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Restrictive Conditions in Automobile Dealership Agreements in the Light of Antitrust Regime under Competition Act, 2002

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ABSTRACT

The Automobile Industry is one of the vital sectors in terms of its contribution to the Indian economy. In a global context, India's automobile industry ranks fourth in manufacturing volume. It significantly contributes to India's GDP, accounting for approximately 7.5% of its total GDP, and employs about 35 million people. From manufacturing automobiles to delivering them to consumers, the industry has various entities at different levels of the supply chain that are interdependent on each other. The industry's two pillars are the automobile dealers and the original equipment manufacturers (hereafter referred to as OEMs). Thus, from the antitrust perspective, it becomes essential to analyze the position & dynamics between these two important players and to prevent the imposition of unfair and restrictive conditions, which would otherwise lead to an adverse impact on the interest of all the stakeholders. In the first part, an attempt is made to discuss the relationship between the dealers and the OEMs to showcase how the manufacturers are in the predominant position as compared to the dealers while establishing the terms of the dealership agreement. The second part delves into analyzing the regulatory framework governing such clauses through the prism of antitrust laws. The concluding part provides suggestions to bolster the regulatory framework dealing with anticompetitive clauses of the agreement.

Keywords: Dealership Agreement, OEMs, Restrictive Conditions, Antitrust Regime, Competition.

I. INTRODUCTION

Automobile dealership agreements are crucial to the functioning of the automobile industry as they allow manufacturers to distribute their products through a network of authorized dealerships. These agreements often include restrictive conditions that limit the ability of dealers to operate their businesses and raise concerns regarding their compatibility with antitrust laws.

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Antitrust laws are designed to prevent anticompetitive behavior and promote fair competition in the market. In the context of automobile dealership agreements, these laws seek to prevent manufacturers from imposing unfair or restrictive conditions on their dealerships, which could lead to a lack of competition among dealerships and also harm consumers. The restrictive conditions in automobile dealership agreements can include provisions that limit the ability of dealers to sell competing products or services, further, it require dealers to purchase a certain amount of inventory or dictate the pricing of products. These conditions can limit consumer choice and raise the cost of entry for new dealerships, effectively creating market entry barriers. Ultimately, the compatibility of restrictive conditions in automobile dealership agreements with antitrust laws is a complex and ongoing issue.

II. OVERVIEW OF RELATIONSHIP BETWEEN AUTOMOBILE DEALERS AND ORIGINAL EQUIPMENT MANUFACTURERS (OEMS)

The Original Equipment Manufacturers (OEMs) and Automobile dealers form the shaft and bolt of the Indian automobile industry. OEMs are the ones who manufacture, and automobile dealers sell those products and services to the end consumers, constituting a vital part of the automobile market supply chain.³ These two components form the industry's foundation as they also play a crucial role in the after-sale markets, offering spare parts supply, vehicle maintenance, repairs, and other ancillary services such as insurance and vehicle finance.⁴ However, a power imbalance often characterizes the relationship between automobile dealers and OEMs. OEMs dominate due to their control over the production and distribution of vehicles and parts. Since automobile dealerships are typically small businesses such as sole proprietorships, partnership firms, or family-owned enterprises and are often categorized as MSMEs, they have historically lacked bargaining power in contractual arrangements with large corporations such as OEMs.⁵ As a result, the terms of such contracts have tended to favor OEMs. The dealer's lack of bargaining power has also resulted in instances of unfair business practices, which further exacerbate the power imbalance. Additionally, OEMs typically sell their vehicles to dealerships, who then sell them to consumers, with the OEMs dictating the terms and conditions of these transactions. This power imbalance can result in OEMs abusing their dominant position to the detriment of dealerships. For example, OEMs may engage in practices such as imposing arbitrary performance targets, mandating the purchase of unnecessary or unwanted inventory, and

³ "Automotive Industry: Ministry of Heavy Industries, Ministry of Heavy ..." (*Automotive Industry*) Available at: <https://heavyindustries.gov.in>, accessed March 8, 2023

