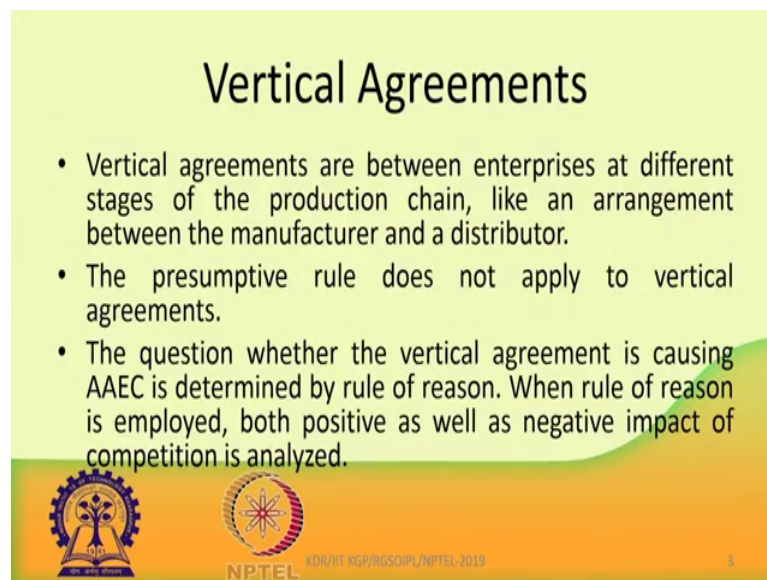


Intellectual Property Rights, And Competition Law
Prof. K D Raju
Rajiv Gandhi School of Intellectual Property Law
Indian Institute of Technology, Kharagpur

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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Vertical Agreements

- Vertical agreements are between enterprises at different stages of the production chain, like an arrangement between the manufacturer and a distributor.
- The presumptive rule does not apply to vertical agreements.
- The question whether the vertical agreement is causing AAEC is determined by rule of reason. When rule of reason is employed, both positive as well as negative impact of competition is analyzed.

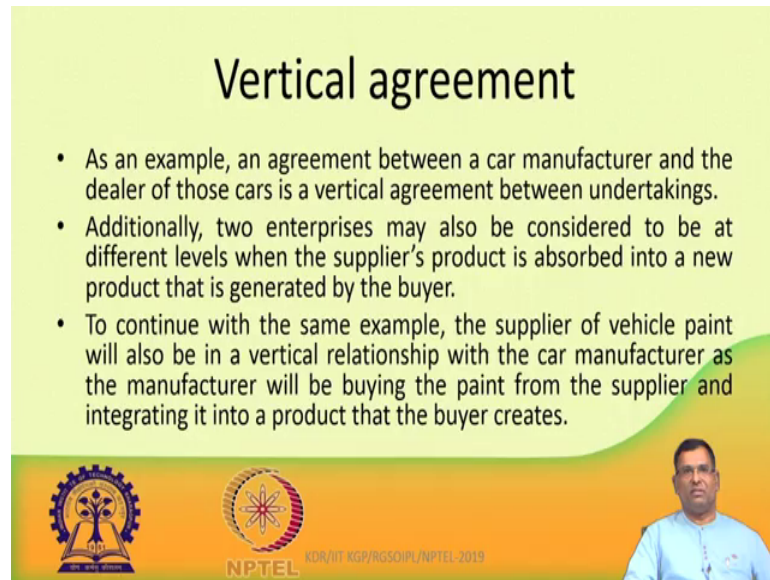
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Basically the vertical agreements are nothing but agreement between the enterprises working at different stages of production chain and at different manufacturing level or at different distribution level. Horizontal agreements are at the same level 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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Vertical agreement

- As an example, an agreement between a car manufacturer and the dealer of those cars is a vertical agreement between undertakings.
- Additionally, two enterprises may also be considered to be at different levels when the supplier's product is absorbed into a new product that is generated by the buyer.
- To continue with the same example, the supplier of vehicle paint will also be in a vertical relationship with the car manufacturer as the manufacturer will be buying the paint from the supplier and integrating it into a product that the buyer creates.

