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Is there a Case for Essential Facilities Doctrine in India?

Jaivir Singh



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Author Bio:

Dr Jaivir Singh is Associate Professor at Centre for the Study of Law and Governance, Jawaharlal Nehru University, New Delhi.

Email: jsingh@mail.jnu.ac.in

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R 75, First Floor

Greater Kailash I

New Delhi 110048

www.circ.in

circ@circ.in

+91 11 26463021/22/23

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Abstract

Competition in market is frequently defined as a process of rivalry with the objective of garnering higher market share or more profit. The outcome of a competitive process is expected to result in lower prices, higher output, better quality and innovation. Sometimes, the competitive process faces obstacles when a market player does not have access to certain facilities without which it cannot compete effectively. These are known as 'essential facilities'. The duty to share is mandated by the essential facilities doctrine. This doctrine imposes on firms, that control an essential facility, 'the obligation to make the facility available on non-discriminatory terms.'

Though EFD has been incorporated in the telecom, electricity and oil & gas sector, however, in the case of the issue of access to medicine, pharmaceutical sector, and networking goods, the guidelines are either not present or are inadequate. It is in this backdrop that this paper examines the viability and justification of invoking and implementing the essential facilities doctrine in India. The paper also outlines EFD in other jurisdictions and emphasis on the need for an advancing role of the competition regime to promote and effectuate the doctrine in India.

I. Introduction

The Essential Facilities Doctrine (EFD) has been widely invoked across a number of jurisdictions all over the world and has generated a good deal of attention among people interested in competition and competition policy. In popular jargon, this is also referred to as *Third Party Access or Open Access*. The doctrine requires a monopolist/dominant firm to grant access to a facility (which is difficult to replicate) that it controls and that is necessary for effective competition. Such liability indeed militates against the conventional right of a firm to conduct unfettered economic activity. Thus, if the doctrine is to have substance it is very important that it be sufficiently circumscribed. The doctrine has been in practice for around 100 years now, and originates from the American anti-trust law.¹

Cases implicating the EFD arise when a vertically integrated firm that is a natural monopolist in one market refuses to provide access to the monopolised input to a rival/competitor in the same/adjacent market.

Although such activities can be dealt under 'refusal to deal' case, but traditional 'refusal to deal' cases differ from 'essential facilities' cases. While the former are based on the proviso that a dominant firm and its competitors have had a previous business relationship, essential facilities cases arise where there may not be such a business relationship already. Essential facilities cases are viewed as involving a structural problem in the market, which means that the issue must be addressed for the sake of the effective functioning of the market.

Perhaps the pivot over which EFD cases revolve is to decide when the shared use becomes essential. Under what conditions such a use should be granted in order to be able to compete profitably in the relevant market? And, of course, which are those *exceptional* circumstances that may justify the competition authority's intervention, without undermining the objective justifications by a dominant undertaking in refusing to allow such access.² In the end, the answer to the

¹ The essential facility is an exception of general duty that Section 2 of Sherman Act imposes on the business.

² Chirișă, Anca Daniela (2011). 'Access to Essential Facilities: A Comparative Competition Law Perspective of Shared Use and Recent Margin Squeeze Cases', *Competition Survey: Studies, Researches and Analysis*, Vol. 1: 32-41

above question regarding the legal background of granting access to essential facilities is one which sets out the general conditions for a *duty to share*, namely:

- Is access to the necessary facility essential to compete?
- Is there sufficient available capacity to provide access?
- Does the owner fail to satisfy an existing market demand or does he impede competition on the market?
- Is the company demanding access ready to pay a reasonable access fee?

Therefore, unless the answers to the above questions are not all affirmative, the duty to share access does not turn into an obligation imposed on dominant undertakings.

With this brief introduction of the doctrine and its economic foundation, this paper analyses the justification and viability of invoking/implementing the EFD in India. It outlines the specific nature of network goods which turn network industries as prime candidates for the application of the doctrine, leading to the suggestion that envisioning competition in relation to these goods may crucially involve some version of the EFD.

The paper also looks at two other important areas which build the case for the application of the doctrine: pharmaceutical industry and the issue of access to medicines; and infrastructure goods (proposing infrastructure goods as important candidates for invoking EFD is largely an American economic-legal scholarship).³

This is followed by an articulation of the contents of the doctrine in various jurisdictions. It begins by discussing the origins of the doctrine in the US,⁴ leading to a

³ Frischmann, B. and Waller, S. W. (2008). 'Revitalizing Essential Facilities', *Antitrust Law Journal*, 75(1):1-65

⁴ Although EFD is basically considered originating from US case laws, EC is credited with developing a more perfect and comprehensive criteria during the application of EFD

description of the varied interpretation of the doctrine in the American courts.

In India, so far, the ideas associated with EFD have been incorporated in the regulations governing the telecom, electricity and natural gas sectors, and in the intellectual property laws or in their reference to the Competition Act, 2002.⁵ Finally it discusses the efficacy of the doctrine in India and its potential ambit, and also briefly explores the potential role of the India's competition law in this respect.

II. Building the case for the Essential Facility Doctrine

Network Goods and their Specificities⁶

It turns out that EFD application and its motivations are best articulated from an understanding of the economics of network goods. Network goods are characterised by the value of the good/service to a consumer being dependent upon the number of other consumers. Put simply, one is likely to value his cell phone more, if more of his friends possess it. In the present-day, world network goods and services are ubiquitous - some key instances include telecommunications, the internet, computers and computer software; from the transport sector services such as those provided by airlines, railroads, shipping and delivery; from financial sector products such as bonds, equities, derivatives, credit and debit cards ATMs; and from energy sector grid activities such as electricity and natural gas production and distribution. While not exhaustive, a reflection of this cursory list attests to the importance of network goods in the contemporary economy.