⁴ *Ibid.*

⁵ Sharma MM, "How Competition Law Affects Automobile Dealers in India"; <https://www.competitionlawyer.in>, accessed February 28, 2023

unilaterally altering the terms of dealership agreements. Such practices can be viewed as violations of antitrust laws, which are designed to prevent dominant firms' abuse of market power. Due to an imbalanced power dynamic, dealers suffer many issues, such as unfair contractual terms, termination and exit clauses, unclear indemnity provisions, renewal mechanisms, etc.⁶ The main reason behind these issues is the 'one-sided contracts'⁷ drafted by OEMs and signed by dealers without any scope for modifications. This creates an obligation on dealers either to agree with the terms of the contract or go without it. Further, our legal regime also refrains from intervening in such transactions where two business entities are involved, thereby aggravating the issues faced by the dealers.

III. ARBITRARY IMPOSITION OF RESTRICTIVE CONDITIONS IN DEALERSHIP AGREEMENTS

Anticompetitive practices adopted by OEMs can impact various stakeholders in the industry, inter alia including- OEMs and their dealers, and supply chain entities, they are interconnected and categorized based on their position within the supply chain, from raw material suppliers to the final delivery of goods to customers. Arbitrary imposition of restrictive conditions in a dealership agreement refers to a situation where the manufacturer or supplier imposes unnecessary or unfair restrictions on their dealers without any legitimate reasons. Such prescription in the agreement can have significant negative consequences for the dealer, including decreased profitability, reduced market share, and limited growth opportunities. Further, they can create an anti-competitive market and limit consumer choices, ultimately harming both dealers and consumers. It is fruitful to discuss some of the arbitrary restrictions imposed through these agreements by the OEMs. Firstly, Restriction on Maximum Discount and Resale Price Maintenance: Restrictions on maximum discount and resale price maintenance are two types of restrictions that OEMs commonly impose in dealership agreements. That is a restriction on maximum value refers to a provision in the Contract that limits the discount a dealer can offer on a product. This restriction is often intended to maintain consistent pricing across all dealerships and prevent price wars that could negatively impact the manufacturer's or supplier's profits. On the other hand, resale price maintenance (RPM) refers to a practice where the manufacturer or supplier sets a minimum resale price for their products, and dealers must sell them at or above that price. While these restrictions may appear beneficial for manufacturers or suppliers, they can negatively affect competition and consumer welfare. For example, they

⁶ Available at <https://www.fada.in/images/press-release/Brief_Final.pdf> accessed on March 3, 2023

⁷Sharan S,(2020) See <https://www.mondaq.com/advicecentre/content/4454>, accessed on March 4, 2023

can limit price competition between dealerships and prevent consumers from benefiting from lower prices. Additionally, they can limit the ability of smaller or newer dealerships to compete with larger or more established dealerships, ultimately reducing market entry and innovation. As rightly ruled in *the Maruti Suzuki India Limited case*,⁸ that ‘imposing restriction of maximum discount and regulating the resale price’ of the goods comes under Appreciable Adverse Effect on Competition (AAEC), which is anti-competitive by all means. A similar was held in the case of *Fx Enterprise Solutions India vs. Hyundai Motor India Limited*.⁹

Secondly, the obligations imposed through tie-in arrangements by dealers in the automobile industry refer to agreements between car dealerships and manufacturers that require the dealer to sell a particular product or service as a condition for selling another product or service. Tying could be imposed through dominant players (OEMs) refusing to supply the tying products unless the dealer purchases the tied products. For example, a car dealership may be required to sell a certain number of extended warranties or service contracts to maintain its dealership agreement with a manufacturer. In some cases, dealerships may also be required to purchase a certain amount of inventory or accessories from the manufacturer to continue selling their cars. Tie-in arrangements generally have adverse consequences both on consumers and automobile manufacturers, because they limit consumer choices by forcing them to purchase additional products or services they may not want or need. Also, creates an uneven playing field for smaller dealerships that may not be able to meet the manufacturer's requirements. Thirdly, an exclusive distribution agreement concerning any geographical area, if it limits or restricts the supply of any goods outside the market or area allocated to the dealers. For Example: Suppose an OEM enters an exclusive distribution agreement with a particular dealer for a specific geographic region. This agreement prohibits the dealer from selling the goods outside that area, thus, restraining market access in other areas, in such cases, the Competition Act, may consider this agreement anti-competitive; if it results in limiting competition, because, it creates barriers for the dealers to distribute into other areas (territorial restrictions), completely restraining them from market access. Fourthly, automobile dealers undertake various functions, such as selling the vehicle to the end consumers and selling spare parts and accessories that constitute the aftermarket.

