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Competition Law & India: An Analysis of the Test of Illegality

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ABSTRACT

Competition is an essential source of economic growth and development in a country globally while within its domestic boundaries competition serves as a mechanism to create a consumer-friendly market. To achieve this purpose, liberalization alone fails to be sufficient and competition policies need to be enacted to promote competition. Such policies have an essential role in the restructuring of developing and transition market economies; encouraging competition by keeping a check on potential monopolies and making sure that businesses act fairly in relationship to each other. It helps in promoting efficiency and impacts the behavior of individual enterprises and the structure of industries as a whole. It is concerned with the easing of Restrictive Business Practices that hinder free and fair competition and affect the measures taken to either promote a more competitive environment or to prevent a reduction in competition. Taking into consideration the importance of effective policies to avoid anti-competitive agreements, the author of this research paper shall be analyzing the test of illegality of appreciable adverse effect on competition employed by the Competition Act, 2002 in India and its application in different cases. The author will also analyze the effect of reliance on circumstantial evidence by the Courts under Section 3.

Keywords: anti-competitive agreements, per se rule, rule of reason, appreciable adverse effect, test of illegality

INTRODUCTION

"A dynamic and competitive environment, underpinned by sound competition law and policy, is an essential characteristic of a successful market economy"[1]

The competition law in India originated from Article 38 and 39 of the constitution of India, Hazari committee report of 1955 and, the MRTP Act of 1969. The contributions by these in the formation of the Competition Act of 2002 as we see today are multi-fold. The Act of 2002 deals with the following as in agreement among the enterprises, Abuse of dominance, mergers or, the combination among the enterprises. Section 3(1) of the Competition Act, 2002, deals with the provisions regarding the anti-competitive agreements based on two basic rules – the "*per se"* rule and the "rule of reason" both of which have been derived from the U.S. Laws.[2]

While the rule of reason is one that is decided based on the facts and circumstances surrounding each case, the per se rule requires no interpretation, but merely, a straightforward application of the provisions mentioned in the Act. Section 3(3) of the Competition Act 2002 can be interpreted to have the "per se rule" embedded within. This section allows the commission to consider the act to be a violation without any further inquiry if it falls under sub-clause of (a) to (d). This provision indirectly provides for the per se rule.[3]

ANTI-COMPETITIVE AGREEMENTS

Section 3 of the Competition Act states that any agreement which causes or is likely to cause an appreciable adverse effect (AAE) on competition in India is deemed to be anti-competitive. Section 3 (1) of the Competition Act prohibits any agreement concerning "production, supply, distribution, storage, and acquisition or control of goods or services which causes or is likely to cause an appreciable adverse effect on competition within India".[4]

[1] Khemani R.S., *A Framework for the Design and Implementation of Competition Law and Policy*, Preface (World Bank Publication, 1999).
[2] Parthapratim Das, *Development of Competition Law in India*, IPLEADERS (Feb. 17, 2017), https://blog.ipleaders.in/competition-law-india/.
[3] Nikhil Parikshith, *Demystifying the Rule of Per se and Rule of Reason in the Indian Context*, COMPETITION COMMISSION OF INDIA (Jun. 2011), http://citeseerx.ist.psu.edu/viewdoc/download;jsessionid=6444C98DAF610865303CAEF05CCA2631?doi=10.1.1.474.2300&rep=rep1&type=pdf.
[4] Shalaka Patil, Payel Chatterjee, Shashank Gautam, M S Ananth, Aditi Jha, Simone Reis, Pratibha Jain, *Competition Law in India: A Report on Jurisprudential Trends and way forward Introduction,* NISHITH DESAI (Apr. 2013), http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Competition_Law_in_India.pdf.

MEANING OF AGREEMENT UNDER COMPETITION ACT, 2002

For all other purposes in India Law, an agreement needs to have an intention by both parties and requires to be made formally or in writing. However, under Competition Law, an agreement doesn't have the same qualifications.

Under the aegis of the Indian Law, the scope of an agreement has been specifically dealt with under Section 2(b) of the Act which defines the word "agreement" as under:

"Agreement" includes any arrangement or understanding or action in concert-

(i) Whether or not, such arrangement, understanding or action is formal or in writing; or
(ii) Whether or not, such arrangement, understanding, or action is intended to be enforceable by legal proceedings.

