Analyzing the anti-Competitive assumption behind Resale Price Maintenance: Indian experience & International lessons

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I. INTRODUCTION

Resale price maintenance *(hereinafter RPM)* is a vertical price fixing mechanism wherein the producer/manufactures enter into an agreement with the retailers/distributors for setting a particular price above or below which the product/service in the market cannot be traded in. It is a price ceiling/floor strategy adopted where "*the upstream firm dictates pricing policies at subsequent stages of the distribution process."*[4] The first known case of a commodity being traded under a resale price maintenance agreement was Alfred Marshall's Principles of Economics.[5] Frederick Macmillan, head of Macmillan & Company was Alfred Marshall's publisher who decided that this book will be sold under a new system called the net book system wherein "*difference between the retailer's and publisher's price would be fixed which was in essence what came to be called resale price maintenance (RPM*)".[6] Such agreements are looked at with suspicion and doubt by regulators because they have direct impact on consumer welfare as they affect the prices at which the product will be sold and at the same time create a barrier of entry thereby affecting competition in the market. RPM is a complex issue as it can have varied effects on the overall competition in the market. The complexity of the issue can be gauged by the fact that different jurisdictions treat RPM agreements differently. While the USA has evolved from a *per se* approach to *rule of reason*, several jurisdictions including but not limited to European Union, Australia and China continue to regard RPM as (per se) illegal.

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[4] Thomas W. Gilligan, 'The Competitive Effects of Resale Price Maintenance', *The RAND Journal of Economics*, Vol. 17, No. 4 (Winter, 1986), pp.544
[5] William Breit, 'Resale Price Maintenance What do Economists Know and When did They Know it?', *Journal of Institutional and Theoretical Economics (JITE)* vol 147 (1991) pp- 72
[6] ibid

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The aim of this paper is to evaluate the evolution of RPM jurisprudence in India. The paper attempts to understand the concept of RPM, study the approach taken by the Competition Commission of India (*hereinafter CCI*) in landmark cases dealing with RPM. The paper draws a comparison with the jurisprudence of the US Supreme Court on RPM as it stands now and attempts to understand the rationale behind RPM and why firms enter into such agreements. It evaluates whether the recent direction taken by the CCI towards evaluating RPM Agreements in the Automobile Sector, is a step in the right direction and what lessons the CCI could incorporate in its approach for future.

II. INDIAN COMPETITION LAW FRAMEWORK AND JURISPRUDENCE

The Indian competition regime is governed by the competition act, 2002.[7] In it, the relevant section which states resale price maintenance to constitute an anticompetitive agreement is section 3(4)(e). The statutory requirement is qualified by the standard *"such agreement causes or is likely to cause an appreciable adverse effect on competition in India"*.[8] RPM is understood in the broader theme of vertical agreements as is evident from the language of the section. To constitute violation of Section 3(4)(e) it is essential that the vertical agreement must stipulate price of resale by the seller and such agreements must cause adverse effect on competition *(hereinafter AAEC).*

To understand how Indian competition regime has defined RPM and acted against it, we need to understand the evolution of the case laws in this aspect. The first case which related to resale price maintenance was *ESYS Technologies v. Intel Corp*.[9]. It was alleged that Intel (which at the time had 79.3% share of semiconductor chip market) dictated resale price to its distributors and thus was in violation of section 3(4)(e). Given that the distributors existed downstream of the production chain, it constituted a vertical agreement. The DG report found that the agreement between Intel and distributors only talks of suggestive prices and leaves the final pricing to the distributor. The commission did not find Intel to be in violation of section 3(4)(e) because the

[7] The Competition Act, 2002.
[8] ibid s. 3 cl. 4
[9] *ESYS Information Technologies v Intel Corporation* 2014 CompLR 126 (CCI).

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minimum resale price needs to be *enforced* by the upstream party and cannot be merely suggestive – thus highlighting that only proactive and not passive measures are in violation of 3(4)(e).