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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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Vertical Agreements

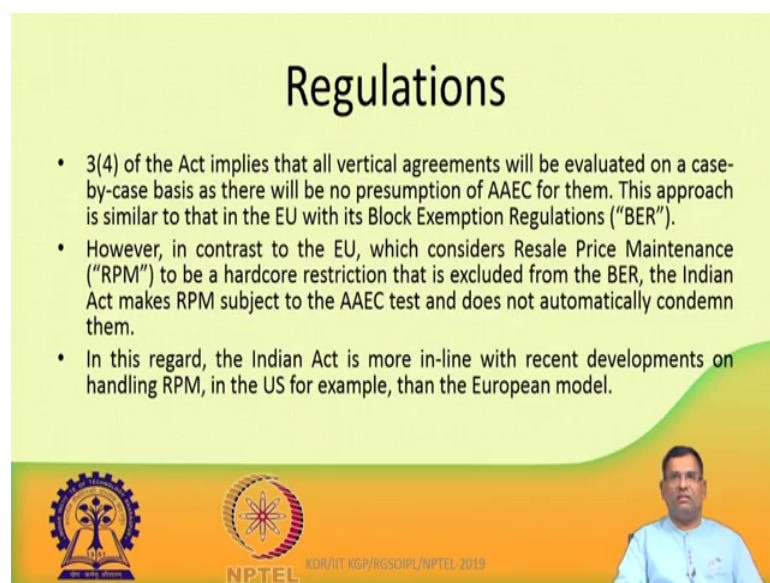
- In order to determine whether any agreement is in contravention of section 3(4) read with section 3(1) of the Act, the following five essential ingredients of section 3(4) have to be satisfied:
- There must be an agreement amongst enterprises or persons;
- The parties to such agreement must be at different stages or levels of production chain, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services;
- The agreeing parties must be in different markets;
- The agreement should cause or should be likely to cause AAEC;

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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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Regulations

- 3(4) of the Act implies that all vertical agreements will be evaluated on a case-by-case basis as there will be no presumption of AAEC for them. This approach is similar to that in the EU with its Block Exemption Regulations (“BER”).
- However, in contrast to the EU, which considers Resale Price Maintenance (“RPM”) to be a hardcore restriction that is excluded from the BER, the Indian Act makes RPM subject to the AAEC test and does not automatically condemn them.
- In this regard, the Indian Act is more in-line with recent developments on handling RPM, in the US for example, than the European model.

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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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Categories of agreements S.3(4)

- Tie-in arrangement (*includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods*);
- Exclusive supply agreement (*includes any agreement restricting in any matter the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person*);
- Exclusive distribution agreement (*includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods*);

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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 from 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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Categories of agreements

- Refusal to deal (*includes any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought*);
- Resale price maintenance (*includes any agreement to sell goods on condition that the prices to be changed on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be changed*).

  
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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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Tie-in arrangement

A tie-in provision requires the downstream party to buy one or more goods or intermediate inputs from the upstream party in addition to the inputs essential to maintaining his identity as part of the product network, thereby "tying" together the purchases.³

"Tie-in arrangement includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods."

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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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Tie-in

- A tie-in arrangement would arise only where the intending purchaser of a product or service is required by the supplier to purchase some other product or service is required by the supplier to purchase some other product or service, as a condition of that purchase.
- A product or service is to be treated as being the subject of a tie-in arrangement when its supply is offered on the condition that the buyer who ordered for some product or service, the basic product, must also purchase some other product or service.



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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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Tying and tied

- The product or service that is required by the buyer is called the tying product or service and the one that is forced on the buyer is called the tied product or service.
- A consumer is forced to buy a product or service that he does not need and so is forced to incur unnecessary costs.
- *International salt co. v. US, 332 U.S. 392 (1947)*



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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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Tie-in arrangements tie a product as a condition to purchase of a product. Such an arrangement might be impulsive on part of downstream party. As it enforces them with a product that the party may not be interested in "consuming" with a product they intend to buy. It leaves them with a very limited choice and a trade-off.

