Intellectual Property Rights, And Competition Law
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Lecture - 12
Introduction to Competition Law - Vertical Agreements

Dear students in this class, we will discuss about the Vertical Agreements and in the last class we talked about Horizontal Agreements and what is prohibitive in nature under the Competition Law. And in this class we will discuss about another category of agreements which are known as Vertical Agreements. In the last class also I have mentioned about vertical agreements.

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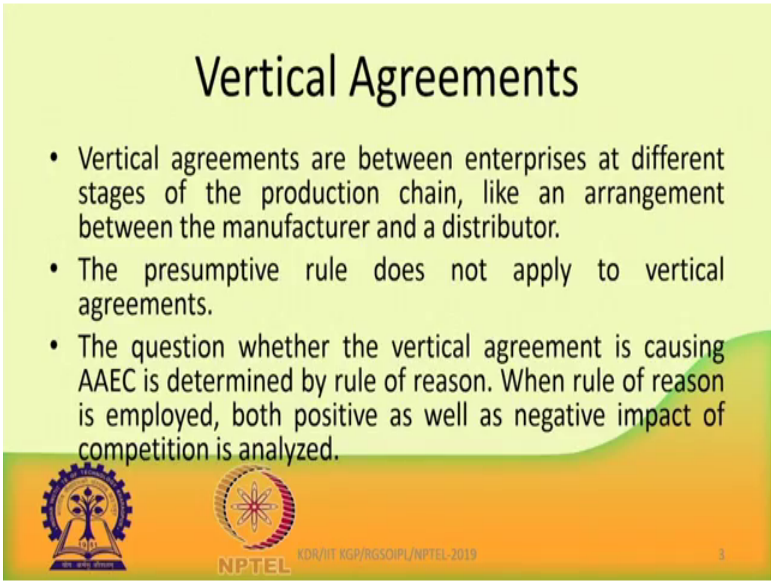

Basically the vertical agreements are nothing but agreement between the enterprises working at different stages of production chain and at different manufacturing level or at different distribution level. Horizontal agreements are at the same level and vertical agreements are at different levels, that is the only difference.

Also the *per se rule* is not applicable to the vertical agreements but per se rule is applicable to the horizontal agreements. So, in the vertical agreements the question is whether they are causing *appreciable adverse effect on competition(AAEC)* determined by the rule of reason. That means, *rule of reason* is also applicable to the vertical agreements, but it will depend upon if there is an *appreciable adverse effect on competition*.

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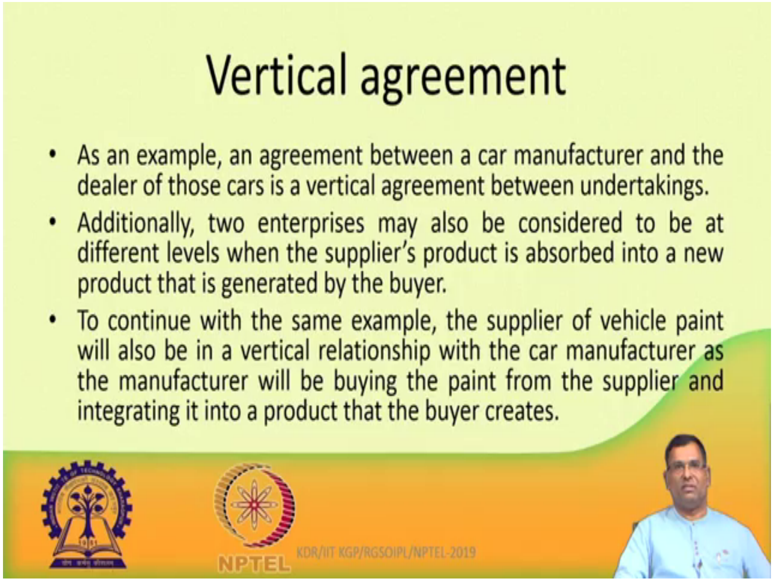

What are these vertical agreements? The vertical agreements are nothing, but these agreements at the different stages or level. You can divide it into different stages or different categories of agreements.

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So, these vertical agreements work at different level and affecting the market. And we will see how these agreements affect the market. So, there must be an agreement amongst the enterprises or persons like in any other combinations. So, the parties to such agreement must be at different stages this is the second condition to fulfil vertical agreement. And their level of production must be different or they are in the chain in respect of production, supply, distribution, storage, sale of price, trade or goods, or provision of services. They must be at different level this is the second condition.

