Competition Law Roundup – August 2014

CCI fines Auto manufacturers (Case no. 3 of 2011)

While antitrust enforcement in other jurisdictions has looked at cartels in the automobile spare parts sector, India and China have proceeded against auto majors for distorting competition in the aftermarket for spare parts. Recent decisions and investigations indicate CCI's enforcement focus on protecting consumer interest and preventing exploitative practices.

On 25 August 2014, the Competition Commission of India (**CCI**) imposed a fine of INR 2,544 crores (~US$ 413 million) on 14 car manufacturers (**OEMs**) in India. This penalty was levied pursuant to the CCI's finding that these car manufacturers had abused their dominant position in the spare-parts market and imposed illegal vertical restraints on their suppliers and authorised dealers.

The CCI's investigative arm, the office of the Director General (**DG**), was initially directed to look into the practices of Honda, Volkswagen and Fiat of restricting the sale of spare parts in the open market and denying access to diagnostic tools and manuals. The DG however, noted that the case involved practices prevalent throughout the Indian automobile sector. Subsequent to this finding, the scope of the investigation was expanded to scrutinize the conduct of 17 OEMs, including, BMW, Ford, GM, Hindustan Motors, Mahindra & Mahindra, Maruti Suzuki, Mercedes, Nissan, Skoda, Tata Motors and Toyota. Predictably, this extension of the investigation was challenged before the Delhi and Madras (Chennai) High Courts – which were quick to stay the operation of the CCI order within days of it being released.

A summary of the regulator's key findings are set out below:

A. The CCI has the jurisdiction to suo-moto expand the scope of the investigation

In response to vehement arguments by various parties, contending that it did not have jurisdiction, the CCI took the view that the Competition Act, 2002 (**Competition Act**) empowered it to evolve its own procedure and the statute in fact obligated it to examine all possible issues in a holistic manner. Consequently, the CCI held that it is not necessary to restrict the scope of inquiry to those parties named in the information (the complaint) alone.

B. The Relevant market: an independent after-market

The OEMs unsuccessfully argued that the sale of cars, supply of spare parts and repair services constitute a singular '*systems market'* as customers engage in whole life costing at the time of purchasing a car. Thus, any increase in the costs of spare parts or repair services would cause reputational harm to the companies; leading to a loss in sales.

The CCI, however, observed that the relevant market for cars and spare parts consists of a *primary product market* and *secondary product market* for each primary product. Primary market was the market for manufacturing and sale of passenger vehicles; and the secondary market —colloquially known as the "aftermarket" –comprised of two sub-markets: (i) market for sale of spare parts; and (ii) market for repair services. This finding was primarily attributed to peculiarities of the automobile industry, inasmuch as customers faced high switching costs if they wished to switch to another competing product and there was – at best –

limited interchangeability in the aftermarket due to technical differences between cars. Thus, once a customer makes his choice of a car, he is "locked-in[to]" the secondary market for that car. The fair trade regulator also noticed that customers could not engage in whole life costing due to information asymmetries.

CCI also rejected the contention of the OEMs that each spare part in the aftermarket should form a separate relevant market due to the limited substitutability among spare parts of each car. In the CCI's view, the relevant unit in the aftermarket is the bundle of goods and services and not the individual unit of spares (like clutch plate, gearbox, etc.). CCI further held that such units are jointly demanded and supplied constituting a '*cluster market*'; and thus, the substitutability and exchangeability applies to the whole bundle of goods and services and not just individual units.

C. Assessment of dominance: dominance of each manufacturer in each of its aftermarket

CCI took note of the fact that the spare parts of one car manufacturer are not substitutable with those of other manufacturers or those within the same brand. Thus, by controlling the production and supply of the spare parts and denying access to diagnostic tools and manuals, each manufacturer shielded itself from all competitive constraints in the aftermarket. Interestingly, the regulator did not accept the argument that a manufacturer could not be dominant in the secondary market, if it did not possess market power in the primary market.

D. Abuse of dominance: abuse only in the aftermarket

The CCI found the car manufacturers' conduct of limiting access of independent repairers for genuine spare parts and diagnostic tools – required to effectively compete with authorized dealers –as one amounting to denial of market access and in violation of Section 4(2). In this regard, it is interesting to note that the CCI rejected the argument that the exclusionary conduct – of limited supply to independent dealers – was justified to protect their intellectual property rights (**IPR**). CCI's rejection was based on the grounds that this defence is only available in respect of anti-competitive agreement and not in cases relating to abuse of dominance.

