

## Regulatory Ambiguity and the Indian Economy

On August 8, 2018, the Competition Commission of India (CCI) cleared the acquisition of Flipkart by Walmart. The government touted it as a large Foreign Direct Investment (FDI) in to India and everyone was euphoric. Walmart – the biggest bricks and mortar retailer was in India with a bang.

But, foreign retail is a restricted area for FDI in India, so what is Walmart here to do? Well that's where the 'jugaad' of Indian regulations come in to play. Flipkart is not a retailer, but a 'market place' and FDI is permitted in that sector. In fact, the CCI noted that the FDI Policy restricts the parties from engaging in business to consumer sales and thus, they are not engaged in the said segment. However, there is no restraint on the parties to offer an online marketplace platform to facilitate sales between retailers and consumers.

At the same time, the plight of retail industry on account of the online juggernaut was apparent to all. The Confederation of All India Traders made a vehement submission opposing the acquisition before the CCI. Whether organized or unorganized retailers – they were all affected by online retail. Indeed, in any other jurisdiction in the world, any competition analysis would have taken in to account the entire competitive landscape – online market place and bricks and mortar, as one clearly impacts the other.

Unfortunately, in the maze of the regulatory framework in India on retail the CCI side stepped the issue, while approving the Walmart acquisition of Flipkart. While the market was analysed for its horizontal and vertical impact, the CCI observed:

*“During the inquiry into the matter, the Commission received representations against the Proposed Combination from trade associations, traders/retailers, etc., which besides expressing concerns on compliance of FDI norms by Flipkart; ‘predatory’ practices and preferential treatment to specified sellers in Flipkart’s online marketplaces; also expressed concerns on the impact of the Proposed Combination on employment, entrepreneurship, small and medium scale enterprises, retailing, etc. . .*

*The Commission notes that majority of the concerns expressed in the representations referred above have no nexus to the competition dimension of the Proposed Combination. Issues falling beyond the scope of the Act cannot be a subject matter of examination by the Commission, though they may merit policy intervention. . .*

*The limited concerns in the representations that may merit examination from competition perspective were deep discounting and preferential treatment to select e-tailers in online marketplaces of Flipkart.*

*In this context, Walmart was asked to furnish detailed information on the said aspects to gauge whether the Proposed Combination would have nexus to any of the said concerns. Upon examination of the relevant facts, it was found that a small number of sellers in Flipkart's online marketplaces contributed to substantial sales. Almost all of these were customers of Flipkart in B2B segment, and hence were common customers, availing significant discounts from Flipkart in both B2B segment as well as in the online marketplaces. Further, the revenue earned from these common customers in the online marketplaces was relatively less vis-à-vis the non-common sellers whose sales on the platform was considerably low. . .*

*While the above factors may merit examination from the perspective of anticompetitive vertical restraints under the Act, the same to be a subject matter of regulation under Section 6 of the Act has to be a consequence of the Proposed Combination. Competition assessment of a combination involves analysis of two counterfactual market scenarios i.e. with and without the combination. The Commission considers the relevant factors mentioned under Section 20(4) of the Act, which, inter alia, includes market share of the parties to the combination, entry barriers, extent of vertical integration and the economic strength of the parties, and determines the effect of the Proposed Combination on competition in the relevant markets. In doing so, the endeavour is to address potential adverse implications resulting from the combination but not to address pre-existing conditions that are not attributable to the proposed combination or problems in the markets. . .*

*Based on the facts on record, the Commission observes that the discounting practice of Flipkart and its preference, if any, to select e-tailers in its online marketplaces are not specific to the Proposed Combination, as they are already prevalent in the market even without the proposed acquisition by Walmart. In other words, the issues about common customers of Flipkart are not directly or indirectly related to the Proposed Combination and thus, the same is not likely to alter the competition dynamics as it exists today. . . The Commission deliberated extensively on the concerns raised in the representations but concluded that the instrument of Regulation of Combinations cannot address these and different policy and legal instruments maybe taken recourse to. . .*

*[T]he Commission is of the opinion that the Proposed Combination is not likely to have an appreciable adverse effect on competition in India and therefore, the same is hereby approved in terms of Section 31(1) of the Act."*

Based on the rationale above, the CCI concluded that the problems in the retail industry (if any) were not caused or likely to be caused by the proposed combination, and that was a policy issue, not within the purview of the CCI.