And the agreeing parties must be at different markets; this is the third condition to fulfil the vertical agreements. And the agreement should cause or likely to cause an *appreciable adverse effect on competition* which is mentioned under section 19 of the Indian Competition Act. Then it will be considered as a vertical agreement.

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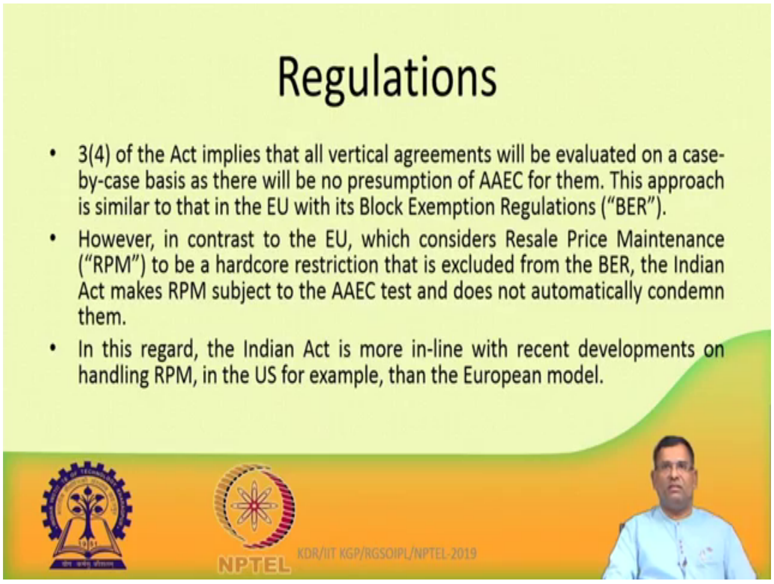

Then we can see that vertical agreement will be always evaluated based on the presumption of *appreciable adverse effect on competition*. We can see the resale price maintenance and different categories of it starting from the tie-in agreements; and ending up with the resale price maintenance. And so, we will see these agreements one by one.

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So, the categories of agreements were mentioned under section 3(4) of the Indian Competition Act and the first one is the tie-in arrangement. So, in tie-in arrangement there is an agreement requiring a purchaser of the goods, as a condition of such purchase, to purchase some other goods which the purchaser does not want.

So that means; the tie-in arrangement is an arrangement pair. I want to purchase something, but I will be forced to purchase something else also along with that particular product i.e. the tie-in arrangement. Then the second category of agreement is the exclusive supply agreement. So, this includes the agreements restricting the purchaser in the course of his trade form acquiring or otherwise dealing in any goods of any other person other than those of the seller. So, the distributor will be prevented from taking distribution agency of any other company.

Thirdly exclusive distribution agreement this is similar to the supply agreement which includes the agreement to limit, restrict, withhold output, supply of goods, allocation of market or any market, disposal or sale of goods. So, tie in arrangement, exclusive supply agreement and exclusive distribution agreement are considered as the vertical agreement.

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Then Refusal to deal: refusal to deal is one of the another pernicious form of anti-competitive practice which restricts or likely to restrict, the class or classes of persons whom goods are sold or from whom goods are bought. So you agree that I am not going to sell to this particular class of persons that is a refusal to deal.

And the last form of vertical agreement is the resale price maintenance, which includes agreements or goods on condition that the price has to be changed on resale by the purchaser which shall be stipulated by the seller; that means, the resale price will be stipulated by the seller unless there is an agreement between these parties. So, resale price maintenance also is considered as a vertical agreement, which is distortive to the market.

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We will start with them one by one. What is this tie-in arrangement? So as I already told you, the tie-in arrangement requires a party to buy more than one product; one product he wants to purchase, but he can purchase only in addition to the purchase of another one.

So, they tie the products. Tying one product with another one is the tie-in arrangements. So, it is very simple that I do not want another product which I will be forced to purchase, that is the tie-in agreement.

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And tie-in agreement intends the purchaser of particular product to purchase some other product required by the supplier. So, even though I do not require that particular product, I will be forced to purchase that particular product then only I can get the services or can get the other product.

The famous case of the Microsoft Media Player; which we will discuss on later stage. So, if you want to purchase the operating system, you have to purchase the media player as well. And so, you are forced to purchase some other product which you do not want. So, that is basically known as the tie-in arrangement.

