

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Competition Issues in Aftermarkets - Note from India

21-23 June 2017

This document reproduces a written contribution from India submitted for Item 4 of the 127th OECD Competition committee on 21-23 June 2017.

More documents related to this discussion can be found at

www.oecd.org/daf/competition/aftermarkets-competition-issues.htm.

Please contact Mr. Antonio Capobianco if you have any questions about this document
[E-mail: Antonio.Capobianco@oecd.org].

JT03414380

India

1. Competition issues in aftermarkets arise when a producer of durable goods, in an attempt to monopolise the aftermarket, behaves in a fashion that restricts alternative producers from offering a complementary good or service. This monopoly behaviour and the concomitant abuse of market power allow the producer in the primary market to charge supra-competitive prices and impose other anti-competitive restraints in the aftermarket.

1. Competition Intervention in Aftermarkets

2. The policy rationale for ensuring effective competition in aftermarkets is to preclude the possibility of aftermarket abuse. When the market does not operate to correct itself, intervention is necessary and therefore, justified. Such a situation was found in the case of *Shamsher Kataria v. Honda Siel Cars India Ltd.*¹ ('the automobile case'). The Competition Commission of India (CCI/'the Commission') issued a ruling in this case which laid down principles to address competition issues in aftermarkets.

3. Following a detailed investigation, the Commission found the conduct of Original Equipment Manufacturers (OEMs/ car manufacturers) in violation of the provisions of Section 3(4)² of the [Indian] Competition Act, 2002 ('the Act') with respect to their respective agreements with local Original Equipment Suppliers (OESs) and authorised dealers. These agreements imposed restrictive covenants and foreclosed the aftermarket for supply of spare parts and other diagnostic tools. Further, the Commission found that the said companies, having dominance in the aftermarkets for their respective brands, abused their dominant position under Section 4³ of the Act for the following reasons:

¹ Case No. 03 of 2011: Order issued on 25 August 2014 against 14 car manufacturers at http://www.cci.gov.in/sites/default/files/032011_0.pdf and another Order issued against 3 more car manufacturers on 27 July 2015 at <http://www.cci.gov.in/sites/default/files/03201127.pdf>

² Section 3: Anti-competitive Agreements: (1) ... (2) ... (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.

³ Section 4 of the [Indian] Competition Act, 2002 prohibits abuse of dominant position. Section 4. (1) No enterprise or group shall abuse its dominant position. (2) There shall be an abuse of dominant position under sub-section (1), if an enterprise or a group- (a) directly or indirectly, imposes unfair or discriminatory- (i) condition in purchase or sale of goods or service; or (ii) price in purchase or sale (including predatory price) of goods or service.

Explanation- For the purposes of this clause, the unfair or discriminatory condition in purchase or sale of goods or service referred to in sub-clause (i) and unfair or discriminatory price in purchase or sale of goods (including predatory price) or service referred to in sub-clause (ii) shall not include such discriminatory condition or price which may be adopted to meet the competition; or (b) limits or restricts- (i) production of goods or provision of services or market therefor; or (ii) technical or scientific development relating to goods or services to the prejudice of consumers; or (c) indulges in practice or practices resulting in denial of market access in any manner; or (d) makes conclusion of contracts subject

1. The car companies were denying market access to independent repairers by not providing access to branded spare parts and diagnostic tools.
2. Such denial of access hampered their ability to provide services in the aftermarket for repair and maintenance of cars.
3. Having a monopolistic control over the spare parts and diagnostic tools of their respective brands, the car companies charged arbitrary and high prices for their spare parts.
4. The car companies were also found to be using their dominant position in the market for spare parts and diagnostic tools to protect their market for repair services, thereby distorting fair competition.