What is of concern to observers in this space is that the analysis of the vertical market was dealt with cursorily and the quick conclusion was that the impact, if any, pre-dated the proposed combination. The dust had seemingly settled, and bricks and mortar retailers remained under severe competitive pressure from online retailers.

On 26 December 26, 2018, the Department of Industrial Policy and Promotion (DIPP) amended the FDI Policy by issuing Press Note 2 of 2018 which made significant changes to the rules applicable to e-commerce entities with FDI,

which, to a great extent address some of the concerns raised by trade associations. The changes can broadly be divided into two buckets – the first, which deal with ensuring that the e-commerce marketplace is a level playing field for all sellers and the second, which seek to clarify the position of sellers that have equity participation from entities operating the e-commerce marketplace (including their group companies).

### **Sellers with ‘equity participation’ prohibited on e-commerce platform**

One of the most significant changes has been the addition of the stipulation that any seller shall not be permitted to sell its products on an e-commerce marketplace if:

- (i) the entity that runs such e-commerce marketplace (*E-Commerce Entity*) or its group companies have an “equity participation” in such seller; or
- (ii) the E-Commerce Entity or its group companies have control over the inventory of such seller.

### **25% sourcing cap on sellers**

The Press Note clarifies that an E-commerce Entity shall be deemed to control the inventory of a seller if more than 25% of the purchases of such seller are from the E-Commerce Entity or its group companies, which would render the seller being ineligible to sell products on the e-commerce marketplace.

An unintended consequence of this rule could be that an Indian seller (which could even be a proprietorship concern) would not be able to source its products freely and necessarily has to diversify its procurement from other channels. This may also place significant compliance burden for E-Commerce Entities to ensure compliance by sellers on their e-commerce marketplace.

### **No exclusivity; E-Commerce Entities to ensure level playing field for all sellers**

The Press Note stipulates that an E-commerce Entity cannot require any seller to sell its products exclusively on its E-Commerce Marketplace and that E-commerce Entity or any entity in which the E-commerce Entity has “direct or indirect equity participation” or is under common control, provides any services (including logistics, warehousing, payments etc.), such services should be provided to all sellers in a fair and non-discriminatory manner.

In spirit, an E-commerce Entity should endeavour to run the E-Commerce Marketplace as a ‘level playing field’ by not favouring any particular sellers and undertaking transactions on an arm’s length basis.

The question that begs consideration is why must the regulatory regime in India be so convoluted? Does a competition regulator need to abdicate space to the sectoral regulator (not according to the Competition Act). Is the DIPP a sectoral

regulator or a policy maker? Assuming the original policy was faulty and had inadvertent consequences, was the competition regulator correct in leaving the analysis on the vertical overlap by saying it is a policy matter, and not for them?

Multiplicity of regulators and ambiguous drafting make it an economy rife with uncertainty. Investments are spooked and enterprises operating in this market lurch from clarification to clarification. Part of this can be blamed on opportunistic politics where the parties in opposition oppose issues for the sake of opposition and when in power, seek to implement just those policies through a web of ambiguous policy announcements and vague regulations. Part of it needs to be borne by regulators who abdicate their domain.

Ostensibly the DIPP clarification was a policy matter, but squarely addresses the competitive concerns raised by brick and mortar retailers for the longest time. When they were put up to the CCI, in the context of the largest merger in the space, it was deemed to be outside the 'domain' of the CCI.

Why is a regulator set up for competition unable to examine the factual situation on the ground? The fact is that retailers were affected on the ground, and even if it were caused by policy, it is squarely a competition issue. It is not as though one wants an overzealous regulator, but regulatory space ought not to be abdicated to policy.

Globally competition policy and the government of the day work in tandem. When the Flipkart-Walmart deal was sanctioned so readily by the CCI one theory was that it was government policy to attract FDI. If that was indeed true, this restrictive notification less than five months later must worry us all. Did the policy change suddenly?

A large multinational looking at scaling up India said that the uncertain regulations in India were the number one cause for concern to their global board. Unfortunately, it is becoming harder to counter this perception.