

ISSN INTERNATIONAL
STANDARD
SERIAL
NUMBER
ISSN-2321-7065

IJELLH



**International Journal of English Language,
Literature in Humanities**

Indexed, Peer Reviewed (Refereed) Journal

UGC Approved Journal



Volume 6, Issue 9, September 2018

www.ijellh.com

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An Analysis of the Anti Competitive Agreements –Horizontal and Vertical

Abstract

Aggressive competition, new start-ups and entrepreneurs are the hallmark of today's consumer markets. There is immense economic activity going on in India. In this scenario there is a need to protect competition so that there is a fair playing ground for everyone.

Competition Law is that area of law, which seeks to promote business activities and dealings in a fair manner. Provisions of anti competitive agreements and abuse of dominance are very important components of Competition Law.

Anti Competitive agreements being horizontal and vertical need to be identified in the markets and weeded out. The consumers need to be made aware of such advanced forms of market manipulation which is arming the markets and in turn the economy. This paper is an attempt to briefly analyse the anti competitive agreement in simple legal language so that the readers are made aware of the various forms of horizontal and vertical legal agreements and their differences.

The main objective of competition policy and law is to preserve and promote competition, as a means to ensure efficient allocation of resources in an economy, resulting in

the best possible choice of quality, the lowest prices and adequate supplies to consumers.¹ The Competition policy would consist of laws to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets. Its core aim would be the economic development of the Nation.

In this context, it is important to study anti-competitive agreements, which have an adverse effect on the market and can harm the market in many ways.

Important Definitions under the Act

The Act provides for several key definitions which are necessary to be understood in order to understand the functioning of the Act. These are:

Cartel: The Act defines ‘Cartel’ as an association of producers, sellers, distributors, traders or service providers who by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of or trade in goods or provision of services.²² Cartel has been put in the category of those anti-competitive agreements through which the manufacturers, sellers, producers of homogenous commodities agree to control the production, supply prices etc of goods so as to get desired profits and control over the market.

Enterprise: As per Section 2(h) of the Act, ‘enterprise’ means and includes a person² or a department of Government, who or which is or has been engaged in following activities:

- (i) Production, storage, supply, distribution, acquisition or control of articles or goods;
- (ii) Provisions of services of any kind;
- (iii) Investing or acquiring of business, holding or dealing in shares or other securities of any other body corporate either directly or through a subsidiary.

However, a department of Government carrying activity relating to sovereign functions of the government which includes activities relating to atomic energy, currency, defence and space shall not be termed as an ‘enterprise’ for the purpose of the Act.

¹Towards a functional competition policy for India: An overview; Edited by. Pradeep. S. Mehta

²Person’ has been defined under section 2(l) of the Act

Person:Section 2(1) of the Act provides an inclusive definition of 'person'. It states that a 'person' includes following:

- (i) An individual, Hindu undivided family, company or a firm;
- (ii) An association of persons whether incorporated or not in India or outside India;
- (iii) Any corporation established by Central or State government or a Government Company as defined under Companies Act.
- (iv) Anybody corporate incorporated by or under the laws of a country outside India
- (v) Any Cooperative Society, local authority or an artificial juridical person.

Agreements causing an adverse effect on competition are known as anti-competitive agreements. Section 3 of the Competition Act, 2002 defines anti-competitive agreements as any agreements in respect to production/supply/distribution/storage/acquisition/control of goods or provision of services that causes an *appreciable adverse effect* on competition in India.

Anti-Competitive agreements are those agreements among the persons involved in a business transaction which have the tendency to harm the Competition in a particular market or which results in undue benefit to one person or group over the loss of others. Such anti-competitive agreements are prohibited under the Competition Act, 2002.

The term 'agreement' as defined under section 2(b) of the Act provides that the agreement does not necessarily have to be in the form of a formal document executed by the parties. It may or may not be in writing. Clearly, the definition so provided is inclusive in nature and not exhaustive and is a wide one.