2. Enforcement Challenges faced by Competition Authorities in Aftermarkets Cases

4. For effective enforcement, any direction given by a regulator should be pragmatic and capable of being implemented. In addition to immediate steps towards compliance taken by infringing enterprises, elimination of anti-competitive practices requires the support of an appropriate regulatory framework. Being conscious of the challenges faced by competition authorities during enforcement, the Competition Appellate Tribunal (COMPAT) while upholding CCI's order in the automobile case issued the following guidelines⁴, *inter alia*:

1. To ensure immediate action, COMPAT directed the car companies to furnish individual undertakings before the Commission, within 60 days of its order about schedule of compliance with this order, within mandated frame of time.
2. To develop an appropriate regulatory framework, COMPAT directed Ministry of Road Transport & Highways in consultation with other relevant Government Departments/Agencies/Industry Organizations to take up a program for standardization of automobile spare parts.
3. To remove information asymmetry, COMPAT directed the car companies to develop an extensive information system with extensive details of automobiles and their spare parts manufactured by the car companies so as to facilitate the potential customers in making rational choices at the time of buying automobiles. The Central Government, under the Motor Vehicle Rules, was also directed to notify the minimum standards of information which should be made available through websites and other means of communications.

to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or (e) uses its dominant position in one relevant market to enter into, or protect, other relevant market.

Explanation.—For the purposes of this section, the expression— (a) "dominant position" means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to (i) operate independently of competitive forces prevailing in the relevant market; or (ii) affect its competitors or consumers or the relevant market in its favour. (b) "predatory price" means the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors. (c) "group" shall have the same meaning as assigned to it in clause (b) of the Explanation to section 5.

⁴ Appeal No.60/2014 dated 9 December 2012 http://compat.nic.in/Attachments/JudgementList/4205_Toyota%20vs%20CCI.pdf

4. To remove all restrictions on supply of spare parts as well as to protect the interests of the car companies, COMPAT directed:
 - opening of additional distribution channels to the open market for spare parts on a country wide basis; provided that the apprehensions expressed by the car companies can be addressed through contractual agreements between independent repairers and spare parts suppliers.
 - OES' will be within their rights to certify a product of 'matching quality' with corresponding OEM's spare parts and market them freely in the aftermarket while using their own trademarks.

3. Cases involving Aftermarkets

5. Experiences of a Competition Agency in cases involving aftermarkets can be looked at in terms of different concepts of competition law. These concepts are elucidated upon below in the context of the Commission's experience in the *automobile* and *other* cases.

3.1. Automobile case

3.1.1. Market definition in Aftermarket cases

6. In aftermarket cases, it is important to discuss the two "relevant market" concepts: (a) a unified systems market and (b) aftermarket. The Commission, in the automobile case, defined an aftermarket as:

"a special kind of antitrust market consisting of unique replacement parts, post warranty service or other "consumables" specific to some primary product. The term, therefore, refers to markets for complementary goods and services such as maintenance, upgrades, and replacement parts that may be needed after the consumer has purchased a durable good."

7. The primary basis for determination of the existence of a systems market or aftermarket involves a determination of whether:

- customers engage in whole life costing; or
- reputation effects deter producers of the primary product from setting supra-competitive price for the secondary product.

8. An aftermarket does not exist in every instance where a primary and a secondary product are involved. For example, a razor and its blades may not necessarily be in an aftermarket structure. If razor manufacturing company increases the price of its blades and the consumer cannot use any other brand of blades with that particular razor, then in such a scenario, the relevant question which needs to be posed is: can the consumer switch to another razor brand without incurring substantial switching costs? One of the criteria in deciding whether the primary and secondary products form part of one systems market or two separate markets is the cost of the primary product. If the owner of the primary product can easily switch to another competing primary product, the primary product and secondary product may be clubbed to form a systems market.

3.1.2. Market power in Aftermarkets

9. The underlying principle in the definition of a dominant position is linked to the concept of market power which allows an enterprise to act independently of competitive constraints. Explanation (a) to section 4(2)⁵ of the Act defines “dominant position” to mean:

“a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to-

- (i) operate independently of competitive forces prevailing in the relevant market; or*
- (ii) affect its competitors or consumers or the relevant market in its favour.”*

10. In the *automobile* case, dominance in the aftermarket was established on the basis of the following facts:

- 5. Due to the technical compatibility between the products in the primary market and the secondary market, each OEM is shielded from any competitive constraints in the aftermarket from their competitors in the primary market.
- 6. Further, the OEMs, have ensured that the independent repairers are not able to effectively compete with the authorised dealers of the OEMs in the secondary market for repairs and services by denying them access to required spare parts and tools to complete such repair work.
- 7. Finally, the OEMs have entered into warranty conditions with their consumers which dissuade them from availing the services of independent repairers.