⁵ Section 3.(5) (i): the right of any person to restrain any infringement of, or to impose reasonable conditions, as maybe necessary for protecting any of his rights which have been or maybe conferred upon him under....(various IPR laws)

⁶ This section draws extensively from Economides, N. (2008). 'Public Policy in Network Industries' in Paolo Buccirossi (ed.) *Handbook of Antitrust Economics*, The MIT Press: Cambridge, Massachusetts

For a summary understanding of the nature of network goods it is useful to break the definition into separate demand and supply components. In the demand side of the definition, the special feature of network goods is that they exhibit increasing returns to scale in consumption. To illustrate, consider a simple phone network in a town where a generic customer A wishes to call another similarly generic customer B - the service comes to have economic value in so much so as A connects to a switchboard which is also connected with Customer B so that when Customer A calls B she uses a complementary good consisting of her connection to the switchboard as well as B's connection to the switchboard. Furthermore this complementarity gives rise to the characteristic *network effects* or *network externalities* associated with network goods, where the value to the buyer of an extra unit of the good increases as more units of the good are sold.⁷

Unlike in the standard formulation of demand curve (which slopes downwards), in the presence of network effects, as more units are sold the willingness to pay for the last unit may end up being higher as the utility of the user/customer increases in a larger network. In the supply side definition of network goods, the inherent composite and complementary nature of these goods makes *compatibility* or *interoperability* across networks a crucial constituent of competition in network goods. A typical network good consists of complementary components, when one good will be of a value to the customer if, it is compatible with its complement (such as software and hardware of a computer system). Thus, while links over a network allow the potential imagination of a complementary composite good, it is the manifest compatibility or interoperability that actualises the complementarity.⁸

⁷ For a typical example of a network good pointed out, see Katz, M. L. and Shapiro, C. (1985). 'Network Externalities, Competition, and Compatibility', *American Economic Review*, 75:424

⁸ For a detailed discussion on this, see Economides, Nicholas (1996). 'The Economics of Networks',

Since firms typically involved in network good production will decide on the degree of compatibility strategically, unfettered choice in this regard is likely to favour incompatibility where network effects are very intense, particularly because this strategy tends to award them with very large benefits if they capture a substantial chunk of the market. In fact the theoretical literature predicts that in equilibrium, network good markets gravitate towards 'winner takes all' or at least 'winner takes most' outcomes, particularly when firms choose to make their products incompatible with those of their competitors and thus harnessing all the benefits accruing from the increasing returns to consumption referred to earlier.⁹

The classic real world example of this is the dominance of Microsoft's Windows as the *de facto* operating system for PCs all over the world in recent times. The European Court of Justice (ECJ) in its 2004 ruling on Microsoft indicated that Microsoft's refusal to disclose interoperability information created significant barriers to market entry, owing to indirect network effects, and is thus an abusive conduct. The interoperability decision may be seen as the remedy to the denial of an essential facility to other operating system developers. In network industries especially, this decision is of great importance, though the exceptional market situation in the *Microsoft case* need to be appreciated before intellectual property right holders are forced to licence their exclusive right to competitors. After the EC fined Microsoft with US\$666mn convicting the company for bundling Windows Media Player with Windows in 2003-04, the EC also licenced many protocols used in Microsoft's products. However, EC labelled delayed protocol licencing as violating fair,

International Journal of Industrial Organisation, 14:673-74

⁹ Studies show that even when many firms compete in a network good setting, there is a feedback loop that often causes the market to 'tip' in favour of one player. Shapiro, C. and Varian, Hal R. (1999). *Information Rules: A Strategic Guide to the Network Economy*, Harvard Business School Press, Cambridge, Massachusetts.

reasonable and non-discriminatory (FRAND) terms.

In 2006, Microsoft appealed to the ECJ of First Instance, but it was dismissed and the company began providing interoperability information as required. In the 'winner takes most' market scenario one firm dominates the market with a few small firms continuing to operate. It is important however to note that such dominance may not always be established by practicing 'anticompetitive acts', and could be the natural outcome in markets characterised with intense network effects.

If patents are essential to an industry standard, the standards-setting organisation in charge will typically require that everyone has access to those patents FRAND terms. This licencing obligation (called FRAND licence in the EU and RAND licence in the US) is invoked to ensure that compatibility, interoperability and pro-competitive nature of the industry. Intention is to prevent abusing monopolistic advantage arising out of the patent rights.¹⁰

In February 2012, EC warned Motorola and Samsung over abuse of essential patents in smartphones wars threatening sanctions against companies that use "essential" patents for standards as weapons in courtroom litigation - a reflection of current cases going on between Apple, Motorola and Samsung.¹¹

In October 2011, a Dutch court quashed Samsung's hopes (Samsung uses at least 13 different FRAND-pledged 3G patents) when it declared that Samsung would not be able to win an injunction against Apple's products based on standards-essential, FRAND-committed patents. A notable case involves Microsoft which recently filed a complaint

¹⁰ See for an overview. Layne-Farrar, Anne; Padilla, A. Jorge; Schmalensee, Richard (2007). "Pricing Patents for Licensing in Standard-Setting Organizations: Making Sense of Fraud Commitments," 74 *Antitrust Law Journal* 671.

¹¹ See, "EC Antitrust Chief warns over abuse of 'essential' patents in smartphones wars," *Guardian* 10 February 2021

with the EC, alleging that Motorola Mobility is violating a pledge to licence its standards-essential patents under FRAND terms.

FRAND comes as an explicit credible commitment not to misuse monopoly power inherent in a standard to impose unfair, unreasonable and discriminatory licencing terms, which have potential to damage competition. It is natural to imagine how a standard, which is adopted soon, can translate into an indispensable norm. This power of owners of such standard essential patents can easily be misused. FRAND is an exercise to check this, falling clearly within the ambit of EFD. Indeed the standards setting organisations play significant roles to encourage compliant products to work together. Standards lower costs by increasing product manufacturing volume, and they increase price competition by eliminating 'switching costs' for consumers.

The welfare comparison of non-compatible network good markets against hypothetical perfectly competitive outcomes suggests a greater total surplus (summation of consumer and producer surplus) under the former configuration but such market outcomes are also characterised by a high levels of inequality in distribution of benefits. Instead, if firms choose to be compatible with competitors or are compelled to be so through policy instruments, it turns out that the inequalities are much lower with a higher consumer surplus and a more evenly distributed producer surplus. This is a very crucial point to understand in relation to policy regarding network markets, whether the policy is in the form of regulation or competition/antitrust law.