The second case relating to RPM was *Ghansham Dass Vij v. Bajaj corp.*[10] The commission stated that to be in violation of 3(4) broadly, the agreement must have an AAEC in the market according to factors listed under section 19(3).[11] It also noted that any such enquiry needs to be a balance between the positive (consumer welfare) and negative (restrict competition) aspects of 19(3). In this case the commission found Bajaj to not be a market leader in the relevant market (of hair oil) and thus concluded that since its practice of RPM will have negligible appreciable adverse effect on competition in the market, it is not in violation of 3(4)(e). Thus, this case was landmark in so far as the interpretation of RPM was held to be not per se illegal, but only illegal in so far as its *effect* was capable of adversely affecting the market.

It is important to understand that even though resale price maintenance talks about price setting by the upstream party to the vertical agreement, it is only minimum resale price maintenance which is illegal. As per the judgement in *Shubham Sanitaryware v. HSIL Ltd.*[12] the commission clearly stated that if any agreement caps the price above which the downstream party cannot sell, it will not attract section 3(4)(e) - since it only bars setting of a minimum resale price. The logic behind it is simple, when there is a set minimum resale price, consumer welfare suffers because the sellers cannot compete on price. Since competing on price necessarily means that sellers want to give their product for the lowest possible price, such competition is understood to be in favor of consumer welfare. When a certain upstream player sets a price below which the good cannot be sold by downstream players, that doesn't only affects inter player competition, but also affects intra player competition - because other players who are not under RPM do not have to compete with those under RPM on price, since they know that those under RPM cannot go below a certain level. *M/s Counfreeside v. Timex group*[13] highlighted that for discount control to be a form of RPM, it needs to be enforced on all downstream players and not a few.

[10] *Ghanshyam Dass Vij v Bajaj Corporation Limited* 2015 SCCOnline CCI 174.
[11] Competition Act (n 8) s. 19 cl. 3
[12] *Shubham Sanitarywares v HSIL Limited* 2014 CompLR 58 (CCI).
[13] *M/s Counfreeside v Timex Group India Ltd* 2018 SCCOnline CCI 67.

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The CCI in *Jasper Infotech v. KAFF appliances,*[14] highlighted the positive justifications behind RPM which compel enterprises to enter into such agreements. The commission also stated, as a culmination of the RPM jurisprudence in India, that any alleged RPM is assessed under *rule of reason* analysis. It gave credibility to the economic literature that suggests that using a *per se* illegality standard is not prudent given that many such vertical agreements are constituted between players who produce complimentary goods and services and may not be in a strict competitive relationship, and that their commercial agreements may be efficiency enhancing, which led the CCI to hold no restraints were caused in the market.

The first penalty under RPM was handed down by the commission in *In Re: Enterprise solutions India Pvt. Ltd. v. Hyundai Motors India Ltd.*[15] where it found that the OP had established a 'discount control mechanism' by means of which the maximum discount was controlled, which in turn controlled the minimum resale price. The OP engaged mystery shopping agencies which tracked the discounts offered by the distributor and anyone found in violation of the policy had a penalty from 2 lakhs up to 80 lakhs imposed on them. Thus, the OP in this case, being a significant player in the car industry, through its discount control mechanism, violated section 3(4)(e) as its agreement and actions thereto had AAEC and did not result in consumer benefit. The commission noted that any agreement that directly or indirectly establishes a minimum resale price may restrict competition. The commission also noted in the case of *In Re: Alleged anti-competitive conduct by Maruti Suzuki India Limited*[16] which had similar allegations against MSIL as in the Hyundai case, that it is particularly problematic when such discount control policy is enforced at the behest of distributors, as it helps in maintaining the collective interest of downstream players – saving them from competing against each other on price, and thus harming consumer welfare. These two recent cases affecting the automobile market mark a significant turn in the CCI's jurisprudence towards RPM, as it was the first time CCI held RPM to have AAEC and thus levy penalties for contravention of section 3(4)(e). These cases will be further analyzed in part IV to understand whether the approach taken by the CCI was correct.