11. Therefore, in context of Explanation (a) to Section 4(2) of the Act, what has to be ascertained is whether an enterprise has the “strength” to affect the market and whether it has the ability to use that strength in its favour.

3.1.3. Exclusionary and exploitative behaviour

12. The principle of free competition lies at the heart of the Commission's mandate under the Section 18 of the Act which reads as follows:

“it shall be the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade carried on by other participants, in markets in India.”

13. Therefore, the aim of the Commission is the institution of a system of undistorted competition which is commensurate to the promotion of the interests of consumers. A dominant enterprise can impede free competition in the relevant market over which it enjoys a position of strength. In the aftermarket, one such way of distorting free competition is the refusal by a dominant enterprise to meet, in full or in part, orders placed with it by its customers who are dependent upon the products or services of the dominant enterprise.

14. Section 4(2)⁶ of the Act provides a list of abusive conducts, including exclusionary and exploitative conduct. Specifically, Section 4(2)(c) of the Act states that there shall be an abuse of dominant position if an enterprise indulges in practice(s) resulting in denial of market access in any manner. Denial of market access is specifically

⁵ Supra Note 3.

⁶ Ibid.

aimed at adopting a course of conduct with a view to exclude a competitor from the market by means other than legitimate competition.

15. In automobile case, the Commission observed that each OEM is a monopolistic player in the aftermarket for its own brand of spare parts and diagnostic tools and were in effect the sole supplier of such products to the aftermarket. Each OEM severely limits the access of independent repairers and other multi-brand service providers to genuine spare parts and diagnostic tools required to effectively compete with the authorised dealers of the OEMs in the aftermarket. Such practices amount to exclusionary conduct by denying market access and are violative of Section 4(2)(c) of the Act.

16. To prevent exploitative conduct, Section 4(2)(a)(ii) of the Act provides that there will be an abuse of dominant position, if a dominant enterprise imposes unfair or discriminatory price in purchase or sale (including predatory pricing) of goods or services. The concept of unfairness of a price is related to the notion that such price is unrelated to the 'economic value' of the product and that such price is being charged by the enterprise because of its capacity to use its market power or position of strength in that relevant market to affect its competitors or consumers in its favour.

17. In analysing the unfairness of the prices charged, it is necessary to ascertain whether the dominant enterprise has made use of the opportunities arising out of its dominant position in such a way as to reap trading benefits which it would not have reaped if there had been normal and sufficiently effective competition.

18. It is pertinent to note that several commentators have objected to price regulation from a policy perspective, arguing that in the absence of market failures, excessive prices motivate potential competitors to enter into the market and are therefore, self-correcting. However, in the automobile case, the Commission was of the opinion that in certain industry/sectors the prevalent excessive pricing practices may not be self-correcting. Therefore, in such cases exploitative pricing falls foul of Section 4(2)(a)(ii) of the Act.

3.1.4. Efficiency gains and other objective justifications

19. Clauses (a)-(c) of Section 19(3)⁷ of the Act deal with factors which restrict the competitive process in the markets where the agreements operate (negative factors) while clauses (d)-(f) deal with factors which enhance the efficiency of the distribution process and contribute to consumer welfare (positive factors). The task of the Commission while analysing the appreciable adverse effect on competition is to balance the anti-competitive and pro-competitive factors mentioned under Section 19(3) of the Act.

20. In situations where an agreement providing apparent efficiencies allow an enterprise to create structural entry barriers and consequently eliminate the competitive process, the Commission must look beyond the immediate short term efficiency goals of such allegedly anti-competitive agreements. It is important to appreciate the long lasting anti-competitive effects, if any, of such agreements in the market in which they operate.

