RESALE PRICE MAINTENANCE AS A VERTICAL RESTRAINT UNDER THE COMPETITION ACT, 2002

INTERNERSHIP PROJECT REPORT

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JUNE 2012
ACKNOWLEDGEMENT

This dissertation is an effort made by me with the astute guidance of my mentor, Dr. Vijay Kumar Singh, Deputy Director (Law). His valuable inputs and constant encouragement has inspired me to carry out this research fruitfully. He gave me his valuable time to discuss the facets of this topic and guided me towards an enlightening and holistic research.

I also put on record my gratitude towards the library staff, which has provided me help and access to all the resourceful material for my research. I express my sincere gratitude towards Mr. Alok Tripathi (Joint Director, Competition Commission of India) who gave me food for thought for this topic.

I am indebted towards Competition Commission of India, for providing me an opportunity to have a learning experience.

DIVYA SHARMA
29.06.2012
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LIST OF ABBREVIATIONS

AAEC- Appreciable Adverse Effect on Competition

Tax. L. R- Tax Law Review

EU- European Union

CCI- Competition Commission of India

MRTP Act- Monopolies Restrictive Trade Practices Act

MRTPC- Monopolies Restrictive Trade Practices Commission

S.- Section

Vol.- Volume

Ed.- Edition

Rev- Revised

SC- Supreme Court

US- United States

JILI- Journal of Indian Law Institute

Chi. L. R- Chicago Law Review

RPM- Resale Price Maintenance

Comp Cas- Competition Cases
CHAPTER- I

INTRODUCTION

There are about a hundred systems of competition law in existence today. Some of the laws are more than a century old like the Sherman Act of the US, whereas some of them are as recent as the Indian Competition Act of 2002. Thought the Act was passed in 2002, section 3 and 4 became operational only in 2009 and the combination provisions in 2011. As more and more countries are adhering with the norms of globalisation, liberalization and privatization, they have felt the need to adopt modernized competition laws. However, the need to protect the free market from competitive restraints is by no means a recent phenomenon. The Roman Constitution of Zeno, promulgated in 483 A.D. had provisions to restrain monopolies. Though the Sherman Act, 1890 is considered to be the starting point of modern competition law, it was nothing but an application of the old and recognised principles of the common law. The common law doctrine of ‘restraint of trade’ has played a crucial role in the development of modern competition law. The essence of this doctrine is that it is contrary to public policy to enforce contracts that are in the nature of unreasonable restraints of trade. What is unreasonable was to be determined by considering whether the restraint was so large as to interfere with the interests of the general public. In the US, the common law doctrine of restraint of trade and its relationship with the Sherman Act was explained by Chief Justice White in the landmark case of Standard Oil Company v. US. The Court recognized that, "taken literally," the term "restraint of trade" could refer to any number of normal or usual contracts that do not

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2 Ibid.

3 221 US 1 (1911), Over a period of decades, the Standard Oil Company of New Jersey had bought up virtually all of the oil refining companies in the United States. Initially, the growth of Standard Oil was driven by superior refining technology and consistency in the kerosene products (i.e. product standardization) that were the main use of oil in the early decades of the company’s existence. The management of Standard Oil then reinvested their profits in the acquisition of most of the refining capacity in the Cleveland area, then a center of oil refining, until Standard Oil controlled the refining capacity of that key production market. By 1870, Standard Oil was producing about 10% of the United States output of refined oil. This quickly increased to 20% through the elimination of the competitors in the Cleveland area. Although claims have been made that Standard Oil secretly secured preferential rates from regional rail roads, such a scheme never came into effect, and a more plausible explanation for the rise of Standard Oil was its ability to continuously lower its costs and thereby the cost to the consumer. The resulting competitiveness of Standard Oil compelled the competition to sell out or face bankruptcy, until Standard controlled most of the refining capacity of the U.S.
harm the public. The Court embarked on a lengthy exegesis of English authorities relevant to the meaning of the term "restraint of trade." Based on this review, the Court concluded that the term "restraint of trade" had come to refer to a contract that resulted in “monopoly or its consequences.” The Court identified three such consequences: higher prices, reduced output, and reduced quality. The Court concluded that a contract offended the Sherman Act only if the contract restrained trade "unduly”—that is, if the contract resulted in one of the three consequences of monopoly that the Court identified. A broader meaning, the Court suggested, would ban normal and usual contracts, and would thus infringe liberty of contract. The Court endorsed the rule of reason.\(^4\)

The Indian manifestation of a modern antitrust law can be seen with the enactment of “Competition Act” in the year 2002. The Act came into effect in phases. The provisions dealing with “anticompetitive agreements” and “abuse of dominance” came into effect from the year 2009 and the “combination” provisions were notified in 2011. The Act incorporates the “appreciable adverse effect on competition” (also referred to as “AAEC”) test as the substantive legal standard for assessing anticompetitive behavior and structural changes. Section 3 of the Act which expressly deals with anti-competitive agreements is the focus area of this report, more specifically vertical restraints or agreements as contained in section 3(4) of the Act.

The researcher will be examining Resale price maintenance\(^5\) (RPM) as a vertical restraint. The jurisprudence on anti-competitive agreements in India is still at the nascent stage. The process of identifying an agreement and then condemning it as anticompetitive has always been a grey area in anti-trust cases. As a result the courts have devised tools of investigation in order to expeditiously come to a logical conclusion. Of the many legal principles that have become the cornerstone of anti-trust common law none have attracted more attention than the rules of “per se” and the “rule of reason”.\(^6\) The shift in approach from ‘per se illegality’ to ‘rule of reason’ is the outcome of several US court judgments,

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\(^5\) Clause (e) of Section 3(4)

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which shall be discussed in greater details by the researcher in the coming chapters. Next, the researcher shall analyse the law as developed by the legislature and the Commission in the light of the jurisprudence as developed in US.

1.1 What are Vertical Restraints?

Vertical agreements or restraints are defined by antitrust regulation as “agreements of concerted practices entered into between two or more undertakings each of which operates at different levels of the production or distribution chain”.7

1.1.1 Forms of Vertical Restraints:

Vertical restraints are grouped into price and non-price restraints. The former refers mainly to Resale price maintenance, where a distributor commits to a retail price. This can take the form of a fixed price, either minimum or maximum resale price or even a recommended price. The latter includes:

1. **Exclusive territories or distribution arrangement**, when a distributor is assigned a geographic territory by the manufacturer and given monopoly rights to sell in that area.8 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.

2. **Exclusive dealing**, when a distributor is not allowed to carry the brands of competing manufacturers.9 Exclusive dealing arrangements are essentially contracts in which a seller agrees to sell all or a substantial portion of its products or services to a particular buyer, or when a buyer similarly agrees to purchase all or a portion of its requirements of a product or service from a particular seller.

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7 Xulia González, “Empirical Regularities on Vertical Restraints”, available at
9 Exclusive territories is a way of restraining intrabrand competition and exclusive dealing is a way of restraining interbrand competition.
3. **Full-line forcing**, when a distributor is committed to sell all the varieties of the manufacturer’s products. This is a particular type of tie-in-sales agreement in which the distributor agrees to buy one or more goods from the manufacturer rather than only the goods it wants to buy. In other words it refers to Producer or supplier insistence that the dealer must carry the full range of products in the line.

4. Another important type of agreement is **franchising**. This contract is understood as a license granting the right to trade under the mark and name provided that the licensor’s standard of business is maintained. The distinctive feature of these agreements is that the customer perceives identification between franchisor and franchisee.

5. **Single branding agreements** are also common in occurrence. These contracts impose an obligation on the buyer to purchase all or specific quantity of the good or service from one particular supplier. Often tying agreements may lead to single branding. Tying occurs when a buyer is, in order to purchase a product she desires is forced to purchase a distinct good.

6. **Resale Price Maintenance** - Resale price maintenance is a provision according to which the final price charged to consumers is not set by the distributor but imposed by the producer. This restriction has several variants, including maximum retail price (price ceiling), minimum price, non-binding “recommended retail price” or advertised price. Resale price maintenance or price floors supposes that price cuts can be detected at a sufficiently low cost. Note that these price cuts can take the form of non-monetary concessions such as free delivery for instance. Since this concept is the focal area of research, it has been dealt with in greater details in chapter 2.

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10 Supra n. 8, p.17.
12 Ibid.
13 A good example would be a printer and cartridges that it would require inorder to work. Also see, D.Hilderbrand, “Economics Analysis of Vertical Agreements: A Self-Assessment”, (THE HAGUE, KLUWER, 2005) 80.
Vertical structures involve a number of decision variables that affect the joint profits (retail price or selling effort) or the way this profit is shared between the firms (wholesale price). The decentralization of the decision variables to the retailers can create market inefficiencies since they create externalities. Vertical restraints can solve these inefficiencies in a number of ways. Resale price maintenance alleviates the double marginalization problem. Exclusive dealing enables manufacturers to protect their investments against potential retailer opportunism. Exclusivity deals also promote distributor ex ante investments in specific facilities or in human capital. Lastly, full line forcing helps manufacturers introduce new or improved products to the market.

The attitude of competition authorities and courts towards vertical restraints varies significantly over time and from one country to another. Most horizontal agreements among competitors violate antitrust regulation: they are forbidden per se, and are considered illegal even without evidence of hurting competition. In the case of vertical agreements the rule-of-reason approach is generally applied in most regulations, i.e., a priori presumption exits, and courts must weigh the costs and benefits of a practice on a case by case basis.

1.1.2 Double Nature of Vertical Restraints:

The unique characteristic of vertical restraints is that it may or may not be anticompetitive in nature and may also be pro-competitive at times. Therefore, the extent to which vertical agreements are potentially harmful and, the correct approach for competition policy has been object of lengthy discussion.

Vertical restraints may control both intra and inter brand problems. For instance, resale price maintenance or minimum purchase obligations on the distributor may induce him to set lower prices. In the case of destructive competition between distributors, a

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14 For example, when a manufacturer launches a general product promotion or makes an investement that reduces a retailer’s cost. In the first case, a dealer might encourage customers to buy another lower-priced brand or one with a higher retail margin. In the second case, reduces retailer’s costs of selling competing brands.
15 Supra n. 9.
16 Supra n. 8, p. 16.
17 Ibid. p 19.
manufacturer may alleviate the problem by imposing resale price maintenance, or by allocating exclusive territories. Free rider problems may be addressed by exclusive purchasing agreements. On the other hand, inter brand competition problems, notably free-riding effects and price competition, may be resolved through exclusive dealing arrangements - prohibiting a distributor from selling competing products, or a less direct method such as an obligation to purchase a substantial minimum quantity. 18

Vertical agreements, however, also have many negative effects, such as foreclosure of other suppliers or buyers by raising barriers to entry, reduction of inter brand competition, reduction of intra brand competition between distributors of the same brand, and creation of obstacles to market integration. Practices such as exclusive dealing may be harmful where it gives rise to switching costs. Similarly, consumers may be disadvantaged by the inability to make side-by-side, in-store comparisons and may be liable to make purchases on the basis of inadequate information about the alternatives on offer. Exclusive dealing may thus reduce inter-brand competition. Again, even where there is sufficient inter-brand competition, exclusive territories may weaken intra-brand competition and may lead to higher prices in the downstream market. Resale price maintenance also may be a way to facilitate dealer cartels as price-cutting can be policed more easily. 19

1.1.3 Economics of Vertical Restraints:

In many industries, vertical agreements are fundamental to the way companies distribute their products to consumers. They have also been the focus for vigorous economic debate on the extent to which they might, in principle, give rise to anti-competitive effects. It is therefore an area in which form-based rules have been largely discredited and the case for detailed economic analysis is firmly established as central to the legal assessment.

