ORDER AGAINST 14 CAR MAKERS: CCI AGAIN SHOWS ITS MIGHT!

Background

Keeping up with its reputation of imposing hefty penalties, on August 25, 2014, the Competition Commission of India (**"CCI or Commission"**) in its first order[1] on vertical agreements have found 14 automobile companies[2] (**"OEMs"**) guilty of anti-competitive conduct and imposed a staggering penalty of INR 25.4464 billion *(US$ 424 million approx.)*.[3] This is the largest penalty imposed by the Commission in the year 2014. Under the Competition Act (**"Act"**), CCI has been authorised to impose fines on entities engaging in price manipulation, cartel formation or misuse of their dominance, which can go as high as 10% of their turnover or three times their annual profits.

However, the moot question is about the impact of the order. In the absence of governing regulations and a specific regulator in the auto manufacturing and after sales service/repair sector, the implementation of CCI's order is a challenge. On penalties specifically, the precedents largely suggest that these high amounts have either been drastically reduced in appeal or a stay has been granted. For instance in cases like Cement Cartel or Coal India, where penalties over INR 63 billion *(US$ 1.05 billion approx.)* and 17 billion *(US$ 283 million approx.)* were imposed, the matters are still being contested and nothing has been collected as such. There are a few promising instances as well, such as the DLF case, where the penalty of about INR 6.3 billion *(US$ 105 million)* imposed by the Commission has been upheld by the Supreme Court of India.

Keeping the above in regard, this newsletter analyzes the August 25 order and talks about its implication on the business model of interested parties including OEMs.

1. Brief Facts

The Commission had received information against 3 OEMs for violation of section 3(4) *(anti-competitive vertical agreements)* and section 4 *(abuse of dominant position)* by entering into agreements with original equipment suppliers (**"OESs"**) and authorized dealers, restricting free availability of auto spare parts in the market and imposing unfair prices. These agreements restricted OESs from directly selling spare parts to the independent repairers and car users in the open market. Further, OEM's were not providing technological information, diagnostic tools and software programs to independent repairers that are required to maintain, service and repair technologically advanced automobiles. This led to imposition of unfair and

[1] *Shri Shamsher Kataria v. Honda Siel Cars India Ltd. &* Ors, Case No. 03 of 2011.
[2] BMW India, Ford India, General Motors India, Hindustan Motors, Mahindra & Mahindra, Maruti Suzuki,
[2] BMW India, Ford India, General Motors India, Hindustan Motors, Mahindra & Mahindra, Maruti Suzuki,
Mercedes-Benz India, Nissan Motor India, Skoda Auto India, Tata Motors, Toyota, Honda India, Volkswagen India and Fiat India. CCI is yet to pass final order against Hyundai India, Mahindra Reva and Premier.
[3] 1 USD = INR 60.

discriminatory condition in purchase of spare parts for independent repairers and amounts to denial of market access.

2. Finding of Director General ("DG")

The DG found all OEMs guilty of abuse of dominant position and found their agreement with OESs and authorized dealers to be anti-competitive. He reported that:

2.1 There are 3 separate relevant markets for the purpose of this case **(a)** *1 primary market* – "sale of passenger vehicles in India" and **(b)** *2 aftermarkets*[4] - "sale of spare parts including the diagnostic tools, technical manuals, catalogues etc. for the aftermarket usage in India" and "after sale service of repair and maintenance in India."

2.2 Each OEM is the only source of spare parts of their brands and there is nil possibility of interchangeability of spare parts; therefore, each OEM is in dominant position. OEMs are abusing their dominance by non-availability of spare parts and diagnostic tools in open market imposing unfair terms on independent repairers in violation of section 4(2)(a)(i) and denying them market access in contravention of section 4(2)(c). Further, they are using their dominant position to impose unfair prices on consumers, which contravenes section 4(2)(a)(ii).

2.3 Agreements between OEMs and authorized dealers do not allow them to deal in competing brands of cars or to sell spare parts and diagnostic tools to independent repairers. This amounts to exclusive distribution agreement and refusal to deal in violation section 3(4)(c) and 3(4)(d). Further, the authorized dealers are required to source spare parts directly from OEMs or their approved vendors only, which is in nature of exclusive supply agreement in violation of section 3(4)(b).