[14] *Jasper Infotech v KAFF Appliances* 2019 SCCOnline CCI 2.
[15] *Case Nos. 36 & 82 of 2014.*
[16] *In Re: Alleged anti-competitive conduct by Maruti Suzuki India Limited in implementing discount control policy vis-à-vis dealers, (Case no. 01 of 2019), order dated 23 August 2021.*

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III. EVOLUTION OF RPM JURISPRUDNCE IN USA

Antitrust laws exist in the USA as both federal and state legislations. Our enquiry about the status of about the legality of RPM agreements (vertical price restraint agreements) will be limited to the federal statute in this context. Section 1 of the Sherman act gives us the conditions wherein agreements entered between different parties will be considered illegal if they result "*in restraint of trade or commerce among the several States, or with foreign nations.*"[17] The American jurisprudence with regards to the treatment of resale price maintenance has undergone major change i.e., from being considered illegal per se to the rule of reason when determining illegality. The landmark case of *Dr Miles Medical Co. v. John D. Park & Sons Co*[18] was overruled in the case of *Leegin Creative Leather Products, Inc. v. PSKS, Inc*.[19]

Per se approach and the case of *Dr Miles Medical Co. v. John D. Park & Sons*

This case involved vertical price fixation in its distribution network of both wholesale and retail prices by a drug manufacturing corporation. Dr Miles medical company's drugs were distributed through both joggers and wholesale druggists. The defendant was a wholesale dealer who did not agree to the terms of Mr Miles medical corporation and instead procured the drugs produced by them from other dealers at prices lower than those fixed by Dr Miles Inc thereby inducing those dealers who had signed the RPM agreement with Dr Miles to violate the same. The Court found that the defendant will not be guilty of misconduct as the agreement of the petitioner with other dealers to fix the price of the product disrupts the market, destroys the competition and is against public policy. The Court treated vertical price agreements at par with horizonal price agreements as the impact of fixing prices in under both of these have an adverse impact on competition. Thus, for the Court established that RPM agreements must be subjected to the *per se* rule.

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[17] Sherman Antitrust Act of 1890, Article 1 <https://www.law.cornell.edu/uscode/text/15/1> accessed 24th October 2021

[18] (1911) 220 U.S. 373

[19] (2007) 551 U.S. 877

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However, over the years, the US Supreme Court read various exceptions to the *per se rule* of illegality in the law in the cases of *United States*[20] *v. Colgate & Co and United States v. General Electric*[21] before finally overruling the precedent in 2007.

Rule of Reason approach in the case of Leegin Creative Leather Products, Inc. v. PSKS Inc

This case overruled the long-standing position with respect to the per se approach of RPM and replaced with the approach of the rule of reason. Rule of reason means that the market regulator has to consider all the circumstances and has to weigh all the factors into consideration in deciding whether a restrictive practice should be regarded as causing unreasonable restraint on competition.[22] Leegin Creative Leather Products was a leather manufacturing concern which adopted a policy wherein they would not deal with the retailers who refuse to follow their pricing policy. PSKS, Inc was dealing in the Brighton line of products manufactured by the Leegin creative leather incorporation through its retail stores. After almost a year Leegin Inc found that Kay's Kloset run by PSKS was selling the Brighton line at a 20% discounted rate after which Leegin requested them not to sell it at that rate. This request was refused by the store owing to which Leegin Inc stopped dealing with the store as result of which Kay's Kloset suffered losses. PSKS sued Leegin on the ground that their pricing and promotion agreement policy was a violation of antitrust laws. The Court in this case carried an in-depth discussion about how Dr Miles was a primitive approach and how the law needs to represent the realities of the present. By relying upon recent economic studies which established the positive effects of RPM and the development of law in the years since the 1911 precedent, the Court ruled the adoption of *rule of reason* is a better approach. The Court remarked that the primary purpose of antitrust law is to protect inter-brand competition and thus administrative convenience provided under *per se rule* could no longer justify its existence and thus, a market regulator is expected to conduct an economic analysis before holding any agreement to have restraining effects.

IV. JUSTIFICATIONS FOR RESALE PRICE MAINTENANCE

[20] (1919) 250 U.S. 300
[21] (1927) 272 U.S. 476
[22] *Leegin* (n 20)

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RPM has always been a controversial area while adjudicating upon vertical agreements. The controversy in part belongs to the complex effects RPM agreements seem to have on competition in the market. There have been numerous conflicting studies when it comes to the assessment of RPM. In reality RPM, is a complex mechanism which can have a variety of economic effects and as a result sometimes leads to conflicting jurisprudence on the issue. However, despite the treatment of RPM agreements, it has been accepted that RPM doesn't always prohibit competition in the market, instead it can have some positive results as well. Guidelines on Vertical Restraints issued by European Commission also recognize that vertical restraints often have positive effects in the market and help promote non-price competition and the quality of goods.[23] It was primarily in recognition of the positive effects of Resale Price Maintenance, that the US Supreme Court moved from the *per se* rule in the case of *Dr Miles*[24] to a *per reason* rule in the *Leegin Leather*[25] as discussed above. There is a growing consensus that RPM can have positive effects on competition in the market in the following ways.