There is a case where tie-in arrangement can be anti-competitive in the external party's market. Apart from its own market the tied-in product enters and tries to capture market share through some other production chain. This may increase the firm's market share.



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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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Market power

- *Jefferson Parish Hospital dist No.2 v. Hyde, 466 U.S. 2 (1984)*
- The court held that the case involved a "tying arrangement" because the users of the hospital's operating rooms (the tying product) were compelled to purchase the hospital's chosen anesthesiological services (the tied product),
- that the hospital possessed sufficient market power in the tying market to coerce purchasers of the tied product, and that, since the purchase of the tied product constituted a "not insubstantial amount of interstate commerce," the tying arrangement was therefore illegal "per se."

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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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Exclusive supply agreement

Exclusive supply agreement prohibits downstream party from dealing in products other than that of upstream party. Competition act states:

"exclusive supply agreement" includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person;

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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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It is a restriction imposed by upstream party on downstream party. So upstream party trading is open, in the sense it can deal with any other downstream party but downstream party has a closed group. Both parties enter in this agreement only when it is mutually beneficial. To begin with let us consider why upstream party, say manufacturer, would want to get into an exclusive supply agreement.



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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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Exclusive distribution agreement

Exclusive distribution agreement is an arrangement in which a company grants exclusive rights on its products or services to another company. The most common forms include single branding and/or exclusive territory rights, whereby a single distributor obtains the right to market a supplier's product in a specific territory. The supplier's purpose in granting exclusivity is normally to provide the distributor with incentives to promote the product and provide better service to customers. In most cases, the distributor's market power is limited by inter-brand competition.



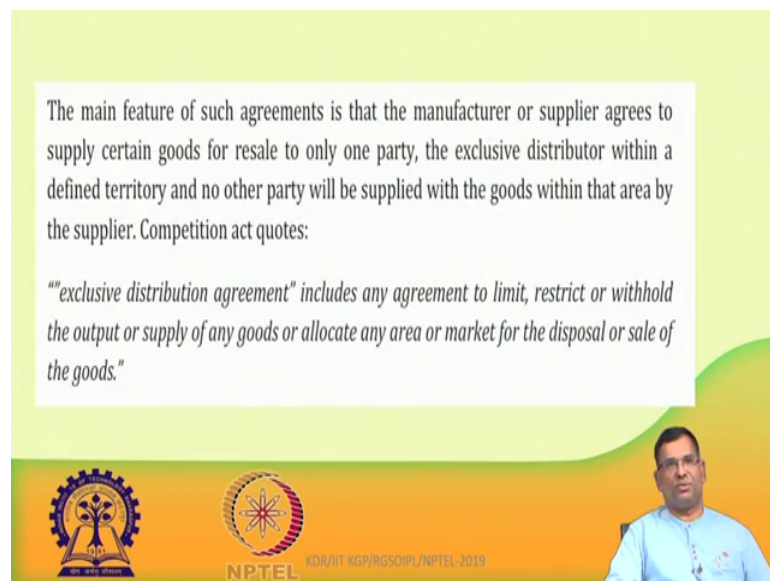
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And exclusive distribution agreement; exclusive distribution agreement is another form of agreement which is market distorting and anti competitive in nature. So, the exclusive distribution agreement is an arrangement where company grants exclusive 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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The main feature of such agreements is that the manufacturer or supplier agrees to supply certain goods for resale to only one party, the exclusive distributor within a defined territory and no other party will be supplied with the goods within that area by the supplier. Competition act quotes:



“exclusive distribution agreement” includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods.”