Further, the CCI also found the OEMs to be guilty of excessive pricing. This conclusion was based on the exorbitant mark-ups of spare parts that varied from 100% to as high as 5000%. These mark-ups were found to be disproportionate to the economic value of the products supplied by the OEMs – constituting excessive pricing as per the provisions of the Competition Act.

Lastly, the regulator found that the OEMs were infringing the provisions of the Competition Act by leveraging their position in the spare parts markets to protect the market for service and maintenance by restricting the use of the spare parts to service and repairs at the workshop of the authorized dealers.

E. Imposition of anti-competitive vertical restraints

In its first ever finding under section 3(4), the CCI held that the OEMs imposed illegal vertical restraints in their agreements with original equipment suppliers (**OES**s) and authorised dealers. Agreements between OEMs and their overseas suppliers were excluded from scrutiny through the application of the 'single economic entity' doctrine (most of the overseas suppliers of spare parts are either group companies or overseas parent companies of the OEMs).

Applying the *rule of reason* standard, the CCI found that restrictions on OESs from supplying spare parts in the aftermarket constituted an illegal exclusive distribution agreement and refusal to deal. Similarly, the agreements with authorised dealers restricted 'over the counter' sales of spare parts by the latter. This, coupled with the denial of access to independent repairers to manuals and diagnostic tools, caused an appreciable adverse effect on competition (**AAEC**) in India.

More importantly, the CCI gave guidance on the scope of section 3(5)(i). Colloquially referred to as the "IPR exemption", the provision exempts agreements that "impose reasonable conditions, necessary for protecting" intellectual property rights conferred under various Indian IPR statutes. The OEMs urged that the restrictions placed by them was in furtherance to the intellectual property rights held by their overseas parents. According to the CCI, none of the OEMs could prove that such rights had been "conferred" by Indian law; nor satisfy the regulator that the conditions imposed by them were "necessary" for the protection of such rights. Accordingly, the CCI held that the IPR exemption was not available.

In addition to the penalty, the CCI has directed OEMs to allow suppliers to sell spare parts in the open market without any restriction; ensure availability of spare parts and diagnostic tools; and refrain from cancelling the warranty on the vehicles and placing impediments on the operation of independent repairers.

The CCI's decision has several 'firsts' to its credit. It is first case where the CCI has found illegal vertical restraints; it is also the first decision on the IPR exemption and considerably narrows it scope; and it is the first case where the CCI has considered mitigation factors while calculating the quantum of penalty.

CompAT upholds the penalty imposed on NSE for abusing its dominant position
(Appeal No. 15 of 2011)

The Competition Appellate Tribunal (**CompAT**) affirmed the INR 55.5 crores (~US$ 9.1 million) fine imposed on the National Stock Exchange (**NSE**) for abusing its dominant position.

The investigation was initiated at the behest of MCX Stock Exchange Ltd. (**MCX-SX**), a competitor of NSE. MCX-SX launched trading in the currency derivatives segment (**CD Segment**) in 2008, but was unable to charge any transaction charges and other fees as NSE was offering these services free, while continuing to charge clients for other segments.

In the majority decision, the CCI found NSE guilty of abusing its dominance by:

i. indulging in predatory pricing in the CD Segment; and
ii. leveraging its dominance in the non-CD Segment to protect its position in the CD Segment.

NSE assailed the CCI's market definition and argued that the relevant market should be the market of the currency futures along with the over the counter (**OTC**) market. The CompAT agreed with the CCI that the OTC and the CD Segment differed in terms of products, underlying securities, settlement mechanisms, participants and regulatory oversight.

However, the CompAT also did not agree with the CCI's market definition. In its view, the CCI erroneously treated equities and currency derivatives to be the "products". Instead, the product was the services provided by stock exchanges. Nevertheless, even with this enlarged composite relevant market, NSE was found to be dominant.