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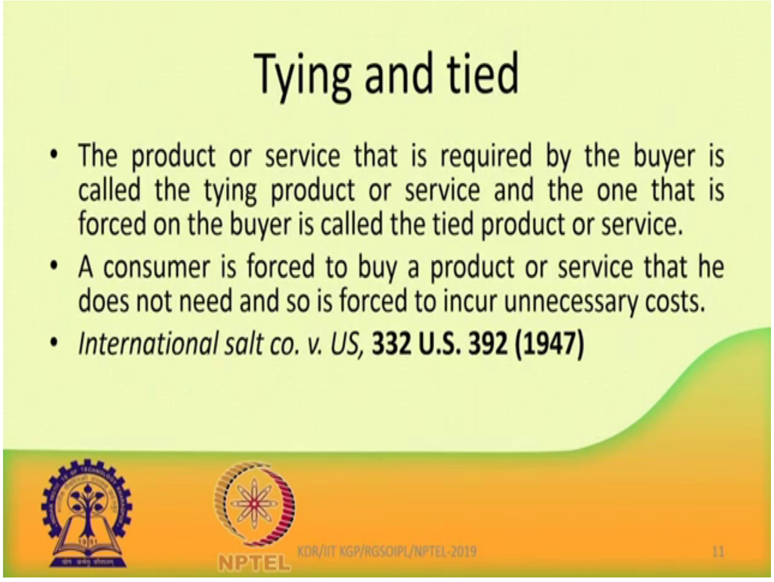

So, how it is going to affect the market; definitely it is going to affect the market and it is directly affecting the consumer welfare, because I do not want to purchase a particular product, which I am forced to purchase. Because I want that one product which is essential for me, but the other one is tied product or service which I do not want actually, I am forced to purchase that one. So; that means, it accrues unnecessary costs to me. So, it is distorting the market.

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So, these agreements are considered as distorting particular market and there is a tradeoff between the parties. So, they try to capture the market through one product while one company wants to sell some of their other products which the consumer does not want.

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For this tying, these companies use their market power as well. For example, the Microsoft softwares, the operating systems and the office, they are holding more than 90 percent of the market; and they impose that you should purchase another product of ours then only you can get the operating system.

Jefferson Parish Hospital case is one of the US cases. The court found that whoever uses the hospital, whoever is availing the service of the hospital operating rooms is tied with a product, what is their product? Their *anesthesia service*. So, if you want to use my operation theatre, you must take my anesthesia service also. So, they tied the anesthesia service along with their hospital operating rooms. So, this was held to be per se illegal; by the US court. So, even though the per se rule is not applicable to the vertical agreements, but the Court used this test and held that it is illegal per se.

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So, the tying can be pernicious to the market, distorting to the market and which is an unnecessary burden on the consumer. So, it is anti-competitive in nature. I will go to the second one i.e. exclusive supply agreements; and exclusive supply agreements basically prohibits the downstream party in dealing with the products other than that of particular party. So, it means there is no competition. So you are not going to take the dealership of somebody else, you are not going to deal with a particular competitive product of the upstream supplier.

So, the exclusive agreement is the agreement restricting the purchaser in any manner in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person. So, it means that you are restricting a particular seller to deal with your product only, not the competitor's product or anybody else's product. So, these exclusive supply agreements are also going to directly affect the particular market.

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The upstream party is always going to impose these restriction and conditions on the downstream purchaser. But you can see that it is always a closed group; the downstream purchaser will be always a closed group and so there can be collusion as well with all the downstream parties. The exclusive agreement thus always restricts, always puts restriction on the market and so is anti-competitive in nature.

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And exclusive distribution agreement; exclusive distribution agreement is another form of agreement which is market distorting and anti competitive in nature. So, the exclusive distribution agreement is an arrangement where company grants exclusive rights to the producers or services to another party for example single brand showrooms or exclusive territory rights; the state distributors and single distributor, exclusive distributor. They cannot take the distribution business of any competitor company or any other company. So, it becomes exclusive distribution agreements. So, this also is to promote product or services to the customers and the distributor is prevented from availing the services of anybody else or the market power is limited by inter brand competition.

So, if there is inter brand competition, then there will be competition in the market and the consumers will get better products and better services; but this inter brand competition will be limited by this exclusive distribution agreements and that it is why it is anti-competitive in nature.

