COMPETITION-RESTRICTING PRACTICES

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Introduction

This paper addresses competition–restricting practices like Anti-competition Agreements. Even though, another main area, namely, Abuse of Dominance is also anti-competition in nature, it is excluded from coverage in this paper, as a separate paper on the subject has been circulated. Treatment given to the above captioned subject is general in content and character and not related to any particular competition law of any country.

Anti – Competition Agreements and Practices

Firms enter into agreements, which may have the potential of restricting competition. A scan of the competition laws in the world will show that they make a distinction between "horizontal" and "vertical" agreements between firms. The former, namely the horizontal agreements are those among competitors and the latter, namely the vertical agreements are those relating to an actual or potential relationship of purchasing or selling to each other. A particularly pernicious type of horizontal agreements is the cartel. Vertical agreements are pernicious, if they are between firms in a position of dominance. Most competition laws view vertical agreements generally more leniently than horizontal agreements, as, *prima facie,* horizontal agreements are more likely to reduce competition than agreements between firms in a purchaser – seller relationship.

Horizontal agreements

Agreements between two or more enterprises that are at the same stage of the production chain and in the same market constitute the horizontal variety. An obvious example that comes to mind is an agreement between enterprises dealing in the same product or products. But the market for the product(s) is critical to the question, if the agreement trenches the law. If parties to the agreement are both producers or retailers (or wholesalers), they will be deemed to be at the same stage of the production chain.

A specific goal of competition policy/law is and needs to be the prevention of economic agents from distorting the competitive process either through agreements with other companies or through unilateral actions designed to exclude actual or potential competitors. It needs to control agreements among competing enterprises (horizontal agreements) on prices or other important aspects of their competitive interaction. Likewise, agreements between firms at different levels of the manufacturing or distribution processes (vertical agreements, for example between a manufacturer and wholesaler) which are likely to harm competition (albeit less harmful than horizontal agreements) need to be addressed in the competition policy/law. The foremost constituent of any competition policy/law is

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obviously the objective to foster competition and its obverse is the need to deal effectively against practices and conduct that subvert competition.

In general the "rule of reason" test is required for establishing that an agreement is illegal. However, for certain kinds of agreements, the presumption is generally that they cannot serve any useful or pro-competitive purpose. Because of this presumption, the law makers do not subject such agreements to the "rule of reason" test. They place such agreements in the *per se* illegal category, which is given a treatment in the following section.

PER SE ILLEGALITY

Such horizontal agreements, which include membership of cartels, are presumed to lead to unreasonable restrictions of competition and are therefore presumed to have an appreciable adverse effect on competition. In other words, they are *per se* illegal. This provision of *per se* illegality is rooted in the provisions of the US law and has a parallel in most legislations on the subject. The Australian law prohibits price fixing arrangements, boycotts and some forms of exclusive dealing. The new UK competition law[1] endorses certain agreements to have an appreciable effect on competition. A *per se* illegality would mean that there would be very limited scope for discretion and interpretation on the part of the prosecuting and adjudicating authorities. The underlying principle in such presumption of illegality is that the agreements in question have an appreciable anti-competitive effect.

Agreements, which are not *per se* illegal, will be subject to the "rule of reason" test.

PER SE ILLEGAL AGREEMENTS

Generally, many competition laws declare that the following four types of agreements between enterprises, involved in the same or similar manufacturing or trading of goods or provision of services have an appreciable adverse effect on competition :

- Agreements fixing prices. These include all agreements that directly or indirectly fix the purchase or sale price. These are known as cartels.
- Agreements limiting technical development or controlling production, supply, markets, investment or provision of services.
- Agreements rigging bids (collusive bidding or bid rigging). These include tenders submitted as a result of any joint activity or agreement.
- Agreements sharing markets. These include agreements for sharing of markets or sources 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.

AGREEMENTS FIXING PRICES - CARTELS

Cartels constitute one of the most pernicious forms of objectionable and restrictive trade practices. Cartels are defined differently in and for different contexts. For instance, the definition of a cartel typically employed in economic analysis is different from the one employed in international accords. But, for the purposes of this paper, the following definition would generally suffice.

[1] New UK Competition Law - Competition Act, 2000

A cartel is said to exist when two or more firms, that are not *de facto* or *de jure* controlled by Government, enter into an explicit agreement to fix prices, to allocate market share or sales quotas, or to engage in bid-rigging in one or more markets. The objective of a cartel is to raise prices above competitive levels, injuring the interests of the consumers including other firms (whose competitiveness is harmed by cartelisation) and Governments[2].

With globalisation and the accompanying integration of economies, the effects of cartels are perhaps more wide spread than previously experienced. In the last decade of the previous millennium and the early years of present millennium, cartels are more prevalent, persistent and damaging than previously thought. There are instances of price fixing cartels, in which multinational companies carve up the world into areas of control. A report on hardcore cartels reveals that billions of dollars of total global overcharges have been the result of international hardcore cartel operations. The report draws attention to the fact that the average illegal gain from price fixing is about 10% of the selling price. Most of the hardcore cartels are impacting developing countries, as there is increased enforcement of anti-cartel laws in the industrialised countries. Also a vast majority of firms involved in hardcore cartel activity is from industrialised and developed countries[3].