This means that to fall under this definition, concerted action on the part of the enterprises or persons is a pre-requisite. Even when parties to such an arrangement do not intend to create any legally enforceable mutual duties and liabilities, it shall be considered as an agreement under this Act.[5]

In the landmark case of **Registrar of Restrictive Trade Agreements v. W. H. Smith and Sons**[6], the court observed that "*people who combine together to keep up prices do not shout it from the housetops. They keep it quiet…. They will not put anything into writing nor even into words."* and in doing so held that an agreement in such cases may be informal and widened the scope to include agreements that weren't so in its strictest sense. Further, in **Technip S. A. v. S.M.S Holding Pvt. Ltd.**[7]**,** the court laid down that the section covers an understanding as well as an agreement, informal as well as a formal agreement or arrangement which leads to the purchase of share to acquire control of a company.

APPRECIABLE ADVERSE EFFECT ON COMPETITION

Agreements are anti-competitive if they affect competition adversely. Different phrases have been used in different jurisdictions regarding this. For example: In the United States, agreements in 'restraint of trade' or 'attempt to monopolize' are punishable, whereas in the EU, if the 'object' or

[5] Abir Roy & Jayant Kumar, *Competition Law in India*, 2nd Ed., Eastern Law House, 2018, p. 51.
[6] Registrar of Restrictive Trade Agreements v. W. H. Smith and Sons, (1968) 3 All ER 721.
[7] Technip S. A. v. S.M.S Holding Pvt. Ltd., (2005) 5 SCC 465.

'effect' of an agreement is prevention, restriction or distortion of competition, it may be held anti-competitive. In India, the phrase used is 'appreciable adverse effect on competition.'[8]

The concept of appreciable adverse effect (**"AAEC"**) has been applied since the MRTP Act 1969. In **Mahindra and Mahindra**[9], which came under the MRTP Act, the Apex Court observed that only where a trade practice has the effect, actual or probable, or restricting trade practice. The Act is clear that while considering the impact on competition, not only the actual effect but even the probable effect should be taken into consideration.[10]

However, the term appreciable adverse effect of competition has not been defined under the Competition Act, 2002, neither a particular standard has been laid down to determine when an agreement is anti-competitive or when it causes AAEC. The determination of 'appreciable' has proved to be a main problem under the Competition Act.

Rules for Determining "Appreciable Adverse Effect on Competition"

Every restraint is not harmful and to determine the extent of harmfulness, the tests which were laid down by the United States were recognized, adopted, and applied in India through case law before the Competition Act 2002, was enacted.

Rule of Reason

The rule of reason requires an inquiry into facts peculiar to the business to which the restraint is applied, its condition before and after the restraint was imposed, the nature of the restraint and its effect, actual or probable, history of the restraint, the reason for adopting the particular remedy, the purpose or end south to be achieved.[11]

The rule of reason, for the very first time, was established in the case of **Chicago Board of Trade v. United States.**[12] The court observed that — *"legality of an agreement or regulation cannot be determined*

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[8] Anamika Shukla, *Competition Regime In India: In Depth Analysis Of anti-Competitive Agreement,* International Journal of Law and Legal Jurisprudence Studies, Vol 4 Issue 2 (2017), http://ijlljs.in/wp-content/uploads/2017/04/Competition_law_regime_in_India_with_analysis_of_anti-_competitive_agreements.pdf.

[9] Mahindra and Mahindra Ltd. v. Union of India, AIR 1979 SC 798.

[10] Anamika Shukla, *Competition Regime In India: In Depth Analysis Of anti-Competitive Agreement,* International Journal of Law and Legal Jurisprudence Studies, Vol 4 Issue 2 (2017), http://ijlljs.in/wp-content/uploads/2017/04/Competition_law_regime_in_India_with_analysis_of_anti-_competitive_agreements.pdf.

[11] Chicago Board of Trade v. United States, 246 U.S. 231 (1918).
Payal Malik, *Competition Law in India: Developing Efficient Markets for Greater Good,* VIKALPA, Vol. 41 Issue 2 (April-June 2016), https://journals.sagepub.com/doi/pdf/10.1177/0256090916647222.

[12] Chicago Board of Trade v. United States, 246 U.S. 231 (1918).

by so simple a test, as to whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind. To restrain is of their very essence."

