Annex II

ANTI-COMPETITIVE BEHAVIOUR

A. Horizontal agreements

Horizontal agreements or forms of coordinated behaviour between competing undertakings are divided into two categories: those which constitute "hard-core" restraints such as price-fixing, output restraints, market division, customer allocation and bid rigging, which can be normally expected to reduce or eliminate competition and to lack redeeming effects on economic efficiency, and those which may not harm competition significantly or that may be positively pro-competitive or have beneficial effects that outweigh the anti-competitive effects.

In some jurisdictions, the former are considered per se offences, i.e., the violation is established on proof that the agreement exists, while the second category is considered under a "rule of reason" analysis to ascertain their likely impact in the circumstances of the individual case.

Agreements which contain restrictions that are not per se offences are examined on a case-by-case basis to assess whether taken overall, the anti-competitive effects are outweighed by positive effects, for instance, because they promote the development of new products and services, encourage investment or enhance inter-brand competition. Examples of such agreements that are generally subject to the "rule of reason approach" include:

(a) The establishment of labelling and other product standards;
(b) Joint or restricted advertising or promotion;
(c) Exchange of some types of information (information about costs, current prices and sale conditions, however, will usually be deemed anti-competitive);
(d) Research and development;
(e) Specialization or rationalization agreements.

Some of the factors that are usually taken into consideration in assessing the effects of these agreements include the size of the firms involved, the number of market operators, the homogeneity of the products and the general competitive situation in the market.

B. Vertical agreements

Vertical agreements are those between independent undertakings which operate at different levels of the market (for example, between a producer and distributor). Vertical restraints contained in such agreements vary a great deal in scope and their effects on competition depend on the particular context. Some vertical restraints, for instance, while limiting intra-brand competition, may eliminate free-riding and thereby increase overall inter-brand competition. Others may be used as a vehicle for collusion at the producers' level and thereby restrict horizontal competition. For this reason, analysis of vertical agreements implies a more subtle analysis than that for horizontal agreements and there
are fewer clear-cut offences. Vertical agreements are therefore, generally dealt with on a case-by-case basis or are exempted by category, where specific criteria are fulfilled.

Non-price vertical restraints include the granting of exclusive territories (by geographic market segment), limitations on the category of customers to which the seller may sell, exclusive selling or purchasing, tie-in provisions (which oblige the purchaser of one type of service to purchase other services from the same supplier), and full-line forcing (which obliges the purchaser to buy a complete range of services from the supplier).

Various tests and criteria have been drawn up or category exemptions adopted to screen out vertical agreements which do not have significant anti-competitive effects. The first is a market share test. Where the parties to an agreement have only a small market share in the relevant market(s), then even if a non-price vertical restraint causes some foreclosure of the market, it is unlikely to significantly increase entry costs and deter entry. The second test looks at entry conditions. Even if the parties have a non-negligible share of the market but entry to the market in which they operate is relatively easy, then the agreement is unlikely to have significant anti-competitive effects. Where these tests are not met, a more detailed examination would be warranted.

Some of the other relevant issues to be considered in making an assessment of non-price vertical restraints include:

(a) Whether one of the parties is a new entrant or is already established but attempting to enter a new market;

(b) The nature of the product or service and the extent to which the restraints contribute to the production or distribution - of the product or service (for example, aftersales service, special sales advice) or to the efficient transfer of know-how or intellectual property;

(c) The duration of the agreement;

(d) What the effect would be on the market if a particular practice was prohibited, for example, would there be less investment in research and development?

(e) If the agreement is part of a network of agreements, what will be the overall effect?

C. Abuse of a dominant position/monopolization

Provisions against the abuse of a dominant position or monopolization are common to most competition laws. Dominance or monopolization occurs when a firm has an economic position which would enable it to behave independently of its competitors. Dominance does not preclude the existence of some competition, but does imply that the dominant firm is able to have an appreciable influence on the market, i.e., the power to raise prices without losing market share. There are three stages of analysis to determine whether a firm is monopolizing a market or abusing a dominant position:
(a) **The definition of the relevant market**

In all areas of enforcement, it is necessary to define the relevant product and geographic market. The product (or service) market is defined in terms of the product(s) which are substitutable. Factors which help determine the product market include: the physical properties of the product, end use(s), price, elasticity of demand in response to a change in price and supply-side substitutability. The geographic market is defined by the area in which it can be expected that the products might compete in the short term.

