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PER SE RULE VIS-À-VIS RULE OF REASON: A COMPARATIVE STUDY OF INDIA AND U.S. COMPETITION LAWS *

Introduction

The competition law in India originated from the Article 38 and 39 of the constitution of India, Hazari committee report of 1955, MRTP Act of 1969 (amended in the year 1984 and 1991)[1]. All these have contributed a lot in the formation of the Competition Act of 2002 as we see today. This Act of 2002 deals with the following as in agreement among the enterprises, Abuse of dominance, mergers or the combination among the enterprises. The section 3(1) of the Competition Act 2002[2] deals with the provisions regarding the anti competitive agreements. And in order to determine that the agreement or combination is anticompetitive in nature or not we have the two main rules regarding it which are dealt below.

There are two main rules in the Competition law where it is decided that any of the agreements or practices of any of the business enterprise or the company if is anticompetitive in nature or not. Both of these rules have originated in United States. The "rule of reason" is derived from the Section 1 of the Sherman Act. Whereas the per se rule has been derived from the various case law in the American courts such as, Northern Pacific Railway Co v. United States and many others.[3]

The rule of reason where requires a lot of inquiry and case to case interpretation of the provisions of the Act in order to determine that whether the issue in discussion is violative of the provisions

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[1] TCA Anant, Competition Policy In India:- An Overview

[2] 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.

[3] Nikhil Parikshith, Demystifying the Rule of Per se and Rule of Reason in the Indian Context, June 2011

or not, on the other hand the per se rule is merely the application of the provisions mentioned in the Act. Here as per this rule there is not much interpretation, there is no as such prolonged inquiry and if there is prima facie violation of the provision then this rule will be made applicable. In the Indian context we have the famous case of Neeraj Malhotra v Deustche Post Bank Home Finance Ltd. & Ors from which the Competition Commission of India defined the provision of the per se rule and the rule of reason. The rule of reason where is more reasonable and extensive in nature, it requires much of inquiry etc. the burden of proof initially lies on the plaintiff to prove that the agreement or the transaction in issue had the anticompetitive effect on the market as such.

The section 3(3) of the Competition Act 2002 can be interpreted to be having the "per se rule" embedded in it as here this section here this section allows the commission to have the violation be made without the further inquiry if it is voilative under the sub clause of (a) and (d). This provision indirectly provides for the per se rule.

EVOLUTION OF "RULE OF REASON" IN UNITED STATES.

The Sherman Act of 1890 was passed to curb the monopolistic approach of the various rail road companies of the America, which were exploiting the farmers, shippers, traders etc for their own benefits through the restricted trade practices and making others enter into the anti-competitive agreements. Also this was the time when there were trusts which were "legally" driving out the competition in their favor, through the practices which were unfair and unjust in nature. By the year 1888 both the major parties had adopted or agreed to the term that there was the need to curb the monopoly (but they were not sure about the method of how to do so). So, in the year 1890 the United States came up with the piece of legislation "The Sherman Act of 1890" to overcome this problem.[4]

The rule of reason in the united state has evolved through the various case laws. The section 1[5] of the Sherman Act states that every agreement, contract, combinations etc which are restraint to the trade are void and illegal in nature. The term when was interpreted by the supreme court of United State then it as stated by the court that "When…the body of an act pronounces as illegal every contract or combination in restraint of trade or commerce among the several states, etc., the plain and ordinary meaning of such language is not limited to that kind of contract alone which is in

[4]Richard Whish and Brenda Sufrin, Article 85 and the "Rule of Reason, Competition Law

[5] Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

unreasonable restraint of trade, but all contracts are included in such language, and no exception or limitation can be added without placing in the act that which has been omitted by congress."[6]

In the case of Chicago Board of Trade V. United State[7], the rule of reason was explained by the court as follows: - "The legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the 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. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court interpret facts and to predict consequences."

All these above cases laid down a three point check on the inquiry, whether it is a anti-competitive in nature or not, which are[8]:-

1. What is the possible harm which may take place from the activity of the collaborators?
2. The object which they are trying to achieve is a legitimate one?
3. Does there exists any other means to achieve their objective through the legitimate means?

These three test questions in themselves are very elaborative in nature and in order to satisfy them there is need of a very detailed inquiry as well as determination of what is reasonable and what is not would turn out to be very comprehensive in nature.