A. RPM Facilitates Inter-brand Competition.

RPM agreements can greatly help increase inter-brand competition. It has come to be accepted that RPM often promotes competition on factors other than the price of the good. This is particularly true of industries which rely on dealers to reach final customers, case-in-point, the automobile industry. A minimum RPM Agreement, which sets the minimum price that a retailer must charge for the good usually invite scrutiny by any regulator. However, it has some redeeming qualities as well which make it an ideal solution for manufacturers. By guaranteeing retailers a uniform minimum price which must be charged for the goods, manufacturers ensure profit-margin to the retailers. RPM also incentivizes dealers to compete on non-price factors as well expend resources to attract more customers which in turn help achieve the manufacturer's aim as well. By diverting useful resources towards advertising and promotional schemes, retailers promote the goods and make it stand out in the market with respect to competition. At the end of the day, RPM agreements

[23]Vertical Guidelines, European Commission, para. 106 <https://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf> accessed 22 Oct 2021

[24] *Dr Miles* (n 19).

[25] *Leegin* (n 20).

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are a result of the various distribution problems which manufacture faces[26] and thus it is important to incentivize its distributors who help in making sure the product reaches the end consumer. RPM is essential in incentivizing retailers to compete against rival brands by increasing sales effort.

B. RPM help new entrants in a market

Contrary to the popular belief that Resale Price Mechanism only leads to cartelization among distributors, RPM agreements can greatly help new entrants penetrate into market. New manufacturers entering into a new market can make use of RPM agreements to attract distributors as well as motivate them to invest in capital and labour costs which are required in the distribution of the goods. Thus, RPM not only ensures competition among established players but also provides platform for new entrants to penetrate the market.

C. RPM helps check the abuse of free-riding

Perhaps the greatest benefit of RPM is that it helps to alleviate the problem of free-riding. Free-riding is understood as the practice when one retailer invests to promote the manufacturer's product however, another retailer by offering discounts is able to undercut other retailers and thus free ride on their investment's costs. Minimum RPM agreements ensure that no retailer is able to compete against other retailers on price and in the long run benefits all the retailers. The practice of free-riding has also been exacerbated by the rise of online shopping where customers prefer to try the product by visiting a brick-and-mortar store but prefer to buy it online due to the price advantage online sellers enjoy. If the practice of free-riding is allowed, very few distributors would have the incentive to promote and educate the consumer about the product, thus reducing the overall sales of the product. RPM on the other hand, eliminates free-riding by removing the possibility to attract customers by price cutting.

[26] Pauline M. Ippolito & Thomas R. Overstreet, Jr., 'Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works', (1996) 39 *J. L. & Econ.* 285, 322-325

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A comprehensive analysis of RPM shows that in-fact it is an essential feature of the distribution process[27] which allows manufacturers to distinguish their product as well as reward retailers for their efforts. RPM is a complex competitive tool which on one hand can reduce intra-band competition, however, stimulates inter-brand competition.[28]

V. LESSONS AND WAY FORWARD FOR THE CCI

CCI's evolving jurisprudence towards RPM has been traced in part II of the paper. As we have seen, in only two cases did it found the party guilty and imposed any penalty. However, upon analysing both the *Hyundai* and *Maruti* cases, one observes that the CCI has made some grave errors in its judgement, which can lead rather lead to a chilling effect on the market and the manufacturers. Both the judgements involve assessment of the Automobile sector. In India, car retailers are primarily exclusive dealers and with very few multi-brand dealerships. The manufacturers rely heavily on their dealers to reach out to their final customers as well as offer customers a number of services which help them distinguish their products. Automobile dealership is a very capital intensive and low-margin business.[29] But at the same time manufacturers rely on dealers to offer high-quality services to the customers. Given the fact that every downstream player has a limited number of capital and resources, RPM is a means to ensure that the limited resources are not spent entirely on price competition. RPM becomes a very important tool for the manufacturers to ensure that retailers invest their resources in promotions to attract customers and helps keep check the upon the problem of free-riding. RPM helps manufacturers rectify distribution inefficiencies, keeps the retailers in sound financial health and encourages them to compete on non-price factors. Customers pay as much regard to the car manufacturer as to the retailer-ship, based on the services it offers and the relationship that gets build in the process is crucial for after-sale services.[30] According to a study conducted in 2008, it was found that reputation of a dealer acquired through word-of-mouth increased customer confidence