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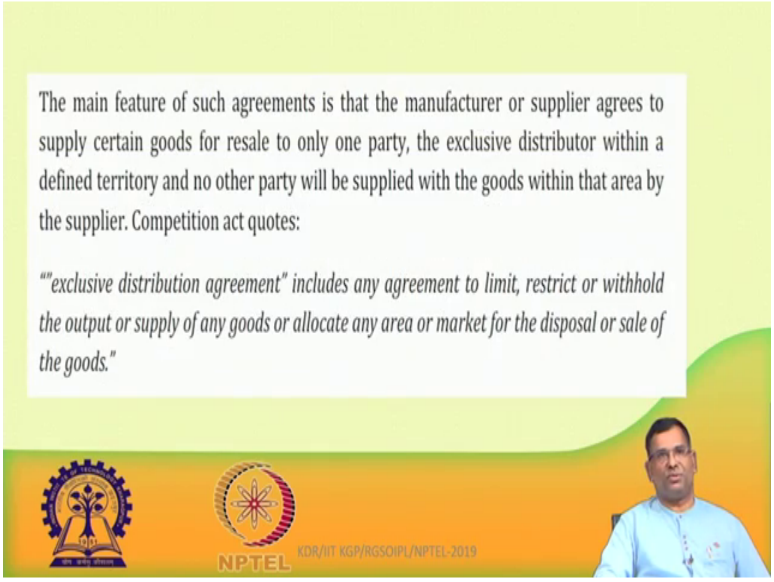

And the main features which we can see is that: agreements to restrict or withhold the output or supply of goods or allocate any area, geographical area or market for the disposal of the sale of goods.

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Section 3(4) of the Competition Act says that allocate any area or market for the disposal of sale of the goods, this is a terminology which is used. So, the geographical distribution of goods includes regional distribution or state distribution or specific area can be demarcated by the upstream supplier which will affect the competition in the market.

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And, then another form of anti-competitive practice is the refusal to deal with customers or suppliers ultimately which is directly going to affect the market. For example I refuse to deal with you if you deal with my competitor. So, I put a condition that if you deal with my competitor, I refuse to deal with you. This is going to ultimately affect the market at large. So, it is considered to be anti-competitive in nature.

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So, in antitrust law this refusal to deal is considered anti-competitive in nature. Because every firm has a duty to the public, every firm has a duty to offer their services to everybody and you cannot refuse the services. And imposing additional obligations on a firm to do some business with its rival is not possible at all. So, the antitrust rules look into this refusal to deal as an unreasonable restriction which restrict competition in the market.

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So, refusal to deal happens in certain circumstances with the competitors. For example, Micromax and the Ericsson case in India; can you really refuse to deal with your competitor? The answer is no.

In a perfect competition market you cannot refuse to deal with anybody, you cannot refuse to license with anybody. We will discuss about the standard essential patents and the concept of standard essential patents, how it has emerged from this refusal to deal. A monopolist cannot refuse to sell a particular product or service to its competitors. And if the monopolist is doing a business with the competitor, monopolist needs legitimate business reasons for such policies.

So, if you want to refuse, there must be very strong reasons to refuse such kind of services; otherwise it will be considered as anti-competitive in nature.

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In some of the cases even though it is a vertical agreement the activities are per se illegal. For example, restraint of trade, which we were discussing in the last classes, especially under the US law restraint of trade is considered to be a felony.

But in Indian Competition Act it is not considered to be a felony. For the vertical agreements, as I told you earlier, the per se rule is not applicable, but in certain circumstances the court can declare it is as per se rule, especially when refusal to deal exists.

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And if you look into one of these cases, it is almost the same case which we discussed about *the hospital case.* In 2014 the Indian Competition Commission has discussed about this particular case. So, here the *Xcel Healthcare*, the stockist for pharmaceuticals in Goa were violating the CCI order and they continued to control the supply.

And these particular companies continued to control the supply of pharmaceuticals in Goa through a stipulation. All stockist in Goa must obtain a no objection certificate from it; and this pressurised the pharmaceutical companies in not to supply or stockist with any other company. So, exclusive agreement is also considered to be market distorting and anti-competitive in nature.