In another study, which formed the background paper for the World Development Report, it was revealed that in the 39 cartels studied, the firms involved were mostly from the developed countries and only a very few from developing countries. Most of the cartel members were from Europe, USA and Japan. What is disturbing is that of the 39 cartels examined, 16 had harmful effects in developing countries' markets. Complete information is not available in respect of the remaining cartels on their impact on developing countries[4].

While most studies (OECD 2000, Levenstein and Suslow, 2001; footnotes 3 and 4) point to a 20 to 40 percent fall in prices after the collapse of a cartel, which itself is evidence that a cartel leads to overcharging of prices to the detriment of consumers, there are estimates of what the developing countries lose because of cartelisation. The Exhibit[5] next page is a bar chart indicating total imports of 12 cartelised products by developing countries in the last decade of the millennium that ended recently (1990 – 2000). It may be seen therefrom that by 1995, the annual imports of the 12

[2] Stigler G.J. - 'A Theory of Oligopoly', Journal of Political Economy 72, 1964

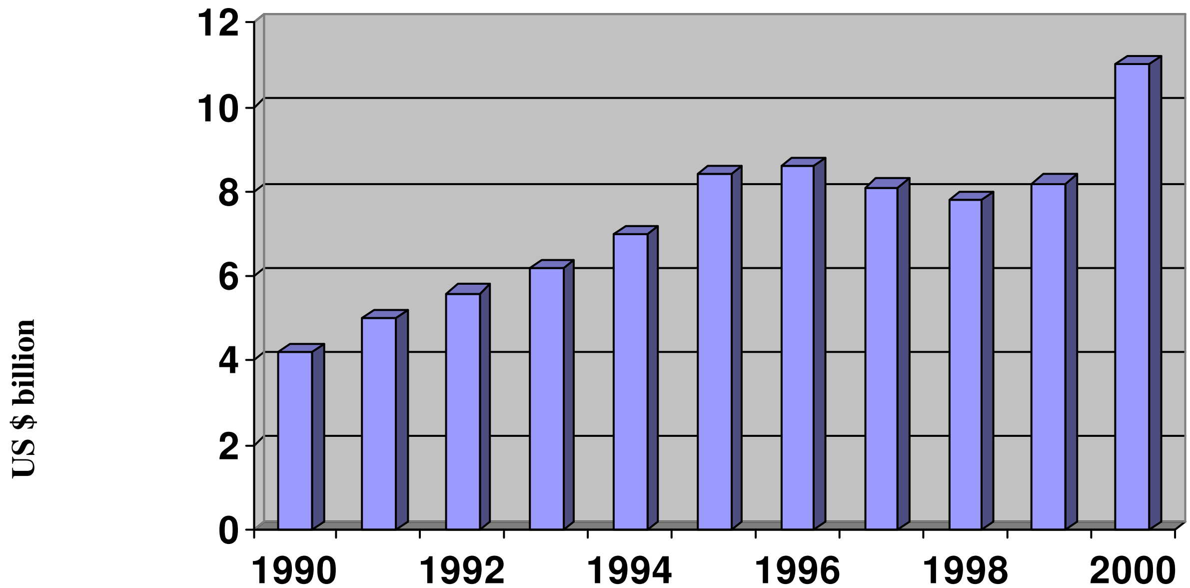
[3] OECD. - Report on Hard Core Cartels for the Meeting of the OECD Council at Ministerial Level, 2000.

[4] Levenstein, M.C & Suslow V.Y. – 'Private International Cartels and Their Effect on Developing Countries,' Background paper for the World Development Report, World Bank, Washington DC, 2001.

[5] Simon J. Evenett. – 'Can Developing Economies Benefit from WTO Negotiations on Binding Disciplines for Hard Core Cartels?' – Paper prepared for UNCTAD Secretariat- World Trade Institute, Berne, Switzerland, 2003.

EXHIBIT

IMPORTS OF TWELVE CARTELISED PRODUCTS BY DEVELOPING COUNTRIES



SOURCE: SIMON J. EVENETT, 2003 (footnote 5)

cartelised products by developing countries exceeded US$ 8 billion. Cumulatively, the imports exceeded US $ 80 billion since 1990. Assuming a 20 to 40 percent price overcharge, the conclusion is devastating that the developing countries paid US $ 12.5 to 25 billion more than they should have for these 12 products alone.

Even this estimate of overcharges is likely to be a substantial underestimate, as the calculations do not reckon all the products supplied by the cartels and omit the damage caused by undetected hardcore cartels (Simon J. Evenett, footnote 5).

Another analysis[6] of the damage caused by a vitamins cartel is also revealing. The vitamins cartel divided up the world market for different types of vitamins during the 90s. The overcharges paid by 90 countries importing vitamins were estimated. The overcharges according to the analysis were more in the jurisdictions with weak cartel enforcement regimes. For instance, the Latin American countries that did not enforce effectively their cartel legislations witnessed their vitamin import bills escalate by more than 50%, whereas the escalation was less than 40% in respect of Latin American countries that enforced such legislation. Damage wise, India incurred overcharges of more than US $ 25 million. 10 European countries suffered an overcharge of about US$ 660 million. All the 90 importing countries put together suffered overcharges by US $ 2700 million during the 90s.

The financial impact of the vitamin cartels, or for the matter of other cartels, is much more than the dollar value, if the purchasing power parity ratio is reckoned. In the case of India, for instance, the

[6] Clarke J.L., and Evenett. S.J. – 'The Deterrent Effects of National Anti-Cartel Laws: Evidence from the International Vitamins Cartel', Antitrust Bulletin, Washington DC, 2003.

purchasing power parity ratio is 8.7. The damage of US $ 25 million translates into a whopping US $ 220 million. The poor countries directly or indirectly bear the cost of this unlawful practice in terms of higher prices and reduced choice (see Box 1 below).

