dhall, Key Concepts in Competition Law, in COMPETITION LAW TODAY, CONCEPTS, ISSUES AND THE LAW IN PRACTICE (Vinod Dhall, Ed. 2007) at 16-20.

⁴¹ RICHARD WHISH, COMPETITION LAW, 626-638 (6th Edn. 2009). The Competition Act, 2002, in § 3 (4) mentions five kinds of vertical agreements – tie-in arrangements, exclusive supply agreements, exclusive distribution agreements, refusal to deal and resale price maintenance.

⁴² Such agreements to sell to a particular class of customers are also known as customer allocation agreements.

judge even after consumption.⁴³ Exclusive distribution agreements also lead to cost savings due to the creation of economies of scale in transportation and distribution of goods. As observed by the CCI in **Ghanshyam Dass Vij v. M/s Bajaj Corp. Ltd. and Ors.**⁴⁴ *“Exclusive distribution agreement in broader sense means an arrangement between the supplier and distributor wherein the distributor sells the product/s within a defined area or to a particular group / category of customers. Such arrangements particularly affect intra-brand competition as they restrict entry of another player into the market. It may also affect the inter-brand competition since the outlets of distribution are limited thereby impeding competition amongst players engaged in several similar services. However, it may be noted that such arrangement can be objectively justified on certain grounds like protection from free riding, efficient management of sales of products, economic efficiency, etc.”*⁴⁵

In **Société Technique Minière v. Maschinenbau Ulm**⁴⁶ the ECJ had stated *“With regard to small and medium-sized concerns in particular, the exclusive dealership system often offers the undertaking concerned the only opportunity of participating in foreign trade and of thereby adapting itself to the demands of a larger market, because as a general rule such concerns do not have sufficient financial resources to set up their own*

⁴³ Andersen and Philipsen have outlined characteristics of goods by placing them in three categories- 1. Goods with “search characteristics” or which have low pre buying quality detection costs. Here consumers can inspect the goods and gain knowledge about them before buying. Examples of these would be clothes, furniture and footwear. 2. Experience goods, or those where pre buying costs of quality detection are higher, whereas the post buying quality detection costs are much lower and can be used for further consumption of the product. Examples of experience products would typically be wine, hotels, newspapers and restaurants. 3. Credence goods or those which are characterized by both pre and post buying high costs of quality detection. Examples of such goods would be health services, legal advice, child day care. See Esben Sloth Andersen and Kristian Philipsen, *The evolution of credence goods in customer markets: exchanging ‘pigs in pokes’ available at http://www.researchgate.net/profile/Esben_Andersen/publication/267402623_The_evolution_of_credence_goods_in_customer_markets_exchanging_%27pigs_in_pokes%27/links/5450b28c0cf201441e938b9a.pdf* (last accessed on 06/04/17).

⁴⁴ Case No. 68 of 2013.

⁴⁵ Ibid at 75.

⁴⁶ Case no. 56/65 available online at <http://curia.europa.eu/juris/liste.jsf?language=en&num=C-56/65> (last accessed on 06/04/17).

*sales organization in countries other than their own. Thus there is less and less opposition to the view that exclusive dealing agreements of the kind at issue are perfectly compatible with the general objectives of the Common Market. This is also true even as regards the particular aims of rules or competition. Where this view is opposed, the opposition is centred on the means necessary for reaching an objective agreed by all.*⁴⁷

- **Selective Distribution Agreement** – An agreement where dealers are required to meet certain criteria before becoming part of the distribution network.

Selective distribution is frequently used for the distribution of luxury goods and branded products. Like exclusive distribution agreements, selective distribution arrangements also restrict the number of distributors and channels of resale of the product. The main difference between exclusive and selective distribution agreements is that in case of the latter, the number of dealers usually does not depend upon territories allocated but upon selection criteria pertaining to the features of the product. Further, the restriction on resale is usually applicable against non authorized dealers, so that only the authorized dealers and final consumers can be the buyers. Selective distribution can be on the basis of qualitative or quantitative criteria. In case of purely qualitative distribution, the supplier selects dealers on the basis of objective criteria like training of sales personnel, service provided at the point of sale, the range of the products being sold etc. without putting a specified limit on the number of dealers.