The main reason for adopting a wide connotation for the term 'agreement' in Competition law is because the persons so involved in anti-competitive activities may not enter into formal written agreements so as to keep it a secret affair. For example Cartels are usually shrouded in secrecy. Section 3 of the Act prohibits any agreement with respect to production, supply, distribution storage, acquisition or control of goods or provision of services which causes or is likely to cause appreciable adverse effect on competition within India.³ Thus the term 'agreement' has been given a wide meaning. The 'agreement' is the factum rather than form in which such arrangement or understanding is reached or sought to

³ Section 3(1)

be operated. In order to ascertain the existence of such 'arrangement' or 'understanding', the whole context must be looked into. In case of oral or informal agreements, it is necessary to prove the existence of an agreement. Proof will generally be based on circumstantial evidence and parallelism of action between enterprises indicate this.

Further section 3(2) provides that any agreement in contravention of this provision shall be void. On the basis of the provisions of Section 3 of the Act, anti-competitive agreements are divided into two categories namely horizontal agreements and vertical agreements.

Horizontal agreements are agreements between two or more competitors that occupy the same stage of production chain and are in the same market. Vertical agreements involve a purchasing or selling relationship between firms, and may be pernicious if they are between firms in a position of dominance. Most competitive laws view vertical agreements more leniently than horizontal agreements because, prima facie, the latter are more likely to reduce competition than are agreements between firms in a purchase – seller relationship. The effect of the horizontal or vertical agreements on competition is judged on the basis of two separate criteria viz per se rule and the rule of reason.

Anti-competitive agreements.-

1. No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India.
2. Any agreement entered into in contravention of the provisions contained in subsection (1) shall be void.
3. Any agreement entered into between enterprises or associations of enterprises or persons or associations of persons or between any person and enterprise or practice carried on, or decision taken by, any association of enterprises or association of persons, including cartels, engaged in identical or similar trade of goods or provision of services, which-
 - a. directly or indirectly determines 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 geographical area of market, or type of goods or services, or number of customers in the market or any other similar way;
 - d. directly or indirectly results in bid rigging or collusive bidding, shall be presumed to have an appreciable adverse effect on competition: Provided that nothing contained in this sub-section shall apply to any agreement entered into by way of joint ventures if such agreement increases efficiency in production, supply, distribution, storage, acquisition or control of goods or provision of services.
4. Any agreement 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 an agreement in contravention of sub-section (1) if such agreement causes or is likely to cause an appreciable adverse effect on competition in India.

Section 3 of the Act provides three types of the agreements as anticompetitive agreement

1) *Which directly or indirectly determines purchase or sale prices –*

Agreements that are entered into with the sole purpose of defeating competition through fixing prices are prohibited as it is not in the best interests of the consumer. The prohibition under this head relates to price fixing and pricing methods. Thus, any agreement entered into for the purpose and with the effect of raising, depressing, fixing, pegging or stabilizing the price of a commodity is per se illegal and this also includes agreements relating to specific forms of price computation and also price discrimination.

- 2) *Limits or controls production, supply, markets, technical development, investment or provision of services* – Any agreement that stipulates the amount of production or restricts the market where the goods or services are to be offered is prohibited.
- 3) *Shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way* – If the retailers/distributors mutually enter into an agreement dividing the market by geographical areas amongst themselves and supplying only to those customers, or if they mutually agree to offer only particular goods or services to the deterrence of the consumers, such an agreement is prohibited.
- 4) *Directly or indirectly results in bid rigging or collusive bidding* – as per explanation of Section s.3(3) bid rigging means any agreement that has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding.

Section 3 of the Act prohibits both the horizontal and vertical agreements. Section 3(3) prohibits four categories of horizontal agreements between enterprises in the same industry.

(a) Horizontal Agreement: These are the agreements which generally occur between two or more entities or enterprises that stand at par with each other in terms of production, supply distribution etc in the same market. For example an agreement between manufactures of a particular commodity of not selling a particular product below agreed price or for not to supply a products to a particular market would be deemed as horizontal anti-competitive agreements.

Competition Act, 2002 prohibits following types of horizontal agreements namely:

- (i) Agreements regarding fixing of purchase or selling prices of a product either directly or indirectly.⁴
- (ii) Agreements with regard to limit, control production, supply, investment, provision of services of particular products and for a particular quantity.⁵

⁴ Section 3(3)(a)

(iii) Agreement regarding sharing of market

(iv) Bid Rigging Agreements.