Besides, the primary market, the dealers are also a vital part of aftermarket services; however, access to the same is restricted by the OEMs by putting the Clause of “Single Brand Franchise Model”. This Clause restrains the dealers from undertaking the dealership of any OEM's

⁸*Maruti Suzuki India Limited v. CCI, NCLAT, Competition Appeal (AT) No. 15, [2021]*

⁹*Fx Enterprise Solutions India Pvt. Ltd. v. Hyundai Motor India Limited, SCC OnLine CCI 26 [2017]*

competing player; and also, it also restrains after-sales service repairs and maintenance to a specific OEM. Such Standard clauses require dealers to obtain prior approval from the OEM before undertaking other dealerships. Further, such arrangements generally form part of an “exclusive supply agreement” or “refusal to deal” which is anti-competitive. Fifthly, in the automobile industry, the aftermarket refers to the market for motor vehicle replacement components, accessories, and maintenance services. Due to the long lifespan of automobiles, the aftermarket is crucial for consumers as it allows them to maintain and repair their cars without incurring the high cost of replacing them.¹⁰ This makes the aftermarket a vital aspect of the automobile sector, providing consumers with cost-effective solutions for keeping their vehicles in good condition. OEMs have historically dominated the repair industry by restricting access to repair manuals, tools, and parts. Given that they are in the dominant position, they do not allow authorized dealers, repair manuals, etc., over-the-counter without their consent, depriving the dealers of access to the aftermarket. Consecutively, this leads to excessive repair service charges and the non-availability of spare parts to the consumers, such restrictions resulted in AAEC.¹¹In *ShamsherKataria v.Honda Sion*¹², in the instance case, the agreement between the automobile manufacturers and their authorized dealers prevented the latter from procuring spare parts from anyone other than the manufacturers. The Court held that such an agreement is "an anticompetitive exclusive supply and refusal-to-deal agreement." In the instance case, the Court relied upon the case of *Eastman Kodak Company v. Image Technical Services*¹³ Inc. wherein the Court ruled that “such policies of after-sales services locked in the consumer’s right to choose and thus were considered anti-competitive.” Similarly, in *the Tekla Corporation &Anr vs. Survo Ghosh &Anr case*, the Court held that “it is not permissible to impose contractual limitations” that would restrict or obstruct the consumer’s ability to use a product after it has been sold. This dominance has also been a significant barrier for small, independent repair shops, which have struggled to access the information and parts necessary to fix devices. Such a clause is prohibited under Section 3 of the Competition Act, 2002. Sixthly, another important clause is the “Lock-In”Conundrum,the automobile dealers to obtain dealerships of OEMs and invest their significant capital for infrastructure and after-sale services, making them dependent on the OEMs. Because of the dominant position of the OEMs, in negotiating the terms of the dealership agreement dealers are left with the only option to agree to even unfair and restrictive terms. A recent example of such dealer exploitation could be Harley Davidson's exit from the Indian Market in

¹⁰ Gupta P, “The Concept of AfterMarkets under Competition Law”, available at: <https://articles.manupatra.com/> accessed on March 6th, 2023

¹¹See <https://commonslibrary.parliament.uk/researchbriefings> , accessed March 8, 2023

¹²*ShamsherKataria v. Honda Siel Cars India Ltd* [2014] Comp LR 1 (CCI), [45]

¹³ *Eastman Kodak Co. v. Image Tech. Servs.* [1992] 504 US 451

2017. The dealers were caught off guard and had no options when foreign OEMs left the country with a meager compensation plan that didn't even cover the initial investment made by the dealers. This proves that the balance is tilted in favor of OEMs. The OEMs use their superior bargaining power to compel the dealers to attain impracticable goals, which include withdrawing credit facilities, offering incentives, and promoting the sales of less popular models. Dealers are sometimes forced to resort to unethical practices like creating fake sales records and generating false invoices to meet the unfeasible objectives enforced by the OEMs. Furthermore, the OEMs might impose anticompetitive conditions, like the compulsory purchase of accessories, insurance, and financing limitations, or sudden termination of the dealership, which could be considered as an abuse of their dominant position under Section 4 of the Competition Act, 2002.