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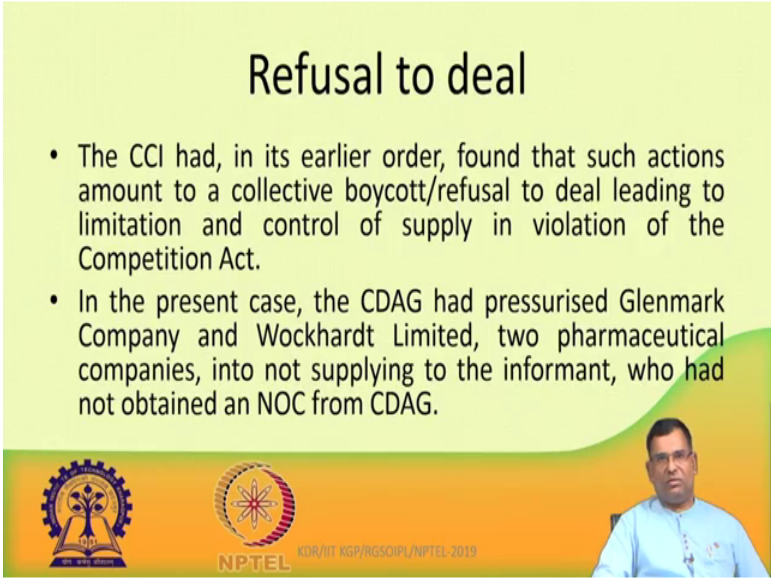

All the big pharmaceutical companies refuse to deal and they give exclusive marketing rights and also distribution agreements. Now the watch dog in the Competition Commission of India is there to look into these kind of violations.

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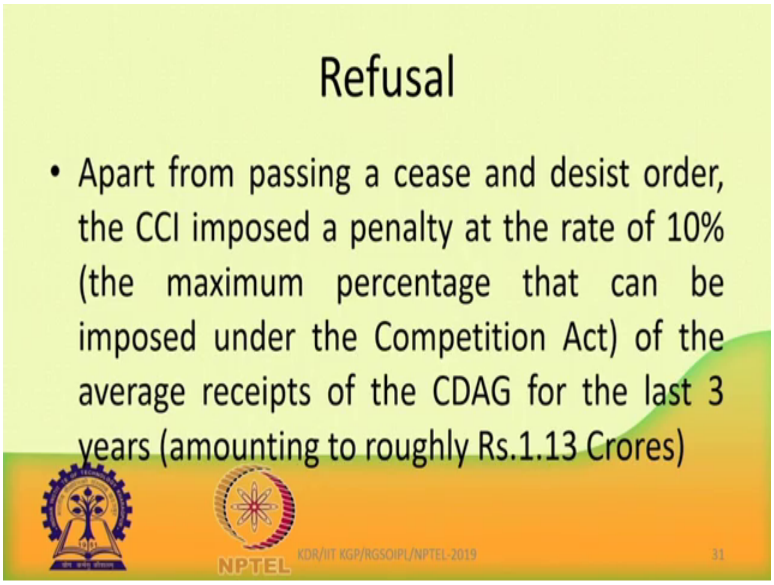

So, you can find that heavy fines will be imposed by the Competition Commission of India in such kind of cases and whether it is in Foreign jurisdictions or in the Indian jurisdictions.

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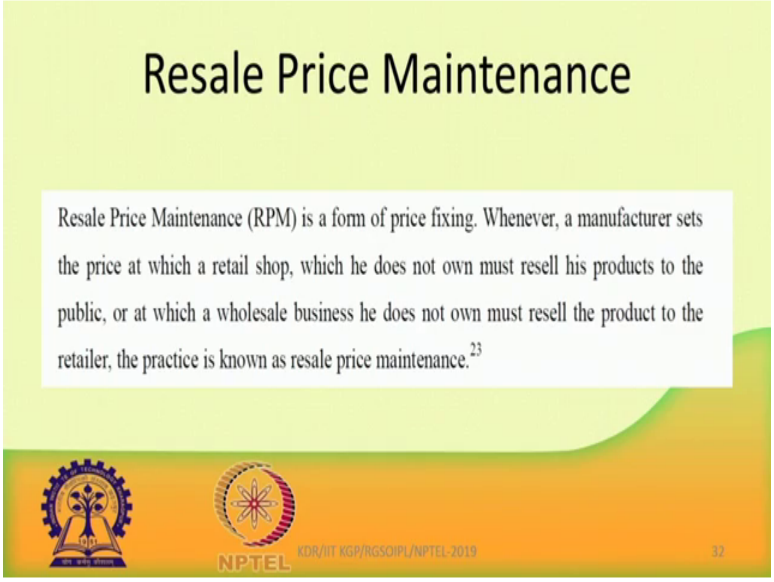

And the last form of vertical agreement is the Resale Price Maintenance. In the Resale Price Maintenance the manufacturers set the prices at which the retail shop person will sell his particular product, and there is no freedom to the retail shopkeeper to have a competitive price in the market.