In **Metro v. Commission**⁴⁸, the ECJ held that “*selective distribution systems constituted, together with others, an aspect of competition which accords with Article 81 (1) provided that resellers are chosen on the basis*

⁴⁷ Ibid at 241.

⁴⁸ 2 CMLR 44 [1978].

of objective criteria of a qualitative nature relating to the technical qualifications of the reseller and its staff and the suitability of its trading premises and that such conditions are laid down uniformly for all potential resellers and are not applied in a discriminatory fashion."⁴⁹ In case of quantitative selective distribution, the number of dealers is limited, sometimes by methods like fixing requirements of maximum or minimum sales etc. Selective distribution agreements lead to economies of scale in transportation, help in solving free rider problems and creating a brand image. The combination of selective distribution with territorial allocation also protects investments made by authorized dealers. According to the EU Commission Notice, Guidelines on Vertical Restraints, purely qualitative selective distribution systems usually fall outside Article 101(1) TFEU, provided that three conditions are satisfied. Firstly, the nature of the product should be such that it legitimately requires a selective distribution network. Secondly, resellers must be chosen on the basis of objective, qualitative criteria that are laid down uniformly and such criteria should not be applied in a discriminatory manner. Thirdly, the criteria must not go beyond what is necessary.⁵⁰ This was applied in the case of **Pierre Fabre**,⁵¹ where Pierre Fabre Dermo-Cosmétique (a producer and distributor of cosmetics and personal care products, through various pharmacies in the European market) argued that their products required personalized service, and that is why they had banned sales via the internet. The Court of Justice held that such Internet sales ban could not be justified by the need to give individual advice to customers or to protect brand image.⁵²

⁴⁹ Ibid at 21.

⁵⁰ See EU Commission Notice, Guidelines on Vertical Restraints, para. 175 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

⁵¹ Case C-439/09 Pierre Fabre Dermo-Cosmétique SAS v. Président de l'Autorité de la concurrence [2011] ECR I-000.

⁵² Ibid at 42-46.

Selective distribution agreements do not raise antitrust concerns provided there is sufficient inter brand competition and the agreements do not lead to market foreclosure.⁵³ As observed by the CCI in **Shamsher Kataria V. Honda Siel Cars India Ltd. and others**,⁵⁴ *the efficiencies of the selective distribution system...need to be analyzed in perspective of the ability of the restrictive clauses to create foreclosure effects and barriers to entry in the market. Article 101(3) (analogous to section 19(3) of the Act) provides that an agreement, containing restrictive clauses which 'contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit', will cause AAEC if such restrictive clauses 'afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.'*⁵⁵

- **Exclusive Supply Agreement** – An extreme form of limited distribution which usually takes place by means of an agreement which restricts the supplier to sell to only one buyer.

In the **Shamsher Kataria**⁵⁶ case, the CCI held that *"the agreements (containing clauses) requiring the authorized dealers to source spare parts only from OEMs or their approved vendors...are in the nature of exclusive supply.... under the terms of section 3(4)(b) of the Act"*⁵⁷. Exclusive supply can also take place by forcing a quantity requirement on the supplier, where the buyer and supplier agree upon incentives if the supplier focuses on only one buyer. In the case of intermediate goods or services, exclusive supply is also called industrial supply. Exclusive

⁵³ See EU Commission Notice, Guidelines on Vertical Restraints, paras. 174-185 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

⁵⁴ Case No. 03/2011.

⁵⁵ Ibid at 20.6.31.

⁵⁶ Shri Shamsher Kataria V. Honda Siel Cars India Ltd. and others, Case No. 03/2011.

⁵⁷ Ibid at 20.6.42 (II).

supply, in absence of market power has limited foreclosure effects.⁵⁸ Such agreements are particularly useful in the event of “hold up” problems which occur when there are client specific investments required to be made by the buyer or supplier, relating to special equipment, technical know-how or training. In such cases, the investor may not agree to make the investment before supply requirements are determined.⁵⁹ Exclusive supply, or single branding agreements are thus prohibited only if they foreclose the market, facilitate collusion, or limit in store inter brand competition. Cases in which the European Commission held that single branding agreements resulted in the infringement of Article 101 (1) TEFU include the **Spices case**⁶⁰ and the **Bloemenveilingen Aalsmeer case**.⁶¹

- **Franchising Agreement** – An agreement where a license is granted to the franchisee giving him the right to use intellectual property of the franchisor, including trademarks, signs and know-how, for the use and distribution of goods or services of the franchisor, in lieu of a franchise fee paid by the franchisee.