All the above is prejudicial to the consumer interest and has appreciable adverse effect on competition.

3. Issues

3.1 Whether the automobile market as whole, from manufacturing to aftermarket service, is a single unified **"system market"** or there exists separate relevant markets at different stages?

3.2 Is there abuse of dominance by OESs in spare parts market?

- Abuse by denying access to market to the independent repairers/service providers;
- Abuse by imposing unfair prices for aftermarket sale of spare parts;

3.3 Whether the OEMs are entitled to benefit arising out of statutory exemption provided to agreements related to intellectual properties?

[4] "Aftermarket" means a market comprising of complementary or secondary products and services which are purchased after another product i.e. the primary product which they relate to.

3.4 Whether agreements by OEMs with OESs and authorized dealers are anti-competitive in nature?

4. Main Contentions of the Opposite Parties

The OEMs contended that:

4.1 The relevant market in the present case is an indivisible and unified "system market" of cars. The market of sale of spare parts is not distinctive from market of sale of cars. A "system market" for complimentary products is appropriate for durable products like car as customers engage in "whole life costing".[5] The relevant product market would be various product markets in the Indian automotive sector based on various segments of automobiles, *viz.* small or economy car segment, mid market car segment and the luxury car segment.

4.2 On the issue of unfair pricing they contended that reputation of each OEM and price consideration by the consumers deter them from charging supra-competitive prices hence there prices are not unfair.

4.3 Restriction imposed by them on OESs and authorized dealers are for the safety of consumers and to enhance the service to the car owners in the absence of "matching quality"[6] law in India. Further, the restriction under agreements with OESs from sale in open market without the consent of OEM is a reasonable condition imposed to protect their IPRs, and such agreements are protected from scrutiny of the Commission by section 3(5).

5. Decision of the Commission

5.1 Relevant Market

The Commission agreed with the finding of the DG on identification of the relevant market. It held that primary market of "manufacture and sale of cars" and aftermarkets "sale of spare parts, diagnostic tools etc." and "service of repair and maintenance" are three separate relevant markets. It rejected the contention of unified "system market" and opined that Indian car owners do not engage in "whole life costing" because they do not have access to relevant information for such analysis. *Interestingly*, the Commission took the position that determination of relevant market is not an end by itself but a means to determine strength of an enterprise in a particular market. Therefore, the Commission has to identify that market as a relevant one where dominance of an enterprise is felt. Here it may be noted that the Commission took a circular path for determining relevant market. At first, the Commission is presuming/considering that in a particular market the enterprise is dominant or can be proven dominant and then considering that as relevant market, it subsequently establishes dominance using the factors enshrined in the Act.

[5] "Whole life costing" means analysis of costs of life cycle of a car from purchasing to repair and maintenance based on information available to the customers.
[6] "Matching Quality" law is an appropriate legislative and regulatory framework for safety and standards relating to spare parts and after sales services.

5.2 Abuse of Dominance

5.2.1 *Determining Dominance*: The Commission considered the factors that allow OEMs to act independently and afford the OEMs with an opportunity to foreclose markets for its competitors and exploit customers. It noted that there is no intra or inter-brand interchangeability and compatibility between spare parts of one brand/model of car and spare parts of another brand/car. Therefore, customers do not have choice to switch and each OEM acts independently of its competitors. OEMs strength in primary market *(manufacture and sale of cars)* enables it to affect the competitors in the secondary market *i.e.* independent service providers, thereby limiting consumer choice to OEM recognised authorised dealers only. This forces the consumers to react in a manner which is beneficial to each OEM. The lock-in-effect and entry barriers imposed by the OEMs result into high dependency of car owners on them and gives OEMs a position of strength and, therefore, a position of dominance.