Yet another case of a cartel offence relates to Zambia. Box 2 next page traces the case which is essentially a syndicate action.

AGREEMENTS LIMITING TECHNICAL DEVELOPMENT ETC

Limiting or controlling supply of goods and services to the markets may also lead to their artificial scarcity, which will manifest itself in increased prices. By regulating the supply, enterprises in concert, may create and maintain shortage of goods and services in the market, in order to shore up prices and consequently profits. In a manner of speaking, enterprises acting together may create barriers to entry for new entrants, so that the latter may not step into the market to bridge the artificially created scarcity. Such practices hurt the consumers and need to be curbed and eliminated.

Some agreements which constitute concerted actions on the part of the enterprises acting together may have underpinnings to limit or control technical development. Enterprises which are at a particular level of technology in the manufacture of a particular product might come to an understanding that none of them would indulge in innovation, new technology or technological developments, to prevent stealing a march over the rest of the group. This stifling of technical development will be to the detriment of quality improvement and even price reduction, thus resulting in prejudice to consumer interest.

IMPACT OF HARDCORE CARTELS IN SOME AFRICAN COUNTRIES

BOX 1

Hardcore cartels in heavy electrical equipment, steel and aluminum have inflicted overcharges reported at US $44 million for Zimbabwe, US $ 34 million for Kenya and US $270 million for South African Customs Union[7]. Besides overcharging, another dimension is worth noting in terms of the adverse impact of the cartel behaviour on the developing countries. Heavy electrical equipment is needed for installation of power generation plants, most of which are set up by Government or Government-owned public enterprises. Cartel behaviour on the part of the equipment suppliers increases the cost of power generation plants thus stretching their treasuries leading to less allocation for other development expenditure. The electrical cartel also indulged in bid-rigging. Every member of the cartel was allotted a potential project and other members put in supporting bids. If a non-member entered the bid, it was outbid by the cartel members by lowering their prices to the levels below which, the non-member could not operate. The field was thus left open as an exclusive preserve of the cartel members. A basic amenity like electricity thus became very expensive for the consumers. Such prejudices to consumer interest, caused by bid-rigging, affect more the developing countries than the developed because of prevalence of poverty.

[7] CUTS. – 'Pulling Up our Socks' – A Study Of Competition Regimes of 7 Developing Countries of Africa and Asia under the 7-Up Project, Cuts Centre for Competition, Investment & Economic Regulation, Jaipur, India, 2003.

SYNDICATE CARTEL IN ZAMBIA

BOX 2

A syndicate is generally a group of people or firms undertaking a joint business venture. When groups in the same or similar lines of business act in concert, they are also regarded as acting as a syndicate. In Zambia, transport operators formed a cartel, though not formally or through a written agreement. The cartel itself was an understanding among the operators, a kind of unwritten and informal agreement. This cartel was preventing outsiders to enter the transport network business and fixing prices for consumers. Higher than the normal prices fixed by the cartel, impacted the consumers and the poor ones, in particular, very adversely. Zambia Competition Commission enquired into the anti-competitive cartel offence and noted that the United Transport and Taxis Association (UTTA) was indeed a cartel. The enquiry by the Commission addressed the cartel behaviour of the UTTA in price fixing. Also covered in its enquiry was the approval accorded to the fare by the Road Traffic Commission and the use of intermediaries at the bus stops. The enquiry and the resultant action by the Commission brought a sense of scare among the transport operators (members of the cartel) and made them behave more responsibly towards the consumers. However cartel behaviour has not been completely eliminated but thankfully the transport operators fix fare (and fair) prices independently in defiance of UTTA's dictate[8].

The syndicate system in surface transport system can be noticed in many developing countries, as for instance, in Nepal. The majority of transport operators in that country have formed local syndicates, which allow none other than syndicate members to ply their vehicles on designated long routes. These syndicates prevent new operators from entering the transport business and also involve sometimes in vandalizing buses belonging to those operators, who violate their dictates.

Box 3 below is an illustration of limiting or controlling production and supply of goods.

THE INDIAN JUTE MILLS ASSOCIATION CASE

BOX 3

The Indian Jute Mills Association formulated a scheme for a reduction in production in jute goods by 15 % for its members. This scheme was assailed before the Monopolies and Restrictive Trade Practices Commission (MRTP Commission) as a restraint of trade and competition. The Association defended its scheme arguing that in the then prevalent conditions in jute industry, its members agreed to restrict their output so that efficient units among them may not go ahead with production and thereby elbow out the less efficient units among them. The MRTP Commission[9] holding that the impugned scheme had the effect of restricting competition observed:

"If only the efficient units were allowed to produce the jute goods, their cost of production would have been lower than the cost of production of less efficient units. When competition takes its logical course, there is no distortion of competition……. Undistorted competition does not mean that less efficient units of production should be propped up by artificial support to continue in production, even though forces of demand and market price did not justify their continuance".

However, generally, the underlying object of such schemes and agreements is to regulate the flow of supply of goods by the producers generally to earn higher profits by creating conditions of scarcity in the market.

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[8] Adhikari, 2002. – 'Competition Policy in Small Economies' – Discussion Paper, SAWTEE, Kathmandu, 2002.