⁵⁸ The EU Guidelines state, for example, “On a market for a certain type of components (intermediate product market) supplier A agrees with buyer B to develop, with his own know-how and considerable investment in new machines and with the help of specifications supplied by buyer B, a different version of the component. B will have to make considerable investments to incorporate the new component. It is agreed that A will supply the new product only to buyer B for a period of five years from the date of first entry on the market. B is obliged to buy the new product only from A for the same period of five years. Both A and B can continue to sell and buy respectively other versions of the component elsewhere. The market share of buyer B on the upstream component market and on the downstream final goods market is 40 %. The market share of the component supplier is 35 %. There are two other component suppliers with around 20- 25 % market share and a number of small suppliers. Given the considerable investments, the agreement is likely to fulfill the conditions of Article 101(3) in view of the efficiencies and the limited foreclosure effect. Other buyers are foreclosed from a particular version of a product of a supplier with 35 % market share and there are other component suppliers that could develop similar new products. The foreclosure of part of buyer B's demand to other suppliers is limited to maximum 40 % of the market”.

⁵⁹ EU Commission Notice, Guidelines on Vertical Restraints, para. 107 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

⁶⁰ OJ [1978] L 53/20, [1978] 2 CMLR 116.

⁶¹ OJ [1988] L262/27, [1989] CMLR 500. See also RICHARD WHISH, COMPETITION LAW, 638. (6th Edn. 2009).

These agreements are very common for sale of goods like clothes, cars, or with respect to fast food chains like, for example, McDonald's or Burger King. In addition to intellectual property rights, the franchisor may also offer technical or commercial assistance to the franchisee.⁶² Franchising helps the franchisor to establish a uniform and standardized system of distribution network for his products.⁶³ Franchise agreements are necessary to protect intellectual property rights, maintain common identity and reputation of the chain. They also prevent free riding, thereby encouraging franchisees to invest in the business.⁶⁴ In **Pronuptia de Paris GmbH, v. Pronuptia de Paris Irmgard Schillgallis**⁶⁵ the European Court observed that *"in a system of distribution franchises...an undertaking which has established itself as a distributor on a given market and thus developed certain business methods grants independent traders, for a fee, the right to establish themselves in other markets using its business name and the business methods which have made it successful. Rather than a method of distribution, it is a way for an undertaking to derive financial benefit from its expertise without investing*

⁶² EU Commission Notice, Guidelines on Vertical Restraints, para 189 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

⁶³ In the US, under the amended Federal Trade Commission's Franchise Rule of 2007, "franchise" means *"any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that: (1) the franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark; (2) the franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and (3) as a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate of \$500 or more at any time before, to within six months after, commencing operation of the franchisee's business"* See Federal Register / Vol. 72, No. 61 / Friday, March 30, 2007 / Rules and Regulations available online at <https://www.ftc.gov/sites/default/files/070330franchiserulefrnotice.pdf> (last accessed on 06/04/17).

⁶⁴ EU Commission Notice, Guidelines on Vertical Restraints, para 191 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

⁶⁵ Case 161/84 [1986] ECR 353, available online at <http://eur-lex.europa.eu/legal-content/CS/ALL/?uri=CELEX:61984CJ0161#DI> (last accessed on 06/04/17).

*its own capital. Moreover, the system gives traders who do not have the necessary experience access to methods which they could not have learned without considerable effort and allows them to benefit from the reputation of the franchisor's business name. Franchise agreements for the distribution of goods differ in that regard from dealerships or contracts which incorporate approved retailers into a selective distribution system, which do not involve the use of a single business name, the application of uniform business methods or the payment of royalties in return for the benefits granted. Such a system, which allows the franchisor to profit from his success, does not in itself interfere with competition*⁶⁶

