COMPETITION COMMISSION OF INDIA

Case No. 36 of 2014

In Re:

M/s Fx Enterprise Solutions India Pvt. Ltd **Informant**

And

M/s Hyundai Motor India Limited **Opposite Party**

CORAM

Mr. Ashok Chawla
Chairperson

Mr. M. L. Tayal
Member

Mr. S. L. Bunker
Member

Mr. Sudhir Mital
Member

Mr. Augustine Peter
Member

Appearances: Mr. Rajshekhar Rao, Ms. Sonam Mathur and Ms. Kabyashree Chaharia, Advocates for the informant alongwith Mr. Ankit Aggarwal, Managing Director of the informant.

Order under section 26(1) of the Competition Act, 2002

1. The present information has been filed under section 19(1)(a) of the Competition Act, 2002 ('the Act') by M/s Fx Enterprise Solutions India Pvt. Ltd. ('the informant') against M/s Hyundai Motor India Limited ('the opposite party'/ HMIL) alleging *inter alia* contravention of the provisions of sections 3(1) and 3(4) of the Act.

2. Facts, as gathered from the information, may be briefly noted:

3. The informant is an authorized dealer of HMIL engaged in the business of reselling and servicing of 'Hyundai' products since 2006 from Plot No. 38, Delhi Mathura Road, Faridabad, NCR. The business activities of an authorized dealer comprise of sales of vehicles, spare parts and accessories thereof. They are also engaged in after sales service and repair of vehicles including related activities like finance, insurance and sale/ purchase of pre-owned vehicles. The opposite party is engaged in the business of manufacturing, sale and servicing of 'Hyundai' automobile range, accessories, spare parts, *etc.* ('Hyundai products').

4. The informant avers that the automobile dealership market is by-product of the primary market for sale of vehicles. The dealerships functions as a single brand franchisee to sell various makes of automobiles by a single manufacturer/ OEM. In the current automobile marketing system in India, the dealers order vehicles in advance in a 'push' system driven by the manufacturer's agenda. This means that the dealer has to order certain number of vehicles in order to be eligible for incentives offered by the manufacturer *i.e.* the manufacturer drives the sale of its cars by pushing them to the dealer.

5. In line with the above strategy, the opposite party operates on a zero credit policy *i.e.* it requires its dealers to pay for the vehicles, spare parts and

accessories at the time of placing the order, and not when the products are delivered to the dealer. As per the informant, the opposite party also coerces dealers to take "inventory funding" from banks like Standard Chartered, ICICI, Axis Bank *etc*. Such pressure is exerted especially in situation where the dealer is unable to achieve sales targets due to shortage of funds at the dealer level. In such cases, the opposite party often connects the banker with the dealer so that the bank is able to provide the dealers with sufficient funds. The banker and the dealer then enter into an agreement which opens a 'line of credit' which results in automatic transfer of funds to the opposite party's account when the dealer places an order with the opposite party and the vehicles or spare parts are dispatched to the dealers.

6. The informant has alleged that such multiple layers of incentives provided by the opposite party coupled with unrealistic targets for the dealers to achieve have given rise to certain malpractices. Some of the dealers of the opposite party indulged in certain malpractices such as raising of false and fabricated invoices for sales of vehicles against which incentives for achieving targets were claimed.

7. The informant has pointed out that the dealership arrangement with the opposite party is exclusive from the dealer perspective; which requires dealers to seek prior consent of the opposite party before taking dealership of another brand. Therefore, the dealers are required to sell and service Hyundai products exclusively. Further, as submitted by the informant, the dealers are also bound to procure all the spare parts, accessories and all other requirements either directly from the opposite party or vendors that are specifically approved by the opposite party. The Dealership Agreement strictly prohibits sourcing dealers' requirements from OES who manufacturer the automobile components for the assembly line purpose as well as the aftermarket requirement.

8. The opposite party even monitors that the maximum permissible discount level is being adhered to by its dealers through a 'Discount Control Mechanism'. The dealers are not authorized to give a discount which is above the recommended range. The level of discount is determined by the opposite party which varies for different models of vehicles. Appreciating the illegal nature of the activity, the employees of the opposite party avoid the use of official email address to co-ordinate the discount control mechanism. Further, the opposite party encourages dealers to report instances of price/discount undercutting by other dealers in the region to ensure full transparency in the market. At the end of every month a penalty sheet is circulated where penalty is levied on all those dealers who were found to have offered discounts to customers over and above the recommended range.