[9] MRTP Commission's order dated 11 October 1977 in Indian Jute Mills Association – RTPE No. 80/1975

Enterprises may combine to limit supply of goods to the market and to impose conditions restricting dissemination of technology and thus prejudice competition. Box 4 below bears testimony to such prejudice.

LIMITING PRODUCTION AND RESTRICTING TECHNICAL KNOW-HOW

BOX 4

Sarabhai M Chemicals Private Limited, an Indian company, entered into a technological know-how agreement with its overseas collaborator, E. Merck A.G., providing for the provision of know-how by the latter to the former. The know-how was to enable Sarabhai to manufacture pharmaceutical chemicals, vitamins, insecticides etc in India. The agreement stipulated that Merck by itself or its licensees (like Sarabhai) should not directly or indirectly manufacture certain items (about 520 out of 600 items) in India and that Merck would be free to import into India such items and sell the same. Sarabhai's request for technological know-how for the manufacture of certain pharmaceuticals and Vitamins was turned down by Merck. The MRTP Commission[10] held that the agreement had an adverse effect on competition because of the denial of access to the technological know–how and was also a barrier to entry to other intending manufacturers.

AGREEMENTS RIGGING BIDS

Bid rigging is a part of horizontal agreements and is regarded as a practice to cause or is likely to cause an appreciable adverse effect on competition.

Bid rigging means any agreement between persons or enterprises, engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding.

Bid rigging takes place when bidders collude and keep the bid amount at a pre-determined level. Such pre-determination is by way of intentional manipulation by the members of the bidding group. Bidders could be actual or potential ones but they collude and act in concert. Bid rigging is the way that conspiring competitors effectively raise prices where purchasers-- often Government, Provincial authorities or Local authorities—acquire goods or services by soliciting competing bids.

Bid rigging is often resorted to in public procurement tenders. The possibility of bid rigging will be particularly relevant to public sector purchasers, given their legal obligations to award contracts by competitive tender. The rigging parties perceive Government to be blind to collusive practices and consequently indulge in bid rigging while responding to tenders. This imposes heavy costs on public treasury and therefore on taxpayers. This also undermines confidence in the Government. Consumers are visited with high prices and with prejudice to their interests. Box 5 next page describes a medical oxygen supply cartel.

[10] MRTP Commission's Order 6 July 1978 in Sarabhai Chemicals Private Limited, RTPE No. 45/75 – (1979) 49 Comp. Cases 145.

MEDICAL OXYGEN SUPPLY CARTEL

BOX 5

Four foreign companies, namely, Air Liquide (France), Praxair (US), AGA (Germany) and Indura (Chile) were the suppliers of medical oxygen to both public and private hospitals in Argentina. These companies formed a cartel and entered into an agreement to indulge in bid rigging and to distribute and divide customers among themselves. The Competition Authority in Argentina conducted 4 raids, in which it found certain documents showing exchange of information about the customers, bids, prices etc. As a result of bid rigging and collusion, **hospitals and consumers were forced to pay high prices**. And the cartel members enjoyed illegally high profits. The Competition Authority succeeded in getting the four companies prosecuted and levied with fines amounting to US $24 million. The successful prosecution of the bid rigging and price fixing cartel was welcomed by the consumers in Argentina[11].

An agreement in collusion not to respond to an invitation to tender until after discussions with other persons invited to tender is also a bid rigging offence. The Exeter Hospital case in Box 6 below lays down this principle.

EXETER HOSPITAL AGREEMENT

BOX 6

The electrical goods suppliers entered into an agreement in October 1966, that they would not tender for the contract for the supply of goods to Exeter Hospital in UK, before they had met and discussed the contract generally and the tender price in particular. During the following month, November 1966 they met and agreed that three of their members would **each** prepare a detailed tender for the contract, that another two would prepare check estimates and the remaining another two would do no more than receive cover prices. It was also agreed that as between those who would prepare detailed tenders, the middle price would be taken and the party (Member) who had prepared it would be treated as the successful tenderer. The agreement further mandated that those who had prepared the tender below the middle price would submit tenders exceeding that price and those who received cover prices would not tender below that price. It was further agreed that the successful tenderer would pay £ 500 to each of the other two who had prepared the detailed tenders and £ 200 to each of those who had prepared the check estimates. The Registrar of Restrictive Trade Agreement took the view that the agreement was a restriction under section 6 (1) of the Restrictive Trade Practices Act, 1956. When the matter came up before the Judicial Court, it was held that an agreement of this nature preventing the supply or acquisition of any goods fell within the ambit of the restrictions in section 6 (1) (a) of the said Act. The judicial reasoning was in favour of a broad construction of section 6 (1) of the Act in the larger interests of the hospital and the patients[12].

AGREEMENTS SHARING MARKETS

Agreements between persons, enterprises or their associations acting in concert which share 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 are regarded as having an appreciable adverse effect on competition. Enterprises often tend to share markets, whether by territory, type or size of customers or in some other way.

[11] Recent Important Cases, report by UNCTAD Secretariat, September 2005.
[12] [1971] 1 All ER 347, dated 31 July 1970.

Customer or market allocation arrangements among enterprises involve the assignment to particular enterprises of particular customers or markets for the products or services in question. Obviously, such arrangements are designed to strengthen or maintain trading patterns, in which competitors forego competition in respect of each other's customers or markets. Restrictive arrangements of this nature may be with reference to a particular line of products or to a particular type of customers.