Explanation to Section 3(3)(d) defines 'bid rigging' as *an agreement between parties engaged in identical business, which has the effect of eliminating or reducing the competition for bids or adversely affecting or manipulating the process for bidding.*

(v) Agreements in the form of Cartels.

Cartels are created by anti-competitive horizontal agreements among business enterprises. They pose a great threat to competition and ultimately tend to destroy the free trade. In fact cartels are secret agreements between business firms with the sole objective of fixing prices or sharing markets between them.⁶

(b) Vertical Agreements- Section 3(4) of the Indian Competition Act context refers to vertical agreements

Any agreement 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.

It can be said that almost all horizontal agreements tend to eliminate some kind of competition. However it cannot be said that all horizontal agreements are anticompetitive.

In order for any anticompetitive action to qualify as a vertical anticompetitive agreement, it is necessary that the anticompetitive action was result of an "agreement" that is a concerted action that involves two or more people and not unilateral conduct.

In India, the agreements entered into amongst persons at different stages or levels of the production chain in different market vis-à-vis production, supply, distribution, storage, sale or price of, or trade in goods or services are not per se void provided that such agreements have no appreciable adverse effect on competition. vertical restraint on trade is not *per se* void as such agreements may at times have pro-competitive effects. This is the major distinguishing factor between horizontal and vertical anti-competitive agreements. Vertical restraints are subject to rule of reason approach, which reflects the fact that such

⁵Section 3(3)(b)

⁶Rajkumar S. Adukia, 'An overview of provisions relating to Competition laws & Consumer Protection Laws in India' Retrieved from <http://www.caaa.in> on 29/04/2016

restraints are not always harmful and may in certain cases produce beneficial effect in a particular market.

For vertical restrictions, s.3(4) of the Act states that any such agreement, including following specific types (tying, exclusive supply, exclusive distribution, refusal to deal, and resale price maintenance), shall be in contravention of the prohibition in s.3(1) if it results in an adversarial effect on competition

It is difficult to define and provide a yardstick for horizontal anti-competitive agreements and vertical anti-competitive agreements but there are following differences between these two :

horizontal anti-competitive agreements	vertical anti-competitive agreements
In Horizontal Agreements the parties to the agreement are enterprises at the same stage of the production chain engaged in similar trade of goods or provision of services competing in the same market	In Vertical Agreements the parties to the agreements are non-competing enterprises at different stages of the production chain
Horizontal Anti-Competitive Agreements are entered into between rivals or competitors.	Vertical Anti-Competitive Agreements are entered into between parties having actual or potential relationship of purchasing or selling to each other
Horizontal Anti-Competitive Agreements are per se void	Vertical Anti-Competitive Agreements are not per se void
The 'rule of presumption' is applied to horizontal anti-competitive agreements	The 'rule of reason' is applied to vertical anti-competitive agreements
Examples of Horizontal Anti-Competitive Agreements are cartels, bid-rigging, collusive tendering etc	Examples of Vertical Anti-Competitive Agreements are resale price maintenance, tie-in agreements, exclusive supply and distribution agreements etc.

International Perspective

Agreements that constitute restraints of trade if they are on balance anti-competitive are prohibited.⁷ Entities are prohibited from engaging in unfair or deceptive acts or practices in interstate commerce. The Federal Trade Commission can challenge a vertical anticompetitive agreement under this provision.⁸ It is unlawful for any person to lease or make a sale of goods is made so as to substantially lessen competition or tend to create a monopoly in any line of commerce.⁹

Article 81 of the EC Treaty also identifies following acts which are deemed as restrictive of competition which are as follows:-

- a. directly or indirectly fix purchase or selling prices or any other trading conditions;
- b. limit or control production, markets, technical development, or investment;
- c. share markets or sources of supply;
- d. apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- e. make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Conclusion

Therefore nationally and internationally, it is very important to identify the types of anti-competitive agreements in complicated markets and take actions to prevent them. This would

⁷*Sherman Act* – Section 1

⁸Section 5 of the Federal Trade Commission Act

⁹Section 3 of the Clayton Act.

make way for a more vibrant economy with stabilized prices, research and innovations and efficiencies in production and distribution.