In Shri Ramamurthy Rajagopal v. Doctor's Associates Inc, Subway International and Ors. ⁶⁷ the CCI held that “*Subway*” is an international restaurant chain and is engaged in the business of fast food/ quick service restaurants and operates its business through its franchisees. In view of the abovementioned facts, the relevant market in the instant case appears to be “*market of services of franchisee for a fast food restaurant chain/ quick service restaurant chain.*”⁶⁸ Further, the clauses in the franchising agreement “*do not have any AAEC in the market since the size of the concerned market is huge as compared with the market size of ‘Subway’ food chain business. Therefore, the impact of such restriction, if any, is negligible..(and)..does not contravene any provision of Section 3 of the Act.*”⁶⁹

- **Tying Agreement – An agreement where the supplier makes the supply of one product (the tying product) conditional upon the buyer buying a distinct, separate product (the tied product).**⁷⁰

⁶⁶ Ibid at 15.

⁶⁷ Case No. 90 of 2014.

⁶⁸ Ibid at 15.

⁶⁹ Ibid at 13.

⁷⁰ Two products are distinct if in the absence of the tie, the products can be purchased from two different markets. For example, a printer and its cartridge would constitute distinct products, belonging to different markets, as there could be separate printer suppliers and cartridge suppliers. Whereas, if the buyer is forced to buy all his cartridges from a particular printer

Tying can commonly take place in the forms of contractual tying, refusal to supply, withdrawal of guarantee and technical tying or bundling.⁷¹ In Europe, cases like **Hilti**⁷² have described that two products can be regarded as distinct in face of direct evidence, that is when given a choice, customers purchase the tying and the tied products separately from different suppliers, or indirect evidence such as market presence of firms specializing in manufacturing the tied product without the tying product.⁷³ The EU guidelines on vertical restraints elaborate that there are cases where firms with little market power tend not to tie two products. For instance, if customers want to buy shoes with shoelaces, it is not feasible for distributors to provide separate laces. Therefore, it is part of commercial usage for shoe manufacturers to supply shoes with the laces and the same is not considered to be a tie.⁷⁴ Tying has several efficiency justifications. Tying agreements produce efficiencies associated with joint production or distribution of goods, and ensure uniformity in quality and standards. Where the tied product is not produced by the supplier, economies of scale arise when suppliers buy large quantities of the tied product and these benefits can be passed on to the consumers in the form of lower prices.⁷⁵

In **Sonam Sharma v. Apple & Anr.**⁷⁶ the CCI observed that “a tying arrangement occurs when, through a contractual or technological requirement, a seller conditions the sale or lease of one product or service on the customer’s agreement to take a second product or service.

supplier (as a result of a tie) this will limit his chances of buying cartridges sold by other cartridge suppliers.

⁷¹ RICHARD WHISH, COMPETITION LAW, 679-680 (6th Edn. 2009)

⁷² Hilti v Commission [1991] ECR II-1439.

⁷³ Ibid at 67.

⁷⁴ EU Commission Notice, Guidelines on Vertical Restraints, para 125 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

⁷⁵ Ibid at para 222.

⁷⁶ Case No: 24/2011.

In other words, a firm selling products X and Y makes the purchase of product X conditional to the purchase of product Y. Product Y can be purchased freely on the market, but product X can only be purchased together with product Y. The product that a buyer is required to purchase in order to get the product the buyer actually wants is called the tied product. The product that the buyer wants to purchase is called the tying product.' 'More often, tying is a sales strategy usually adopted by the companies to promote / introduce a slow-selling or unknown brand when it has in its portfolio a fast selling or well known product, over which it has certain market power.'⁷⁷ "A tie arrangement, therefore, must be assessed with respect to foreclosure in the handset market and to foreclosure in the service market; and whether the agreement results in consumer harm".⁷⁸

- **Resale Price Maintenance Agreement (RPM) – An agreement where price restraints are imposed on the buyer as to the price at which he may sell the product.**⁷⁹

RPMs are regarded to be a hard core restriction under EU law.⁸⁰

However, for RPMs to be a source of concern, the suppliers entering into such agreements should be endowed with considerable market power.⁸¹

In **Jasper Infotech Private Limited v. Kaff Appliances (India) Pvt.**

⁷⁷ Ibid at 66.

⁷⁸ Ibid at 65.