While assessing dominance, the CompAT primarily considered the circular issued by NSE on 30 March 2009 for zero transaction fee, which was valid up to 30 June 2009. During this period, it was observed that NSE was a clear leader with a 53.19 per cent market share compared to 46.81 per cent of MCX-SX. The most relevant question, according to the tribunal, was whether the NSE could continue with its no transaction fee policy, as compared to its competitor MCX-SX. The tribunal held that the size and resources of NSE were "tremendous" and it was clear that NSE could continue with the zero transaction fee policy because of its relative strength in other segments. On the other hand, MCX-SX was forced to adopt the same policy; otherwise, it could not have made entry into the market.

NSE went on to argue that its conduct could not be termed as abusive as it had waived transaction to develop a nascent market. Moreover, NSE submitted that its price was not predatory and that the pricing had be considered from the perspective of all stakeholders not just MCX-SX. The CompAT rejected these arguments. In its opinion, the development of the nascent market could not proceed for an unspecified period and did not demonstrate prudent commercial behaviour by NSE. The tribunal found NSE's conduct to be a blanket example of predation and the mere possibility of exclusion or foreclosure was sufficient to demonstrate abuse of dominant position.

However, with regard to the conduct relating to leveraging, the COMPAT overruled the CCI as it felt that the enterprises operated in one single relevant market and the question of leveraging did not arise.

Other Cases

- Supreme Court of India refuses to stay the INR 630 crores (~US$ 103 million) penalty levied on realty major, DLF Limited for abusing its dominant position - Civil Appeal No. 6328 of 2014
- Electricity utilities and distribution companies in the state of Maharashtra to be investigated for unfair pricing - Case No. 12 of 2014
- CCI rejects complaint filed against National Thermal Power Corporation for anti-competitive unilateral conduct in the procurement of mine development and operator services - Case No. 35 of 2014

Daido Steel to acquire equity stake in Sunflag Iron and Steel (C-2014/08/199)

Japanese specialty steel maker, Daido Steel Co. Ltd (**Daido**) will acquire a 10 per cent equity stake in Sunflag Iron and Steel Company Limited (**Sunflag**). Daido exports steel to India and has been providing technical assistance to Sunflag since 2010. The CCI observed that the combination would not raise any competition concerns and approved the combination on 27 August 2014.

Interestingly, the CCI order does not specify whether Daido is acquiring 'control' in Sunflag. Indian merger control regulations exempt acquisitions below 25 per cent, if the acquiring does not acquire control in the target entity.

Sun Pharma – Ranbaxy referred to phase II (C-2014/05/170)

The proposed merger of Sun Pharmaceutical Industries Ltd (**Sun Pharma**) with Ranbaxy Laboratories Ltd (**Ranbaxy**) has been referred to a phase II investigation by the CCI. In the, prima facie, opinion of the regulator, the proposed combination is likely to cause an AAEC in India.

Further to the CCI's directions, the parties have published details of the combination for public comments. The published details state that Sun Pharma and Ranbaxy have a combined presence in 18 therapeutic areas, 127 therapeutic groups and 246 molecules. The combined market share of 37 molecules ranges from 15.5 - 93.7 per cent. The last date for submission of comments is 25 September 2014.

The parties believe that the pharmaceutical sector in India is highly fragmented and competitive market where there are a large number of players producing differentiated products with limited entry barriers. As such, the combination is not likely to cause anti-competitive effects.

Other Combinations

- TPG Capital to acquire 34.5 per cent equity in Sutherland Global Holdings Inc., a global business outsourcing services provider - C-2014/07/187
- Joint venture between Sanofi-Sythelabo and Apollo Health and Lifestyle for operating specialised diabetic care clinics – C-2014/07/194
- CCI approves SCM Soilfert Limited's public offer for acquiring shares of Mangalore Chemicals and Fertilizers Limited - C-2014/05/175
- Mitsubishi-Hitachi and Siemens enter into a joint venture for metal plant building solutions - C-2014/06/180
- Wipro GE Healthcare to acquire assets of GE India Technology Centre Private Limited used in bio-technology and life sciences research - C-2014/07/195
- Japan based manufacturer of ethical pharmaceuticals, agricultural chemicals and veterinary drugs, Meiji Seika to acquire Medreich Limited, a manufacturer of pharmaceutical preparations - C-2014/07/189
- CompAT stays CCI's gun-jumping order on Thomas Cook - Appeal No. 48 of 2014

Should you have any questions, please contact members of our competition team.

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