So, price maintenance is for the wholesale business as well as the retail business. So, this will be known as the Resale Price Maintenance. And resale price maintenance is also considered to be anti-competitive in nature.

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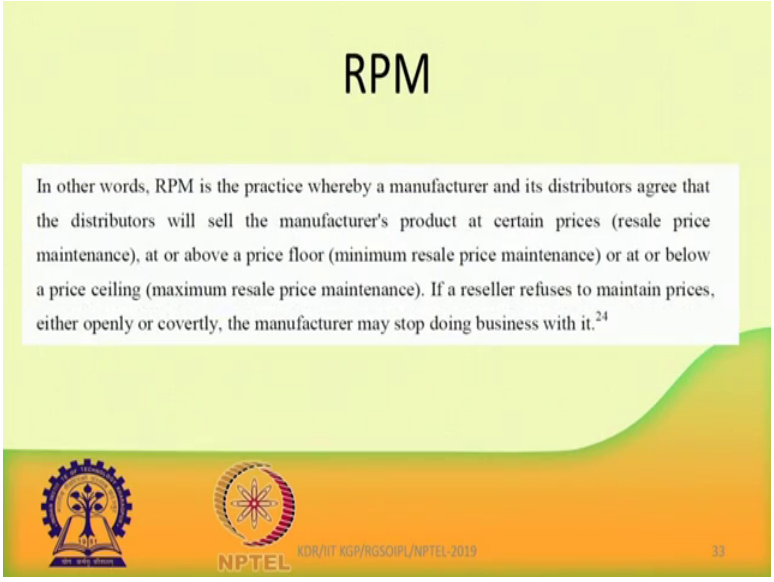

The manufacturer through a system of distributors and towards the retailers, the retailers agree for a resale price maintenance fixed by the manufacturer; so the minimum retail price are fixed by the companies so that they can exploit the particular market, but this is considered to be exploitative in nature.

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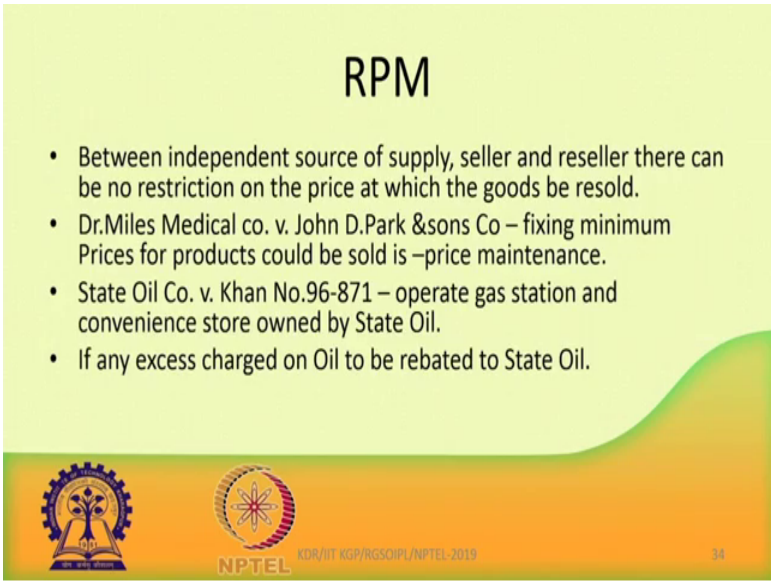

We can find a number of cases whether it is in Foreign markets or in the Indian markets resale price maintenance are the usual anti-competitive practices which is managed by the Indian companies as well.

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So, the price fixing is also within the purview of the Competition Law.