⁷ Section 19. Inquiry into certain agreements and dominant position of enterprise (1) ... (2) ... (3) The Commission shall, while determining whether an agreement has an appreciable adverse effect on competition under section 3, have due regard to all or any of the following factors, namely: (a) creation of barriers to new entrants in the market; (b) driving existing competitors out of the market; (c) foreclosure of competition by hindering entry into the market; (d) accrual of benefits to consumers; (e) improvements in production or distribution of goods or provision of services; (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

Against this background, in the automobile case while looking at vertical agreements entered into by the car companies (which may have certain efficiency enhancing conditions or other objective justifications) the Commission did not lose sight of potential long term anti-competitive structural effects on the automobile market in India.

3.1.5. Remedies and other policy considerations

21. After holding the car companies liable for infringing conduct, the Commission in the automobile case while deciding remedies, considered the following as its primary objectives:

1. to correct the distortions in the market,
2. to provide corrective measures to make the market more competitive,
3. to eradicate practices having foreclosure effects, and
4. to put an end to the present anti-competitive conduct of the parties.

22. Also, to arrive at proportionate penalty, the Commission took into account certain aggravating and mitigating factors. The aggravating factors were:

- Anti-competitive conduct of the opposite parties impacts a very large number of consumers in the country.
- Anti-competitive conduct of the opposite parties has restricted the expansion of spare parts and independent repairers segment of the economy to its full potential, at the cost of the consumers, service providers and dealers.
- Despite the fact that some of the car companies made consumer-friendly commitments in other jurisdictions like Europe, they failed to adopt similar practices in India.

23. On the other hand, the mitigating circumstances given weightage while fixing the quantum of penalty were:

- The absence of appropriate legislative and regulatory framework for safety and standards relating to spare parts and after sales services.
- Some car companies indicated willingness to voluntarily discontinue many of these practices and offer greater choice and freedom to the consumers, repairers and dealers.

24. In light of these considerations, the Commission imposed a penalty at the rate of 2% of the average annual turnover of the car companies. Subsequently, COMPAT slightly modified the quantum of penalty to 2% of the average annual turnover of spare parts in the aftermarket of immediately preceding three years before the year of inquiry.

3.2. Other cases

25. The Commission also had the occasion to examine the competition issues in the aftermarkets in real estate, banking, financial etc. sectors. While examining such issues, the Commission observed: "...[A]n aftermarket is a special kind of antitrust market consisting of unique replacement parts, post warranty service or other consumables specific to some primary product. The term, therefore, refers to markets for complementary goods and services such as maintenance, upgrades, and replacement parts that may be needed after the consumer has purchased a durable good. Further, an independent secondary aftermarket would generally exist if consumers are not able to ascertain the life time cost of the primary product/ service at the time of its purchase,

there is a high switching cost to shift to substitutes and the manufacturer/ service provider of the primary product/ service has the ability to substantially hike the price of the good/service offered in the secondary market (i.e. aftermarket) in spite of reputational concerns.⁸

26. As in majority of such cases, the afore-noted factors could not be established; the same were closed at the preliminary stage itself⁹.

4. Conclusions

27. The kind of parameters which have been defined even in other jurisdictions and literature for accepting the systems market approach do not normally exist in the Indian market. These parameters include availability of relevant information (e.g. life-cycle cost) to the consumers, his ability/ inability to take a rational/ analytical decision based on complex data (which may or may not be available), the reputational impact of anti-competitive conduct in the aftermarket on the firm's product in the primary market etc. These factors are aggravated in the Indian market situation due to peculiar characteristics of Indian consumers besides the complex nature of aftermarkets.

28. Despite these challenges, CCI is evolving the jurisprudence to effectively address competition issues in aftermarkets.

⁸ Onicra Credit Rating Agency of India Limited And Indiabulls Housing Finance Limited, Case No. 43 of 2016 decided on 03.02.2017.

⁹ Ibid.