Another method under this type of market sharing manifests in the form of quantity allocations rather than on the basis of territories or customers. Quota restrictions or allocations are often prescribed in sectors having a surplus capacity, the object being to raise prices. Under such arrangements, enterprises often agree to limit supplies to a proportion of their previous sales, and in order to enforce this, a pooling arrangement is created whereby enterprises selling in excess of their quota are required to make payments to the pool in order to compensate those selling below their quotas.

The allocation of exclusive territory or market to a single dealer necessarily prevents or distorts intra-band competition, as other dealers of the suppliers stand excluded from that territory or market. The Indian MRTP Commission[13] has held that where an agreement clause has the effect of confining the distributor within a specified area for effecting sales, it constitutes a restraint on competition.

However, allocation of territories needs to be distinguished from agreements designating the selling points from which the dealers or distributors will operate. The MRTP Commission[14] ruled that an agreement to fix selling points in contradistinction to one for the allocation of territories to the distributor does not constitute a restriction on competition.

A manufacturing cartel dividing the market is described in Box 7 below.

MANUFACTURING CARTEL DIVIDING THE MARKET

BOX 7

Three Timken Corporations (American, British and French) manufacture anti-friction bearings. They allocated trade territories among themselves and cooperated with each other in fixing prices, in order to eliminate outside competition. The Supreme Court of the US examined the effect of the cartel members dividing the market and observed that the dominant purpose of their action in concert was to avoid all competition either among themselves or with others. The Court further ruled that agreements between legally separate persons and companies to suppress competition among themselves cannot be justified and that collusive control of the trading operation (allocations) would not liberate them from the applicability of the antitrust law (competition law)[15].

VERTICAL AGREEMENTS

By and large, as noted earlier, vertical agreements will not be subjected to the rigors of competition law. However, where a vertical agreement has the character of distorting or preventing competition, it will be placed under the surveillance of the law.

For instance, the following types of agreements, *inter alia*, will be subjected to the "rule of reason" test.

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[13] RTPE No. 216/1997- (2000) CTJ 141 (MRTPC).
[14] Registrar of Restrictive Trade Agreements vs. Usha Sales Private Limited – (1977) 47 Comp. Cases 480.
[15] 341 US 593 (1951).

- Tie – in arrangement;
- Exclusive supply agreement
- Exclusive distribution agreement;
- Refusal to deal;
- Resale price maintenance.

TIE-IN ARRANGEMENT

Tie-in sales and bundling are practices, which happen where a manufacturer makes the purchase of one product (tying product) conditional on the purchase of another (tied product). A set of tied products is sometime called a bundle.

A tie-in arrangement is anti-competitive, if it causes or is likely to cause an appreciable adverse effect on competition. The tied product may be totally unrelated to the product requested (tying product) or a product in a similar line. Such a practice of tie-in sale is resorted to, in order to promote the sale of slower moving products and in particular, those subject to greater competition from substitute products. In a large number of cases, the manufacturer or supplier may be in a dominant position in respect of the tying product and therefore in a position to impose as a condition for its sale, the acceptance of another product (tied product).

A tying contract compels a customer to take a product, he does not necessarily want, in order to secure one, which he does want. This practice is likely to lessen competition and is therefore anti-competitive in character.

In a tying arrangement, it is necessary to prove that (i) the products involved in the arrangement are distinct and separate items, (ii) the buyers of the products recognise them as such, and (iii) the main (tying) product and other products have distinct and separate markets. An extreme version of tying arrangement is ‘Full-line forcing’, where the purchaser of a product is coerced by the supplier to buy the complete range of his/her products, though not desired to be so bought. Such practices undermine the interest of the purchasers (consumers) in the sense that they are forced to forego their choice among products which compete with the tied product.

Some simple examples of tie-in are requiring the buyers of cars to pay towards the servicing of cars with the sale price, insisting by the gas distributor on the buyer of gas connection to buy a gas stove as a condition, prescribing a condition by banks on a customer to take a fixed deposit for allocation of a locker etc.

Box 8 next page is an illustration of a tie-in arrangement undermining the interest of consumers.

FEDERAL TRADE COMMISSION VS BROWN SHOE COMPANY
A TIE-IN ARRANGEMENT

BOX 8

One of the largest shoe manufacturers in the U.S. is the Brown Shoe Company. It owned some retail shoe stores. In addition, there were about 650 retail stores, franchisees of Brown. Only about 250 of the said 650 retail franchisees had executed franchise agreements. The franchise agreements stipulated that the franchisee should concentrate on Brown's shoes in return for Brown's provision of architectural plans, merchandising records and group insurance at lower rates than what the franchisee could individually obtain and so on. Brown admitted that it did not grant such benefits to retailers who did not participate in the franchise programme. The Federal Trade Commission held the franchise programme violative of the Federal Trade Commission Act and the Clayton Act, both competition laws of the U.S.

The matter went up to the Supreme Court of U.S. In its ruling, the Supreme Court observed that the franchise programme conflicted with the policy of the Sherman Act and the Clayton Act against anti-competitive contracts and that it infringed on the freedom of purchasers to buy in an open market. In other words, the Brown franchise programme was unfair and was undermining competition in the market[16] .