(b) **Identification of a dominant position.**

A firm is dominant if it has substantial market power. This has to be assessed in the context of the particular market concerned. A low market share would suggest little or no market power. A high market share does not necessarily result in market power. Other factors in this assessment include: the size of the market shares of other firms in that market, entry barriers to the market (such as costs of entry, government regulation, supply arrangements, "switching costs" for buyers, transport costs), evidence of strong vertical integration, control over distribution systems, control over intellectual property and the likelihood of entry and strength of potential competitors.

(c) **Abuse of a dominant position**

Abusive conduct by a dominant firm broadly includes behaviour which interferes with the competitive process and, in particular, attempts to eliminate or restrict actual or potential competition. Examples of such conduct include predatory pricing to drive out rival firms, refusal to supply, tied sales, limiting access to network facilities, price discrimination, vertical restraints and raising costs for rivals.

Markets which may be particularly vulnerable to the abusive exploitation of market power are those which have been heavily regulated in the past and which leave the incumbents with well-entrenched market power, even after the regulatory framework that established that market power has been removed.

D. **Mergers and acquisitions**

Mergers and acquisitions are important to market dynamics. They are a means by which firms can take advantage of available economies of scale, expand into different product and geographic markets, move into different stages of production or acquire access to technology and know-how as a complement to existing operations. Moreover, the threat of possible takeover may provide an incentive for better company management.

Notwithstanding the arguments in favour of mergers, there are certain instances where the result may be detrimental to competition in the relevant market. This is much more likely to be the case for horizontal mergers than for vertical or conglomerate mergers, but even so, relatively few horizontal mergers are challenged. The presumption of a negative effect on competition arises where the firms concerned have a significant market share, where the market is highly concentrated and where the market conditions are such that the likely effect of the merger is to create or strengthen dominance or otherwise substantially lessen competition.
Vertical mergers may sometimes also be detrimental to competition if they have the effect of foreclosing competition in upstream or downstream markets. Even conglomerate mergers may harm competition in some circumstances although the arguments as to the circumstances in which this is likely to harm competition are more controversial.

From an enforcement perspective, the characteristic problem of merger control is that once the transaction has occurred, it may be very difficult to limit any adverse effects except by the fairly clumsy method of divestment. Most jurisdictions, therefore, opt for a pre-emptive form of control whereby parties must seek the approval of the competition authorities before completion. Notification is clearly not necessary for all such transactions and there is generally a screening process based on the size and market shares of firms participating in the merger before undertaking a detailed assessment of the likely effects on competition.

E. Enforcement of competition laws

While the adoption of a competition law is a necessary first step towards the establishment of competition policy, the effective enforcement of the law is equally important. Enforcement agencies have a significant role in interpreting the often general substantive principles in concrete cases and, along with any other institutions involved in enforcement, making significant decisions about the effects of particular practices on competition in the particular case. Precedents established by enforcement action become an important guide to enterprises on the actual policy being pursued. Mention has been made of the need for appropriate institutional machinery, preferably an independent agency enjoying considerable independence to enable it to focus on applying the law. This does not mean that it should not be accountable. Most laws require the agency to submit annual reports to the Minister with responsibility for competition policy or to Parliament. In addition, decisions made by the competition authority are subject to review by other administrative or judicial bodies in all countries.

The essential first principle of competition law enforcement, as for any other policy, must be that decisions are taken transparently, fairly and consistently. For enforcement to be transparent, the law itself has to be well known to businesses and its provisions well publicized. This can be achieved initially through the distribution of leaflets and the holding of seminars on different aspects of the law. Subsequently, after a period of enforcement, guidelines are often issued on what is acceptable or unacceptable behaviour in areas where case-by-case analysis is necessary. Such guidelines must also be backed up by publicity on decided cases to illustrate enforcement activity.

Many competition authorities also emphasize compliance with the law rather than prosecution, preferring prevention rather than cure. Such methods would seem to be particularly useful in relation to mergers and acquisitions where per se rules are not possible. Procedures for giving informal guidance to firms planning to merge are widely used in many countries and frequently avoid the need for formal, lengthy investigations, costly for both the authority and the firms involved.
Closely linked with the choice of an administrative or judicial system is the issue of whether certain offences should be criminal or subject to administrative proceedings and fines. Most countries appear to have opted for the administrative system of enforcement.