⁷⁹ One way of classifying restraints would be 'price' and 'non-price' restraints. Price restraints usually are in the form of minimum resale price maintenance, where the buyer is forced to observe a minimum price threshold below which he cannot sell, or maximum resale price maintenance, where the buyer cannot go above a certain price threshold while selling his goods. For a detailed economic analysis see Y. Spiegel and Y. Yehezkel, Price and Non-Price Restraints when Retailers are Vertically Differentiated, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=236024 (last accessed on 06/04/17).

⁸⁰ EU Commission Notice, Guidelines on Vertical Restraints, para 223 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

⁸¹ See generally Massimo Motta, Patrick Rey, Frank Verboven and Nikos Vettas, Hardcore restrictions under the Block Exemption Regulation on vertical agreements: An economic view, available at http://ec.europa.eu/dgs/competition/economist/hardcore_restrictions_under_BER.pdf (last accessed on 06/04/17).

Ltd.⁸² the CCI held that “*Such an agreement hinders the ability of dealers/distributors to compete on the price of the product. The Commission feels that such prescription of MOP [market operating price] by the Opposite Party to its dealers and insistence to follow MOP pricing regime prima facie seems to be in contravention of section 3(4) (e) read with section 3(1) of the Act*”⁸³.

RPMs have several benefits, including the preventing of free riding of dealers on efforts of competing dealers who spend considerable time, money and effort in promoting the product, or explaining the attributes of the product to potential customers. In the absence of RPMs, customers, after learning about the product, or even availing of demonstrations from one dealer, can buy it at a cheaper rate from dealers who have not made such investment.⁸⁴ RPMs foster intra brand competition and encourage distributors to increase sales effort, which in turn benefits the consumers. In cases where the supplier introduces a new product, RPMs are a useful mechanism during the introductory period, to expand demand for the product by setting lower prices.⁸⁵ RPMs also help in addressing problems of double marginalization.⁸⁶

⁸² Case No. 61 of 2014.

⁸³ Ibid at 15.

⁸⁴ See Resale Price Maintenance, OECD Glossary of Statistical Terms, available online at <http://stats.oecd.org/glossary/detail.asp?ID=3298> (last accessed on 06/04/17),

⁸⁵ EU Commission Notice, Guidelines on Vertical Restraints, para 225 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

⁸⁶ The double marginalization problem arises in situations where independent firms are operating and have the tendency to maximize their own profits, to the detriment of the supplier's interest. A typical example would be where an upstream company supplies an input to a downstream company at a price above the marginal cost. If the downstream firm also has market power, it may charge a price which is higher, for a quantity which is lower rather than a price and quantity would maximize joint profits. See Margaret E. Slade, *The Effects of Vertical Restraints: An Evidence Based Approach, The Pros and Cons of Vertical Agreements*, p. 18, available at <http://www.konkurrensverket.se/globalassets/english/research/report-the-pros-and-cons-of-vertical-restraints-18mb.pdf> (last accessed on 06/04/17). See also Patrick Rey, *Vertical restraints – an economic perspective*, available at <http://www.fne.gob.cl/wp-content/uploads/2013/11/Patrick-Rey.-Vertical-Restraints.pdf> (last accessed on 06/04/17).

- **Refusal to Deal** – An agreement which restricts, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought. In **Shri Ghanshyam Dass Vij v. M/s Bajaj Corp. Ltd. and Ors.**⁸⁷ the CCI observed that “*refusal to deal/ supply (occurs) wherein an enterprise, generally with stronger market power refuses to deal with its customers or suppliers. The obvious effect in such scenario is that the downstream market gets affected due to such refusal. It may also be noted that no enterprise is obliged to supply its products to any company/ supplier/ distributor. However, under certain circumstances, such conduct may attract the provisions of the Act which will depend on case to case basis*”.⁸⁸

According to Dobson and Waterson, vertical restraints can be beneficial in addressing supply and distribution problems, in the following ways:

<i>Problems in supply and distribution</i>	<i>Contractual solutions</i>
1. Successive (manufacturer then retailer) mark ups	Two-part tariffs Quantity requirements Retail price ceilings
2. Damaging competition between retailers	Resale price maintenance Exclusive distribution
3. Free riding by retail price discounters on the pre-sales services and/or reputation of full price dealers	Service requirements Resale price maintenance Exclusive distribution Refusal to supply Exclusive dealing
4. Providing the optimal number and density of dealers and capturing economies of scale in distribution	Resale price maintenance Refusal to supply
5. Free riding by manufacturers on product's image, advertising, and customer drawing power or on investment in dealers	Exclusive dealing
6. Damaging competition between manufacturers	Exclusive dealing Tie-in sales Exclusive distribution

⁸⁷ Case No. 68 of 2013.