9. The informant has alleged that the sale of vehicles to end-consumers can be differentiated from sale of vehicles to an authorized dealer. For a dealer, there is a specific demand for "Hyundai" products since they are not inter-changeable with products by another OEM. Consequently, the market consists of only 'Hyundai' products as the possibility for the dealer to switch to products manufactured by another OEM depends solely on the existence of substitutability which is not available in case of exclusive agreements as in the present case. Therefore, there is no such inter-changeability for a dealer since the dealer is contractually required to only deal in 'Hyundai' products, a violation of which would lead to breach of the contract. Even without any contractual obligation on the dealer, it is not feasible to easily substitute Hyundai products with those of another OEM by a dealer. First, the opposite party owns intellectual property rights over its products which virtually mean they cannot be interchanged with any other products. In the case of an automobile dealer, the continuation of business is dependent on supply of products from the particular OEM. There is no substitutability between vehicles, spare parts or accessories

belonging to different brands, with the result that there cannot be effective competition at this level.

10. Based on the above factual matrix, the informant has pointed out the following contraventions of the Act by HMIL:

Contravention under section 3(4) of the Act by HMIL

11. It is submitted that the relationship between HMIL and its authorized distributors is a vertical relationship *i.e.* a relationship between enterprises at different stages or levels of the production and distribution chain. Under Section 3(4), agreements among enterprises at different stages or levels of production chain will be considered anti-competitive, if they cause or are likely to cause an Appreciable Adverse Effect on Competition (AAEC) in India. The agreement may be in relation to production, supply, distribution, storage, sale or price of good or provision of service.

12. It has been alleged that the restriction imposed by HMIL on the maximum permissible discount that may be given by a dealer to the end-consumer; amounts to a 'resale price maintenance' (RPM) restriction under section 3(4)(e) of the Act. It has been alleged that the object of such vertical price restraints is primarily restriction on price competition between enterprises operating in the market. RPM implies a direct or indirect object to fix or enforce a minimum resale price to be observed by the distributors or any downstream resellers of the manufacturer's products.

13. In the present case, the restriction imposed by HMIL on the discounting policy of its dealers operates as the RPM. Under the Act, the term "price is defined widely to include every valuable consideration, whether direct or indirect, or deferred, and includes any consideration which in effect relates to the sale of any goods or to the performance of any services although ostensibly relating to any other matter or thing."

Therefore, on account of the fact that discounts are directly related to the price or consideration being paid for a given vehicle, it is submitted that HMIL is in fact limiting the competition between dealers by specifying the limits on their discounting policies and thereby restricting competition in the market.

14. It has also been alleged that HMIL also monitors that the maximum permissible discount level is being adhered to by its dealers thorough a 'Discount Control Mechanism' (DCM). The dealers are not authorized to give a discount which is above a recommended range. The level of discount is determined by HMIL which varies for different model of vehicles. A strict monitoring mechanism to check such discounts has been put in place by HMIL. It has been further submitted that appreciating the illegal nature of this activity, the employees of HMIL avoid the use of official email address for such communication. A separate email account is created through a different service provider for this purpose. This alternative email address is primarily used by HMIL officials to coordinate the aforesaid DCM.

15. The informant has also alleged that dealers face substantial switching costs if they were to switch to another OEM; therefore, the informant claims that they are "locked in" to the relationship. It has been submitted that the informant has invested INR 14 to 15 crore in the dealership business, and have incurred further costs to maintain inventory, brand image *etc.* Further, the informant is required to maintain inventory which amounts to INR 12 to 14 crore. Therefore, as per the informant, the ability to switch for the dealer becomes difficult due to sufficiently high costs.

16. The informant has also submitted that HMIL is responsible for price collusion amongst competitors through a hub and spokes arrangement. The informant has alleged that HMIL perpetuates a hub and spokes arrangement where bilateral vertical agreements between the suppliers and

the dealers and horizontal agreements between the dealers that come about through the role played by the supplier.

17. The informant has also alleged that HMIL of illegal tying. It has been submitted that HMIL has control over the sources of supply for the dealer's products and ties the purchase of the desired cars to the sale of high-priced and unwanted cars to the dealer. Further, it designates sources of supply for complementary goods for the dealer. Such practices result in "tie-in" arrangement as described under section 3(4)(a) of the Act.