Rule of Reason can be applied to agreements under the purview of Section 3(4) of the Competition Act, 2002 in consonance with Section 19(3) of the Act[13].

Per Se Rule

The Per Se Rule came into existence as a result of the heavy burden imposed on the Courts by the Rule of Reason. In the case of **Northern Pacific Railway Co**.[14], the court held that — "there are certain agreements which, because of their pernicious effect on competition and lack of any redeeming virtue, are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."

Further in the case of **Tata Engineering and Locomotive Co.Ltd**.[15], the court observed that section 38 of the 1969 Act provides that a restrictive trade practice shall be deemed to be prejudicial to the public interest unless the MRTP Commission, which is authorized to inquire, is satisfied with any one or more circumstances mentioned in this section.

In the present Act, the *per se* rule is embedded within this Section and hence, any agreement which is in contravention to Section 3(1) shall be void.

Appreciable Adverse Effect: Horizontal Versus Vertical Agreements

The Competition Act does not categorize agreements into horizontal or vertical however the language of Sections 3(3) and 3(4) makes it abundantly clear that the former is aimed at horizontal agreements[16] and the latter at vertical agreements.[17]

Presumption Rule for Horizontal Agreements

While Section 3(1) of the Competition Act, 2002 is a general prohibition for associations or enterprises to enter into any agreement that has an appreciable adverse effect on competition; the words in Section 3(3) are specific. Section 3(3) provides that any agreement which falls within the section "shall be presumed" to have an appreciable adverse effect on competition. The words

[13] *Section 19(3) of the Competition Act, 2002 lays down six factors, each, or any of which are taken into consideration by the Courts in order to determine appreciable adverse effect on competition.*
[14] Northern Pacific Railway Co. v. United States, 356 U.S. 1 (1958).
[15] Tata Engineering and Locomotive Co.Ltd v. Registrar of Restrictive Trade Agreements, AIR 1977 SC 973.
[16] *Between actual or potential competitors operating at the same level of the supply chain.*
[17] *Between firms operating at different levels, i.e. agreement between a manufacturer and its distributor.*

"shall be presumed" in section 3(3) gives rise to a presumption of illegality of the agreements against the defendants. This presumption rule given under section 3(3) has been explained by the courts in numerous cases[18] one of the landmark ones being **Sodhi Transport Co. v. State of Uttar Pradesh.**[19]

In the landmark case of **Builders Association of India v. Cement Manufacturers' Association**[20], 11 cement manufacturers shared information regarding price, manufacturing units, dispatch rates in the meetings held by them. Similar changes in prices displayed by the companies were also noticed. CCI observed that the above was enough circumstantial evidence to presume cartelization of the 11 cement manufacturers to *"(a) directly or indirectly determine purchase or sale prices and (b) limit or control production, supply, markets, technical development, investment or provision of services"*[21] and held certain the 11 cement manufacturers guilty of violating sections 3(3)(a) and (b) of the Act.[22]

The only exception to the per se rule is in the nature of joint venture arrangements which increase efficiency in terms of production, supply, distribution, storage, acquisition or control of goods or services. Thus there has to be a direct nexus between cost/ quality efficiencies the agreement and benefits to the consumers must at least compensate consumers for any actual or likely negative impact caused by the agreement.[23]

Rule of Reason for Vertical Agreements

Unlike horizontal agreements, vertical agreements relating to activities referred to under Section 3(4) of the Competition Act have to be analyzed per the rule of reason analysis under the Competition Act. In essence, these arrangements are anti-competitive only if they cause or are likely to cause an AAEC in India.

To determine whether an agreement has AAEC under Section 3(4), Section 19(3) of the Act specifies certain factors for determining AAEC. These factors are merely suggestive and cannot be taken to be the final determinants to identify if a particular agreement or arrangement causes

[18] Sodhi Transport Co. v. State of Uttar Pradesh, AIR 1980 SC 1099; R.S. Nayak v. A.R. Antulay , AIR 1986 SC 2045.
[19] Sodhi Transport Co. v. State of Uttar Pradesh, AIR 1980 SC 1980.
[20] Builders Association of India v. Cement Manufacturers' Association, Case No. 29 of 2010 decided on 31st August, 2016.
[21] Section 3(3), Competition Act, 2002.
[22] Anshuman Sakle, CAM Competition Team, *The Curious Case of the Cement Cartel*, INDIA CORPORATE LAW (Nov. 14, 2016), https://corporate.cyrilamarchandblogs.com/2016/11/curious-case-cement-cartel/.
[23] Shalaka Patil, Payel Chatterjee, Shashank Gautam, M S Ananth, Aditi Jha, Simone Reis, Pratibha Jain, *Competition Law in India: A Report on Jurisprudential Trends and way forward Introduction,* NISHITH DESAI (Apr. 2013), http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Competition_Law_in_India.pdf.