⁸⁸ Ibid at para 76.

Source: Michael Waterson, P. Dobson, Vertical Restraints and Competition Policy, Office of Fair Trading.⁸⁹

3.6 Antitrust concerns arising out of vertical restraints:

As discussed, vertical agreements are a common feature of commercial life and have several efficiencies which benefit the consumers, manufacturers and dealers. The main question to be addressed is in spite of these efficiencies, what is the need of putting vertical agreements through the antitrust scanner? It is, therefore, important to deal with the anti-competitive concerns arising out of vertical agreements. As observed in Europe in the case of **Van Den Bergh Foods v. Commission**⁹⁰ vertical agreements must be assessed in their economic context in order to determine whether they have an anti-competitive effect - such agreements do not have the object of restricting competition.⁹¹

Apart from reduction of intra brand competition, which is the usual consequence of vertical restraints, the two main concerns that competition authorities have with vertical agreements are market foreclosure and collusion, at the upstream or the downstream levels.⁹² These are dealt with separately as follows:

- **Market foreclosure:**

The primary concern of competition authorities is that vertical restraints may lead to foreclosure of the market, at any level of the supply

⁸⁹ Available at http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft177.pdf (last accessed on 06/04/17).

⁹⁰ [2004] 4 CMLR 14.

⁹¹ Ibid at 80.

⁹² The EU guidelines categorically state that foreclosure and collusion at the supplier's level may harm consumers by increasing wholesale product prices, product choices, discouraging innovation and reducing product quality, whereas, foreclosure and collusion at the distributors' level can harm consumers by increasing retail product prices, limiting the choice of price-service combinations and distribution formats, lowering the availability and quality of retail services and reducing more effective methods of distribution. See EU Guidelines on Vertical Restraints, para 101 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

chain.⁹³ For instance, a supplier who establishes an exclusive distribution network, by a system of selective or exclusive distribution, may prevent its competitors from getting access to customers at a reasonable cost. This may result in the exit of firms in the upstream market and also discourage the entry of new competitors.⁹⁴ This problem of foreclosure is aggravated in situations where there is sufficient buyer power in the downstream market and exclusive distributors are appointed over very large territories, for example, where a very large store becomes the exclusive distributor of leading brand. Again, in situations where majority of the suppliers apply selective distribution formats, the same results in foreclosure of the market with respect to other distributors, as the latter are unable to have access to the products. Foreclosure of distribution chains, whether arising from exclusive or selective distribution reduces the possibilities for consumers to take advantage of the benefits offered by competitive distribution formats such as lower prices, enhanced transparency and wider access.⁹⁵ As held by the COMPAT in **Dr. L.H. Hiranandani Hospital v. Competition Commission of India and Ors.**⁹⁶ *“While exclusive contracts can benefit competition in the market by ensuring supply sources or sales outlets, reducing contracting costs, or creating dealer loyalty, they become anti-competitive when a firm uses exclusive contracts to impede efforts of new firms to break into the market or of smaller existing firms to expand their presence.”*⁹⁷

⁹³ The UK Office of Fair Trading defines market foreclosure as follows: “A market is foreclosed either completely or partially when undertakings face barriers to entering that market, or barriers to expansion once in that market.” See Office of Fair Trading, Vertical Agreements, Understanding Competition Law, available online at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284430/oft419.pdf (last accessed on 06/04/17).

⁹⁴ See Margaret E. Slade, *supra* note 86, p. 19.

⁹⁵ See EU Commission Notice, Guidelines on Vertical Restraints, paras 153-178 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

⁹⁶ Appeal No. 19 of 2014

⁹⁷ *Ibid* at 23, quoting para 69.