IV. LEGAL FRAMEWORK

The legal regime on antitrust law in India is governed by the Competition Act, 2002, (hereinafter referred to as Act) and rules and regulations made thereunder, to ensure a level playing field and effective competition in the market. The Act aims to promote competition, protect the interest of consumers, ensure freedom of trade, and prevent practices having an appreciable adverse effect on competition (in short "AAEC"). The Competition Commission of India (CCI) is a statutory body established by the Government of India in 2003, responsible for enforcing the Act promoting competition throughout India and preventing activities that have an AAEC on fair competition in the market. The Act provides for anti-competitive agreements (whether vertical or horizontal agreements), abuse of dominant position, and combinations. The following agreements shall be presumed to have an "AAEC" " namely- (a) directly or indirectly determine purchase or sale prices; (b) limits or controls production, supply, markets, technical development, investment, or provision of services; (c) shares the market or source of production or provision of services by way of allocation of the geographical area of the market, or type of goods or services, or a number of customers in the market or any other similar way; (d) Further, agreements amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, 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 termed as anti-competitive only if such agreement causes or is likely to cause an AAEC in India. Although the current regulatory framework for competition in India requires reinforcement to address the issue of dominant Original Equipment Manufacturers (OEMs) in the automobile industry, it significantly impacts the implementation of anticompetitive dealership clauses. These clauses could potentially harm competition in the market, which could

result in elevated prices and limited choices for consumers. The Indian automobile industry has been under scrutiny by the Competition Commission of India (CCI), which has actively investigated and imposed penalties on automobile players who engage in anticompetitive practices. For Instance, In the case of *Shamsher Singh Katariya (2014¹⁴)*, CCI imposed a “fine of INR 2.54 billion on 14 car manufacturers for engaging in anticompetitive practices, which included the use of dealership clauses.” The legislation governing competition law in India prohibits specific agreements that may harm competition. Section 3 of the Competition Act,¹⁵ prevents enterprises or individuals from entering into contracts that could adversely (significantly) affect competition within the country. This provision applies to both horizontal and vertical agreements. In the automotive market, where dealers and OEMs operate vertically, dealership agreements fall under the latter type of agreement. If such contracts contain clauses that limit competition or restrict market access, they may be scrutinized under Section 3 of the Act. Anticompetitive provisions that could be prohibited under Section 3 include exclusive dealing, tying, minimum purchase requirements, and resale price maintenance agreements. Section 4 of the Competition Act, 2002¹⁶ addresses situations where an enterprise misuses its dominant position in the market to the detriment of other businesses or consumers. In the context of anticompetitive dealership agreements, Section 4 may come into play if a car manufacturer holds a dominant position in the market and uses it to impose unfair or discriminatory terms on its dealers. An enterprise is deemed to have a dominant position, if it can operate independently of competitive pressures in the relevant market or influence its competitors, customers, or the need to its advantage. As the relationship between OEMs and dealerships is unequal, the dealers may not have the leverage to negotiate the terms of the dealership agreement. This increases the risk of OEMs exploiting their dominant market position, in such instances, dealers may approach the Competition Commission of India (CCI) to investigate whether any clauses in the dealership agreement are unfair or one-sided and may be considered an abuse of dominant position by the OEM under Section 4 of the Competition Act.

V. JUDICIAL RESPONSE

The Indian judiciary plays a significant role in shaping the antitrust regime concerning ‘automobile dealership agreements’. For instance, in *ShamsherKataria v. Honda Siel Cars India Ltd. (2014)¹⁷*, Court ruled that car manufacturers could not impose unreasonable restrictions on