Some believe that vertical agreements are very different from agreements between competing firms and appear only when they help improving the efficiency of the vertical structure. Competition agencies should therefore let firms design these arrangements as they wish. Others believe that any contractual term that restricts one party’s freedom of

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19 Ibid.
trade - and this would be the case for most if not all vertical restraints - can only be harmful and should thus be banned.\textsuperscript{20}

Vertical restraints restrict competition to a considerable lower extent than horizontal agreements. Moreover, vertical restraints often have pro-competitive effects. Among other things, vertical restraints can be employed to reduce transaction costs or to achieve other efficiencies between firms at different levels of the production and distribution chain.

Vertical restraints may lead to a broad range of efficiency gains. These efficiencies could create additional value by lowering the cost of producing an output, improving the quality of the product or creating a new product itself. Another benefit is the elimination of double marginalisation.\textsuperscript{21} Furthermore, vertical restraint may also be a solution for the free- rider-problem. Distributors might be unwilling to invest in the marketing of new products or services unless the manufacturer imposes a territorial restraint that ensures that late-entering distributors will not “free ride” on the earlier distributors' initial efforts and investments to establish the manufacturer's position in the marketplace.\textsuperscript{22} It can also increase sales and create brand image by imposing certain standards of quality on the distributors.

However, vertical restraints can also lead to anti-competitive effects. Negative anti-competitive effects, which may result from vertical restraints, are: foreclosure by raising barriers to entry, reduction of interbrand competition (including facilitation of collusion, both explicit and tacit), reduction of intra-brand competition, and creation of obstacles to market integration. They either may restrict competition in a harmful way or may introduce competition by the opening up of new markets. They directly or indirectly impair the free flow of goods and help maintain different price levels.

\textsuperscript{20} Patrick Rey, “The Economics of Vertical Restraints”, available at http://www.economics.soton.ac.uk/staff/verge/Verticals.pdf
\textsuperscript{21} Double marginalization is defined as the “exercise of market power at successive vertical layers in a supply chain.” Dating back to Lerner (1934) the problem that arises as a result of double marginalization is tied to an impetus to mark up the product’s price above marginal cost. According to a 2005 Caltech paper (Vertical Integration of Successive
Therefore, vertical restraints generally have both: pro- and anticompetitive effects. In fact, the same vertical restraint can have very different effects depending on the context. Thus no per-se rules are appropriate to handle vertical restraints. A substantiated economic case by-case analysis is required. An economic expert opinion may facilitate the self-assessment of companies as required by competition law.
CHAPTER-II

UNDERSTANDING RESALE PRICE MAINTENANCE

2.1 General Concept:

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.\(^{23}\)

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.\(^{24}\)

RPM maybe resorted to either individually or collectively. Under individual RPM, the supplier prescribes the wholesale or retail prices for the goods to be resold and takes actions to enforce the same. While under a collective RPM arrangement suppliers of goods decide the wholesale or retail prices for resale of goods by the byers. RPM is referred as a vertical restriction in the antitrust terminology as opposed to price fixing arrangements among manufactures in respect of sale of goods or among buyers in respect of purchase of goods covered by section 3(1)(a). When RPM is enforced, the price of goods becomes the same at all points of resale irrespective of difference in location, the character, the quality of services provided with the goods and different demands on the resources of the wholesaler or retailer.\(^{25}\)

It is essential to distinguish RPM from direct price maintenance by manufacturer, who owns a chain of retail stores and stipulates the price at which each of these must sell his products. Such direct price maintenance is prevalent in India in several industries, like

\(^{23}\) SM Duggar, GUIDE TO COMPETITION LAW, Vol 1, 5\(^{th}\) ed. 2010, p. 753. Also see, Fair Trade, Resale Price Maintenance Re- examined by PWS Andrew and FA Friday, (Macmillan), p.9.


\(^{25}\) Supra n. 23, p 754.
footwear industry. Similarly, there are agency arrangements where the wholesaler or distributor may be an agent of the manufacturer and he is selling on behalf of the manufacturer.26 Such cases do not fall within the ambit of RPM as the ownership of the goods remains with the manufacturer.

The resale prices are enforced by virtue of the supplier’s power to withhold supplies of the goods. Therefore, RPM is seen as a technique to prevent price competition among manufacturers and distributors. The form of RPM is widely prevalent in India is fixed price or maximum price stipulation. This is justified on the ground that in conditions of shortages, it would prevent arbitrary price rise and curb the tendency of profiteering on the part of wholesalers and retailers.

Normally branded goods are subjected to RPM as opposed to non-branded goods. This is because non-branded goods cannot be controlled as they pass through various trade channels. Non-branded goods, not only these goods pass through various channels of trade, what adds to the complexities is the unorganised market, no doubt market nowhere can always be homogenously comprised but especially in our case where market remains divided between rural and urban, barriers of language, and consumers belonging to vastly varying categories like elite, middle and low middle class, where to some information regarding service and facilities that can be availed of more easily than others who may not any clue of it practices like “free-ride”, misleading consumers and such other aspects if introduced problems for branded goods may become quite significant. The case is worst when we come to unbranded goods and thus, subjecting non-branded goods to RPM may not serve the purposes like free-ride or providing better retail services.

2.2 Economics of RPM:

Some of the reasons indicate that RPM enhances consumer welfare; others indicate the opposite. This means any economic assessment of a particular case must interpret the facts in that situation with competing theories in view. Therefore, it becomes important to understand the pro-competitive effects and at the same time the harmful effects of maintaining RPM.

26 Supra n. 23, p. 754.
The following are considered to be the positive effects of RPM-

2.2.1 Efficient Retail Services:

It many have a tendency to repair market failure by establishing a retail floor price. Therefore, by selling its brand to retailers on the condition that each retailer’s price not falls below some minimum level, the manufacturer prevents any retailer from taking sales away from another by charging a lower price.

RPM occurs in markets where goods do not require detailed information, extensive product demonstration, or significant post-sale service commitments. Such products include women’s fashion accessories, shoes, candy, and designer jeans. In the case of such products, retailers may use RPM-protected margins to invest in retail services like longer hours of operation, more attractive store furnishings, and other amenities that owe little to specialized information. Besides shopping amenities, retailers with reputations for selling high-quality merchandise provide what has been called a “quality certification” service to manufacturers. A manufacturer may use RPM to ensure that reputable retailers—those who help the manufacturer build and maintain a good reputation for its brand—carry its brand by affording those retailers protection from free-riding discounters.

2.2.2 RPM and Free-Rider problem:

Many economists believe that RPM is a method for addressing the free-rider problem. A free rider is someone who enjoys the benefits of someone else’s investment without having to pay compensation. An example of the free-rider problem could be a high-tech, information-intensive consumer durable good, where presale assistance by a knowledgeable salesperson at a retail establishment is required to inform and persuade a consumer of the product’s merits. Upon getting the requisite information from the full service retailer, the shopper leaves the store without making a purchase and visits a discount store to buy the product for a lower price. The discount store, which can offer the

29 Ibid.
30 Supra n. 27.
lower price because it does not employ knowledgeable salespersons, gets a free ride from the full service retailer who incurs costs to promote the product. This situation may be unsustainable for the full service retailer. It cannot continue to employ knowledgeable salespersons and still match the discounter’s low price. The full service retailer must curtail service to survive. In the end, the free rider prevents consumers from having access to retail services which they value. Those consumers must decide what brand of good to buy, or whether to buy a good at all, with less than optimal information about their choice set. As a result, products that require retail service become less available. The consequences are bad for consumers and bad for the manufacturer.

The possibility that free riders may extinguish retail service altogether in a market without RPM requires that allowable non-price vertical restraints are not up to the task. It also requires that retailers cannot separate those aspects of retail service that build demand for the manufacturer’s product from other retailer activities and “sell” them to consumers, or the manufacturer, on a stand-alone basis. In many instances, transaction costs appear to prevent separate service sales from eliminating all free riding.

2.2.3 Beyond the Free-Rider problem:

Minimum RPM can mitigate problems between manufacturers and retailers even when consumers are unlikely to free-ride. For example, when retailers decide on the level and types of services and sales effort to provide for a product, they consider their own markup, not the manufacturer’s markup. Suppose that Levi Strauss & Co, a popular denim wear manufacturer, has a $50 wholesale markup on a brand of women’s jeans while its retailer has a $10 retail markup. The retailer would not spend $15 on promotional displays or extra sales efforts that would induce one additional consumer to buy; however, Levi’s profits would increase, so it is in Levi’s interest to motivate the retailer to invest and compete for incremental sales. This example illustrates just how easily the private interests of retailers and manufacturers can be misaligned, especially when there is a large difference in markups. In stark contrast to price-fixing arrangements, promotional, brand image, or

32 Notice that this is similar to the real estate agent incentive incompatibility described in Steven D. Levitt, Stephen J. Dubner, Freakonomics, (New York: HarperCollins, 2005).
sales-effort investments are competitive and geared towards incremental sales. To address the incentive problem, minimum RPM arrangements would offer larger discount-restricted markups to retailers; convey the types of services, effort, and brand image desired; monitor retail prices, and terminate retailers who do not comply.

Apart from this RPM may lead to other pro-competitive effects like:

1. Sparing the manufacturer the task of specifying and monitoring the retailer’s performance along multiple service dimensions. This is because RPM induces retail services without their being specified exhaustively. The retailer provides the sought after, but difficult-to-specify, retail services to avoid termination and to capture the protected retail margin.  

2. RPM limits intrabrand competition in prices among retailers. But this limitation can have the effect of enhancing intrabrand competition along other dimensions of rivalry among retailers. RPM also can have the effect of enhancing interbrand competition among manufacturers and retailers alike for sales of different brands because retail service affects consumers’ choices among competing brands. It is interbrand competition that disciplines a manufacturer who has adopted an RPM policy and ultimately establishes retail prices in the marketplace. In this respect, the argument that RPM restrains retail price competition at the expense of consumers is deceiving.

At this point it becomes essential to understand the concepts of interbrand and intrabrand competition, which is:

**Interbrand competition** means competition between firms that have developed brands or labels for their products in order to distinguish them from other brands sold in the same market segment. Although not perceived as being fully equivalent by consumers, branded products nevertheless compete with each other, but normally to a lesser degree. Coca-Cola

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33 For example, the “Brighton Retail Pricing and Promotion Policy” of the Leegin case, discussed in the next chapter.


35 Ibid.
versus Pepsi is an example of inter-brand competition. Interbrand competition has several benefits. Suppliers will often want to structure their distribution systems to permit them to compete more effectively with the products of rival suppliers. No manufacturer will ever wish unilaterally to keep its margins high unless it sells more in consequence of those higher margins.

**Intrabrand competition** means Competition among distributors or retailers of the same branded product, be it on price or non-price terms. For example, a pair of Levi’s jeans may be sold at a lower price in a discount store as compared to a department store but often without the amenities in services that the latter provides.