Likewise, exclusive supply agreements have to potential to foreclose other buyers. Here, the market share of the supplier at the upstream level and the market share of the buyer at the downstream level are both relevant for creating market foreclosure. If the supplier at the upstream level is dominant then exclusive supply obligations imposed by the former can foreclose other buyers from the market. The buyer power at the downstream level is also of crucial importance. If the buyer downstream has no market power, then competition is unlikely to be affected by this restraint. However, where both the supplier at the upstream level and the buyer at the downstream level have sufficient market power, exclusive supply obligations have the potential to create market foreclosure.⁹⁸ In cases of refusal to deal, market power of the entity refusing to deal is significant. As observed by the CCI in **Shri Ghanshyam Dass Vij v. M/s Bajaj Corp. Ltd. and Ors.**⁹⁹ *“refusal to deal/ supply (occurs) wherein an enterprise, generally with stronger market power refuses to deal with its customers or suppliers. The obvious effect in such scenario is that the downstream market gets affected due to such refusal.”*¹⁰⁰

RPMs may also be used by a manufacturer with market power to foreclose smaller rivals. For instance, if a supplier offers increased margins to dealers, it may induce them to prefer the former’s brand over rival brands when advising customers, or induce them not to deal in competing brands at all.¹⁰¹ By restricting price competition between dealers, RPMs may also discourage efficient dealers from entering the market. It may prohibit the giving of discounts and thereby expanding the

⁹⁸ See generally *Tampa Electric Company V. Nashville Coal Co.* [365 U.S. 320 (1961)].

⁹⁹ Case No. 68 of 2013.

¹⁰⁰ *Ibid* at 76.

¹⁰¹ See EU Commission Notice, Guidelines on Vertical Restraints, para 224 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

distribution formats, which also hinders entry of firms at the downstream level.¹⁰²

Tying is another method of foreclosing the market with respect to tied goods, the tying products, or both. The extent of foreclosure of the tied product would depend upon the percentage of sales of the tied product in the total market for the tied product. Though tying is an effective mechanism for market foreclosure where the supplier of the tying product has sufficient market power, a tie may also lead to less competition for customers who value the tied product and because of that are induced to buy the tying product. This leads to foreclosure with respect to the tying product and usually happens in cases where the tied product is an important complementary product of the tying product. Tying also induces the charging of supra competitive prices.¹⁰³

As observed by the CCI in **Sonam Sharma's case**¹⁰⁴ *“the following conditions are necessary and essential in respect of anticompetitive tying:*

1. *Presence of two separate products or services capable of being tied: In order to have a tying arrangement, there must be two products that the seller can tie together. Further, there must be a sale or an agreement to sell one product or service on the condition that the buyer purchases another product or service (or the buyer agrees not to purchase the product or*

¹⁰² Till 1997, US courts held that a vertical restraint imposed by a seller on his customers, *other than resale price maintenance*, would be tested under the rule of reason. In 1997, in *State Oil Co. v. Khan*, [522 U.S. 3 (1997)] the US judiciary chose to apply the rule of reason in the determination of “maximum resale price maintenance” because of the precompetitive features associated with the latter. This proactive approach was taken further when the US courts held that the per se illegality rule was inapplicable even while determining “minimum price maintenance” in *Leegin Creative Leather Products Inc. v. PSKS Inc.*, [127 U.S. 2705 (2007)].

¹⁰³ See EU Commission Notice, Guidelines on Vertical Restraints, paras 216-217 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

¹⁰⁴ *Sonam Sharma v. Apple & Anr.* Case No: 24/2011.

service from another supplier). In other words, the requirement is that purchase of a commodity was conditioned upon the purchase of another commodity.

2. *The seller must have sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product: An important and crucial consideration for analyzing tying violation is the requirement of market power. The seller must have sufficient economic power in the tying market to leverage into the market for the tied product. That is, the seller has to have such power in the market for the tying product that it can force the buyer to purchase the tied product.*
3. *The tying arrangement must affect a "not insubstantial" amount of commerce: Linked with the above requirement, tying arrangements are generally not perceived as being anti-competitive when substantial portion of market is not affected.¹⁰⁵*

- **Collusion:**

The second concern is that vertical agreements can facilitate manufacturer and dealer cartels. In the United States, in cases such as **Continental T.V. Inc. v. GTE Sylvania Inc.**¹⁰⁶ and **Business Electronics Corp. v. Sharp Electronics**,¹⁰⁷ the U.S. Supreme Court observed that there is support for the proposition that vertical price restraints reduce intra-brand competition because they facilitate cartelization. In fact in Sylvania, the Supreme Court said that *"there may be occasional problems in differentiating vertical restrictions from horizontal restrictions originating in agreements*

¹⁰⁵ Ibid para 69.