The key to policy intervention is not to push for the traditional antitrust orientation where the encouragement of free entry ostensibly lowers prices and competition reduces profits. If this was encouraged in relation to network industries, entry may not lead to the elimination of dominant firm profits - one firm could still continue to dominate the market. Instead to improve market outcomes, the role of antitrust is to ensure and encourage compatibility across all producers so that not

only do consumers benefit but producers also share in the rewards.

In addition to this compatibility or standardisation, over the network platform is important for encouraging innovation. However, if antitrust law or a policy instrument is to perform this role, it needs to legally counter the proprietary right of producers to design their platforms and exclude others. It may be noted that adapting network theory to law is interesting for a simple reason that these very efforts are indeed difficult.¹² EFD may be useful in this context.

Infrastructure

Infrastructure is another area where EFD is/can be invoked at multiple levels. Primarily, most infrastructure goods are capital-intensive and therefore not easily replaceable. This logic is traditionally given for engaging into EFD debate for electricity, telecom, gas pipe lines, roads/bridges and other such major infrastructural works. However, academically, there are sound economic arguments that build a case for EFD.

Traditional approach to the EFD is to approach the issue from the 'supply' side. Instead if 'essentiality' were approached from the 'demand' side the doctrine ends up gaining a lot more substance, particularly in infrastructure. According to Frischmann and Waller,¹³ the demand for infrastructure is influenced by infrastructure good being (a) non-rival in consumption - the marginal cost of allowing a marginal user is zero,¹⁴ (b) driven by downstream production and is not in itself a commodity for direct consumption, and (c) an input into a wide variety of goods, private, public and non-market goods, suggesting that the social value created by its use is

¹² See pg 485 in Lemley, M. A. and McGowan, D. (1998). 'Legal Implications of Network Economic Effects', *California Law Review*, 86(3):479-611.

¹³ Frischmann, B. and Waller, S. W. (2008). 'Revitalizing Essential Facilities', *Antitrust Law Journal*, 75(1):1-65 (*Supra* n. 4)

¹⁴ This is subject to the condition that no congestion externalities emerge

substantial but also very difficult to measure.¹⁵

Thus, the social benefits derived from the downstream uses of transport, electricity (and also other goods that are characterised by the abovementioned attributes like basic research, environmental ecosystems and the internet) is best kept in a state of open access as is possible.

However, the case for open access is stronger for public or social infrastructure because measuring demand for such infrastructure is difficult due to information and appropriation problems - consumers are not willing to pay the full value of the positive externalities and to the extent that they are willing to pay, it will be an amount lower than that which will maximise social welfare. In other words even if transaction costs of measuring demand were zero, suppliers would favour existing use and applications that involve appropriable and observable benefits at the expense' of applications that generate positive externalities. Therefore, support (subsidy) for such infrastructure goods is important or it will be undersupplied. The particular conceptual insight here is that with an orientation towards open access neither the government nor the markets choose any winners, rather the open access accords benefits to all.

Thus, there may be two roles for the EFD. First, in case the infrastructure is purely commercial, the MCI test (emanating out of a case between MCI and AT&T in the US) is sufficient, so one can begin by screening to check if the issue involves infrastructure and if so, traditional legal tests provide the appropriate test. However, it must be noted that this orientation would inhibit the use of the test in relation to access to non-infrastructure assets as was the case in Aspen Skiing.

Second, if the infrastructure that additionally yields public and/or non-market goods

¹⁵ This discussion around infrastructure draws on Frischmann, B. M.(2004). 'An Economic Theory of Infrastructure and Commons Management', *Minnesota Law Review*, 89.

ultimately, the EFD should play an even greater role and allow greater access to reap the benefits of positive externalities. Thus, an infrastructure orientation would expand access, and therefore liability, to infrastructure assets, products, platforms, networks and processes that support downstream positive externalities and thus the promise of dynamic growth.

III. The Essential Facilities Doctrine - Cross-country Analysis

American Origins and Development of the Doctrine

It appears that initially as the EFD was being formed, the US Supreme Court did not invoke the doctrine by name, though three cases are conventionally mentioned as having applied the doctrine establishing case laws.¹⁶ In all these three cases the US Supreme Court said that the defendants denied access to a facility that they controlled, access to which was needed for competition and therefore violated antitrust law.

In the earliest of the judgments - *Terminal Railroad (1912)*¹⁷ the Court said that the railroad company that owned a bridge across the Mississippi (leading in and out of St Louis) must give rival companies access to the bridge on equal and non-discriminatory terms. Similarly in *Associated Press (1945)*¹⁸ the Court told a news network to open membership on non-discriminatory terms to rival newspapers. Likewise in the case of *Otter Trail (1973)*¹⁹ the Court found an antitrust violation when a regulated power company refused to transmit power from rival

companies to localities that wanted to buy cheaper power.

However the EFD was articulated explicitly for the first time by the Seventh Circuit Court's opinion in the *MCI case (1983)*.²⁰ This case was the outcome of an attempt by MCI to compete with AT&T in long distance calls at a time before AT&T was divested and had a monopoly in long distance as well as local calls. MCI had gained technical expertise in the long distance market but needed to use AT&T's local loop to complete calls, which was denied. In the resulting case the Court affirmed the liability incurred by AT&T in refusing 'to provide the necessary interconnection' which it saw as a violation of Section 2 of the Sherman Act, basing the liability on the EFD. The court listed conditions that defined the doctrine or in other words formulated a test, by stating that for the doctrine to kick in it must be shown that: (1) a monopolist controls an essential facility, (2) the facility cannot be reasonably duplicated, (3) the monopolist has denied access, and (4) it was feasible for the monopolist to share the facility.

Subsequently as the lower American courts came to engage with the doctrine, there arose an unusual case of *Aspen Skiing (1985)*.²¹ The case dealt with a situation that arose when the defendant, who owned three of four ski slopes and the plaintiff, who owned the fourth slope, and after initially selling joint tickets to customers (enabling them to ski on all four slopes), later retracted from the agreement. The court applied the test formulated in the MCI case, finding that the monopolist controlled the essential facility, that there was an inability to duplicate the facility on account of environmental restrictions, that the denial of access was

¹⁶ While the law review literature on Essential Facilities is quite extensive, some of the most pointed and detailed description of the doctrine is presented in Lao, M. (2009). 'Networks, Access and "Essential Facilities" from Terminal Railroad to Microsoft', *S.M.U. Law Review*, 62(2).