5.2.2. *Abuse of Dominant Position*: The Commission held that all the OEMs restrict the availability of the diagnostic tools/repair manuals etc. which is required to effectively repair models of their respective brand of automobiles to independent service providers and multi brand retailers. Such practices amounts to denial of market access by OEMs under section 4(2)(c) of the Act. Further, there is a high mark up margin in prices of aftermarket spare parts, disproportionate to the economic value of the products supplied and the prices are exploitive and unfair under section 4(2)(a)(ii). The CCI also found the OEMs guilty of leveraging under section 4(2)(e) by using dominance in the market of sale of spare parts for protecting the relevant market of after sale service and repairing.

5.3 Anti-competitive Agreements

5.3.1 Vertical agreements between OEMs and OESs have restrictions on OESs from supplying spare parts in the independent after market without the approval of the OEM. The DG couldn't find even a single instance where such an approval would have been given. Therefore, these agreements are in the nature of exclusive supply agreement as per section 3(4)(b) leading to appreciable adverse effect on competition in India. Further, the agreements with authorized dealers require them to source spare parts from OEMs or their approved vendors only. The authorized dealers are not allowed to deal in competing brands of cars and cannot sell spare parts and diagnostic tools over the counter resulting in exclusive distribution agreement and refusal to deal as per section 3(4)(c) and 3(4)(d). Such agreements also restrict access to genuine spare parts and diagnostic tools and lead to the rise in the usage of spurious spare parts jeopardizing consumer safety.

5.3.2 The Commission rejected the safe harbour of section 3(5) *(protection of intellectual property rights)* to agreements between OEMs with OESs. The Commission held that the Act only recognizes protection to those IPRs which have been conferred under those Indian legislations which are listed in section 3(5). None of the OEMs could provide sufficient evidence to establish their claim over a particular type of IPR. Further, the Commission said that only reasonable and necessary restriction related to IPRs are protected and restrictions imposed by OEMs are not reasonable and necessary.

5.4 Order

The Commission imposed a penalty of 2% of total turnover in India on 14 OEMs and ordered them to submit a compliance report within 180 days. **The OEMs have been directed to cease and desist from anti-competitive conducts, allow OESs to sell spare parts in the open market and put in place an effective system to ensure availability of aftermarket spare parts, diagnostic tools and other relevant information in the public domain.** The Commission said that OEMs can make reasonable and necessary provision in their agreements with respect to protection of IPRs. Further, the OEMs have been directed not to impose a blanket condition that warranties would be cancelled if the consumer avails services of any independent repairer. However, necessary safeguards may be put in place from safety and liability point of view.

Analysis and Conclusion

The Commission has imposed penalty on "total turnover" of the OEM's rather than on "relevant turnover" in the spare parts market. According to Competition Appellate Tribunal's (**"COMPAT"**) decision in Aluminium Phosphide tablets cartelisation case,[7] penalty should be calculated on the basis of the "relevant turnover" instead of overall turnover of the guilty enterprise. The Commission in this case had clearly distinguished the primary market and aftermarkets, and have held aftermarket of sale of spare parts as the relevant market. Clearly, the turnover of only the relevant market should have been considered for determining the penalty. The OEMs may use this ground in appeal.

This decision of the Commission is a wakeup call for all the market players and the government as well. The Commission has espoused the need to have an appropriate framework for safety and standards relating to spare parts and after sales services and have requested the government to look into it. The order also sends a message to the business world to do assessment of their market behaviors and their agreements. Sophisticated industries similar to the auto manufacturing sector *(e.g. computer industry, mobile industry and other industries where after sale services and use of defective parts is sensitive due to model specific technology and standard)* need to assess their after market conducts.

Further, the OESs and authorized dealers who have contracted with OEMs need to quickly asses there agreements and question OEMs on implication of the order. Though the Commission's order does not give any specific directions to them, nonetheless they are a party to these anti-competitive agreements. This also raises an interesting question – whether every non-protesting party to a vertical anti-competitive agreement is hit by the order or only the dominant party? Only time will tell!

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[7] *M/s Excel Corp Care Ltd v. CCI,* Appeal No. 79, 80 and 81 of 2012. The Commission has challenged this order before the Supreme Court of India.