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Essential Facilities Doctrine

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Introduction

Essential Facilities Doctrine (EFD) (or third party access) is a framework in competition policy whereby a dominant firm cannot refuse to grant access to an essential facility (that is difficult to replicate), which it controls, to other firms. More often, 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 are based on the proviso that a dominant firm and its competitors have had a previous business relationship. EFD cases arise where there may not be such a business relationship already and therefore such cases are viewed as involving a structural problem in the market.

For a facility to be considered essential, one needs to invoke whether: (a) access to the necessary facility essential to compete, (b) there is sufficient capacity available to provide access, (c) owner is failing to satisfy an existing market demand or is impeding competition in the market, and (d) the company demanding access is ready to pay a reasonable access fee.

Why do we need EFD?

Network Goods

Network goods are those goods whose value or utility to the consumer depends on the number of other consumers using the particular good. A good example of a network good is cell phone network. The greater the number of people using that network, the more utility or satisfaction a consumer can derive from using it (since he can access more people on the network).

When we look at network goods from the demand side, we see that these goods tend to have increasing returns to scale in consumption. The complementarity of these goods 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.[i] From the supply side, the inherent composite and complementary nature of these goods makes *compatibility* or *interoperability* across networks a crucial constituent of competition in network goods.

Think about for example, the European Court of Justice (ECJ) ruling of 2004 against Microsoft, which bundled Windows Media Player with every version of windows and its refused to disclose interoperability information.

In another case, Samsung lost when a Dutch court declared it could not win an

injunction against Apple products based on standards essential, FRAND committed patents [Fair, reasonable and non-discriminatory (FRAND) terms are licensing terms used in EU (RAND in US)].

Pharmaceutical Industry and Access to Medicines

Pharmaceutical products – owing to their essential nature – naturally mandate EFD implementation. For instance, the 2005 amendment brought India's patent laws in line with the Trade Related Aspects of Intellectual Property Rights (TRIPs) framework and promoted a product patent regime, which undermined the generic pharmaceutical industry of India. India, which suffers from one of the world's worst public health and access-to-medicines issues due to poverty, has therefore found ways to make sure that medicines are available at a relatively cheap price using various measures.

Very recently, India has invoked the compulsory licensing doctrine against Bayer, and granted the license to Natco. It is pertinent to mention that the Controller found that following three criteria (as mentioned in Section 84 of the Indian Patent Act 2005) were satisfied in this case, namely, (a) since Bayer supplied the drug to only two percent of the patient population, the reasonable requirements of the public with respect to the patented drug (Nexavar) were not met, (b) Bayer's pricing of the drug (2.8 lakhs for a month's supply of the drug) was excessive and did not constitute a "reasonably affordable" price, and (c) Bayer did not sufficiently "work" the patent in India.

India is not the only country. Thailand, Malaysia and Indonesia are other Asian countries that have also granted compulsory licensing two AIDS drugs.

Infrastructure

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.

Infrastructure good, usually, is: (a) non-rival in consumption – the marginal cost of allowing additional user is zero, (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 substantial but also very difficult to measure. This builds a strong case for EFD.

So whenever infrastructure aids to positive externality (which is usually true) thereby yielding public and/or non-market goods, EFD should play a pivotal role. 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 (*see next section for the test)*. Although, the applicability of the test is inhibited relation to access to non-infrastructure assets as was the case in Aspen Skiing.[ii]

The Essential Facilities Doctrine – Cross-country Analysis

US

Though hardly invoked by its name, EFD is applied very frequently in US, where the US Supreme Court held that the defendants had denied access to a facility that they controlled, access to which was needed for competition and therefore violated antitrust law. The EFD was articulated explicitly for the first time by the Seventh Circuit Court's opinion in the MCI

case.[iii] 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.

Though on the whole courts tended to reject absurd essential facilities claims, the doctrine of Essential Facilities came under a series of academic attacks and finally in 2004 the US Supreme Court expressed its own displeasure with the doctrine in the Trinko case.[iv]

This case was a product of a class action suit brought against the telecom company Verizon on the grounds that the company had failed to adequately share its network with rivals as required by the Telecommunication Act of 1996. 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).

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.

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.

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 consciously endorse the doctrine. However, until 1998, the ECJ had not formally granted constraint force to EFD.

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. The courts held that 'exceptional circumstances' must exist for any refusal to license intellectual property rights to be countered wherein the notion that a higher standard must be met before a dominant firm can be compelled to license its intellectual property rights was more clearly expressed in *Magill*[v] and *IMS Health.*[vi]

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. 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

Interestingly, Australia is has explicitly institutionalised EFD by using the route of mandated regulation rather than through the interpretation of competition law or regulatory laws.

An 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 was incorporated in the existing Australian competition law to create a national access regime.

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.

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 licensing regime, discussed above), 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.

Telecom

After the National Telecom Policy in 1994, the first regulatory body in the country, TRAI was formed. In the TRAI Act, 1997 essential facilities concerns are dealt through the provisions dealing with interconnection. It is also the duty of the regulatory authority to ensure interconnection and technical compatibility between various service providers and maintain a register of such agreements. Department of Telecom sued TRAI for possessing overreaching powers and won the case, in 2000 an amendment ordinance restored TRAI's power to regulate tariffs and arbitrate interconnect issues.

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

Private sector participation has increased from 5 percent in 1999 to 84.5 percent in 2010. Growth rate of rural telephones has also increased from 16 percent in 2004 to 32.81 percent in 2010 (of which 84.5 percent of connections are provided by the private operators).

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. 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 PNGRB Act, 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.

To boost competition in the sector Ministry of Petroleum and Natural Gas issued a draft regulation according to which 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. 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 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. The competitive market so created would ensure lower costs to consumers.

Indeed, the Act under Section 38(2)(d) directs the Central Transmission Utility to provide non-discriminatory access of transmission to the licensee 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 Licensee under Section 39(2) (d) and 40(2) (d) of the Act respectively. Thus, the legislation incorporates the basic idea of essential facility to encourage generation, transmission and distribution of electricity efficiently.

The Role of Competition Commission

While 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.[vii]

However, the Competition Act, 2002 has sufficiently empowered the judiciary to invoke the EFD if it needs to do so. Although 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 the abuse of a dominant position.

One important suggestion however, is to recognise that the Competition Commission can take cognizance of Section 18 along with section 64(1) to formulate a regulation to provide free access to common facilities under the EFD. Given the scope therefore, 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.

Conclusion

The essential facilities doctrine imposes a legal antitrust/antimonopoly liability on monopolistic/dominant firms to share facilities that may be difficult for rivals to duplicate easily. 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.

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.

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[i] 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.

[ii] 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).

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

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

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

[vi] Case C-418101, IMS Health GmbH & Co. v. NDC Health GmbH & Co., 2004 E.C.R. 1-5039

[vii] Something similar to EFD doctrine 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 that private bodies that possess dominant position in the market, are under an implied duty to act in the public interest. 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.

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