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HORIZONTAL AND VERTICAL AGREEMENTS OF COMPETITION ACT, 2002: AN ANALYSES

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“Competition is the law of the jungle, but cooperation is the law of civilization.”

— Peter Kropotkin

Man, according to Hobbes, is an altogether selfish animal. He is anything but a social animal; indeed, he finds nothing but grief in the company of his fellows, and lives in a continual fear of danger to his life. Therefore, man is driven by evident necessity to join some authority to protect himself. According to him, it is men and arms that are responsible for the maintenance of law and order in the state. because the condition of man (wherein men live without other security, than what their own strength) is a condition of war of everyone against everyone; in which case everyone is governed by his own reason; and there is nothing he can make use of, that may not be a help unto him, in preserving his life against his enemies; it followed, that in such a condition, every man has a right to everything; even to one another's body. And therefore, as long as this natural right of every man to everything endured, there can be no security to any man, (how strong or wise so ever he be,) of living out of time, which nature ordinarily allowed men to live. And consequently, it is a precept, or general rule of Reason, that every man, ought to endeavor peace, as far as he has hope of obtaining it; and when he cannot obtain it, that he may seek, and all helps, and advantages of war. The first branch of which rule, contained the first, and fundamental law of nature; which is, to seek peace, and follow it. The second, the sum of the right of nature; which is, by all means we can, to fend ourselves From very olden days it is being prevalent that any person does the business it is done for the sake of 'earning' and only 'earning'. This statement was wrongly interpreted as 'doing profit by any means is business. This lead to a business motivated evolution leading to development of businesses to an extent where each sector was rich with multiple business owners, eventually leading to a competition. Giving rises to the need of regulating all for a growth enabling environment.

In order to address the growing global business expansion, there arose a necessity to establish an act that would serve multiple purposes.

Firstly, it aimed at fostering the economic development of the country.

Secondly, it sought to establish a commission that would effectively prevent practices that could have a detrimental impact on competition.

Additionally, the act aimed to promote and sustain competition within the market, while also safeguarding the interests of consumers.

Lastly, it aimed to ensure the freedom of trade by facilitating participation in the market. To fulfill these objectives, the Government of India took the initiative to appoint a high-level committee on competition policy and competition law in October 1969. This committee was tasked with advising on a modern competitive law that would cater to the aforementioned purposes.

Competition law serves the purpose of maintaining a fair and balanced market environment rather than creating competition itself. It is not merely a legal framework, but rather an economic mechanism established by society to prevent any potential imbalances. This law exemplifies how legal regulations can effectively control the market and ensure that individuals engage in fair business practices. It is intriguing to observe how this law facilitates the survival of small business owners by creating opportunities for them. Recently, I came across a news article regarding the purchase of a specific quality of rice by Reliance, totaling 20,000 tons. This implies that Reliance now holds a monopoly over the availability of this rice, making it mandatory for consumers to purchase the product exclusively from them. Interestingly, a survey reveals that the actual harvest of "wada basmati rice" never exceeds 15,000 tons. However, numerous shops and supermarkets individually sell quantities surpassing this figure throughout the year. Although such statistics are not projected in any reports or other sources, it is alarming to witness how small entrepreneurs are manipulated or forced out of the market. A well-known case that highlights the significance of competition law is the Metro-Cash and Carry scenario. In this case, a market was opened for business-to-business (B2B) transactions, offering products at even lower rates than wholesale prices. Additionally, end consumers were allowed to make purchases, which ultimately led to a decline in sales for small local shops. However, we can take pride in the Indian justice system, which took a bold step by strictly enforcing B2B sales and prohibiting business-to-consumer (B2C) transactions. This is how competition law comes into existence. In simple terms, competition law refers to a set of

legislations aimed at preventing market distortions caused by anti-competitive practices carried out by businesses. It is commonly referred to as antitrust law in the United Nations, Canada, and the European Union. When individuals enter the market, their primary intention is to generate profits and gradually become the dominant player. However, instead of organic growth, some individuals resort to tactics that harm other market participants. It is crucial to address and regulate such actions, and this is where competition law plays a vital role.

The implementation of a comprehensive competition act can bring about substantial benefits for both businesses and consumers. From a business perspective, such a policy promotes fairness by combating anti-competitive practices that can force efficient and well-managed companies to exit the market. Moreover, it guarantees consistency as it is enforced by a unified authority adhering to a standardized set of rules. Additionally, it reduces the burden of regulation by being proactive, efficient, and effective, thereby eliminating the necessity of allocating resources and time towards creating new regulations in response to emerging products or markets. To give effect to the competition in the market act bring about two types of agreement horizontal and vertical, these agreements create anti-competitive market. It enhanced competition law, and has a significant impact on consumers, resulting in reduced prices and enhanced services.