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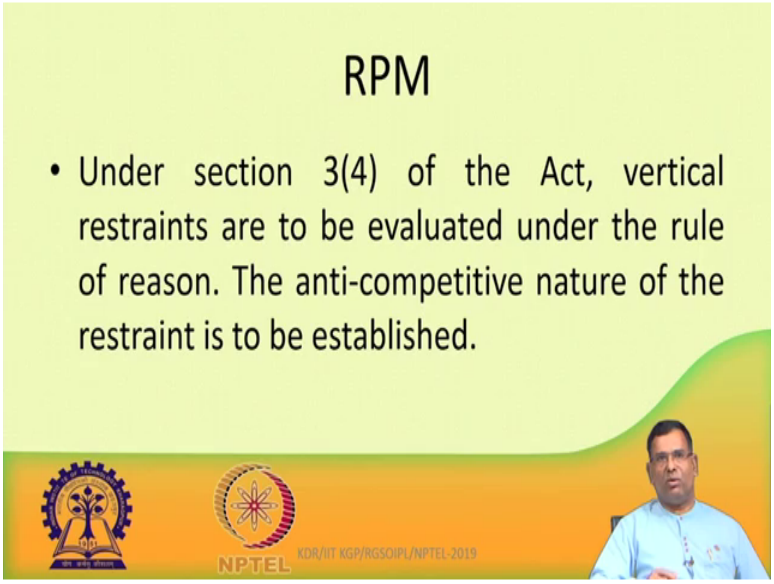

And under 3(4) of the Indian Competition Act, all vertical restraint are to be evaluated under the *rule of reason*, then this anti-competitive nature can be established.

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We can look into the pro-competitive benefits. What are the pro-competitive benefits in order to calculate whether it is per se illegal or not? So, you can have all these practices without any harm to the competitive process in the market. But I think this argument is not a valid argument because all these practices have an anti-competitive effect on the market, then how can you practice this without affecting the competitive process in the market.

Then again, sale support to the retail is extended by the manufacturers which may not be exploited by the free riders. So, there is a connection between the seller and the company and the retailers. The company will see that their product is sold in the market; then the question of free riding in the market is not going to happen. Then full service retailers and product requiring retail service though very rare, then incremental sales, all these are considered to be pro-competitive benefits. So, if you can prove the pro-competitive benefits, then it would not be considered as anti-competitive in nature.

But it is unlikely to happen, and very unlikely to prove these pro-competitive factors.

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So, you can find a number of other factors.

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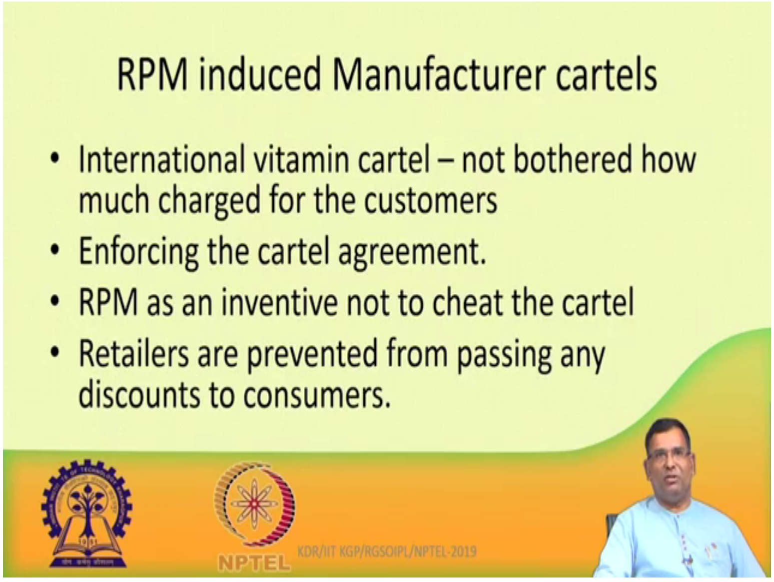

This resale price management, usually induces the cartels as well. So, you can find a number of examples of the *International vitamin cartel* which is one of the best example. And there is no mechanism to monitor this international cartels, other than territorial in nature. So, controlling these cartel agreements is also very difficult in nature.

So, in this class we were trying to discuss about all the vertical agreements which are anti-competitive in nature and the different levels of market and different levels of competition. So, horizontal agreements and vertical agreements, are the anti-competitive practices that are distorting the market and thus anti-competitive in nature; and competition provisions of each and every country and the Indian competition act also prohibits these kind of activities.

So, we will stop this particular class here on the horizontal agreements and vertical agreements; and in the next class we will talk about the Abuse of Dominant Position.

Thank you.