The following can be the harmful effects of RPM:

**2.2.4 RPM-induced retailer cartels:**

In the case of a cartel among retailers, those firms conspire to set retail prices at monopoly levels and get manufacturers to enforce their agreement and prevent opportunistic discounting. In this scenario, retailers use the manufacturer’s RPM policy as a cover for their own price-fixing arrangements. Retailers thereby delegate both the implementation and the enforcement of the cartel to the manufacturer. The manufacturer becomes the cat’s paw for the retail cartel. Consumers are made worse off, the same as they would be if the cartel were operated directly by retailers without the participation of a manufacturer. The textbook example of an RPM-induced retailer cartel involves retail druggists who, working through a trade association, cajoled a manufacturer of tooth paste to implement RPM. But there is no evidence that retailer cartels held together by RPM are common. One reason is that the retailer cartel story does not account for how retailers could avoid their cartel being undermined by other forms of nonprice competition. Another difficulty facing such a cartel is that manufacturers often have several distribution channels for their products. If

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36 Available at http://www.concurrences.com/anglais/droit-de-la-concurrence-150/Glossary-Competition-Law-Terms/inter-brand-competition, visited on 17th June 2012.

retailers in one channel attempted a price increase using RPM, consumers might be easily diverted to other channels.\textsuperscript{38}

2.2.5 RPM induced Manufacturer Cartels:

In the usual manufacturer cartel, sellers collude on the price they charge their customers and do not endeavor to set the resale price of their product. For example, in the international vitamins cartel, participants agreed upon the prices they charged but did not try to influence the prices their customers charged.\textsuperscript{39} Nonetheless, a cartel of manufacturers might use RPM to help monitor and enforce the cartel’s agreement. Once parties to the cartel reach an agreement to raise prices, each of them has a strong incentive to cheat on that agreement by secretly cutting price and expanding output. Incremental sales that stem from furtive discounts can be very remunerative if the cartel has jacked up prices well above incremental costs.\textsuperscript{40}

To rein in this kind of cheating, the manufacturers in this scenario agree among themselves to implement RPM policies with retailers to reduce the incentives to cheat. The idea is that it is easier for manufacturers to observe the retail prices of their competitors’ products than the prices those manufacturers charge retailers. RPM agreements establish minimum retail prices for every manufacturer’s products. If these agreements are enforced, they take away the profitability of secret upstream discounts by manufacturers because retailers are not able to pass those discounts on to consumers in the form of lower retail prices. Without lower retail prices, retailers sell no more of the cheating manufacturer’s product than before. By secretly cutting its prices below the cartel level, the manufacturer merely sells the same quantity at a lower price, which is not a recipe for making money. The only way the price-chiseling manufacturer could profit from lower prices would be if the firm did not enforce its RPM policy so that its retail price would fall and sales would increase. But this would be more easily detected by the other cartelists than a secret upstream price cut and could elicit an unfriendly response. This is not a recipe for making money either. In short, under this scenario, manufacturers agree to fix prices to retailers and then, to make

\textsuperscript{38} KennethG. Elzinga and DavidE.Mills THEECONOMICSOF RESALEPRICEMAINTEANCE, 3 ISSUES IN COMPETITION LAW AND POLICY 1841 (ABA Section of Antitrust Law 2008).
\textsuperscript{40} Supra n. 34.
cheating on that agreement unprofitable or more easily detectable, they agree to fix retail prices as well.\textsuperscript{41}

2.2.6 RPM and Foreclosure:
Since RPM permits a manufacturer to control its retailers’ profit margins, this practice might facilitate an implicit contract between the manufacturer and those retailers of the following nature. The manufacturer ensures retailers of an attractive profit margin on sales of its own brand in exchange for their refusing to take on the distribution of competing brands, including brands offered by new entrants.

2.2.7 RPM’s Association With Exploitation of Consumer Information Gaps:
An anticompetitive effect of RPM that has thus far escaped mention by the Supreme Court is its association with promotion that exploits consumer information gaps and, not infrequently, is misleading or fraudulent.\textsuperscript{42} This occurs because RPM moves the promotion from the manufacturer or brand seller to the retailer, where promotion excesses are more difficult to monitor and control. If a manufacturer launches an advertising campaign for its product, it can expect scrutiny from national and state consumer protection agencies. Misleading ads may be attacked not only by government enforcers but also by rivals in suits under common law, state unfair competition statutes, or the federal Lanham Trademark Act.\textsuperscript{43}

2.3 Resale Price Maintenance under MRTP Act:
Under the MRTP Act resale price maintenance was dealt in two categories-

(a) Resale Price Maintenance as a Restrictive Trade Practice:
Section 33(1) (f) of the MRTP Act registration of any agreement to sell goods on condition that the prices to be charged on resale by the purchaser shall be the price stipulated by the seller unless it was clearly stated that the prices lower than those prices may be charged, thereby covering vertical resale price maintenance. While, section 33(1) (d) contained


\textsuperscript{42} Although the US Court has yet to acknowledge RPM’s association with exploitation of consumer information gaps, the matter has been documented in the literature. Warren S. Grimes, Spiff, Polish, and Consumer Demand Quality, Vertical Price Restraints Revisited, 80 CAL. L. REV. 815, 834-36 (1992)

\textsuperscript{43} Supra n. 34.
provisions regarding horizontal resale price maintenance. Therefore, the expression resale price maintenance denoted a practice whereby a manufacturer or supplier required the dealer to resell the goods sold to him at or not below the price stipulated by the manufacturer or supplier. Further, minimum resale price maintenance was prohibited under the Act.\textsuperscript{44} But the registration of such a resale price agreement, whether for minimum or maximum resale price was registrable under section 33(1) (f).

A maximum price is a stipulated price and will not constitute unless it is clearly stipulated in the agreement that prices lower than that may be charged. Simply a circular allowing to sell at less than the printed price cannot itself modify an agreement with the dealer which is bilateral in nature.\textsuperscript{45}

**(b) Prohibition of Minimum Resale Price Maintenance:**

The only type of trade practice which was expressly prohibited under the MRTP Act was maintenance of minimum resale prices.\textsuperscript{46} Section 39(1) of the Act provided *that without prejudice to the provisions of this Act with respect to registration and to any of the powers of the MRTP Commission or of the Central Government under this Act, any term or condition of the contract for sale of goods by a person to a wholesaler or retailer or any agreement between a person and a wholesaler or retailer relating to such sale shall be void insofar as it purports to establish or provide for the establishment of minimum prices to be charged on the resale of goods in India.*

Further, a supplier of goods was prohibited from notifying to dealers or otherwise publishing minimum resale price of the good.\textsuperscript{47} Also, the trade practice of maintaining minimum resale price was per se void. It did not require any order of the MRTPC to declare it void as was required in case of other restrictive trade practices. This approach under the MRTP Act is significantly different from the *Leegin’s* case which will be discussed in greater detail in chapter 3.

\textsuperscript{44} Sections 39-40 of the MRRT Act.
\textsuperscript{45} In re Hindustan Lever Ltd. (1977) 47 Comp Cas 543 (MRTPC) affirmed by the SC in Hindustan Lever Ltd v. MRTPC, (1977) 47 Comp Cas 581.
\textsuperscript{46} Supra n. 23.
\textsuperscript{47} Section 39(2) of the MRTP Act.
Section 40 - Prohibition against Withholding Supplies:

Section 40 of the MRTP Act prohibited the supplier from withholding supplies of any goods from any wholesaler or retailer on the ground that such wholesaler or retailer is selling or is likely to sell the goods at a price below the minimum price. While the supplier withholds the supply for the apprehension that the goods are likely to be sold by the dealer for less than the minimum resale price, it would be covered under this provision. However, the supplier can take the defense that he had other reasons to withhold supply of goods and those reasons should be sufficient enough to withhold the supply. In Food Grain and Kirana Merchants Association v. Delhi Kanodia Oil Agency, the MRTPC observed after perusal of sections 39 and 40 of MRTP Act, that refusal to sell without anything more did not come within the ambit of Section 40 and that under section 39 and section 40 what was crucial was refusal to sell following a demand for resale price maintenance and/or refusing to comply with it.

The withholding of supplies was also permitted in case where the supplier had reasonable cause to believe that the wholesaler or retailer had been using as loss leaders any goods of the same or similar description whether obtained from that supplier or not. A wholesaler or retailer is said to use the goods as loss leaders when he resells them otherwise than in a genuine seasonal or clearance sale not for the purpose of making profits on the resale but for the purpose of attracting to the establishment at which the goods are sold, customers likely to purchase other goods or otherwise for the purpose of advertising his business.

Exemption from Prohibition:

Section 41 of the Act empowered the MRTPC to exempt any class of goods from the operation of the provisions relating to prohibition of minimum resale price maintenance. The section provided as follows:

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48 1980 Tax LR 129.
49 See MRPTP Act Section 40 (2) which provided- Nothing contained in sub-section (1) shall render it unlawful for a supplier to withhold supplies of goods from any wholesaler or retailer or to cause or procure another supplier to do so if he has reasonable cause to believe that the wholesaler or the retailer, as the case may be, has been using as loss leaders any goods of the same or a similar description whether obtained from that supplier or not.
50 Explanation II to section 40 of MRTP Act.
1) The Commission may, on a reference made to it by the Director General or any other person interested, by order, direct that goods of any class specified in the order shall be exempt from the operation of sections 39 and 40 if the Commission is satisfied that in default of a system of maintained minimum resale prices applicable to those goods - 1

(a) the quality of goods available for sale or the varieties of goods so available would be substantially reduced to the detriment of the public as consumers or users of those goods, or

(b) the prices at which the goods are sold by retail would, in general and in the long run, be increased to the detriment of the public as such consumers or users, or

(c) any necessary services actually provided in connection with or after the sale of the goods by retail would cease to be so provided or would be substantially reduced to the detriment of the public as such consumers or users.

(2) On a reference under this section in respect of goods of any class which have been the subject of proceedings before the Commission under section 31, the Commission may treat as conclusive any evidence of fact made in those proceedings.

These grounds of exemptions under section 41 were directed to protect the interests of public as consumers or users of goods of a particular class. The MRTPC has passed the order of exemption under section 41 in some cases. The important cases in which such orders have been made relate to matches\(^{51}\) and newspapers\(^{52}\).

### 2.4 Shift from MRTP Act to the Competition Act:

In October, 1999, the Government of India appointed a High Level Committee on Competition Policy and Competition Law to advise a modern competition law for the country in line with international developments and to suggest a legislative framework which may entail a new law or appropriate amendments to the MRTP Act. The Committee presented its Competition Policy report to the Government in May 2000 [the report will be referred to hereinafter as High Level Committee (2000)]. The draft competition law was drafted and presented to the Government in November 2000. After some refinements, following extensive consultations and discussions with all interested parties, the Parliament passed in December 2002 the new law, namely, the Competition Act, 2002.

\(^{51}\) The application was made by Western India Match Co. Ltd.

\(^{52}\) The application was made by Bennet Coleman & Co. Ltd.
With respect to anti-competitive agreements, the shift in the approach can be noticed when the requirement for a compulsory registration was removed.

Further, it becomes pertinent to note the observations of the Raghavan Committee Report observed as follows in Paragraph 4.4.1 with respect to RPM:

“In a number of countries RPM is presumed to be per se anti-competitive. The majority of members of committee also felt that RPM should be treated as presumed to be illegal. However, after considerable discussions, in order to arrive at a consensus, it was decided not to treat it as presumed to be illegal. It will be judged under rule of reason.”