We can summarize as,

Competition law serves the purpose of safeguarding and fostering competition in order to ensure the efficient allocation of resources within an economy. This, in turn, leads to the availability of a wide range of high-quality choices, competitive prices, and sufficient supplies for consumers. In India, the Competition Law draws its legal and constitutional foundation from Articles 38 and 39, which are part of the Directive Principles of State Policy under Part IV of the Constitution. The initial competition law in India was enacted in 1969 as the Monopolies and Restrictive Trade Practices Act (MRTP Act), building upon the principles outlined in the Directive Principles. However, the MRTP Act underwent amendments in 1984 to broaden the definition of monopolistic trade practices. Despite these efforts, the MRTP Act faced several challenges. Firstly, its licensing requirements and stringent regulations hindered efficiency and growth. Secondly, the MRTP Commission lacked the authority to impose significant penalties for violations. Additionally, there was ambiguity surrounding the definition of anti-competitive acts. As a result, certain aspects of the MRTP Act have become outdated in light of international developments in competition laws. Consequently, there is a

need to shift the focus from restraining monopolies to promoting competition. To address these concerns, the government has established a parallel, and upward restraining agreements. The Competition Law in India represents a new era in competition regulation and is crucial for creating a level playing field and fostering further development in the country.

Horizontal agreements are generally considered more likely to reduce competition than vertical agreements, and are therefore viewed more strictly by competition laws. Some examples of horizontal agreements that are considered illegal include: price-fixing, market division, output restriction, and bid-rigging.¹

Section 3(3) states²:

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.

[Provided further that an enterprise or association of enterprises or a person or association of persons though not engaged in identical or similar trade shall also be presumed to be part of the agreement under this sub-section if it participates or intends to participate in the furtherance of such agreement.]

¹ <https://www.ipleader.in>

² Bare act, Competition Act 2002 (amendment)

Explanation. - For the purposes of this sub-section, "bid rigging" means any agreement, between enterprises or persons referred to in sub-section (3) 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.

Agreement/practice/decision + Similar trade of Goods/ Services + Effect of the agreement= Presumption of AAEC³

Vertical agreements are agreements made between two or more parties which are operating at different levels of the production, supply and distribution chain for the purposes of that agreement. For example, between a manufacturer and a supplier or between a supplier and a retailer.

The parties only need to be operating at different levels of the chain for the purposes of the specific agreement, that is, the parties could ordinarily be competitors. But provided that they are acting at different levels in respect of the arrangement in question (for example, a manufacturer agreeing to supply the goods made by another manufacturer), it will be deemed a vertical agreement.⁴

Section 3 (4)⁵

Any other agreement amongst enterprises or persons including but not restricted to 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 [dealing] 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.

³ <https://www.ipleader.in>

⁴ <https://harperjames.co.uk>

⁵ Bare Act, Competition Act, 2002 amendment

[Provided that nothing contained in this sub-section shall apply to an agreement entered into between an enterprise and an end consumer.] Explanation. - For the purposes of this sub-section,-

- a) "tie-in arrangement" includes any agreement requiring a purchaser of goods or services, as a condition of such purchase, to purchase some other distinct goods or services;
- b) "exclusive dealing agreement" includes any agreement restricting in any manner the purchaser or the seller, as the case may be, in the course of his trade from acquiring or selling or otherwise dealing in any goods or services other than those of the seller or the purchaser or any other person, as the case may be;]
- c) "exclusive distribution agreement" includes any agreement to limit, restrict or withhold the output or supply of any goods [or services] or allocate any area or market for the disposal or sale of the goods [or services];
- d) "refusal to deal" includes any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods [or services] are sold or from whom goods [or services] are bought;
- e) "resale price maintenance" [includes, in case of any agreement to sell goods or provide services, any direct or indirect restriction] 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;

Common types of vertical agreements include:

- Distribution agreements – where one party appoints another (the distributor) to purchase the goods and market them under its own name.
- Supply agreements – where one party agrees to purchase the goods solely from the other party (the supplier).
- Franchising agreements – where one party (the franchisor) permits the other party (the franchisee) to use the franchise name, branding and know-how in return for an agreed sum. The franchisor often has some control over how the franchisee conducts the business but also provides assistance and support.
- Selective distribution agreements – where a supplier allows a group of specified enterprises to market its goods, with each member of the group having to meet certain criteria and possibly being subject to certain restrictions, for example, where it can market the goods.

