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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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ROUNDTABLE ON FIDELITY REBATES

Note by India

15 – 17 June

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More documents related to this discussion can be found at www.oecd.org/daf/competition/fidelity-rebates.htm*

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1. Introduction

1. India's market since its economic liberalization in 1991 has only been burgeoning and it is now one of the world's fastest growing economies. The growth has helped changed India's image in the global market. There are numerous domestic firms which have done phenomenally well over the past decades and several other emerging startups are slowly and steadily making their impact across the country. They are building up their brands and fueling the market growth even more. Competition in the market is widely encouraged as it not only provides more options to the consumers but also ultimately boosts the economy of the nation. Several companies come up with different kinds of schemes from time to time to attract customers and generate more sales of their products or services. It is a way of sustaining in the competitive market.

2. Fidelity rebate or loyalty discount is one such scheme that is adopted by many companies in order to retain their customers and indirectly discourage them from approaching their rival competitors. Loyalty discount schemes in a way induce customers to go back to the same company to purchase the goods or services since they are getting the same at lower price compared to the deals offered by other firms. In other words, the patronage of customers is retained by way of such schemes.

3. The fidelity rebate means where discounts are offered in return of exclusive arrangement between the company and the buyer. This concept is not new in the Indian market. There are many such schemes that are prevalent currently. For instance, through the common 'cash-back' scheme offered by e-commerce companies, customers are offered a certain amount of "cash back" if they purchases goods or services from them. That cash can further be used in future to purchase other goods services from the said service provider. Another example on fidelity rebate in the Indian context would be that of Airline sector. Airlines have the 'travel miles' offer for their loyal customers. For instance, Airlines have 'Frequent Flyer Programs' - a loyalty program - wherein every time the passenger flies, he earns miles and the said miles can be used to buy tickets in future from that Airline for any sector. In other words, a person gets rebate for buying the services of that company. Such incentives appear to have the loyalty-inducing effect on the customers who are ensnared to remain exclusive with the company.

2. Indian Competition Law and Fidelity Rebate

4. Loyalty discounts result in exclusivity but the same is not prohibited *per se* under the Competition Law. However, the enterprise offering such schemes might come under anti-trust scrutiny. It may benefit consumers or impede the competition in the market according depending upon the facts and the circumstances. It can also be a case of legitimate business practice to compete on merit for more business. Thus, economic justification can negate such anti-competitive issue. However, an enterprise may come up with a scheme with the intent to drive out competitors thereby resulting in distortion of competition in the market. Sometimes, companies deliberately offer their product/ services at heavily discounted rates or make their customers enter into such agreements that it prevents them from approaching other competitors for the same product/ services. The argument of economic justification has to connect with the facts and market dynamics at that relevant period.

5. As not much case law exists in respect of such business practices as of today under the Indian Competition Law due to the infancy of the regulatory regime, it would be worthwhile to recapitulate the statutory architecture governing such practices.

6. In this regard, it would be appropriate to refer to Section 3 of the Act which proscribes anti-competitive agreements. In particular, Section 3(4) deals with agreements which may be termed as vertical agreements. It lists five categories of vertical agreements which would be in contravention of sub-section

(1) of Section 3 if these cause or are likely to cause an appreciable adverse effect on competition in India. Vertical agreements are therefore subject to the rule of reason. This softer treatment itself points to the fact that vertical agreements may have beneficial aspects that need to be weighed against the harmful effects to see if the agreement is, on balance, anti-competitive. The harmful effects may include restrictions on intra-brand competition, foreclosure of competition, and compartmentalization of markets, and the pro-competitive effects can include efficiency gains, increase in inter-brand competition, and prevention of free-riding.

7. The five vertical agreements particularly listed in sub-section (4) are: (a) tie-in arrangement; (b) exclusive supply agreement; (c) exclusive distribution agreement; (d) refusal to deal; and (e) resale price maintenance. Each of these categories of agreements has been explained in the Explanations below subsection (4).

8. For the present purposes, it would be pertinent to make reference to the provisions relating to 'exclusive supply agreement'. Explanation (b) to Section 3(4) states that '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. It is, thus, an agreement placing restrictions on the buyer in favour of the seller, prohibiting the buyer to deal in the goods of any competitor of the seller.

9. It may be pointed out by virtue of the provisions contained in Section 19(3) of the Act, the Commission, while determining whether an agreement has an appreciable adverse effect on competition under Section 3, shall have due regard to all or any of the following factors, namely: (a) creation of barriers to new entrants in the market; (b) driving existing competitors out of the market; (c) foreclosure of competition by hindering entry into the market; (d) accrual of benefits to consumers; (e) improvements in production or distribution of goods or provision of services; (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services. Thus, while clauses (a)-(c) deal with factors which restrict the competitive process in the markets where the agreements operate (negative factors), clauses (d)-(f) deal with factors which enhance the efficiency of the distribution process and contribute to consumer welfare (positive factors). An agreement which creates barriers to entry may also induce improvements in promotion or distribution of goods or vice-versa. Hence, whether an agreement restricts the competitive process is always an analysis of balance between the positive and negative factors listed in Section 19(3) of the Act.

10. Similarly, it would be apposite to refer to the provision contained in Section 4 of the Act which prohibits abuse of dominant position whereunder also such fidelity rebate schemes may be scrutinized. Section 4(1) of the Act states that no enterprise shall abuse its dominant position. Further, section 4(2) of the Act, inter alia, states that there shall be an abuse of dominant position under sub-section (1), if an enterprise: (a) directly or indirectly, imposes unfair or discriminatory- (i) condition in purchase or sale of goods or service; or (ii) price in purchase or sale (including predatory price) of goods or service; or (b) limits or restricts- (i) production of goods or provision of services or market therefor; or (ii) technical or scientific development relating to goods or services to the prejudice of consumers; or (c) indulges in practice or practices resulting in denial of market access in any manner; or (d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or (e) uses its dominant position in one relevant market to enter into, or protect, other relevant market.

11. Under this provision, firstly, the relevant market needs to be delineated and then the dominance of the enterprise is assessed in such relevant market. While assessing the alleged abuse of the dominant enterprise, all the relevant facts and circumstances are given due consideration. There are no decisive

factors as such to conclude that fidelity rebate is anti-competitive or abusive within the meaning of the Act but considerable attention is given to the fact that efficiency defence given is reasonably justified.

12. It is important that the market dynamics are understood clearly in order to assess the supposition of price cuts. In an oligopolistic market structure, such pricing practices play a significant role in bringing changes in the structure of the market. A negative impact of such practice will not only lessen up the choices for the buyers but will also lead to a dysfunctional market rather than an efficient one. Therefore, keeping tabs on the market players also becomes equally important. The mandate of CCI is to prevent any such activities and create a deterrent in the market through the Act. The Competition Act, 2002 was enacted keeping in mind the changing landscape of the industry post- liberalization. The very purpose of the Act was to promote competition and efficiency in the market and ultimately benefit the consumers. Furthermore, Section 49 of the Act obligates the Commission to undertake advocacy for promoting competition in different sectors of the economy. Though several sectors are regulated by their respective regulators, CCI will have overarching jurisdiction across the sectors over matters which have competition concerns.

13. Lastly, CCI, from time to time, studies the markets of different sectors with the purpose of adopting more economic approach in its stance and expanding its radar. It conducts seminars, workshops and conferences in collaboration with other institutions and regulators to bring about more clarity on the respective sectors. It is open to new approaches, if any, that would help understand the industry better and ultimately, the behaviour of the players in the market.

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