2.5 Competition Act 2002:

As per the Indian Competition Act resale price maintenance includes any agreement to sell goods on condition that the prices to be charged on the resale by purchaser shall be the prices stipulated by the seller unless it is clearly stated that the prices lower than those prices may be charged.

Resale price maintenance refers to a practice whereby a manufacturer or a supplier of goods secures that those goods are sold by persons to whom they are not supplied at, or not below a specified stipulated by the manufacturer or the supplier. In short, it limits pricing opportunities and not the resale itself.

The price stipulation may be prescribed in 3 forms-

**Fixed price**, when the goods are to be sold only at that price and no departure is permitted. A fixed price contract is a contract that provides for a price which usually is not subject to any adjustment unless certain provisions (such as contract change, economic pricing, or defective pricing) are included in the agreement. These contracts are negotiated usually where reasonably definite specifications are available, and costs can be estimated with reasonable accuracy. A fixed price contract places minimum administrative burden on the contracting parties, but subjects the contractor to the maximum risk arising from full responsibility for all cost escalations.

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53 Raghavan Committee Report on Competition law.
54 Explanation to section S. 3(4)(e).
**Minimum resale price** when the goods shall not be sold below that price and if it is not followed by the dealer, the supplies are stopped and he may even be liable to pay compensation.\(^{55}\) Minimum RPM is a vertical price restriction imposed by an upstream manufacturer on downstream distributors, dealers, or retailers (henceforth, all will be referred to as “retailers”). Typically, a manufacturer specifies a minimum price above which its retailers must sell its product(s). The manufacturer monitors the retailers or employs a monitoring agent\(^{56}\) to ensure their performance. If retailers are discovered pricing below the specified minimum price, they are terminated or threatened with termination. For example Sony, LeapFrog, Black & Decker, Cisco Systems, JVC, Samsung, and Panasonic have all employed minimum RPM strategies.\(^{57}\)

**Maximum resale price** when the goods shall not be sold below but not beyond that price. This form is the opposite of minimum. Earlier, only maximum resale price arrangements were considered under the rule of reason but now that has changed and even minimum resale price arrangements fall under the scope of rule of reason. This point is elaborated further in the next chapter.

Resale Price maintenance enables a supplier to exercise control over the distributors by prescribing the price and margin of profit at each stage of distribution. Thus, he can secure the support of distributors at each level of distribution by ensuring an adequate margin to them.\(^{58}\)

In fact resale price maintenance has the tendency to kill price competition between the actual distributors of the goods and often keeps the prices higher than what would be otherwise, which the consumer has to pay at the end of the day.\(^{59}\)

Firms are involved in a vertical relationship if they operate at different but complementary levels of the production/distribution chain. All upstream/downstream or input/output

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\(^{55}\) V.K Aggarwal, COMPETITION ACT, 2002 (PRINCIPLES AND PRACTISES), 1\(^{st}\) ed. 2011, p. 131.


\(^{58}\) DPS Verma, Regulation of Resale Price Maintenance, 21 JILI 74(1979).

\(^{59}\) Supra n. 55, p. 131.
relationships are vertical, and any restriction that is imposed by one member of a vertical relationship on the other member of that relationship is a vertical restraint. Authors disagree, however, in that for some, any form of nonlinear–pricing rule constitutes a restraint, whereas in most cases nonlinear prices are excluded. Nonlinear prices do not really constitute a restriction on behavior although some of the incentives effects that nonlinear prices are meant to generate are similar to the incentive effects that are often associated with exclusive dealing. However, those who indulge into the practice of resale price maintenance defend themselves by arguing the following: 60

1. That it guarantees an adequate margin of profit between wholesalers and retailers and, thus, leads to a large number of outlets which benefits the consumers. 61

2. It maintains price stability and attracts the consumer and if the lessor price is charged for their goods that might harm their reputation as regards quality. 62

3. It enables the small traders and shop keepers to service the competition of big merchants and powerful chain stores. 63

4. It prevents the practice of loss leader. 64

5. For the sale of durable consumer goods like car, scooter, television etc. requiring a long term after sale service, it is necessary to ensure sufficient margin of profit to provide satisfactory service and is not undercut by sellers interested only in quick sale.

60 Supra n. 55, pp 131- 132.
63 Ibid.
64 Loss leader pricing is an aggressive pricing strategy in which a store sells selected goods below cost in order to attract customers who will, according to the loss leader philosophy, make up for the losses on highlighted products with additional purchases of profitable goods. Loss leader pricing is employed by retail businesses. Loss leader pricing is, in essence, a bid to lure customer traffic away from the businesses of retail competitors. Retail stores employing this pricing strategy know that they will not make a profit on those goods that are earmarked as loss leaders.
However, these advantages are of no use if the injury caused to the consumer outweighs these advantages. Therefore, the practice minimum resale price maintenance is prohibited inorder to protect the interest of consumers.

A rule of reason approach can be a sound platform for establishing a sound policy. That policy, however, should recognize the rather striking differences in the competitive risks posed by differing vertical restraints. The policy should deter the most pernicious vertical restraints while preserving freedom of action for manufacturers and retailers to use vertical restraints that pose lesser threats and have strong pro-competitive benefits.
CHAPTER- III

SHIFT IN APPROACH FROM “PER SE RULE” TO “RULE OF REASON”: US JURISPRUDENCE

In US vertical agreements have been held to fall within section 1 of the Sherman Act since the *Dr Miles Medical Co. v. John D. Park & Sons* Case. The treatment of vertical agreements in the United States, relating to both price and non-price restraints, has seen its fair share of controversy since inception. Judgments of the U.S. Supreme Court have been followed by pages of growing economic and jurisprudential criticism. The Court itself has been divided in its decisions with regard to the suitable standard to be applied to resale price maintenance.

In *Dr Miles Medical Co. v. John D. Park & Sons* the SC held that an agreement between a drug manufacturer and its dealer customers to maintain a minimum resale price violated Section 1 of Sherman Act. The court held that once Dr Miles sold his products, it relinquished any right to deprive the public of whatever advantages may be derived from competition in subsequent traffic. The court emphasised that resale price maintenance restricted freedom of trade on the part of dealers who own what they sell.

In 2006 the SC granted a certiorari *Leegin v. Kat’s Korner* to consider whether the per se rule should apply. After this decision all vertical restraints are subject to the rule of

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65 Sherman Act, S. 1: Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal... .
66 220 US 373 (1911) Dr. Miles sold patented drugs to wholesalers and retailers and set specific minimum wholesale and retail prices at which the drugs could be sold. The court ruled that resale price maintenance clearly reduced competition between retailers and between wholesalers and was therefore illegal.
67 Ibid.
69 The Consumers Goods Pricing Act of 1975, amending 15 U.S.C Ss 1, 45(a) repealed the “fair trade” exemption established under the 1937 Miller–Tydings amendment to Sherman Act and the 1952 Mcguire Amendment to the FTC Act. The Miller- Tydings and Mcguire Acts has created federal antitrust exemptions for certain agreements fixing minimum or stipulated resale prices of branded commodities that freely and openly competed with commodities of the same general class produced or distributed others. The exemption applied only in states with statutes authorising the agreements and only where the contracting parties did not compete with each other. Fair trade agreements were enforceable against contracting parties and, in some states, against non-contracting parties (nonsigners) having notice that the commodity was “fair traded”. 46 states enacted fair trade laws. State SC decisions declared 5 of the state laws unconstitutional, and the courts of many states ruled that statutes binding nonsigners were unconstitutional.
70 551 US 877 (2007)
reason rather than a per se rule. Prior to this 2007 decision, vertical territorial restrictions and maximum resale price maintenance were judged by the rule of the reason while minimum resale price maintenance was per se illegal. The historic ruling in *Leegin* removed the special treatment for minimum resale price maintenance.\(^{71}\)

### 3.1 The *Leegin* Case:

The Facts of the *Leegin* case were as follows- *Leegin* sold belts under the brand name “Brighton” which were distributed by small retailers, like Kat’s Korner, located outside of Dallas, Texas. *Leegin* controlled the distribution of its belts through the “Brighton Retail Pricing and Promotion Policy” which suggested prices for the designer belts. The manufacture also created a special program to target star retailers. Kat’s Korner, because of the volume of belts it sold, was one of the stars until *Leegin* became disappointed with the size and atmosphere of the store. Strife between the manufacturer and retailer emerged when Kat’s Korner discounted the price of the belts in order to compete with other retailers. As a result, *Leegin* informed Kat’s Korner that it would no longer be a distributor of the Brighton line of belts. Kat’s Korner sued *Leegin* for violation of the antitrust laws, claiming that *Leegin*’s actions violated the per se rule against minimum resale price maintenance established by the United States Supreme Court in *Dr. Miles Medical Co. v. John D. Park & Sons, Co.* in 1911.

The retailer won a $1.2 million judgment against *Leegin*, which appealed the ruling all the way to the Supreme Court. *Leegin*’s argument on appeal was that Dr. Miles should be overturned in light of the rule of reason treatment the Court had ruled applied to other vertical restraints. The Court, in a five to four decision, ruled in favor of *Leegin*, holding that the per se rule in Dr. Miles was “a flawed antitrust doctrine that serves the interests of lawyers....more than the interests of consumers.” As a result vertical restraints are governed by rule of reason.

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3.2 Distinguishing between Dr. Miles and Leegin:

The Court’s rejection of a per se rule in favor of the rule of reason was predicated on identifying several pro-competitive benefits from minimum resale price maintenance. Justice Kennedy’s opinion states that the rule in Dr. Miles was based on formalistic legal thinking as opposed to a consideration of business realities. The 1911 Court adopted a per se rule because the restriction on minimum prices was viewed as a restraint on alienation that was disfavored at common law. The 2007 Court stated that equating the restriction on minimum resale prices with restraints on alienation ignored the reality that such restraints were fewer suspects when applied to chattels than when applied to land. Furthermore, such reliance on historic, and antiquated, doctrine, did not take into consideration the realities of the manufacturer-dealer relationship.72

The Court’s rejection of a per se rule in favor of the rule of reason was predicated on identifying several pro-competitive benefits from minimum resale price maintenance. At the outset, citing the economics literature extensively, the Court identified three pro-competitive benefits to minimum resale price maintenance-

First, allowing manufacturers to restrict retailers’ ability to discount was an effective tool to prevent free-riding in the provision of services that might be beneficial to consumers.

Second, minimum resale price maintenance was an important business tool to discipline retailers who did not meet manufacturer expectations by providing the retailers a guaranteed margin whose loss could be threatened through termination.

Finally, minimum resale price maintenance, by reducing intrabrand competition through price cutting, promoted interbrand competition that permitted entry and innovation by manufacturers. Put together, the Court identified the benefits of resale price maintenance in cementing the manufacturer-retailer relationship through curing retailer opportunism that permitted competition at the manufacturing level.73

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73 Supra n. 71.
3.3 The Road to leegin case:

Shortly after Dr. Miles had been decided, the Court began placing qualifications on the per se rule. In *United States v. Colgate*, a 1919 case, the Court held that suggested prices by a manufacturer did not constitute an agreement for purposes of Section One of the Sherman Act. In a series of subsequent cases, the Court held that the per se rule did not apply if the manufacturer retained title, as would be the case in a consignment arrangement or under an intellectual property license. In 1967, the Court held in *United States v. Arnold, Schwinn, & Co.*, that a vertical territorial restriction was per se illegal. A year later, the Court held the maximum resale price maintenance was per se illegal in *Albrecht v. Herald Tribune*. Then, in the 1970's, the reaction began with the Court overruling Schwinn in its 1977 *GTE Sylvania* decision, holding that vertical territorial restrictions had some pro-competitive benefits and therefore should be judged by the rule of reason. Twenty years later, the per se rule of Albrecht went by the wayside in *State Oil v. Khan*, which held that the rule of reason applied to maximum resale price maintenance. Against this background of changing laws, economists were questioning the per se treatment of minimum resale price maintenance, arguing that many of the pro-competitive benefits of

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74 250 US 300 (1919), Colgate, a manufacturer of soap and toilet articles, required its dealers to maintain minimum resale prices or be subject to termination by Colgate. The court affirmed that a firm cannot enforce minimum resale prices among its dealers. However, the court declared that a firm is legally entitled to refuse to do business with dealers who do not agree to their minimum resale prices.