Economic Effects:

Of Horizontal Agreement

- **Reduced Competition:** Leads to cartel formation, reducing market competition and consumer choices.⁶
- **Higher Prices:** Artificially inflates prices by restricting output or fixing prices.⁷
- **Inefficiencies:** May lead to reduced innovation and efficiency due to lack of competitive pressure.⁸

Of Vertical Agreement

- **Market Efficiency:** Can improve supply chain efficiency by ensuring stable supply and distribution.⁹
- **Consumer Benefits:** May lead to lower costs and better services if they create efficiency gains.¹⁰
- **Potential Anti-Competitive Risks:** Can result in market foreclosure, resale price maintenance (RPM), and exclusive dealing that limits market entry.¹¹

Legal Effects:

Of Horizontal Agreement¹²

- **Anti-Competitive and Illegal:** In most jurisdictions, such agreements are considered per se illegal or subject to a strict rule-of-reason analysis under competition law.
- **Heavy Penalties:** Regulatory authorities like the **Competition Commission of India (CCI)**, the **European Commission**, and the **U.S. Federal Trade Commission (FTC)** impose substantial fines on violators.
- **Limited Exemptions:** Some agreements may be allowed under the "efficiency defense" if they result in significant consumer benefits.

⁶ OECD. (2020). Fighting Cartels: Economic Effects of Horizontal Agreements

⁷ Whinston, M. D. (2006). *Lectures on Antitrust Economics*.

⁸ Motta, M. (2004). *Competition Policy: Theory and Practice*.

⁹ Lafontaine, F., & Slade, M. (2007). Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy.

¹⁰ United States v. Colgate & Co., 250 U.S. 300 (1919)

¹¹ Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007)

¹² Ezrachi, A., & Stucke, M. (2016). Virtual Competition: The Promise and Perils of the Algorithm-Driven Economy.

Of Vertical Agreement¹³

- **Evaluated under Rule of Reason:** Unlike horizontal agreements, vertical agreements are often assessed based on their actual impact on competition rather than being outright illegal.
- **Selective Bans:** RPM, exclusive dealings, and tying arrangements can be banned if they significantly harm competition.
- **Regional Differences:** Some jurisdictions, like the European Union, impose stricter controls on vertical restraints compared to others like the U.S.

3. Gaps in the Agreements¹⁴

- **Lack of Clarity in Enforcement:** Enforcement of vertical agreements varies significantly across jurisdictions, leading to inconsistencies.
- **Emerging Digital Market Concerns:** Digital platforms create new types of vertical restraints (e.g., platform bans, algorithmic pricing) that current regulations struggle to address.
- **Limited Coverage of Small Enterprises:** Competition laws often focus on large corporations, leaving smaller enterprises vulnerable to anti-competitive practices.
- **Gray Areas in Vertical Restraints:** Some restrictive agreements, such as most-favored-nation (MFN) clauses, operate in a legal gray area, making enforcement difficult.

Suggestion for horizontal and vertical agreement

For Businesses:

1. **Seek Legal Counsel:** Consult with legal experts specializing in competition law to understand the specific regulations and potential risks associated with your agreements.
2. **Conduct Self-Assessment:** Regularly assess your agreements to identify any potential anti-competitive effects.
3. **Document Agreements:** Maintain detailed records of all agreements, including their purpose, scope, and duration.
4. **Avoid Per Se Illegal Agreements:** Stay away from agreements that are inherently anti-competitive, such as price-fixing, market allocation, and bid-rigging.

¹³ OECD Report on Most-Favored-Nation (MFN) Clauses (2015)

¹⁴ Ibid

5. Consider Pro-Competitive Effects: Highlight the potential pro-competitive benefits of your agreements, such as increased efficiency, innovation, and consumer welfare.
6. Stay Updated on Competition Law: Keep abreast of changes in competition law and regulations to ensure compliance.
7. Cooperate with Competition Authorities: If investigated by competition authorities, cooperate fully and provide accurate information.

For Competition Authorities:

1. Clear and Consistent Enforcement: Establish clear and consistent enforcement guidelines to provide businesses with certainty.
2. Focus on Economic Analysis: Utilize economic analysis to assess the impact of agreements on competition and consumer welfare.
3. Promote Self-Assessment: Encourage businesses to conduct self-assessments of their agreements.
4. Consider Leniency Programs: Implement effective leniency programs to incentivize companies to report anti-competitive behavior.
5. International Cooperation: Collaborate with other competition authorities to address cross-border anti-competitive practices.
6. Public Awareness: Promote public awareness of competition law and its importance for a competitive market.

By following these suggestions, businesses can minimize the risk of antitrust violations and maximize the benefits of their agreements, while competition authorities can effectively enforce competition law and protect consumer welfare.