¹⁰⁶ 433 U.S. 36 (1977).

¹⁰⁷ 485 U.S. 717 (1988).

among the retailers.”¹⁰⁸ This difficulty can arise when distributors/retailers cartelize to enter into restrictive agreements with suppliers, or when a vertically integrated supplier also competes downstream with the distributors with whom it has restrictive agreements.¹⁰⁹

However, the concept of proving agreement and collusion in vertical relationships has not been without controversy. For example, in the case of **Pittsburg Corning**¹¹⁰ the European Commission applied the concept of concerted practice to discriminatory prices used by a producer of cellular glass, in order to prevent parallel imports. The supplier had introduced a new higher price system which was designed to make all parallel exports impossible in view of the transport costs and the prices charged by the supplier. The Commission found that there was a concerted practice between the supplier and two of its distributors on the basis of the fact that these distributors had implemented the scheme initiated by the supplier. Scholars have criticized this approach, as the thrust of vertical collusion should not be on the finding of agreement in the horizontal sense, but its actual content.¹¹¹

RPMs are usually regarded to be the main culprit for fostering collusion. RPMs create price transparency and therefore become a useful mechanism for eliminating intra-brand competition and encouraging collusion.¹¹² RPMs induce dealers to keep prices above the competitive level and reach a

¹⁰⁸ 433 U.S. 36 (1977) at 58 (Footnote 28).

¹⁰⁹ See also Eugene F. Zelek Jr., Louis W. Stern, Thomas W. Dunfee, A Rule of Reason Decision Model After Sylvania, 68 Cal. L. Rev. 1, 25 (1980) available at <http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2297&context=californialawreview> (last accessed on 06/04/17).

¹¹⁰ Dec. 72/403/EEC, Pittsburg Corning Europe [1972] L 272/35.

¹¹¹ See generally Ioannis Lianos, Collusion in Vertical Relations under Article 81 EC” Law and Governance in Europe Working Paper Series, (1/2007) available at http://www.ucl.ac.uk/laws/clge/wp-series/ucl_clge_001_07.pdf (last accessed on 06/04/17).

¹¹² According to Rey and Tirole, RPMs foster collusion. They argue that in where RPMs are imposed, changes in retail prices are known to be defections from the collusive agreement, so price cuts are easier to detect. However, RPM may also make it harder to sustain collusion if the short term gain from defection is higher and long run cost from defection is lower with imposition of the RPM than without it. See Patrick Rey and Jean Tirole, A Primer on Foreclosure, in HANDBOOK OF INDUSTRIAL ORGANIZATION VOL 3, (MARK ARMSTRONG AND ROB PORTER, Eds. 2007) at 2145-2220.

collusive equilibrium. RPMs may also lead to reduction of competition at the supplier level, particularly where suppliers use the same distributors and apply similar RPMs.¹¹³

Similarly, allocation of exclusive territories with respect to dealers can create dealer monopolies and prevent entry. Vertical restraints may encourage cartel formation amongst manufacturers. For instance, agreements of exclusive dealing can tie up the dealer to the manufacturer and eliminate the need for manufacturers to grant secret price cuts in order to steal customers from rivals. Where suppliers impose obligations on the dealers not to sell to particular competitors, the situation becomes even more dangerous, as it takes the shape of horizontal collusion to specifically exclude certain brands and create a “selective club” of leading suppliers.¹¹⁴

Because of the efficiencies and detriments outlined above, courts have to carefully assess the legality of vertical agreements. The legal treatment of vertical agreements and the evolution of the law in different jurisdictions have been discussed in the next chapter.

¹¹³ See EU Commission Notice, Guidelines on Vertical Restraints, para 224 available at http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf (last accessed on 06/04/17).

¹¹⁴ Ibid at para 182.