75 388 US 365 (1967), Schwinn, the nation's largest manufacturer of bicycles in the 1950's, sold and consigned bicycles through a series of wholesale distributors and licenced retailers. By their contracts with Schwinn, the wholesalers were limited in the geographical territories in which they could sell bicycles and were required to sell only to licenced Schwinn dealers. Licenced dealers were permitted to sell other brands of cycles but had to give at least equal standing to Schwinn bicycles. The court ruled that if Schwinn sells its products to wholesalers, thereby parting with ownership and the accompanying risk of loss, it cannot require wholesalers to submit to restrictions on their sales such as territorial divisions or prohibition of selling to non-licenced dealers. In fact, the court went as far as to say that all franchise restrictions were per se illegal if title had passed from the franchiser to the franchisee. However, if Schwinn were engage in the same sort of restrictions while maintaining ownership of the goods, that is selling goods on a consignment basis and allowing the wholesalers and retailer to return unsold products, then reasonable restrictions would be permissible. It would be the difference between vertical restraints and vertical integration.

76 390 US 145 (1968), was a decision by the United States Supreme Court, which held that wholesalers could not require franchisees and retailers of their products to sell items at a certain price; advertisements regarding sales, therefore, always included the language "Available at participating retailers only".


78 522 US 3 (1997), The case before the court involved a gasoline wholesaler and Chicago service station. State Oil Co. attempted to force the gasoline station owner, Barkat Khan, to sell State Oil's product at certain prices; Khan resisted and filed suit under anti-trust law.
territorial restriction applied a fortiori to minimum resale price maintenance. Practitioners and scholars knew that shoe would drop sometime, and consistent with the decennial shift in the tide, minimum resale price maintenance went the way of maximum ten years after the Khan decision.

In many ways the per se rule had been chipped away. First, the limitations placed by Colgate, the consignment and licensing cases removed major areas of business practice from the scrutiny of the per se prohibition. Requirements of legal pleading, however, also weakened the per se rule.

In *Monsanto Co. v. Spray-Rite Service Corp.*, 79 decided in 1984, the Court required an antitrust plaintiff raising a claim of price fixing conspiracy among manufacturer and distributors to rule out the possibility that the defendants were acting independently. Four years later, the Court ruled in *Business Electronics v. Sharp* 80 that an antitrust plaintiff claiming an agreement to set resale prices based on a pattern of dealer termination must show that the manufacturer and retailer had agreed to set a specific price. These two hurdles made it quite a bit difficult to plead an antitrust claim based on resale price maintenance. Under *Leegin*, the plaintiff must in addition show that the anticompetitive effects of setting minimum resale prices outweigh any pro-competitive benefits. 81

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79 456 US 725 (1984).- Supreme Court in United States v. Colgate & Co., recognized the manufacturer's right to deal with whomever it wanted, and as importantly, its right to refuse to deal. This distinction allowed manufacturers to announce terms under which they would deal with their resellers and then refuse to deal with those who failed to comply. Colgate's progeny in 1984 further built upon this right in Monsanto Company v. Spray-Rite Service Company, stating that, "under Colgate, the manufacturer can announce its re-sale prices in advance and refuse to deal with those who fail to comply, and a distributor is free to acquiesce to the manufacturer's demand in order to avoid termination".

80 485 US 717 (1988). Petitioner and another retailer (Hartwell) were authorized by respondent manufacturer to sell its electronic calculators in the Houston area. In response to Hartwell's complaints about petitioner's prices, respondent terminated petitioner's dealership. Petitioner brought suit in Federal District Court, alleging that respondent and Hartwell had conspired to terminate petitioner, and that such conspiracy was illegal *per se* under § 1 of the Sherman Act. The court submitted a liability interrogatory to the jury asking whether there was an agreement or understanding between respondent and Hartwell to terminate petitioner's dealership because of its price cutting, and instructed the jury that the Sherman Act is violated when a seller enters into such an agreement or understanding with one of its dealers. The jury answered the interrogatory affirmatively, awarding damages, and the court entered judgment for petitioner for treble damages. The Court of Appeals reversed and remanded for a new trial, holding that, to render illegal *per se* a vertical agreement between a manufacturer and a dealer to terminate a second dealer, the first dealer must expressly or impliedly agree to set its prices at some level.

*Held:* A vertical restraint of trade is not *per se* illegal under § 1 of the Sherman Act unless it includes some agreement on price or price levels.

81 Supra n. 71.
In its landmark decision in *Continental TV Inc v. GTE Sylvania*, the SC drew a fundamental distinction between unlawful vertical price restraints and vertical non price restraints, which it held were subject to rule of reason analysis, that market impact of vertical non price restraint is complex because of their potential for simultaneous restriction of intrabrand competition and stimulation of interbrand competition and that interbrand competition is the primary concern of antitrust law. 11 years later the court confirmed and explained this ruling in *Business Electronics v. Sharp* as follows:

“Although vertical agreements on resale prices have been illegal per se since Dr Miles…we have recognized that the scope of per se illegality should be narrow in the context of vertical restraints. *In Continental TV Inc v. GTE Sylvania* we refused to extend per se illegality to vertical non price restraint, specifically to a manufacturer’s termination of one dealer pursuant to an exclusive territory agreement with one another. We noted that especially in vertical restraint context, departure from rule of reason standard must be based on demonstrable economic effect rather than upon formalistic line drawing.”

Although the theoretical difference between vertical price and nonprice restraints may be reasonably clear, the practical problems of proof in vertical restraint cases sometimes make it difficult to distinguish between the two.

### 3.4 Reflections on *Leegin*:

Notwithstanding above in view, the *Leegin* did not held that minimum RPM agreements are per se legal. Indeed, both the majority and the dissent in *Leegin* agreed that minimum resale price maintenance can be harmful to competition and consumers. Indeed, the majorities explicitly recognised this harm and therefore expressly disclaimed any suggestion that rule of reason analysis should become a *de facto* rule of *per se* legality.

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82 388 US 365 (1967), a landmark antitrust decision of the Supreme Court of the United States. Facing declining sales, GTE Sylvania attempted to reduce the number of competing Sylvania retailers by "limit[ing] the number of franchises granted for any given area [of the country] and requir[ing] each franchisee to sell his Sylvania products only from the location or locations at which he was franchised." 433 U.S., at 38. When Continental was denied such a franchise, they filed a lawsuit alleging violation of the Sherman Act.

83 Supra n. 79.


85 Supra n. 78.
Indeed the court itself identified at least two ways in which purely vertical RPM agreement might be unlawful. In both instances, the wrongfulness is premised on market power – either the retailers or the manufacturers:

a) “A dominant retailer….might request RPM to ..........innovation in distribution that decreases costs. A manufacturer might consider it has little choice but to accommodate the retailer’s demands for UPR if the manufacturer believes it needs access to the retailer’s distribution network.”

In this context, let us also not forget many times retailers through their trade association may form a cartelisation and force the manufacturer to behave as cat’s Paw and introduce the RPM.

b) “A manufacturer with market power......might use resale price maintenance to give retailers an ...........not to sell the products of rivals or new entrants” - Let us keep in view the issue of foreclosure and also of manufacturer’s cartelisation.

In both these examples, the dominant (or at least very powerful) firm uses minimum RPM to exclude or raise entry barriers for its competition. Anti-competitive minimum RPM can also result from collusion or conscious parallelism in concentrated industries. We in India have recently noticed when numbers of cement manufacturers were imposed with huge penalty in the hands of the CCI for indulging into such anti-competitive conduct going against the welfare of the consumers.

The majority in *Leegin* thus further directed that courts applying the rule-of-reason test “would have to be diligent in eliminating .....anti-competitive uses (of resale price maintenance) from the market”, and predicted that courts might “devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anti-competitive restraints and to promote competitive ones.”

**3.5 Position after Leegin case:**

The legality of RPM remains uncertain, despite Leegin, because no clear articulate standards yet exist to assess RPM under the rule of reason. Leegin may have invalidated the per se rule and replaced it with rule of reason, but it did not furnish definitive criteria to
judge the reasonableness of RPM. Instead Leegin simply invites lower courts to devise rules to evaluate the reasonableness of RPM under the rule of reason. Since Leegin a few lower court cases have been discussed and none have really analysed the reasonableness of RPM arrangements under the rule of reason.\(^86\)

Several courts have dismissed the applicability of rule of reason in RPM arrangements as per the *Bell Atlantic v. Twombly*\(^87\) decision, which requires the plaintiff to plead specific facts sufficient to create a plausible basis for recovery. This case was a decision of the Supreme Court of the United States involving anti-trust law and civil procedure. The facts leading to this case are as follows- Twombly and Marcus brought a class-action lawsuit alleging that Bell Atlantic and a number of other large telephone companies had engaged in anti-competitive behaviour in violation of section 1 of the Sherman Act. Specifically, the plaintiffs alleged that these large telephone companies had acted in order to disadvantage smaller telephone companies and charge consumers more by, for example, refraining from entering markets where another large company was dominant (thereby preventing a price war).

Their complaint was dismissed by U.S. District Court for the Southern District of New York, as failing to allege sufficient facts to state a claim for a violation of the Sherman Act. This decision was reversed by the Second Circuit Court of Appeals, and the Supreme Court agreed to hear the case in 2006. As an initial matter, the Supreme Court clarified the requirements of proving a claim of anti-competitive behaviour under Section 1 of the Sherman Act. The Sherman Act prohibits entering into a "contract, combination, or conspiracy" to restrain trade. The Court held that while parallel conduct — actions by competing companies that might be seen as implying some agreement to work together — is "admissible circumstantial evidence" from which an agreement to engage in anti-

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\(^{87}\) 127 S. Ct. 1955 (2007) - Plaintiffs, subscribers to local phone and internet services, sue Bell Atlantic and local telephone companies alleging violations of anti-trust laws, allowing each local phone company to monopolize its own market. It was held that Under § 1 of the Sherman Act, stating a claim requires a complaint with enough factual matter (taken as true) to suggest that a valid claim arises.
competitive behaviour may be inferred, parallel conduct alone is insufficient to prove a Sherman Act claim.\textsuperscript{88}

The Court then upheld the District Court's dismissal of the plaintiff's complaint, holding that the mere allegations contained in the complaint that the competitors had agreed not to compete were insufficient to state a claim of conspiracy under the Sherman Act. The Court found that \textit{Twombly}'s complaint had not provided enough facts for the court to find it plausible that the companies had engaged in a conspiracy; instead, the complaint provided factual bases for parallel conduct — not enough under the Court's new interpretation of the Sherman Act — and merely stated that an agreement had taken place, with no details to support that allegation. The Court held that the dismissal of the complaint was therefore proper. The Court's opinion changed the existing interpretation of the notice pleading requirements of Federal Rule of Civil Procedure 8(a)(2) (and the standards for dismissal under Federal Rule of Civil Procedure 12(b)(6)), creating a new, stricter standard of a pleading's required specificity.\textsuperscript{89}

Before the \textit{Twombly} decision the lower Courts generally held that a complaint could be dismissed if the plaintiff could prove no set of facts in support of his claim which could entitle him to relief. \textit{Leegin}'s reasonableness requirements make the already heightened \textit{Twombly} standard even more rigorous in RPM cases. Plaintiffs must allege the facts that plausibly suggest not only that an RPM arrangement exists but also that its unreasonable. This element can place additional burdens of pleading facts establishing a relevant market and anti-competitive effects of RPM arrangements on the plaintiff in order to avoid dismissal. Some district courts have dismissed plaintiffs’ claims, finding their conclusionary allegations to lack factual support and rendered their market definition facially implausible.\textsuperscript{90}

Such interplay between \textit{Leegin} and \textit{Twombly} can be interpreted to understand RPM as per se legal. Pre-\textit{Leegin} plaintiffs relied on liberal pleading standards to bring RPM claims.