¹⁷ United States v. Terminal R.R. Ass'n of St. Louis, 224 U.S. 383 (1912)

¹⁸ Associated Press v. United States, 326 U.S. 1 (1945)

¹⁹ Otter Tail Power Co. v. United States, 410 U.S. 366 (1973)

²⁰ MCI Commc'ns Corp. v. AT&T, 708 F.2d 1081 (7th Cir.), cert. denied, 464 U.S. 891 (1983).

²¹ Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 738 F.2d 1509, 1519-22 (10th Cir. 1984), *affd on other grounds*, 472 U.S. 585, 611 (1985).

without justification and that feasibility of access was demonstrated by past practice.²²

Though on the whole courts tended to reject absurd essential facilities claims,²³ the doctrine of Essential Facilities came under a series of academic attacks and finally in 2004 the US Supreme Court expressed its own displeasure (albeit as dicta) with the doctrine in the *Trinko case*.²⁴ This case was a product of a class action suit brought against the telecom company Verizon on the grounds that the company failed to adequately share its network with rivals as required by the Telecommunication Act of 1996. The US Federal Communication Commission found Verizon in breach of the Act and fined it for not providing *inter-connect* facilities to rivals. The Supreme Court stated that non-compliance with the Telecommunication Act, 1996 was not a valid basis for antitrust liability and that the defendant did not have a general duty to deal with rivals with whom it had not dealt before.

In relation to the EFD, the Court stated that the doctrine may be present in the lower courts but it refused to recognise or rebut the doctrine. Instead it said that even if the doctrine were valid, it would be applicable only when there was no means of access and that in the case on hand, the Telecom Act already mandated access or in other words the doctrine was not applicable in a regulated industry.

The *Trinko* judgment was of course in consonance with a series of academic attacks - one particularly prominent attack by Areeda famously states that the EFD is less a doctrine than an epithet 'indicating some acceptance to the right to keep one's creations to oneself, but not telling us what these acceptations

are.'²⁵ Since the US Supreme Court disavowed previous case laws, the US Congress set up a review commission to look into the doctrine which however came up with the decision that such matters are best left to the courts.

Here it is useful to discuss the well-known work of Frischmann and Waller which has attempted to rejuvenate the EFD both by providing sound economic rationale and also by connecting it with other fields of law.²⁶ They draw up an important link between the doctrine and Intellectual Property (IP) law. As is well known, IP law is an attempt to strike a balance between open access (which promotes widespread borrowing, sharing and participation in creating ideas) and exclusion (without which innovators may abandon their efforts for fear of free riding).

It is argued that a similar tension is evident in antitrust when the EFD says that a liability is incurred by a dominant firm when it refuses access to a facility on a non-discriminatory basis, specifically in situations where sharing is feasible and competitors cannot easily make a facility of their own - marking an analogous tension between open access and exclusion.

²² The case did reach the US Supreme Court on other matters but the Court did not engage with the 'Essential Facilities' aspect of the case

²³ A list of such dismissed cases can be found in Lao (2009), *op. cit*

²⁴ *Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 410-11 (2004)

²⁵ Areeda, P. (1989). 'Essential Facilities: An Epithet in Need of Limiting Principles', *Antitrust Law Journal*, 58(3):841-853. In addition to this much quoted attack on the doctrine, others who have written against the doctrine include: Boudin, M. (1986). 'Antitrust Doctrine and the Sway of Metaphor', *Georgia Law Journal*, 75:397-403; Werden, G. J. (1987). 'The Law and Economics of the Essential Facility Doctrine', *Saint Louis University Law Journal*, 32; Hylton, K. N. (1991). 'Economic Rents and Essential Facilities', *BYU Law Review*; Gilbert, R. J. and Shapiro, C. (1996). 'An Economic Analysis of Unilateral Refusals to Licence Intellectual Property', *Proceedings of the National Academy of Sciences*, 93; Mc-Gowan, D. (1996). 'Regulating Competition in the Information Age: Computer Software as an Essential Facility Under the Sherman Act', *Hastings Comm. and Ent. Law Journal*, 18; and Lipsky, A. B. and Sidak, G. J. (1999). 'Essential Facilities', *Stanford Law Review*, 51.

²⁶ Frischmann and Waller (2008), *op. cit*.

To achieve the right balance Frischmann and Waller go on to interpret the 'public interest' principle of Anglo-Saxon law as being tantamount to access to assets understood as infrastructure. In these goods, they argue, an orientation towards open access generates significant positive externalities and any move to further the 'internalisation' of the externalities by pushing for regimes of maintaining strong property rights are inefficient.

In other words supporting regimes oriented towards open access to infrastructural resources support society's economic interest in wealth maximisation and allocative efficiency. Thus, it is argued that if there is a refusal to grant access to infrastructure, which is manifestly a move to acquire or maintain a monopoly position, antitrust liability should ensue.

It is worth mentioning that interoperability in network goods has had its impact on EFD jurisprudence in the US. In the final settlement worked out under the supervision of the courts in Microsoft case, Microsoft was required to licence interoperability information to producers of non-Microsoft servers - this was clearly a reasoned move to encourage 'open access' with the hope that it would encourage continuing innovation.²⁷

IV. The Essential Facilities Doctrine in Other Jurisdictions²⁸

Europe

The European Union recognises essential facilities as a principle associated with the abuse of dominant position (Article 82 of the Treaty of Rome), so much so that recent European guidelines on abuse of dominance

²⁷ A detailed account of the Microsoft case can be found in Lao (2009), *op. cit.*

²⁸ Some of the following discussion draws from Waller, S. W. and Tasch, W. (2010). 'Harmonizing Essential Facilities and Refusals to Deal', *Antitrust Law Journal*, 76(3); and Lao (2009), *op. cit.*

consciously endorse the doctrine.²⁹ However, until 1998, the ECJ had not formally granted constraint force to EFD. In the last 15 years the European economies have been largely affected by regulatory reforms aiming for introducing competition in markets where the existence of essential facilities constitutes a hard barrier to entry in natural monopoly industries such as telecommunications, electricity, gas, railways, and the postal sector, etc.