[27] Richard Brock, *The Antitrust Paradox* (The Free press, 1993) ch. 14
[28] *Continental T.V., Inc. v. GTE Sylvania*, Inc., 433 U.S. 36 (1977) [51-52]
[29] Ben Strubel, Long-Term Investors Should Steer Clear Of Car Dealership Stocks , *Seeking Alpha* <https://seekingalpha.com/article/4208030-long-term-investors-should-steer-clear-of-car-dealership-stocks> accessed 20th October 2021
[30] Shilpi Bhattacharya, Aditi Khemani, 'Hyundai and the Law of Resale Maintenance in India' (2020) vol LV No 50 *EPW* (47-53) p.50

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substantially.[31] Thus, benefits of RPM in an automobile market are significant and as a result the manufacturers are also entrusted with the responsibility of ensuring that retailers are awarded for their efforts.

However, in both the cases, The CCI paid little if any regard to the positive justifications of the RPM. The CCI also failed to assess the industry and the market structure of the retail automobile sector which provides justification for RPM in the first place. Under Section 19(3) the Commission must weigh in several factors while establishing AAEC, however, in its order the CCI fails to substantiate it finding with any actual evidence. In the *Hyundai Case,* the CCI did not even acknowledge the pro-competitive justifications put up by Hyundai. This was in complete contrast to *M/s Jasper*[32] case where the restraints were justified given the pro-competitive effects it seemed to have on the market.

While it can be argued that the CCI is placed a higher threshold in the *Hyundai* case due to it being a significant player in the market and thus having more AAEC, however, in its judgement the CCI fails to establish Hyundai as a significant player with a significant share in the market, thus, holding back its own economic analysis of the market. While the *Maruti* judgement does not suffer from this particular lacuna, however, there are several lapses made by the CCI, nonetheless. Both the DG and the CCI did not formally define either the 'relevant geographic market' or 'relevant product market' in their judgement[33] before concluding that MSIL had 51% market share. This is not only unsound jurisprudence but also flies in the face of past CCI policy.

Further the DG in the *Hyundai* case defined relevant market for assessment of RPM to be "*Intra Brand Sale of Hyundai Brand of Cars in Delhi and NCR*." In doing so, the DG followed an effect-based approach. Assessing the market based on the harm it causes rather than evaluating the market in a comprehensive way to assess the competitors and the restraints caused to the competition due to the conduct of the parties, is an important role of the DG and provides the base for all further inquiry. Not only the market definition pre-supposes the harm caused by RPM but is also contrary to the final judgement of the CCI, which rules that RPM not only causes harm at intra-brand level, but also results in harm at inter-brand level.

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[31] Veena, A and H R Venkatesha "Dealers Performance and Customers Preference in Passenger Car Marketing," *XIMB Journal of Management*, (2008) Vol 5, No 2, p 59

[32] (n 15)

[33] *Maruti Suzuki* (n 15) para. 13.

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In both the *Hyundai* and the *Maruti* cases, the CCI has held RPM to have AAEC however, upon analysing judgements, it seems that CCI instead of undertaking a thorough analysis of the economic effects of RPM, has relied on pre-conceived notions of anti-competitive effects of RPM. In both the cases, the CCI makes that claim that RPM leads to cartelization and collusion at both the distributor level and the manufacturer level, resulting in harm to consumers. However, the CCI in both instances, fails to prove any actual collusion which may have caused harm to the consumers. Meanwhile CCI in its conclusion also failed to take into account there is very less brand loyalty in the medium tier price range, where Hyundai and Maruti compete.

In both the cases, the CCI recounted the negative aspects of the RPM and made some broad critiques of the RPM mechanism however, in both instances it failed to connect its reasoning to the facts of the particular case.