18. The informant has further submitted that the first element that has to be fulfilled to prove tying is to establish that the tying involves two separate products. In this case, HMIL has tied the sale of complementary products such as CNG kit, engine oil, printing services and insurance policy for dealers, and ultimately the final consumers, to the sale of its vehicles. The tying product in this case is 'Hyundai' vehicles whereas the tied products are the complementary goods such as CNG kit, engine oil, printing services. *etc.*, to HMIL dealers. Further, it has been added that the second element that is necessary to establish tying is to prove that the buyer was forced or coerced to purchase a product that was not desired. The informant has submitted that the test of coercion serves as an operational criterion for distinguishing transactions in which the purchaser voluntarily acquires the tied products from transactions in which the seller compels the purchase of tied products against the buyer's will. In this case, the dealer has little or no choice but to procure from the approved vendors. Any change would mean violation of the terms of agreement with HMIL as a result of which the dealership may be terminated. The informant has further submitted that the final condition that needs to be established to prove illegality of tying is to demonstrate sufficient economic power in the tying product to produce an appreciable restraint in the market for the tied product or an AAEC. The economic power in this case emanates from the lock-in of the dealer with HMIL.

19. The informant has further alleged an exclusive supply agreement under section 3(4)(b) of the Act. As per the informant, since a HMIL dealer is required to seek approval of HMIL before undertaking business not related to 'Hyundai' products acts as 'entry barriers' for a dealer to operate a dealership of another OEM. The informant has submitted that although the HMIL dealership agreement does not explicitly restrict the dealer from undertaking dealership business of another automobile manufacturer, the effect of the requirement of HMIL's consent are a restrain on the ability of the dealer to open an additional dealership business of another OEM. The informant has further submitted that since a dealership network is essential for automobile manufacturers, the exclusive supply agreement can potentially create entry barriers for other OEMs. Therefore, the network of similar vertical agreements for one manufacturer will cause an AAEC in the relevant market.

Contravention under section 3(1) of the Act by HMIL

20. The informant has quoted the Commission's decision in *Ramakant Kini* v. *Hiranandani Hospital* where it was held that section 3(1) is enforceable *de hors* the applicability of section 3(3) or 3(4) of the Act. The informant has submitted that the Commission should look into the freedom of trade, consumer welfare aspects and adverse effect on competition as a result of the dealership agreement. The informant has submitted that the effect of the exclusive agreement between dealers and HMIL has an adverse effect on the end-consumer *i.e.* restriction of their choices and the resultant effect. The informant has submitted that it is important to analyze the *de facto* anti-competitive effect of the exclusive agreement on the restriction of choice for both the dealer and the end-consumer.

21. The Commission has perused the material available on record including the additional documents besides hearing the counsel for the informant

who appeared and made submissions before the Commission on 01.07.2014.

22. On perusal of the information, it appears that the existing dealership agreements of HMIL prohibit the dealers to source spare parts requirements from any source other than its approved vendors, resulting in such dealers being forced to source 'Hyundai line Products' only through the official vendors. The Commission is of *prima facie* opinion that such agreements between OEM and its dealers are in the nature of exclusive supply agreement in violation of the provisions of section 3(4)(b) of the Act.

23. The Commission is of further opinion that HMIL by not allowing the authorized dealers to deal in competing brands of automobile is *prima facie* restricting competition in the markets in as much as an HMIL dealer is required to seek its prior approval before taking dealerships of such competing brands. In the opinion of the Commission, such restriction/ stipulation is *prima facie* in violation of the provisions of section 3(4)(c) of the Act.

24. The informant has also provided specific averments in the information regarding restrictions imposed by HMIL on the maximum permissible discount that may be given by a dealer to the end-consumer. This appears to be a 'resale price maintenance' restriction and falls foul of the provisions contained in section 3(4)(e) of the Act. Further, the informant has also averred specific business practices of HMIL which are stated to result in illegal "tie-in" arrangement as described under section 3(4)(a) of the Act.

25. Finally, the informant has also alleged that HMIL is responsible for price collusion amongst and alongwith its dealers through a hub and spokes arrangement. The Commission is of the opinion that the specific averments

made by the information in this regard merit a detailed investigation of such alleged collusive practices in the present case.

26. In view of the above discussion, *prima facie* a case of contravention of the provisions of section 3 of the Act, as detailed above, is made out against the opposite party and the Director General (DG) is directed to cause an investigation to be made into the matter and to complete the investigation within a period of 60 days from receipt of this order.

27. The Secretary is directed to send a copy of this order alongwith the information and the documents filed therewith to the Office of the DG forthwith.

Sd/-
(Ashok Chawla)
Chairperson

Sd/-
(M. L. Tayal)
Member

Sd/-
(S. L. Bunker)
Member

Sd/-
(Sudhir Mital)
Member

Sd/-
(Augustine Peter)
Member

New Delhi
Date: 12/09/2014