AAEC. Although these factors are suggestive, the intent of the legislature is reflected in the mandatory language of Section 19(1) of the Act which lay down that CCI should carry a balanced assessment of the anti-competitive as well as the pro-competitive effects of the agreement.[24]

Section 19(3) of the Act states that while determining whether an agreement has an appreciable adverse effect on competition under section 3, the commission shall give due regard to all or any of the following factors:

(i) creation of barriers of new entrants in the market;
(ii) driving existing competitors out of the market;
(iii) foreclosure of competition by hindering entry into the market;
(iv) accrual of benefits to consumers;
(v) improvements in production or distribution of goods or provision of services;
(vi) Promotion of technical, scientific, and economic development through production or distribution of goods or provision of services.[25]

The first three relate to the negative effects on the competition while the remaining three relate to positive or beneficial effects on competition. In **Automobiles Dealers Association v. Global Automobiles Limited & Anr.[26],** CCI held that it would be prudent to examine any action in the backdrop of all the factors mentioned in Section 19(3). The agreement should be the cause of the adverse effect on the competition. Even if such a consequence is probable, the agreement is anti-competitive. The probability and not mere possibility of its consequence as appreciably affecting competition is the requirement.[27]

ANALYSIS AND CONCLUSION

The appreciable adverse effect test is one that has been adopted into the jurisprudence of Indian Competition Law. A commonality that emerges through the string of cases decided under Section 3 of the Act as discussed is the reliance on circumstantial evidence by the courts and CCI.[28] The advantage of using this test and relying on circumstantial evidence is that any explicit agreement or correspondences regarding the cartels or price-fixing will be strictly hidden and possibly destroyed; thus, if there are parallel behaviors in the functioning of firms which harm or have

[24] *Ibid.*
[25] Section 19(3), Competition Act, 2002.
[26] Automobiles Dealer Association v. Global Automobiles Ltd., Case No. 33 of 2011, decided on July 3, 2012.
[27] D. P. Mittal, Competition Law and Practice, Taxmann, 3rd Ed., 2011, p. 176.
[28] Tanya Varshney, *Effects on Competition and Circumstantial Evidence in Antitrust Investigation,* INDIA CORP LAW (Jun. 28, 2018), https://indiacorplaw.in/2018/06/appreciable-adverse-effects-competition-circumstantial-evidence-antitrust-investigations.html.

adverse effects on the market can be presumed to be anti-competitive under the Act. However, a clear disadvantage of relying on circumstantial evidence is the ambiguity in assessing parallelism and adverse effects on competition.[29]

Another positive aspect is the definition of the term agreement in Indian Competition law. It has been defined in wide terms to include all kinds of agreements because the parties to the agreement often decide not to formalize their agreement, in fact sometimes they try to hide the agreement or any trace of it, especially in case of cartels. In this way, incorporating a wide definition of the term agreement helps ease identifying anti-competitive practices.

The Competition Act of 2002 has attempted to deal with anti-competitive practices, but it has failed to define certain provisions that are used in the Act, like relevant market, market definition, etc. The Act needs to address all the loopholes at the earliest to make the Act effective legislation. Further, the Competition Regulatory Authority must be well-versed with the provisions of the Act to deal effectively with different kinds of anti-competitive practices.[30]

[29] *Ibid.*

[30] Amit Kashyap and Sonia Garg, *Critical Analysis of Anti-Competitive Agreements and Appreciable Adverse Effect of Competition in India*, INTERNATIONAL JOURNAL OF CURRENT ADVANCED RESEARCH, Vol 7 Issue 2, (February 2018) http://www.journalijcar.org/sites/default/files/issue-files/5643-A-2018_0.pdf.