¹⁴ Supra 11

¹⁵ The Competition Act, 2002, s 3

¹⁶ The Competition Act, 2002, s 4

¹⁷ *ShamsherKataria v. Honda Siel Cars India Ltd* [2014] Comp LR 1 (CCI), [45]

dealerships, such as mandating them to purchase spare parts only from the manufacturer or use manufacturer-approved workshops for repairs. Such limits were considered anticompetitive and violated the provisions of the Competition Act, of 2002. Similarly, in *Fx Enterprise Solutions India Pvt. Ltd. v. Hyundai Motor India Ltd. (2017)*¹⁸, the Competition Commission of India (CCI) imposed a “penalty of Rs. 87 crores on Hyundai engaging in anti-competitive practices by enforcing resale price maintenance conditions on its dealerships.” In *Vishal Pande (Informant) v. Honda Motorbike and Scooter India Pvt. Ltd*¹⁹, the CCI ruled that manufacturers cannot enforce exclusive dealership agreements that bar dealers from interacting with other competitors, as it constitutes an anti-competitive practice under Section 3(4)(b) and (d) of the Competition Act, 2002.²⁰ In, *Tata Motors Limited v. Competition Commission of India (2017)*, the CCI imposed a penalty of Rs. 1,346 crores on Tata Motors for abusing its dominant position in the commercial vehicle market by imposing unfair and discriminatory conditions on its dealerships. The above cases reveal that the judiciary through their judicial ingenuity penalizes those OEMs, who were adopting anticompetitive business practices by violating the principles of fair competition in the automobile sector.

VI. CONCLUDING REMARKS AND SUGGESTIONS

Automobile dealers face precarious conditions due to restrictive practices and unfair dominance by OEMs. Dealers take on significant risks by investing in OEMs' businesses, yet their interests remain inadequately protected under the current Competition Act, which mainly relies on mutual contractual mechanisms. The standard contractual relationships between dealers and OEMs favor OEMs, denying dealers the right to negotiate terms. Therefore, specific provisions are needed to protect dealers by prohibiting unfair contract terms and termination practices, ensuring a level playing field. Technological advancements have allowed OEMs to dominate the supply chain, creating power imbalances and restrictive conditions in agreements. Despite this, antitrust laws aim to maintain a competitive environment but are undermined by loopholes exploited by OEMs. Protecting dealer's rights and balancing them with OEM's duties is crucial for the competitive growth of India's automobile sector and also to protect the interest of consumers.

(A) Suggestions

To mitigate these imbalances and ensure a competitive marketplace, several regulatory and contractual reforms are needed. First, it is imperative that dealership agreements incorporate specific "exit clauses" detailing both parties' notice period requirements, compensation

¹⁸Fx Enterprise Solutions India Pvt. Ltd. v. Hyundai Motor India Limited, SCC OnLine CCI 26 [2017]

¹⁹ Vishal Pande (Informant) v. Honda Motorcycle and Scooter India Pvt Ltd, [2018]

²⁰ Supra 13

mechanisms, and conditions for inventory returns upon termination. These clauses should ensure that termination is fair, transparent, and not unduly burdensome to dealers. Furthermore, establishing a "Right to Repair" framework, mandating OEMs to provide independent dealers with access to essential vehicle data and tools, would mitigate monopolistic control in the aftermarket, thus promoting consumer choice and fair competition. To facilitate swift and cost-effective dispute resolution, specialized tribunals focused on OEM-dealer conflicts could be established, reducing the financial strain on dealers and allowing for timely redressal of grievances.

These reforms would create a more balanced framework, providing dealers with the autonomy to make decisions that best suit their business needs while preserving OEMs' legitimate commercial interests. By enhancing contractual fairness and regulatory oversight, the suggested measures would contribute to a robust and competitive automobile sector, where dealers' rights are protected, and consumer interests are prioritized.

(B) Concluding Remarks

The analysis of restrictive conditions in automobile dealership agreements highlights the imbalanced power dynamics between Original Equipment Manufacturers (OEMs) and dealers, revealing how current practices favor OEMs at the cost of fair competition. The automobile industry's competitive structure is essential for consumer choice and market accessibility, yet restrictive conditions imposed by OEMs often compromise these goals. While antitrust laws, specifically the Competition Act, aim to safeguard market fairness, OEMs' leverage allows them to bypass these regulations through one-sided contractual terms that dealers are compelled to accept. Addressing these challenges within the antitrust regime is crucial to restoring equilibrium in the automobile market and fostering a more competitive and consumer-friendly environment.