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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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Third point emphasised in the section 3(4) of The Competition Act, 2002, is to "allocate any area or market for the disposal or sale of the goods" i.e. geographical distribution of goods. This can be evident more in the case of distribution of goods. An upstream party, assuming it has monopoly, would want to extract maximum producer surplus. Hence, it would want to exercise third degree price discrimination- practice of dividing consumers into two or more groups with separate demand curves and charging different prices to each group. This division of consumers can be done by dividing the market w.r.t its geography.



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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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Refusal

- Sometimes the refusal to deal is with customers or suppliers, with the effect of preventing them from dealing with a rival: "I refuse to deal with you if you deal with my competitor."
- For example, in a case from the 1950's, the only newspaper in a town refused to carry advertisements from companies that were also running ads on a local radio station.
- The newspaper monitored the radio ads and terminated its ad contracts with any business that ran ads on the radio.



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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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Refusal

- One of the most unsettled areas of antitrust law has to do with the duty of a monopolist to deal with its competitors. In general, a firm has no duty to deal with its competitors.
- In fact, imposing obligations on a firm to do business with its rivals is at odds with other antitrust rules that discourage agreements among competitors that may unreasonably restrict competition.

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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Refusal to deal

- But courts have, in some circumstances, found antitrust liability when a firm with market power refused to do business with a competitor.
- For instance, if the monopolist refuses to sell a product or service to a competitor that it makes available to others, or if the monopolist has done business with the competitor and then stops, the monopolist needs a legitimate business reason for its policies.

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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Refusal

- Business Electronics v. Sharp Electronics
- Per se illegal
- Restraint of trade – refers not to a particular list of agreements, but to a particular economic consequence, which may be produced by quite different sorts of agreements in varying times and circumstances.
- Vertical agreements is not illegal per se unless it includes some agreement on price or price levels.



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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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Indian case

- **Collective boycott/refusal to deal by the Chemists & Druggists Association, Goa (CDAG), M/s Glenmark Company and, M/s Wockhardt Ltd.**
- 27 October 2014, the Competition Commission of India (CCI) following a complaint filed by M/s Xcel Healthcare, a stockist for pharmaceuticals in the state of Goa, found that the Chemists and Druggists Association, Goa (CDAG) had continued to violate an earlier order of the CCI against it.
- The CCI found that CDAG had continued to control the supply of pharmaceuticals in Goa through a stipulation that all stockists in Goa must obtain a no-objection certificate (NOC) from it and pressuring pharmaceutical companies into not supplying to those stockists who did not obtain an NOC.

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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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Refusal to deal

- The CCI had, in its earlier order, found that such actions amount to a collective boycott/refusal to deal leading to limitation and control of supply in violation of the Competition Act.
- In the present case, the CDAG had pressurised Glenmark Company and Wockhardt Limited, two pharmaceutical companies, into not supplying to the informant, who had not obtained an NOC from CDAG.




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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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Refusal

- Apart from passing a cease and desist order, the CCI imposed a penalty at the rate of 10% (the maximum percentage that can be imposed under the Competition Act) of the average receipts of the CDAG for the last 3 years (amounting to roughly Rs.1.13 Crores)




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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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Resale Price Maintenance

Resale Price Maintenance (RPM) is a form of price fixing. Whenever, a manufacturer sets the price at which a retail shop, which he does not own must resell his products to the public, or at which a wholesale business he does not own must resell the product to the retailer, the practice is known as resale price maintenance.²³



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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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RPM

In other words, RPM is the practice whereby a manufacturer and its distributors agree that the distributors will sell the manufacturer's product at certain prices (resale price maintenance), at or above a price floor (minimum resale price maintenance) or at or below a price ceiling (maximum resale price maintenance). If a reseller refuses to maintain prices, either openly or covertly, the manufacturer may stop doing business with it.²⁴



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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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RPM

- Between independent source of supply, seller and reseller there can be no restriction on the price at which the goods be resold.
- Dr.Miles Medical co. v. John D.Park &sons Co – fixing minimum Prices for products could be sold is –price maintenance.
- State Oil Co. v. Khan No.96-871 – operate gas station and convenience store owned by State Oil.
- If any excess charged on Oil to be rebated to State Oil.