\textsuperscript{89} Ibid.

Since anti-competitive activity is often concealed, plaintiffs typically presented general allegations and depended on discovery to provide substantive proof of their allegations. Leggin and Twombly no longer permit such a strategy.\(^9\) If plaintiff fails to allege a plausible basis for recovery with specificity, their claim will be dismissed pre-discovery under Twombly. Thereby, this higher pleading standard, combined with Leegin’s reasonableness standard discourages litigation by making it more difficult and expensive to bring and maintain RPM standards.

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CHAPTER-IV

INDIAN LAW ON VERTICAL RESTRAINTS

Drawing from the foregoing it seem it is not unrealistic to suggest that Indian legal position with respect to vertical restraints in general and especially minimum resale price maintenance is not far removed from the jurisprudence of Leegin laid down by the US Supreme Court. In fact the contribution of Leegin as well as the conundrums it presents along with the challenge it lays down regarding drawing a balancing approach while examining the arrangements of RPM in the absence of any defined criteria, method or guidelines is writ large on Indian position as well. The Indian legal regime with respect to legal status of minimum resale price maintenance agreements and their effect on competition and consumer’s welfare is articulated very recently in Sections 3, 4 and 19 of the Competition Act, 2002.

In India, Section 3 of the Act deals with anti-competitive agreements. It prohibits any agreement with respect to production, supply, distribution, storage, and acquisition or control of goods or services, which causes or is likely to cause, appreciable adverse effects on competition within India. Under Section 3, any such agreement is considered void. The Act does not specifically use the terms horizontal agreement or vertical agreement but Section 3(3) refers to horizontal agreements while section 3(4) refers to vertical agreements.

Section 3 starts as follows:

(1) No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India. Therefore, such agreements are considered to be void.\(^2\)

While section 3(4) which deals with vertical restraints reads as follows:

(4) Any agreement amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, supply,

\(^2\) Section 3(2)- Any agreement entered into in contravention of the provisions contained in subsection (1) shall be void.
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.

Explanation.—For the purposes of this sub-section,—
(a) "tie-in arrangement" includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods;
(b) "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;
(c) "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;
(d) "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;
(e) "resale price maintenance" includes any agreement to sell goods on condition that the prices to be charged 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 charged.

4.1 Issues in Relation to RPM:

4.1.1 Determining “AAEC”: 

The term “appreciable adverse effect on competition” used in section 3 is not defined in the Act but it examines agreement which “causes or is likely to cause an appreciable adverse economic effect on competition within India.” The phrase requires firstly, determination of “competition within India” and then whether that competition “is or likely to be adversely and appreciably affected” by the said agreement. Adverse effect results when the agreement harms the competitors in the consumer welfare sense of economics, i.e effect on price or output. The conduct of the party, therefore, should be such which may have appreciable effect on competition within India. The conduct or

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contract between two parties not resulting in such consequences, is not prohibited.\textsuperscript{94} Thus, only agreements which can produce the effect, actual, probable of causing appreciable adverse effect on competition within India is forbidden under section 3(1)\textsuperscript{95} and not otherwise.

Further, the Act specifies a number of factors which the Commission should take into account when determining whether an agreement has an appreciable adverse effect on competition, including whether the agreement creates barriers or forecloses competition by creating impediments to entry, or drives existing competitors out of the market. The Commission should also take into account the possible pro-competitive effects of an agreement, viz., benefits to consumers, improvements in the production or distribution of goods or the provision of services, and the promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services. These factors are contained in section 19 (3) which read as follows-

\textit{Section 19(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:}

\begin{itemize}
\item[(a)] creation of barriers to new entrants in the market;
\item[(b)] driving existing competitors out of the market;
\item[(c)] foreclosure of competition by hindering entry into the market;
\item[(d)] accrual of benefits to consumers;
\item[(e)] improvements in production or distribution of goods or provision of services;
\item[(f)] promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.
\end{itemize}

While criteria (a)-(c) help to determine whether an agreement has an appreciable adverse effect on competition, criteria (d)-(f) provide various arguments that can be used to justify such agreements.

\textsuperscript{94} See Pawan Hans Ltd. v. UOI, (2003) 114 Comp Cas 676 (SC); Mahindra and Mahindra Ltd. v. UOI (1979) 2 SCC 529.

\textsuperscript{95} (1) No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India.
Vertical agreements are considered illegal only if only if they result in effecting the competition adversely to an appreciable degree and, thus the test applied is the rule of reason analysis.\textsuperscript{96}

Vertical agreements are between non competing undertakings operating at different levels, therefore, not prima facie anti-competitive as the horizontal agreements which are made between the competitors. As already mentioned that these are mainly distribution between the manufacturer (producer) and the retailer (distributor), which may require the distributor to observe certain restraints like-

1. To purchase second product distinct from the main product which is a condition of purchase

2. To purchase a specific brand of product exclusively from a particular manufacturer and not from others.

3. To sell the products in the territory exclusively assigned to the distributor.

4. To resale the product at fixed minimum price.

These restrictions are applied for various reasons. When a supplier deals in complex products he may desire that consumers purchasing them receive minimum pre-sale service and fully informed about the products and qualities, and, therefore, the retailers are specialized. If the products are luxury and branded items, he may restrict supply to retailers selling from high quality locations to ensure the aura of exclusivity and prestige of the products in the mind of consumers. Such agreements contribute to the improvement of the production and distribution and promote technical and economic progress, which is reflected in the reduction in prices or constant supply to customers. However, such

\textsuperscript{96} See Raghavan Committee Report Para no/ 4.5-9. “to attract the provisions of law in all these cases it needs to be established whether the restraints create barriers to new entry or force existing competitors out of the market. The key issue is the extent to which these arrangements foreclose the market to manufacturers (interbrand rivalry) or retailers (intrabrand rivalry) and the extent to which these raise rival’s cost and/or dampen existing competition. The cost of such arrangement need to be weighed against the benefits. For example some of these restraints held to overcome free-ride problem and allow for exploitation of scale economies in retailing.”
arguments may be considered to be anti-competitive if one or more of the firms have market power.\(^97\)

However, if the restraints are such that they foreclose the market, reduce rivalry and facilitate collusion, they are void. Thus, vertical agreements as mentioned earlier have both negative and positive effects. If the negative effects outweigh the positive effects then the agreement is void. The negative effects could be as follows:\(^98\)

1. Reduction of interbrand competition between companies operating on market, including facilitation amongst suppliers or buyers.

2. Reduction of intrabrand competition between distributors of the same brands.

3. Foreclosure of other suppliers or other buyers by raising entry barriers.

Since the focus of this report is on resale price maintenance as a vertical restraint it becomes essential to through some light on how has it been dealt under the Competition Act of 2002. As it has already been mentioned, the term resale price Maintenance has been defined in Explanation (e) to sub- section 4.

**Determining AAEC in case of RPM:**

Clause (e) of section 3(4) has two main ingredients, (i) sale of goods which is made by the manufacturer in the wholesale or retail outlets, is preconditioned to the effect that resale, thereof should be on stipulated price, (ii) agreement therefor should not have clearly provided that prices lower than the stipulated price may be charged. In other words an agreement to sell goods which are entered into on principal basis contains provision about resale price by way of recommended price or maximum ceiling price, there should be freedom to charge lower price and it should be stated in unequivocal words.\(^99\) This clause covers vertical agreements in the marketing channel, in contrast to horizontal price maintenance arrangements.\(^100\)

\(^{97}\)Supra n. 93, p. 188.  
\(^{98}\) Supra n. 93, p189.  
\(^{99}\) Supra n. 23, p. 755.  
\(^{100}\) Supra n. 23, p. 755.
Therefore, even though vertical restraints like RPM may be frowned upon because they prevent price competition amongst wholesalers, distributors or dealers which ultimately affect the consumers adversely, these restraints are subjected to rule of reason.

Provisions of Section 3 require that such agreements be put to a serious scrutiny and if found that such agreements cause or likely to cause ‘appreciable adverse effect on competition’ same be treated void. Law in India in other words seems to have incorporated the rule-of-reason test to determine the legality or otherwise resale price maintenance agreements. However, what are the grounds, circumstances, standards and methods that be applied to determine as to whether an agreement is or likely to cause adverse impact remains undefined despite there being few vague and open-ended indications contained in Section 19(3) and that makes any determination an arduous task. More importantly the term ‘adverse effect’ appearing in Section 3(1) as well as in the concluding sentence of Section 3(4) is prefixed by the word ‘appreciable’ makes the job more arduous as the word ‘appreciable’ is too fluid, vague and introduces space for subjective approach. It may be relevant to mention that the word ‘adverse’ has been prefixed by ‘appreciable’ even in the provisions of Section 19(3).

As already mentioned earlier any agreement, vertical or horizontal has to be tested by the standard laid down in section 3(1) and section 19(3) provides that the Commission shall consider the factors in clauses (a) to (f) while determining AAEC. These factors are grouped into the two categories of positive factors and negative factors. In this particular section the researcher had made an attempt to analyse the AAEC with respect to RPM as per the factors laid down in the section.

(a) Creation of New Barriers:

Entry barriers simply mean the obstacles that would not allow new firms from entering when prices rise above the competition level. In the absence of such barriers it is implied that there will be full freedom of entry which allows the competitors to encroach upon the sales of the existing producers by offering substitute products which could eliminate excess profits of those producers.\(^{101}\) Basically they are obstacles that make it difficult to enter a given market. The term can refer to hindrances a firm faces in trying to enter a

\(^{101}\) Supra n. 93, p. 347.
market or industry - such as government regulation, or a large, established firm taking advantage of economies of scale - or those an individual faces in trying to gain entrance to a profession - such as education or licensing requirements. Barriers to entry can exist as a result of government intervention (industry regulation, legislative limitations on new firms, special tax benefits to existing firms, etc.), or they can occur naturally within the business world. Some naturally occurring barriers to entry could be technological patents or patents on business processes, a strong brand identity, strong customer loyalty or high customer switching costs.  