The first case in Europe (European Union) was the *Commercial Solvents Corp v. Commission of the European Communities* to apply the principle.³⁰ This 1974 judgment said that a dominant supplier of an input abused its dominant position when it refused to supply the input to a customer, the supplier's competitor in the downstream derivative market, 'with the object of reserving such raw materials for manufacturing its own derivatives, and therefore risks eliminating all Competition' from that competitor. Over time, among other things, the European Commission has imposed liabilities on owners of ports, harbours, tunnels etc. who prevented downstream competition through their control of the infrastructure.³¹

²⁹ For instance the guidelines state "The Commission will consider these practices as an enforcement priority if all the following circumstances are present: the refusal relates to a product or service that is objectively necessary to be able to compete effectively on a downstream market; the refusal is likely to lead to the elimination of effective competition on the downstream market; and the refusal is likely to

lead to consumer harm. Communication from the Commission (2008): Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Treatment by Dominant Undertakings"

³⁰ Joined Cases 6/73 & 7/73, *Commercial Solvents v. Commission*, 1974 E.C.R. 223.

³¹ See, Case IV/34.174, *B&I Line PLC v. Sealink Harbours Ltd. & Sealink Stena Ltd.*, 5 C.M.L.R. 255 (1992); Commission Decision (EC) No. 94/19, *Sea Containers v. Stena Sealink*, 1994 O.J. (L 15) 8; Commission Decision (EC) No. 94/119, *Port of*

The European Union has also introduced the notion of 'exceptional circumstances' to counter the privileges of intellectual property rights (IPRs) when such rights are perceived to counter competition. One of the early cases in this regard was *Volvo v. Veng*³² where it was held that the dominant firm's refusal to grant a licence of its 'protected design' for car body panels, standing alone, could not constitute abuse of dominant position, since the right to exclude 'constitutes the very subject-matter of [the IP holder's] exclusive right' under Intellectual Property law. However in this case it was also held that such a refusal could be considered abusive in limited situations, including an 'arbitrary refusal to supply spare parts to independent repairers'. The notion that a higher standard must be met before a dominant firm can be compelled to licence its IPRs was more clearly expressed in *Magill*³³ and *IMS Health*.³⁴ In these two cases, the courts held that 'exceptional circumstances' must exist for any refusal to licence IPRs to be countered.

The exceptional circumstances requirement was translated into a three- part test: (1) the refusal prevented the emergence of a 'new product', which the dominant firm did not offer and for which there was potential consumer demand; (2) the refusal allowed the dominant firm to reserve for itself 'the secondary market ... by excluding all competition on that market'; and (3) the refusal was unjustified. *IMS Health* further clarified that the conditions must be cumulative for 'exceptional circumstances' to be found.

Subsequently such arguments were used to require open access to information for interconnecting with the dominant Microsoft networks. While the European Commission

Rodby, 1994 O.J. (L 55) 52; Commission Decision (EC)No. 354/66, Eurotunnel, 1994 O.J (L 354) 66

³² Case 238/87, *AB Volvo v. Veng*, 1988 E.C.R. 6211

³³ Case C-241/91, *Radio Telefis Eireann (RTE) v. Commission*, 1995 E.C.R. 1-743, 4 C.M.L.R. 718 (1995).

³⁴ Case C-418101, *IMS Health GmbH & Co. v. NDC Health GmbH & Co.*, 2004 E.C.R. 1-5039

has been developing the essential facilities doctrine in this manner, it has also notably not extended open access in cases where firms can create their own facility either on their own or in cooperation with other producers.³⁵ It can thus be maintained that overall the European Union has applied the EFD requiring access to infrastructure largely for instances where there are significant downstream externalities.

Australia

Australia is an example of countries that have institutionalised explicitly the EFD by using the route of mandated regulation rather than through the interpretation of competition law or regulatory laws.³⁶ This was a result of *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd*.³⁷ The defendant *Broken Hill Party* (producer of 97 percent of Australia's steel output) manufactured Y-bar steel which it sold exclusively to its subsidiary *Australian Wire Industries*. In turn *Australian Wire Industries* produced fence posts out of the raw material and sold them. The plaintiff *Queensland Wire Industries* sought steel from *Broken Hill Party* to competitively produce fence posts for the rural market but the prices charged were so high that the plaintiff moved the courts with the plea that this amounted to a 'refusal to sell'. However the judiciary was not convinced about this being conduct that

³⁵ For instance see Case C-7/97, *Oscar Bronner GmbH & Co. v. Mediaprint Zeitungs*, 1998 E.C.R. I-7791, 4 C.M.L.R. 112 (1999). This case, of course, importantly restricts the scope of the essential facilities doctrine by requiring that apart from the owner of the facility being a dominant firm, the facility be indispensable for the doctrine to kick in. However the point also to be noted is that the case in particular demands that a test be performed to see whether the refusal to deal will lead to a monopolisation of the downstream market. See Day, J. (2003). 'Essential Facilities in the European Union: Bronner and Beyond', *Columbia Journal of European Law*, 10.

³⁶ The Australia discussion draws on Marshall (2004).

³⁷ [1987] ATPR 40-180 (Federal Court); [1988] ATPR 40-841 (Full Federal Court); (1989) 167 CLR 177 (High Court).

misused market power and more importantly went on to categorically state that the EFD is not accommodated by the terms of Section 46 (both High Court and Full Federal Court declined to accept EFD).³⁸

Important fallout of this was that the Australian government formed the *Independent Committee of Inquiry into Competition Policy in Australia* which brought out the Hilmer Report that recommended a legislative regime to facilitate third party access to 'essential facilities'. Given the judicial pronouncement on the relation between Section 46 of Trade Practices Act 1974 and Essential Facilities, the Hilmer Report (in contrast to other jurisdictions such as the US and EU) felt that access issues and disputes were better resolved with an administrative solution rather than by relying on a judicial mechanism.