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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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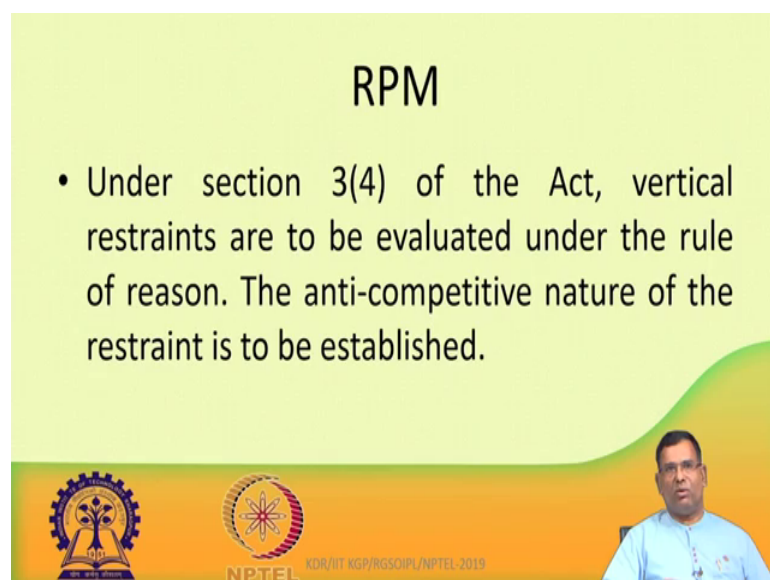
RPM

- Respondent complained that agreement restricted their freedom to charge appropriate prices.
- US SC held that the maximum price fixing is to be subject to antitrust laws, should be evaluated under the rule of reason.
- “rule of reason analysis will effectively identify those situations in which vertical maximum price fixing amounts to anti-competitive conduct.”

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

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RPM

- Under section 3(4) of the Act, vertical restraints are to be evaluated under the rule of reason. The anti-competitive nature of the restraint is to be established.

The slide features a green background with a yellow-to-orange gradient at the bottom. On the left, there are two circular logos: one with a gear and a tree, and another with a star-like pattern. In the center, the text 'NPTEL' is displayed above 'KDR/IT KGP/RGSOIPL/NPTEL 2019'. On the right, a small inset video shows a man in a light blue shirt speaking.

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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Pro-competitive Benefits

- Without any harm to the competitive process in the market.
- Sale support to the retailers extended by the manufacturers may not be exploited by the free riders.
- Stop free riding in the market – enjoying the fruits of some one else's investment.
- Full service retailer – disadvantageous position.
- Product require retail service becomes rare.
- Incremental sales.



The slide features a green and yellow gradient background. At the bottom, there is a banner with the NPTEL logo on the left, a central logo with a gear and a star, and a small video inset of a man in a blue shirt on the right. The text 'NPTEL' and 'KDR/IT KGP/RGSOIPL/NPTEL-2019' is visible in the banner.

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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Pro competitive

- Manufacturers task of monitoring the reseller.
- RPM limits intra brand competition.
- RPM enhances inter-brand competition
- Inter-brand competition – coca cola and pepsi
- Supplier has to compete with competitor.
- Intra brand – distributors and retailers of same brand
- Levis – discount stores – department stores

The slide features a light green background with a wavy orange and yellow border at the bottom. On the left, there are two logos: the Indian Institute of Technology (IIT) Kharagpur logo and the NPTEL logo. The text 'NPTEL' and 'KDR/IT KGP/RGSOIPL/NPTEL-2019' is visible below the logos. On the right, a small inset video shows a man in a light blue shirt speaking.

So, you can find a number of other factors.

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RPM induced Manufacturer cartels

- International vitamin cartel – not bothered how much charged for the customers
- Enforcing the cartel agreement.
- RPM as an incentive not to cheat the cartel
- Retailers are prevented from passing any discounts to consumers.

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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.