The CCI in its judgement has remarked that RPM has resulted in loss of services to consumers and they had to pay higher prices. However, while concluding the same, the CCI failed to assess the effect of the services the consumers do enjoy due to the effect of RPM. The CCI failed to consider that often the consumers prefer a particular dealer not due to the discounts it offers but the quality of services they offer. The failure of CCI to assess the competition among dealers on other than price factors, leads CCI to overlook an important justification for the existence of RPM in the first place. This is further exacerbated by the special needs of the Automobile Sector, in which car dealers are indispensable. Thus, the CCI by making broad remarks in its judgements, failed to take into account the necessary market implications which justify the need for the existence of the RPM agreements in the first place.

It was due to major missteps in the CCI's judgement that NCLAT set aside the CCI's order in the Hyundai case[34] for what it described as lack of application of mind by the CCI and its failure to establish adverse effects on competition in the market.[35] The CCI by not examining the veracity of the DG's findings and blindly adopting them, seems to be moving from the *rule of reason* into the domain of the *per se rule.*

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[34] *Hyundai Motor India Ltd. Vs. Competition Commission of India & Ors,* Competition Appeal (AT) No. 06 of 2017; Decided on: 19.09.2018

[35] Manas Kumar Chaudhuri & Radhika Seth, 'Hyundai NCLAT Decision: The Lack Of Evidence Or Not? - Anti-trust/Competition Law', *Mondaq* <https://www.mondaq.com/india/antitrust-eu-competition-/751292/hyundai-nclat-decision-the-lack-of-evidence-or-not> accessed 24 October 2021

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As already established in part IV, RPM is a complex mechanism resulting in varied effects upon the market. There have been several conflicting studies on actual effects of RPM on final consumers.[36] Thus, it is essential that CCI bases its reasoning on sound economic principles and provides evidence of actual harm caused due to consumers. In doing so the CCI will not only develop a sound jurisprudence trend on a complex issue but also reduce the possibility of the judgement being overturned at the appellate stage. Since, India follows the *reason* rule instead of the *per se* principle, it is essential that the CCI provides evidence for establishing the actual adverse effects on competition. If it fails to do the same, it would instead be applying the *per se* principle while assessing vertical agreements, thus contravening its own statutory mandate and past precedents.

VI. CONCLUSION

In this paper, an attempt has been drawn understand the rationale behind RPM mechanisms. The paper has traced the evolution of RPM agreements in India as well as the US. There is still no consensus whether RPM by default causes adverse effects on the market or could lead to higher prices for the final consumers. In response to the actual realities and economic understanding, the US had to correct its approach and move to the rule of reason. In India, even before the *Leegin* case was decided, the statute laid down the *reason rule* for evaluating vertical agreements and by extension RPM.

The CCI has had the opportunity to deal with RPM agreements in a number of cases involving a variety of industries. In the two recent, cases it has held two of the largest automobile manufacturers guilty of causing AAEC through RPM mechanisms and has levied penalties for the same. This significant turn in CCI's jurisprudence towards RPM also coincides with the Regulator taking a more pro-active and aggressive role in investigating and keeping a watch on major players in Indian market. While this is a welcome step in the right direction, there is also a need for the CCI to base its judgements on sound economic analysis and principles of law, so that it causes much less uncertainty in among the players as well as reduces the possibility of Appellate Tribunals setting aside its orders. The two recent RPM decisions while noble in their intent, suffer

[36] *See* Marvel, Howard (1994), 'The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom', *Antitrust Law Journal*, Vol 63, No 1, pp 69–71.

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major lacunas when it comes to establishing the evidence of adverse effects. The CCI under law is mandated to establish the restraints caused by RPM instead of relying on a broad-brush stroke approach. The CCI needs to develop a sound economic analysis while evaluating RPM cases and needs to take into account the complex effects it can causes. A rigid approach centered around the idea of price, can lead to a narrow application of law when adjudicating upon RPM agreements, The CCI must pay due regard to the positive effects of RPM and needs to approach consumer welfare in a holistic way. If the CCI fails to do so, it would be moving us back 100 years in the jurisprudence concerning vertical restraints, to a time of *Dr Miles* and the *per se rule* of illegality.

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