EXCLUSIVE SUPPLY AGREEMENT

This is a kind of a vertical restraint. Exclusive selling, purchasing or dealing may foreclose the market to a new manufacturer, if a significant proportion of potential retail outlets are tied to existing manufacturers. This practice often manifests in the form of a retailer agreeing to purchase or deal in goods from only one manufacturer[17]. In exclusive purchase or dealing agreements, the ability of new competitors to enter the market or the ability of existing competitors to expand their market share is severely restricted[18].

The degree of competition between retailers is an important factor in examining exclusive supply or purchase practices. If retailers have market power, foreclosure at the manufacturing level is likely to occur. Likewise, if there is a network of agreements covering a significant proportion of retailers, such foreclosure is a distinct possibility. If in the market, barriers to new entry in retailing exist, foreclosure at the manufacturing level is predictable.

Exclusive dealing and restrictions imposed on the dealers by Telco came up before the Indian MRTP Commission. See Box 9 next page.

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[16] 384 U.S.316 (1966).

[17] European Court Decision in Hoffman – La Roche & Co. AG vs.E.C.Commission, 1979, ECR 461 – 1979, 3 CMLR 211, 1979.

[18] European Court Decision in Stergios Delimitis vs. Henninger Brau – 1991, 1 ECR 935 – 1992, 5 CMLR 210, 1992.

TATA ENGINEERING AND LOCOMOTIVE CO LTD VS REGISTRAR OF RESTRICTIVE AGREEMENTS

BOX 9

Tata Engineering and Locomotive Co Ltd manufactures commercial vehicles like trucks and buses. It entered into agreements of exclusive supplies with its dealers. The exclusive supply agreements came up before the Supreme Court of India. The Apex Court[19] observed that exclusive dealings led to specialisation and improvement in after-sale service and that by specialising in each make of the vehicle and providing the best possible service, competition between the various makes was enhanced. The Court observed that where the dealers were required to make a heavy investment in the stocking of commercial vehicles and spare parts and in the maintenance of service stations to provide after-sale service, exclusive dealership did not impede competition but promoted it.

EXCLUSIVE DISTRIBUTION AGREEMENT

Exclusive distribution is another vertical restraint, which can foreclose the market, if practiced by a sufficient proportion of manufacturers. It is a particular form of selective distribution, where the manufacturer supplies only one retailer in a particular territory or allows only one retailer to supply a particular class of customers such as businesses or consumers. This kind of restraint therefore, forecloses markets to retailers.

If a manufacturer imposes an absolute restriction on the number of retailers, the effect is likely to be more significant than if it sets objective standards for all its retailers to meet. Even if objective standards are set, they may still prevent entry of new retail operators. The key factor in this practice is the market power of the manufacturer imposing the restraint. Yet another factor is likely to be the strength of the brands of the manufacturers. The brands may enjoy market power even when they are not market leaders. Retailers may find it difficult to establish themselves, if they are unable to stock certain leading brands which customers expect to find available.

Exclusive distribution agreements are resorted to for maintaining or strengthening already established dominant or monopolistic position. Such agreement may also effectively block the entry of new comers. Exclusive agreement of this nature tends to substantially lessen competition by limiting the challenge of distribution for the independent competitors and also tends to create a monopoly in that line of business.

A case of blade manufacturers is described in Box 10 next page to illustrate as to how an exclusive distribution agreement may not effect competition.

[19] Tata Engineering and Locomotive Co Ltd vs. Registrar of Restrictive Agreements, AIR 1977 SC 973

SAFETY RAZOR BLADES CASE

BOX 10

Centron Industrial Alliance Private Limited is a manufacturer of safety razor blades in India. It entered into agreement with Home Products Marketing Agency for sale of its products on exclusive distribution basis. This agreement came before the Indian MRTP Commission to test if it constituted a restrictive trade practice having an adverse effect on competition. The Commission held that the agreement attracted the provisions of the law, as it was restrictive in nature. However the Commission observed that the exclusivity of the distributor did not affect competition considering the basic features of the industry. For instance, the distributor's share was only 10 % as against a couple of companies having a substantial share of market. The exclusive arrangement was therefore considered as imperative for the survival of Centron[20].

REFUSAL TO DEAL

An agreement of refusal to deal among persons or enterprises 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 is regarded as an anti-competitive agreement, if it causes or is likely to cause an appreciable adverse effect on competition. Refusal to supply or purchase imposes a vertical restraint. A manufacturer, imposing a selective distribution system, would, by definition, be refusing to supply outlets, which are not within the system. In some cases, refusal to supply may be resorted to, to exclude certain competitors, particularly in upstream and downstream markets.

Concerted refusals to supply, be it to a domestic purchaser or an importer, fall under the offence of refusal to deal. Not supplying potential importers by an intentional or wilful refusal by a manufacturer may be the result of customer allocation arrangements, whereby it agrees not to supply those other than designated purchasers. Such practices can also be a result of collective vertical arrangements between purchasers and sellers, including importers and exporters.

Collective Refusal to deal or Group Boycott is generally frowned upon by Competition Tribunals. The Karnataka Chemists and Druggists Association came under flak from the Indian MRTP Commission in India for having indulged in the said offence. Box 11 next page describes the case.

[20] Registrar of Restrictive Trade Agreements vs Centron Industrial Alliance Private Limited – (1978) 48 Company cases 813, MRTP Commission.