In tandem with the Report, Part IIIA of the Trade Practices Act 1974 (Cth) was incorporated in the existing Australian competition law to create a national access regime. This regime attempts to balance the interest of both the suppliers as well as the purchasers and firms with natural monopolies that are vertically integrated are liable to provide access. The access regime provides for commercial negotiations of terms and conditions. When they fail, then arbitration is sought from Australian Competition and Consumer Commission.

Thus, it is evident that Australia follows a national access regime whereby access requirements are limited to the natural monopolies and the whole process is governed by an administrative rather than the judicial process. Indeed the doctrine has been pronounced variously - judicially and/or required administratively, in various parts of the world, including New Zealand, Canada,

South Africa, Israel, Japan, Turkey, Russia and even Guatemala.³⁹

V. Essential Facilities Doctrine and India

The Presence/Application of the Essential Facilities Doctrine in India

The presence of the EFD in India is intimately linked with infrastructure provision (in addition to Indian Patents Act's compulsory licencing regime), albeit not as a doctrine upheld by Indian courts but rather in the regulatory statutes associated with certain infrastructure goods, in particular in the Telecom Regulatory Authority of India (TRAI) Act, 1997, the Electricity Act, 2003 and the Petroleum and Natural Gas Regulatory Board (PNGRB) Act, 2006.

Distinguishing Regulation and Competition Law Since regulation is very important in relation to the EFD in the Indian context and as of yet there is no competition law case where this doctrine has been invoked, as a first step it is important to clarify the relationship between competition law and infrastructure regulation. This relationship can be understood by recognising the contrast of an *ex-post* intervention of competition authority as against an *ex-ante* intervention by regulators.⁴⁰

The former seeks to 'repair' markets by imposing liability whereas the latter intervention type of a regulator aims to 'build' markets. It is this *ex post* role which is very important in the case for India where in network- infrastructure sectors, pre-liberalisation monopolists own networks of transmission and any new entrant cannot easily replicate such a system and secure a reasonable return to investment. Once a regulator has established a competitive market the regulatory institution should disappear and the erstwhile regulated

³⁸ Section 46 of the Trade Practices Act, 1974 was invoked in this case because it prohibits taking advantage of the degree of power for the purpose of eliminating or damaging a competitor, preventing the entry of a person into a market or deterring or preventing a person from engaging in competitive conduct in a market.

³⁹ See Waller and Tasch (2010), *op. cit.*

⁴⁰ Frison-Roche, Marie-Anne (2011). 'Regulation versus Competition', *The Journal of Regulation*, 1-1.30:550-560.

industry should be subject to competition law for any anti-competitive behavioural issues.

This point is hard to specify but before discussions thereon, it would be worthwhile to first describe the various regulatory provisions wherein the pattern of essential facility provision have been enabled by the Indian regulatory regime.

Telecom

Before liberalisation, this sector was largely owned by the government. However, reforms in this sector moved progressively by first opening some value added services (like email to private players) and then moving on to the formation of the National Telecom Policy in 1994 whereby, private participation was encouraged in paging and cellular mobile telephone services, etc. Soon, in 1997, the first regulatory body in the country TRAI was formed.⁴¹

Consequently, to encourage further private investment in the sector, interconnect issue was delegated to the regulator. In the TRAI Act, 1997 essential facilities concerns are dealt by the provisions dealing with interconnection. As has been emphasised earlier, it is important to join interoperable systems such as linking of two or more communication units, systems, networks, links, nodes, etc. because this enhances competition and maximises benefits for consumers.

Under Section 11(1) (c) and Section 11(1) (l) of the Act, it is the duty of the regulatory authority to ensure interconnection and technical compatibility between various service providers and maintain a register of such agreements. For this purpose, TRAI enacted the *Telecommunication (Broadcasting and Cable Services) Interconnection Regulation, 2004* which enumerates the arrangements that guide the interconnection and revenue share among service providers.⁴² Further, TRAI has also

⁴¹ Malik, P. (2010). 'Evolution of Interconnection Regime in India', Linne Asia Working Paper.

⁴² Section 3(2) of the Act asserts that 'Every broadcaster shall provide on request signals of its

enacted *The Telecommunication Interconnection (Reference Interconnect Offer) Regulation, 2002* under which the terms and conditions on which interconnection of its network with that of other service providers seeking interconnection are specified.

The interconnect requirement for each of the service providers is met by enabling access to incumbent's subscribers. As per international regulatory practice, interconnection is provided to new service providers at a price which is determined through a cost based approach. However, in India the amount to be paid by the new operator was stated in the licence agreement itself. This pre-empted the delay that would have been caused by perpetual negotiations to arrive at a mutually agreeable price. The downside was that there was no known basis for the price in the agreement and it was often confused with user charges or inter-operator tariffs.⁴³

The vague price mechanism became an instrument for the incumbents to deter new entrants. TRAI took note of this and passed a *Telecommunication Tariff Order in March, 1999* and a regulation on *Interconnection Charges and Revenue Sharing in the May, 1999* according to which mutual bargaining was permitted and if both the parties failed to reach an agreement, then intervention would be done by the Authority. Even though, Department of Telecom sued TRAI for possessing overreaching powers and won the case,⁴⁴ in 2000 an amendment ordinance restored TRAI's power to regulate tariffs and arbitrate interconnect issues.

Subsequently, the *Telecommunication Interconnection Usage Charges (IUC) Regulation, 2003* was passed under which cost based approach for interconnection charges using audited cost for the operators

TV channels on non-discriminatory terms to all distributors of TV channels...'

⁴³ Uppal, M., Nair, S.K.N. and Rao, C.S. (2006). 'India's Telecom Reform: A Chronological Account', IIPA Working Paper

⁴⁴ Gupta, S. (2007). 'Competition Policy in Telecommunications in India', CCI paper

instead of a complicated cost model and a regular consultation with stakeholders to preserve coherence in the interconnection regime was followed. This success of the interconnect regime engineered by the telecom regulator is reflected in the growth of the sector as well. The number of subscribers has increased to 764.77 million in 2010 from merely 76.54 million in 2004.⁴⁵ Private sector participation which was 5 percent in 1999 has increased to 84.5 percent in 2010.⁴⁶ Growth rate of rural telephones has also increased from 16 in 2004 to 32.81 percent in 2010 of which 84.5 percent of telephone connections are provided by the private operators.⁴⁷

Natural Gas

The gas transmission grid in India was initially restricted to western, central, northern and north-east regions owing to lack of customer base for natural gas coupled with short supply. Moreover, lack of private participation deterred the expansion of gas network at the national level. Gas Authority of India Limited (GAIL) owned 70 percent of the market share with other companies like Gujarat State Petronet Limited and Oil India/Assam Gas Company concentrating on regional consumer base.⁴⁸ To this effect, in order to liberalise the sector, the New Exploration Policy was introduced in 1999 whereby, mandatory state participation in exploration and production was withdrawn and international competitive bidding was allowed.