Further, the new competitors may enter the market with cheaper and new substitute of the earlier products. There can be two types of entry barriers-

1. Structural

2. Strategic

(b) Driving Existing Competitors Out of the Market:

Big firms have the capacity to drive out the existing competitors out of the market because of the monopolistic advantages they have and also as they are in the position to maintain favourable prices of the products due to the efficiency of large scale production. These big firms or enterprises usually enter into the practice of price squeeze inorder squeeze out the existing competitors from the market. A price or margin squeeze is an exclusionary practice used by a vertically integrated firm to leverage its market power in the upstream market to squeeze the margins of its downstream competitors.

(c) Foreclosure of Competition:

Through vertical restraints monopolies may have the ability to prevent the entry of firms into the market. Sometimes the competitors can join together to prevent a potential entrant.

102 The examples given by the US SC in the leegin case- “A manufacturer with market power......might use resale price maintenance to give retailers an ...........not to sell the products of rivals or new entrants”
103 Structural barriers can arise from basic industry characteristics such as technology, cost and demand.
104 It refers to the behaviour of the incumbents and the incumbents may act in such a way as to increase the structural barriers.
This can also be referred to as collective foreclosure. In *United States v. Griffith*, the SC held that the use of monopoly power, however, lawfully acquired, to foreclose competition or to destroy the competitors is unlawful. What is required to be established is that the restraint creates an entry barrier for new entrants or that it drives out the existing competitors from the market.

The Act ensures that while determining what constitutes AAEC only the negative factors are not considered, the following positive factors are also given their due-

(d) Accrual to benefits to customers

(e) Improvement in production and distribution of goods or provision of services.

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106 Supra n. 93, p. 351
107 334 US 100 (1949), In 1939, the four interrelated exhibitor defendants operated more than 200 theatres in 85 towns in Oklahoma, Texas, and New Mexico. Fifty-three of the towns, 62 per cent of the total, were closed towns. In the other 32 towns there were competing theatres. The four defendants first used a common agent and then two agents, each of whom negotiated with distributors for two of the defendant exhibitors. They combined the bargaining power of closed towns with that of the competitive towns to negotiate master agreements. These agreements gave defendants preferential first and second runs. By obtaining film license agreements which set minimum total rental for the entire circuit, defendants were allowed to allocate the rental to individual theatres and to play the film in any theatre they chose. The District Court first found this use of circuit bargaining power not to be in unreasonable restraint of trade and that defendants did not monopolize or attempt to monopolize the supply of films for first run. While the case was pending in 1945, two of the defendants sold a majority of their theaters to a new firm, Theatre Enterprises, Inc. Eight of the organizers of Theatre Enterprises were former officers of the two defendants. In 1948, this firm operated 122 theaters, and by 1950 operated 131. The third defendant, Griffith Amusement, was merged into the fourth defendant, Consolidated Theatres, in 1946. By September, 1948, Consolidated owned 152 theaters in 49 towns, including 7 in Lubbock, Texas, and II in Tulsa. Twenty-four of these were closed towns. This must be compared with the 126 theaters in 53 towns operated by Griffith Amusement and Consolidated in April, 1939. Twenty-seven of those were closed towns. The facts showed a continuation and expansion of the monopolistic market structure that enabled the defendants to control first runs and to limit the access of independent exhibitors to first run.

108 See chapter 2- Economics of RPM- RPM and foreclosure.
109 In case where RPM has not been decided, it gives the retailer an opportunity to charge a very high price for the product. Out of that price the profits retained have to be distributed to all the key players in the distribution channel. However, the retailer may become greedy and charge an exorbitant price which may lead to a situation where the customer may not buy the product at all or if that retailer enjoys market power then he may be in the situation to cause harm to the customer by charging a really high price. Therefore, in the light of such a situation a maximum RPM agreement may ensure that no hardship is brought upon the customer.
RPM can be a part of a distribution system that produces this result. For example, once a brand is in distribution and has achieved a degree of consumer recognition, discounting firms may have an incentive to obtain inventory of this product and resell it at prices below those offered by other retailers. If the boutique stores respond by refusing to continue carrying the product, the manufacturer risks losing the premium image for the brand. One way of dealing with this problem is for the Promotion of technical, scientific and economic development by means of production or distribution of goods or provisions of services.

The inclusion of these factors implies that it is to be examined whether the actions spring from business requirements, probable development of the industry, consumer demands etc. Deliberating issues such as when and how new entrants have been discouraged and what evidences are available in this regard may prove mindboggling and only a matter of speculation [Clause (a) of 19(3)]. Similarly, how to find out in what manner and how much benefits have occurred to consumers, requires collection of huge data and behavioural approach to understanding consumers’ attitudes [Clause (d) of 19(3)]. Determination of questions as to promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services demand availability and analysis of strong evidences, sometimes even evaluating equally competing evidences as we often read from media about various pharmaceutical products – some highlighting their virtues while other downgrading [see Clause (f) 19(3)]. Other sub Clauses in 19(3) are equally riddled with inbuilt vagueness and thus leaving enforcement authority with hardly any concrete guidance. Thus there is strong need for elaboration and data collection mechanism.

In addition to above, there are few other aspects of Indian competition relating to resale price maintenance that deserve mention here. For example, as there exist variety of market circumstances, similarly there are kinds of vertical agreements and putting all these categories under Section 19(3) for testing their ‘adverse effect’ is very unrealistic. For example in case of agreements like resale price maintenance proving benefits could be more difficult than proving determinants which is not the case with other vertical

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110 RPM can improve the quality of the retail services provided and can also help in handing out more information of the products, its uses and other essential things which help in preventing the Free- Rider problem which could ultimately be beneficial for the distribution system.
agreements. Thus, there is need to lay down different standards for different kinds of VAs especially for resale price maintenance if rule-of-reason have to have some meaning.

4.1.2 Production chain:

Generally speaking, unlike horizontal agreements which are mostly agreements between firms operating at the same level, vertical agreements are those agreements in which firms or undertakings have a supply relationship and operate at different levels of chain of production. In case of most goods and services there is a chain of production before the product reaches the consumer. The production chain may spread from gathering of raw materials to processing and creating the final product, distributing and selling the product. To take a concrete example involving production is that of a dairy gathering raw milk, using it as an input for producing processed milk, butter, cheese and yoghurt and distributing and selling the product.

Advent and fast market economy has witnessed vertical agreements assuming increasing importance in the commercial life. Acknowledging this, many have commented that ‘vertical agreements in one sense have become a substitute of vertical integration’. Acknowledging the growing significance and implications of vertical agreements, positive and/or negative on the competition- cornerstone of market economy- competition laws have in most of the countries have attempted to regulate such agreements.

 Basically a production chain is the steps that need to be taken in order to transform raw materials into goods which can then be used by consumers such as you and me. For instance, a primary product might be an apple and some wheat, and the chain of production will turn this into an apple pie. At each step in the production chain, value is added to the product so it can be sold for a greater amount when it becomes the final product. This value is added through the addition of labour, buildings, raw materials and/or manufacturing and processing.\footnote{For example - On wheat farms all around Australia, wheat is grown then harvested by primary producers. The wheat is then sent to the mill where it is turned into flour, which in turn is either sold locally or overseas. This flour is then sent to bakeries, which turn the raw product into dough by adding various ingredients such as yeast, salt and grains. The dough itself is then baked into bread, which can then be sold in either bakeries or supermarkets.}

\footnote{For example - On wheat farms all around Australia, wheat is grown then harvested by primary producers. The wheat is then sent to the mill where it is turned into flour, which in turn is either sold locally or overseas. This flour is then sent to bakeries, which turn the raw product into dough by adding various ingredients such as yeast, salt and grains. The dough itself is then baked into bread, which can then be sold in either bakeries or supermarkets.}
After all these production chain steps, the product then enters the **distribution chain**. This involves adding value to the products by transporting them to wherever the consumer requires them to be. For instance, even after the wood has been turned into a piece of furniture, it is still of little use to your family until it has been brought close enough to your home for you to see it and purchase it. So one of the last stages in the distribution chain is actually getting the furniture to a store for the product to reach the end consumer. Distribution of products takes place by means of channels. Channels are sets of independent organisations (called intermediaries) involved in making the product available for consumption. Merchants are intermediaries that buy and resell products. Agents and brokers are intermediaries that act on behalf of the producer but do not take title to the products.

Goods and services often pass to consumers through multiple channels. While increasing the number of ways in which a consumer can find a good has the potential to increase sales, it also creates a complex system that can make distribution management difficult. In addition, the longer the distribution channel the less profit a product manufacturer might get from the sale.\(^{112}\)

Distribution chain can be classified into two categories.\(^{113}\)

1. **Direct channel**

   Manufacturer \(\rightarrow\) Customer

2. **Indirect channel** which includes the following sub-channels-

   (a) Manufacturer \(\rightarrow\) Retailer\(^{114}\) \(\rightarrow\) Customer (known as One Level channel)

   (b) Manufacturer \(\rightarrow\) Wholesaler\(^{115}\) \(\rightarrow\) Retailer \(\rightarrow\) Customer (Two Level Channel)

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\(^{113}\) Business Studies, Text Book for Class XII, Part II, p. 334.

\(^{114}\) A business or person that sells goods to the consumer as opposed to a wholesaler or supplier, who normally sell their goods to another business. Available at, [http://www.businessdictionary.com/definition/retailer.html#ixzz1zYY5N9a9](http://www.businessdictionary.com/definition/retailer.html#ixzz1zYY5N9a9)

\(^{115}\) Person or firm that buys large quantity of goods from various producers or vendors, warehouses them, and resells to retailers. Available at, [http://www.businessdictionary.com/definition/wholesaler.html#ixzz1zYXgW1HE](http://www.businessdictionary.com/definition/wholesaler.html#ixzz1zYXgW1HE)
(c) Manufacturer → Agent\textsuperscript{116} → Wholesaler→ Retailer → Customer (Three Level Channel)

According to section 3(4) production chain is understood in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provisions of services. Therefore, distribution chain becomes a part of the production chain.

As already mentioned earlier, distribution chain includes the customer, but the question that arises in case of RPM is whether the ultimate or end consumer gets included in the production chain. To examine this question we need to understand if consumer is a part of this definition at all, because if he is not and then if the consumer decides to sell the product further then such consumer would not be a part of production chain and what he does with the product, to whom he sells and at what price he sells it would be his own individual contract with the end consumer. In other words, it will be a contract between the consumer and end consumer out of the production chain.

As already examined by the researcher in preceding paragraphs production chain ends the retailer is in possession of the finished product. Therefore, production chain does not include consumer and thereby the end consumer is not included.

4.1.3 Market Power

Before we look into the nature and scope and effects that vertical agreements exert on the competitive process and the debate surrounding these agreements, a word about their relationship with the market power is also essential to examine.

Enacting vertical agreements by the firm and their impact on the competition is usually and closely connected to the “market power” such firm enjoys. In case a firm that proposes to introduce vertical agreements imposing restraint on the retailers does not enjoy combination of market power on his side, i.e, retailers and customers have variety of

\textsuperscript{116} Party that has express (oral or written) or implied authority to act for another (the principal) so as to bring the principal into contractual relationships with other parties. An agent is under the control (is obligated to) the principal, and (when acting within the scope of authority delegated by the principal) binds the principal with his or her acts. Additional powers are assigned to agent under the legal concept of ‘apparent authority.’ The agent, however, does not have title to the principal’s goods in his or her possession, except where agent's lien is applicable. Available at, http://www.businessdictionary.com/definition/agent.html#ixzz1zYYhukBo
Resale Price Maintenance as a Vertical Restraint under the Competition Act, 2002

choices in the market regarding the goods or services produced by the involved firms or in other words, there already exists enough interbrand competition, imposing restraints through vertical agreements will not have any major effect in the market.