BOYCOTT TRENCHES COMPETITION LAW

BOX 11

Karnataka Chemists and Druggists Association (KCDA) is a Pharma Trade Association in Bangalore, India. The Association issued a circular that no drug manufacturer could appoint a person as its stockist/wholesaler without obtaining a no objection certificate (NOC) from it. KCDA published in its circular, a list of agents affiliated to it and requested all manufacturers to appoint only those as agents. This precluded the non-members of the Association from carrying out their business fairly. Furthermore, KCDA was making frequent and recurrent boycott calls of various manufacturers citing trade issues without any justification. For instance, it resolved and gave a call not to purchase goods from GlaxoSmithKline. The matter was taken up with the Indian MRTP Commission. The Commission observed that because of the insistence on the NOC by KCDA as a pre-condition for appointment of stockists, the manufacturers were deprived of the freedom to choose their distribution partners. The Commission further observed that the call of boycott by KCDA of any dealer, in any manner, written or oral, would restrict competition and that such a practice should be stopped by KCDA[21].

However, in the absence of any purpose to create or maintain dominance or monopoly, a manufacturer or a trader engaged in a business may freely exercise his discretion as to the parties with whom he/she will deal and also announce in advance the circumstances under which he/she will refuse to sell. This right of freely selecting one's customers is known as the Colgate doctrine[22]. Under the doctrine, a manufacturer having announced a policy may bring about adherence to it by refusing to deal with customers who do not observe that policy.

Group boycotts are also nothing but refusal to deal, plain and simple. In order to bring a charge for group boycott, there must be evidence to establish that the group giving the call for boycott has an enforcement mechanism, particularly against members not adhering to the call. The case described in Box 12 next page describes a group boycott.

RESALE PRICE MAINTENANCE

The practice of resale price maintenance is the last and fifth type of anti-competitive agreements, which needs to be decided by the Competition Authority on the rule of reason basis, if it causes or is likely to cause an appreciable adverse effect on competition in India. The expression "resale price maintenance" includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller, unless it is clearly stated that prices lower than those prices may be charged.

[21] Business Line. – 'MRTPC pulls up Karnataka Pharma Trade Association', Business Line, Chennai, 28 May, 2006.
[22] See United States vs. Colgate and Company – 250 US 300 (1919)

GROUP BOYCOTT

BOX 12

A case came up before the Indian MRTP Commission[23] relating to a boycott call by the All India Association of Chemists and Druggists. The decision of the Commission made it clear that the pejorative impact on competition brought about by boycott merits attention not only in India but elsewhere. The Sherman Act in the US holds group boycott illegal *per se* (Jones Knitting Corporation vs. Morgan DC Pa, 244 F Supp 235). Concerted action by business men and dealers resulting in or having the potential of ousting the product of a particular manufacturer from the market constitutes a group boycott.

Resale price maintenance can have direct effect on competition. If the manufacturer fixes an absolute price or specifies a minimum price, there will be no price competition between the retailers. In the final analysis, it is the consumer who will be affected by the absence of price competition. Where the manufacturer specifies a maximum price, it is less likely to be a problem, as it will permit the retailers to compete by charging lower prices. A telling example of resale price maintenance is the case of Dr. Miles Medical Co. in the U.S. described in Box 13 below.

RESALE PRICE MAINTENANCE – A CASE LAW

BOX 13

Dr. Miles Medical Company was a manufacturer of proprietary medicines. It entered into an agreement with its distribution agents that the medicines should be sold at not less than the prices indicated by it. Likewise, it entered into agreements with the retailers that they should not sell at prices less than the full retail prices as printed on the packages. These agreements went up to the US Supreme Court. The Court observed that the system of interlocking restrictions by which Dr. Miles sought to control the prices at which its distributors and retailers may sell its medicines was eliminating competition and that the agreements were in restraint of trade. Furthermore, the agreements were designed to maintain prices after Dr. Miles had parted with the title to the medicines in favour of distributors and retailers and that therefore competition was prevented among those who traded in the medicines[24].

FACTORS GERMANE TO DETERMINATION OF ADVERSE EFFECT ON COMPETITION

The following factors would generally be needed to be taken into account for adjudicatory purposes to determine whether an agreement or a practice has an appreciable adverse effect on competition, namely,

a) creation of barriers to new entrants in the market,

b) driving existing competitors out of the market,

c) foreclosure of competition by hindering entry into the market,

d) accrual of benefits to consumers,

e) improvements in production or distribution of goods or provision of services, and

[23] See MRTP Commission's order dated: 30 January 1996 in RTP Enquiry No. 51/1986 – (1997) 5CTJ 1

[24] Dr.Miles Medical Co. Vs John D. Park And Sons Co, 220 Us 373 (1911).

f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

EXEMPTIONS

Most competition laws have provisions relating to what is known as exemptions. Such provisions exempt certain situations and enterprises from the application of competition law. The models adopted for this purpose are:

A. Incorporation of provisions empowering the government or the Competition Authority to exempt certain classes of enterprises or to exempt certain situations in the market; or

B. Incorporation of provisions specifically exempting certain classes of enterprises or certain situations in the market.

The advantage in the Model A is that the exemption is left to the government implying thereby that the government has the discretion to authorize exemptions having regard to the market conditions, conduct of enterprises, interests of consumers etc. There is a built-in flexibility for the government to authorize exemptions and also to withdraw the same, if the market situation so warrants.

The disadvantage in Model B is that the exemptions are specific and statutory and therefore, if the government wants to withdraw the exemptions, it has to seek amendments to the competition law by its Parliament. Model B therefore is rigid and not flexible.