Subsequently, the *Petroleum and Natural Gas Regulatory Board Act (PNGRB), 2006 Act* was formulated. In this Act, the idea of essential facilities is evident in the definition of 'common carrier' i.e. under Section 2(j) there is non-discriminatory open access given by the Board from time to time to pipelines for transportation of petroleum and petroleum products. Correspondingly, Section 2(m)

defines 'contract carrier' as "such pipelines for transportation of petroleum, petroleum products and natural gas by more than one entity pursuant to firm contracts for at least one year as may be declared by the Board from time to time." Further, the board can regulate the open access and transportation rate under Section 61(e).

To boost competition in the sector, in October, 2008, the Ministry of Petroleum and Natural Gas issued a draft regulation encouraging sharing of infrastructure. According to the draft, once an infrastructure is declared common user facility, it is compulsory for the body owning the capacity to share it with the other users. The first right to use remains with the controlling entity and it is the remnant spare capacity which will be utilised by other entities. This encouraged private players to participate in the network and led to explorations off the East coast and development of new Liquefied Natural Gas terminals like Dabhol and Kochi.⁴⁹

Moreover, private companies like, Reliance Gas Transportation Infrastructure Limited constructed a 1,385 km long East-West pipeline which is second largest in the country. In 2010, India's gas transmission grid stood to 11,148 km with 273.8 mmscmd capacity, which is truly remarkable.⁵⁰

Indeed as a result of such regulations, the natural gas industry has expanded over time and solicited considerable levels of investment. The natural gas production increased from 32.2 to 47.5 billion cubic meters from 2005-06 to 2009-10.

Electricity

The passage of the *Electricity Act, 2003* governed the entry of private players into a sector previously dominated by the public sector. The Electricity Act, 2003 expresses

⁴⁵ Economic Survey (2010-11), Government of India.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ Credit Analysis and Research Ltd., Press Release - Indian Gas Transmission Business

⁴⁹ Bhattacharyya, D. and Singh, D. (2010). India, *The International Comparative Legal Guide to: Gas Regulation 2010*, Global Legal Group: UK.

⁵⁰ Credit Analysis and Research Ltd., Press Release- Indian Gas Transmission Business.

certain dimensions of EFD which can be observed in the way it defines 'open access' [stated under Section 47(2) of the Act]. In relation to electricity, open access implies non-discriminatory provision of distribution or transmission to any licensee, consumer or a person engaged in generation in accordance with the regulations specified by the Appropriate Commission.

The Act provides open access to a person to carry electricity from his captive generating plant to the destination of his use subject to availability of adequate transmission facility as determined by Central or State transmission utility under Section 9(2). The Government of India has recently proposed that open access will be applicable to power demands of beyond one MW and that regulatory commissions need not interfere with the tariffs because the same would be settled between the supplier and the consumer.⁵¹ The matter is yet to be settled due to inter-ministerial consultations.

Further, the Act under Section 38(2)(d) directs the Central Transmission Utility to provide non-discriminatory access of transmission to the licence or generating company on payment of transmission charges and to any consumer when open access is provided by State Commission. A similar provision is made for the State Transmission Utility and Transmission Licence under Section 39(2) (d) and 40(2) (d) respectively.

Likewise, open access is highlighted for distribution as well under Section 42(2) whereby '[t]he State Commission shall introduce open access in such phases and subject to such conditions, (including the cross subsidies, and other operational constraints) as may be specified within one year of the appointed date by it and in specifying the extent of open access in successive phases and in determining the charges for wheeling, it shall have due regard to all relevant factors including such cross subsidies, and other operational constraints.'

⁵¹ www.biharprabha.com/2012/01/govt-bent-to-allow-open-access-to-all-power-consumers-above-1-mw/

Thus, the legislation incorporates the basic idea of essential facility to encourage generation, transmission and distribution of electricity efficiently.

However unlike the other sectors the mandated open access has not translated into the kind of robust position we see in telecom or even natural gas. The Act encourages open access in transmission and distribution, presumably in order to introduce competition in the sector. It does so with the belief that if charges are paid to the utility that owns the infrastructure, multiple players will get access to the existing capacity which in turn will imply efficient use of existing infrastructure and thus alleviate power shortages.⁵² Consequently, the competitive market so created would ensure lower costs to consumers.

However, bringing down the cost paid by consumers involves a series of measures including the minimisation of transmission and distribution losses, decreasing operating costs alongside maintaining low cost for additional power purchasing. In actuality, on the one hand, the cost of purchasing power has actually been increasing and on the other hand, the High Tension (HT) tariff has been lowered to cover average cost, leaving only a nominal margin, if any. Naturally therefore, utilities suffer a financial loss as there has been overdependence (over burden) on HT consumers to cover the losses.⁵³ If the HT tariff were raised this would deter commercial and industrial consumers from purchasing electricity from open access sources resulting in significant financial liability on the government in terms of providing subsidies to agricultural and domestic consumers.

Moreover, as electricity sector has limited grids, open access surges cause congestion in transmission lines leading to interrupted

⁵² Electricity India.com:
www.electricityindia.com/powertrading.html

⁵³ Power Today:
www.powertoday.in/News.aspx?nId=icLQ70X98I4HbklCdQGdPQ==

power supply.⁵⁴ Hence, the problems present within these networks have to be dealt with to bring out an effective mechanism for development of the sector. Unlike the telecom sector the regulation of prices has not provided a regime of easy 'interconnect'.