Thus, it has been viewed and rightly so by those navigating into competition law regime that vertical agreements effect competition in market only when firms imposing a vertical restraint already has market power.\textsuperscript{117} In such cases competition from other firm’s products (interbrand competition) is limited; hence it is desirable that there is enough competition between distributors and retailers of the products of the firm which has market power. Conversely and already pointed out a little earlier it is reiterated for the sake of further clarity that, if the firms exercising vertical restraints do not have sufficient market power or if there is sufficient interbrand competition then the restriction on competition between the distributors and retailers of the same brand may not have any effect on market. Economic theories thus, support the view that if interbrand competition exists, their restrictions on intrabrand competition through vertical restraints should not be capable of restricting competition and the efficiency enhancing effects of vertical agreements would outweigh any possible risks.

The Raghavan Committee Report observes in para no. 4.4-0\textsuperscript{118}

“In the past US antitrust laws have treated vertical restraints like tie-in arrangements quite harshly. This thinking has changed in the recent times and under the rule of reason, vertical agreements are generally treated more leniently than horizontal agreements. This is because vertical agreements can often perform pro-competitive functions. Such agreements are generally considered anti-competitive if one or more of the firms that are party to the agreement have market power. In such a situation the agreement is, in any case, likely to attract the provisions of law relating to abuse of dominance.”

At this point it becomes essential to distinguish market power from dominant position. A firm is in a dominant position if it has the ability to behave independently of its competitors, customers, suppliers and, ultimately, the final consumer. A dominant firm holding such market power would have the ability to set prices above the competitive level to sell products of an inferior quality or to reduce its rate of innovation below the level that would exist in a competitive market. Under our law it is not illegal to hold a dominant

\textsuperscript{117} Supra n. 93, p. 193.
\textsuperscript{118} Raghavan Committee Report on Competition Law.
position, since a dominant position can be obtained by legitimate means of competition, for example by inventing and selling a better product. Instead, competition rules do not allow companies to abuse their dominant position.\footnote{Abuse of dominant position} A dominant position may also be enjoyed jointly by two or more independent economic entities being united by economic links in a specific market. This situation is called collective (or joint or oligopolistic) dominance.\footnote{Available at, http://www.concurrences.com/anglais/Competition-Law/Glossary-Competition-Law-Terms/Dominant-position?lang=en, visited on 23\textsuperscript{rd} June 2012.}

Dominance is essentially a legal rather than an economic concept. Economists focus on the issue of market power rather than dominance. While there are obvious links between the two concepts they are somewhat different. In economic terms market power is defined as power over price. In oligopoly markets with differentiated products all firms have some degree of market power, but not enough to be considered dominant. In differentiated product markets the firm’s demand curve is downward sloping. This means that, if the firm unilaterally increases its prices, it will lose some but, crucially, not all of its sales. This gives it some power over price. Many real world firms therefore have some market power and at the same time face competition from rivals. To be regarded as dominant in an economic sense, a firm, or group of firms, must have sufficient market power to enable it to raise price or act in some other way independently of its rivals.
This distinction between market power and dominant position needs be established clearly as otherwise there can be an anomaly in this respect with section 4 of the Act which deals with abuse of dominance. As already mentioned market power does not establish a dominant position and vice versa. This can be depicted in the case of Wal-Mart which exercises market power however; it is still not dominant in the market. However, if any of the firms or groups which retain market power, abuse that power then the provisions of the abuse of dominance can be attracted.

4.1.4 Determining Relevant Market:

For determining whether a particular agreement is anti-competitive or whether it is an abuse of dominance, the Commission has to start by determining the relevant market. Section 3(4) includes the phrase “different markets”. Therefore, implying that relevant market need to be determined to determine AAEC. The relevant market is where the demand and supply interact. It is the area of effective competition within which the defendant operates.121

Determination of relevant market means-122

1. Identifying particular products/ services produces or rendered by an enterprise.

2. In a given geographical area.

The expression “relevant market” has been defined in section 2 (t)123 of the Act and it has been defined in reference to the relevant product market124 or the relevant geographic

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121 Standard Oil Co. of Clarifornia and Standard Stations Inc v. United States, 337 US 293
122 Supra n. 92, p. 357.
123 “relevant market” means the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets;
124 Defined in section 2 (t)- “relevant product market” means a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use
market\textsuperscript{125} or in reference to both the markets and the factors to be taken into account for their determination are given in section 19(6)\textsuperscript{126} and 19(7)\textsuperscript{127}.

Putting all vertical agreements without any consideration for changing expectations, style and dynamics of market, consumers varying interests and examining them case to case would add to burden of the enforcement authority. Not providing tests for guidelines for defining what constitutes a ‘relevant market’, what are concrete parameters of such ‘relevant market’, and so on does add to the difficulty for the enforcement authority. Say for example in one of the major and latest dispute dealt by CCI involves super-residential complex of DLF. Though the main issue related to dominant position, the related was that of determining “relevant market”. The Commission’s viewed similar looking complex located in gurgoan where DLF complexes were located constituted the relevant market. DLF decided to go in appeal and one of the argument to be relied is that is not gurgoan but NCR region that constitutes relevant market. How to decide the relevance of market is, thus, riddled with complex issues of evidence based on facts rather than just theory. Thus providing a normative prescription as to what constitutes a ‘relevant market’ can go a long way.

\textsuperscript{125} Defined in section 2(s)- “relevant geographic market” means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas.

\textsuperscript{126} (6) The Commission shall, while determining the “relevant geographic market”, have due regard to all or any of the following factors, namely:—
(a) regulatory trade barriers;
(b) local specification requirements;
(c) national procurement policies;
(d) adequate distribution facilities;
(e) transport costs;
(f) language;
(g) consumer preferences;
(h) need for secure or regular supplies or rapid after-sales services.

\textsuperscript{127} (7) The Commission shall, while determining the “relevant product market”, have due regard to all or any of the following factors, namely:—
(a) physical characteristics or end-use of goods;
(b) price of goods or service;
(c) consumer preferences;
(d) exclusion of in-house production;
(e) existence of specialised producers;
(f) classification of industrial products.
CHAPTER- V

CONCLUSION AND SUGGESTIONS

The basic objective of antitrust laws is to preserve and promote competition and the free enterprise system. The antitrust laws are premised on the assumption that private enterprise and competition is the most efficient way to allocate resources, produce the necessary goods at the lowest possible price and assure that high quality products are produced. The antitrust laws require that business people make independent business decisions without consultation or agreement with competitors.

Promoting and fostering the culture of healthy competition and simultaneously catering to consumer welfare would not only lead to better functioning of the economy, promoting higher economic growth but would also give India an edge in the global economy. Keeping this in view, not only institutions like CCI and Competition Appellate Tribunal have been established but taking a reformative approach to law making, that laws like the Competition Act, 2002 have been enacted. Establishment of these institutions and enacting laws have largely been guided by the experiences already globally available, especially US and EU. No doubt, these experiences have been adapted suiting to India’s special requirements. Provisions contained in sections 3(4) and 19, forming the substance of the report and as discussed above testify that while India is keen to learn from others, it has its own independent approach as well.

Acknowledging that unlike horizontal agreements, vertical agreements, especially agreements designed for Resale Price Maintenance (RPM) do pose serious concerns, anxieties and experiences on both sides, namely favourable to promoting competitiveness as well as many times causing impediments or negative impacts on competitiveness. Discussion of benefits and harms have caused a major chunk of this report, the real challenge, therefore, is how to strike a balance between competing claims; benefits versus harm. Wisdom practised for about 100 years in one of the most developed and capitalised system, America, if not been fully reversed has been given a different twist. The rule attaching per se illegality to RPM has now been translated by the US SC in Leegin case to rule of reason test.
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No doubt, after *Leegin* RPM agreements if not per se illegal, they are also not per se legal. Thus, a big space has been left vacant, or in other words, a space occupied by flexibility, vagueness and uncertainties where the courts and enforcement agencies are exposed to massive lack of empirical data and relevant economic analysis to more imaginative and circumspect and creative.

As discussed earlier in chapters 3 and 4, the situation in India is not much different. What has been pleaded in the report is that while RPM agreements have the potential competitiveness in many requests should not be attached to per se illegality. But at the same time should not be conferred with the status of legality even of these arrangements destroy the market, cause failure of the market, foster a culture of cartelisation and creating barriers for new entrants. The need is for striking a balance that is not neutral per se.

It is a well accepted principle in antitrust law that combining substitutes is bad, and combining complements is good, absent evidence to the contrary. But the researcher is not sure how helpful this theorem is when we assess vertical relationships in general, and resale price maintenance in particular.

The problem is this: retailers and retailing may be categorized as either a complement or a substitute, especially in this age of Internet merchandising. From the viewpoint of the manufacturer, retailing is a complementary service – one that is useful and necessary to bring consumer goods to market. In agency terms, manufacturers tend to view retailers as their sales agents. But from the viewpoint of a consumer, retailing may be seen as providing alternative sources for competitively priced goods. In other words, consumers tend to view retailers as their purchasing agents. Both the sales and purchasing functions provide consumer benefits, and the antitrust treatment of resale price maintenance should recognize this. But at the end of the day, the researcher naturally leans toward the outcome that encourages lower prices for consumers. Therefore, absent empirical evidence to the contrary, I believe the antitrust laws should prioritize retailers’ role as purchasing agents

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for consumers. According to this view, we should cast a skeptical eye upon minimum resale price maintenance, because it tends to suppress discounting.

In the end, the researcher has attempted to make a few suggestions which may be very elementary, which are follows-

1. Lay down guidelines for evaluating the different kinds of vertical agreements mentioned in the Act, instead of subjecting all of them to a general rule of reason approach.

2. For drawing a balance approach there is a need to devise a legal framework, as a part of the Competition Act providing guidelines and standard for determining when and what will amount to cause “appreciable adverse effect” by RPM arrangements on competition. As example these guidelines aiming to ensure that inquiry into the appreciable adverse impact should not become too expansive and time consuming. These guidelines may lay down that unless there is independent evidence of collusion among retailers and that a manufacturers Rpm agreements are involuntary and not motivated by retail services, the retail cartel theory of RPM should be discounted.

3. The guidelines may suggest that unless there is independent evidence that a manufacturer using RPM agreement is colluding with its rival, each of whom also uses RPM agreements, the manufacturer cartel theory of RPM be discounted

4. A guideline may lay down that where a manufacturer does not possess enough market power to trigger concerns about exclusion of rivals, i.e where there is abundant interbrand competition, the RPM agreements- augmented foreclosure theory should be discounted.

5. When a manufacturer’s RPM agreements are motivated by retail service provision, there should be a presumption that these agreements are pro- competitive, unless evidence is produced to otherwise.

6. Introducing the term ‘relevant market’ in S. 3 for the sake of clarity. The test for adverse effects becomes all the more complicated if there is any ambiguity with respect to the market involved. the factors that may be considered while
determining are physical characteristics, end use of goods, price of goods or services, consumer preferences, exclusion of in-house production, existence of specialized producers and classification of industrial products.
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