For developing countries (and even for developed countries), Model A is advisable in view of the flexibility it offers.

What are normally covered by exemptions to competition law are a class or category of industries, sovereign functions of the Government carried out through enterprises and International agreements. For instance, the new Indian competition law[25] has the following provision for exemptions:

"The Central Government may, by notification, exempt from the application of this Act, or any provision thereof, and for such period as it may specify in such notification—

(a) any class of enterprises if such exemption is necessary in the interest of security of the State or public interest;

(b) any practice or agreement arising out of and in accordance with any obligation assumed by India under any treaty, agreement or convention with any other country or countries;

(c) any enterprise which performs a sovereign function on behalf of the Central Government or a State Government:

Provided that in case an enterprise is engaged in any activity including the activity relatable to the sovereign functions of the Government, the Central Government may grant exemption only in respect of activity relatable to the sovereign functions."

[25] New Indian Competition Law - Competition Act, 2002

Some countries have a specific policy to foster and even to protect small scale industries. Germany and India are a testimony to having such policies. Exemption of small scale industries from the application of the competition law may not be welcomed by competition purists. But countries who regard small as beautiful would still, despite belief in competition-driven markets, like to offer protection to small scale industries.

While the need for a competition policy including competition law as a complement to and reinforcement for trade policy and trade law cannot be over-emphasised, a question arises as to whether the introduction of the competition policy and the competition law may visit the developing countries with consequences of an adverse nature like injury to the domestic industry, particularly the small scale industries. A solution is that it is desirable to give sufficient time to educate and persuade the small scale industries and in general the domestic industries of the need for competition in the market, particularly International competition. Strengthening the enforcement of competition laws, after going through such process of education, will help to successfully establish a competition regime.

Brusick[26] suggests that discussions on competition "should take into account the need for specific treatment for developing countries……."

While competition policy/law is a desirable objective and instrument for subserving consumer interest and consumer welfare, there is a need to bring about this competition environment gradually than in one stroke. In other words, till the domestic producers and suppliers and particularly the small scale industries get educated and exposed to competition and thereby address themselves towards enhanced efficiency, economies of scale and subserving of the consumer interest (in the broadest sense of the term), the competition policy/law should be gradually strengthened and implemented. For this purpose, it is desirable to provide for a transition period during which the implementation of competition policy/law is steadily but in a step by step manner strengthened, in its application to the market.

EXCEPTIONS

Some competition laws provide exceptions to their applicability for certain agreements/practices. For instance, the new Indian competition law[27] declares that the provisions relating to anti-competition agreements will not restrict the right of any person to restrain any infringement of intellectual property rights or to impose such <u>reasonable conditions</u> as may be necessary for the purposes of protecting any of his rights which have been or may be conferred upon him under the following intellectual property right statutes;

- the Copyright Act, 1957;
- the Patents Act, 1970;
- the Trade and Merchandise Marks Act, 1958 or the Trade Marks Act, 1999;
- the Geographical Indications of Goods (Registration and Protection) Act, 1999;
- the Designs Act, 2000;

[26] Brusick, Philippe - "Competition, Development and the Set" – Paper at World Bank Symposium, Geneva, Nov. 1997.
[27] New Indian Competition Law - Competition Act, 2002

- the Semi-conductor Integrated Circuits Layout-Design Act, 2000.

The rationale for this exception is that the bundle of rights that are subsumed in intellectual property rights should not be disturbed in the interests of creativity and intellectual/innovative power of the human mind. No doubt, this bundle of rights essays an anti-competition character, even bordering on monopoly power. But without protecting such rights, there will be no incentive for innovation, new technology and enhancement in the quality of products and services. However, it may be noted, that the Indian Act does not permit any unreasonable condition forming a part of protection or exploitation of intellectual property rights. In other words, licensing arrangements likely to affect adversely the prices, quantities, quality or varieties of goods and services will fall within the contours of competition law as long as they are not in reasonable juxtaposition with the bundle of rights that go with intellectual property rights.

For example, a licensing arrangement may include restraints that adversely affect competition in goods markets by dividing the markets among firms that would have competed using different technologies. Similarly, an arrangement that effectively merges the research and development activities of two of only a few entities that could plausibly engage in research and development in the relevant field might harm competition for development of new goods and services. Exclusive licensing is another category of possible unreasonable condition. Examples of arrangements involving exclusive licensing that may give rise to anti-competition concerns include cross licensing by parties collectively possessing market power, grantbacks and acquisitions of intellectual property rights.

Yet another exception in most competition laws to its applicability relate to the right of any person to export goods to the extent to which, an agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export. In a manner of speaking, export cartels are outside the purview of competition laws in most jurisdictions. A justification for this exemption is that most countries do not desire any shackles on their export effort in the interest of balance of trade and/or balance of payments. Holistically, however, exemption of export cartels is against the concept of free competition.

FINALE

Protection of competition goes hand in hand with the promotion of efficiency and interest of consumers. Competition is perhaps one of the best incentives for firms to operate as efficiently as possible and to meet the demands of the consumer by minimising cost and prices and maximising value, quality and choice.

Every country needs to draft and craft its competition policy and law to suit its needs, aspirations and domestic milieu. One size fits all does not apply to competition policy and law. There is considerable warrant and logic in favour of flexibility in this area.

COMPETITION LAW SHOULD PROTECT COMPETITION AND NOT COMPETITORS.