VI. Compulsory Licence under Patents Act, 1970

The concept of the EFD doctrine can be inferred in the Indian Patents Act as inherent, among other provisions, in the compulsory licence provision in Section 84(1)(a) read with relevant clauses of Section 84(7). A plain reading of the following texts of the said provisions establishes this point.

Section 84. Compulsory Licences - (1) *At any time after the expiration of three years from the date of the grant of a patent, any person interested may make an application to the Controller for grant of compulsory licence on patent on any of the following grounds, namely:-*

(a) that the reasonable requirements of the public with respect to the patented invention have not been satisfied, or ...

(7) For the purpose of this Chapter, the reasonable requirements of the public shall be deemed not to have been satisfied -

(a) if, by reason of the refusal of the patentee to grant licence or licences on reasonable terms, -

(i) an existing trade or industry or the development thereof or the establishment of any new trade or industry in India ... is prejudiced; or

(ii); or (iii); or

(iv) the establishment or development of commercial activities in India is prejudiced; or

(b) if, by reason of conditions imposed by the patentee upon the grant of licences under the patent... the manufacture, use or sale of materials not protected by the patent, or the

establishment or development of any trade or industry in India, is prejudiced; or

In general, the message is that if "refusal to deal" by the patent holder is 'trade restrictive' or amounts to 'entry barrier', particularly (but not only) with respect to goods not protected by the patent, then it can be a ground for compulsory licence. This goes with the basic facets of the EFD.

The Role of Competition Commission

Divergent examples above show that while such mandated presence of the EFD can be introduced into the regulations of select industries, it is not an easily replicable exercise. The *ex-post* regulation under the competition law is needed not only as markets mature but as potential new market develop. No case associated with the EFD has come before the antitrust authority in India as yet.⁵⁵ However, it is our understanding that the *Competition Act, 2002* has sufficient structure for the judiciary to invoke the EFD if it needs to do so. Of course the doctrine is not mentioned in the Act, but like the European legislation (that appears to have inspired the Indian law), the Act has clauses that prohibit

⁵⁵ Something akin to the EFD has been noted by the Supreme Court, albeit not in the context of antimonopoly law but the duty of private bodies performing public functions. In the case of *VST Industries Limited v. VST Industries Workers' Union and Anr.* It was held "it is noticed that not all the activities of the private bodies are subject to private law, e.g., the activities by private bodies may be governed by the standards of public when its decisions are subject to duties conferred by statute or when by virtue of the function it is performing or possible its dominant position in the market, it is under an implied duty to act in the public interest (emphasis added)...." Further, the court asserted that any private company in India that is controlling infrastructure facility through concession agreement as awarded by the government will be considered as performing a public function and thus is expected to act in public interest. If the company refuses to deal with any competitor then it would be under judicial scrutiny for performing an arbitrary action of a body discharging public functions. (2001) 1 SCC 298.

⁵⁴ Rajamani, G.S. (2004). 'Power Trading: Open Access key to Success', The Hindu media update

the abuse of a dominant position - Section 4(c) asserts that denial of market access to others by a dominant player would be an abuse of dominant position.

In addition, under Section 18 and 19, it is the duty of the Commission to abolish practices that have adverse effect on competition. Specifically, sections 19(3) and 19(4) deal with determining factors that restrict emergence of competition viz. creation of barriers to new entrants, driving existing competitors out of market, etc. and criterion to ascertain the dominant position through market share of the firm, size and importance of competitors, etc. is also specified. One important suggestion however, is to recognise that the Competition Commission can take cognisance of Section 18 along with section 64(1) to formulate a regulation to provide free access to common facilities under the EFD. Given this scope it is up to the judiciary to invoke the doctrine in a case where it needs to be aptly invoked to enhance downstream spill-over which enhances social welfare.

VII. Conclusion

It has been pointed out here that there is a good case (welfare enhancing) to be made for a policy that ensures compatibility or interoperability across the links that form the complementary composite of a 'network good', infrastructure good/service and pharmaceutical patents. The problem with any such policy is that it has to balance incentives to innovate or invest against access to the good/service. In this context, the EFD imposes a legal antitrust/antimonopoly liability on monopolistic/dominant firms to share facilities that may be difficult for rivals to duplicate easily. It has been suggested that such liability is particularly important if the good in question acts as an infrastructural input into a series of downstream products and has a public interest and not-so-easily-replaceable characteristic.

It has also been noted that the doctrine has been put into effect across various jurisdictions all over the world either as an expression of the antimonopoly law or through administrative means using provisions of industry-specific regulation. In

India, the doctrine is addressed by incorporating it into laws governing key infrastructure sectors such as telecom, gas and electricity where interconnectivity across nodes of a network. The concept of EFD can also be read into the Patents Act, 1970, which can apply to any sector.

Notwithstanding relative successes and failures of such interventions, as the Indian economy grows and matures it is inevitable that for wider and more complete encouragement of competition, the EFD will need to flow in from the Competition Commission and competition law which is adequately structured to uphold the doctrine.

In addition if we look at the issue of compulsory licencing from the lens of EFD, there is a need to bring the matters to the table of competition law. It is then for both the competition authority and the courts to balance the economic and competitive interests of the parties involved, in the light of the public interest in opening up the market to competition.

ABOUT CIRC

CUTS Institute for Regulation and Competition (CIRC) was established in 2008 by CUTS International (www.cuts-international.org). With the mission to *be a Centre of Excellence on Regulatory and Competition Issues*, CIRC primarily focuses on economic regulation in infrastructure sectors, and competition policy and law with an objective of reaching out to the target audience in India and other developing countries in Asia and Africa. Its crucial role in research and capacity building in the area of competition policy and law and regulatory reforms has created an intellectual knowledge base. This rich experience of working on regulatory issues and competition policy and law has resulted in many national and international publications which has enriched a more informed discourse on public policies and greatly benefited different stakeholders in the society. Since its inception, CIRC has been undertaking several trainings, seminars and public lectures on competition policy and law in India and abroad. It also organises international symposia on the political economy of competition and regulation in the developing world and India.

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CUTS Institute for Regulation and Competition

R 75, First Floor, Greater Kailash I

New Delhi 110048, INDIA

Tel: +91 11 26463021/22/23, Fax: +91 11 40535921

Email: circ@circ.in, Web: www.circ.in