In the Indian context the Supreme Court in the case of Mahindra and Mahindra V. Union of India[9], TELCO V. Registrar of RT[10], held that the rule of reason is to be applied in the case as here in these the definition of the term "Restricted Trade Practices" is a very exhaustive one and not the inclusive in nature. Later on in the case of Sodhi Transport Co. V. State of U.P[11], the supreme Court held that "shall be presumed" as the presumption alone and not as the evidence itself. Here the Supreme Court stated that the vertical agreement under the section 3(4) of competition Act 2002 shall be interpreted in accordance with the rule of reason and not otherwise.

[6]Supra4
[7] Chicago Board of Trade V. United State 246 U.S. 231 (1918)
[8] Phillip Areeda ,The Rule of Reason in Antitrust Analysis: General Issues, June 1981
[9] Mahindra and Mahindra V. Union of India (1979). 2 SCC 529
[10]
[11]Sodhi Transport Co. V. State of U.P, 1986 AIR 1099

EVOLUTION OF PER SE RULE IN UNITED STATES AND INDIA.

The per se rule as opposed to the rule of reason is used in the cases like of the price fixing, allocation of territories, bid rigging, group boycotts, concerted refusal to deal, and resale price maintenance etc. These are the cases where the court try to avoid the troublesome and the prolong inquiry. In United States the illegal per se often refers to categories of the anti competitive behavior and anti-trust acts which are conclusively to be held as illegal/unreasonable in nature.

In Jefferson Parish Hospital District. No.2 v. Hyde the court here explained that in case where the anti-competitive nature of the act is so great that it is useless to have an inquiry over such issue in order to determine its unreasonableness. Then in that case the court may order accordingly without wasting time on the inquiry etc.

In the nut-shell it can be stated that as per "per se rule" once the certain act falls under the recognized preview of the criteria of per se rule then in that case there is no need for the further inquiry and also all the defenses and the attempt to prove the reasonableness of the act in question shall be precluded. It can also be explained that when there is sufficient indicator of the unreasonableness and anticompetitive potential then in that case the "per se rule" is applied as there is no need for further inquiry etc. this rule of "per se" not only saves time but also cost where the outcome of the inquiry is not worth the unreasonableness.[12]

In the case of FTC v Superior Court Trial Lawyers Association[13] the Supreme Court of United State held that "the "per se" rules in antitrust law serve purposes analogous to "per se" restrictions upon, as in here the court gave the example of prohibition of stunt on the road, here the court held that if the stunt flying is banned on any road than how so ever the driver is trained and qualified the restriction remains the same.

It can also be clearly stated that when the violations are costly in nature and cannot be expensed that much of amount the investigation then in that case there, the judicial system would minimize enforcement costs by conditioning liability on the cheaply observable behavior, and the resulting enforcement errors, corporate compliance costs, and social costs of deterring socially beneficial actions, would not produce an efficiency loss.[14]

The non competing agreements are covered under the section 3(3) of the competition Act 2002. As per the essence of the Act this can be considered as the condemned agreement as per the "per

[12]Supra note 3
[13] FTC v Superior Court Trial Lawyers Association case, 493 U.S. (1990)
[14] Jonathan B. Baker, "per se" Rules in the Antitrust Analysis of Horizontal Restraints, 36 ANTITRUST BULL.733, 740 n 29(1991); See also F F.M. Scherer & David Ross, "INDUSTRIAL MARKET STRUCUTRE AND ECONOMIC PERFOREMANCE", 3rd Edn. 1990

se rule". This is interpreted from the fact that Section 3(3) covers agreements which are considered to be anti-competitive in nature. When it comes to the non-compete agreements the test for the reasonableness is of quite importance and cannot be ignored. The buyer has a legitimate interest deriving from the common law to protect the advantage gained from such acquisition. Therefore, such an agreement should not be per se condemned as anti-competitive and there must be proper test for reasonableness. As per the Raghvan Committee report it can be stated the test for Anti-competitiveness is a per-se determination. This seems apparent from the heavy reliance by the Commission on the position in USA in reference to certain condemned market restrictive agreements[15].

CURRENT STATUS OF PER SE RULE

With the change of time and the various decisions given the supreme court of United States of America, the "per se rule" is losing its effect and now the courts majorly rely on the rule of reason and per se rules are now restricted to a very limited interpretation now, like discussed above in the matters of price fixation etc. So, this "per se" rule is now very much narrowed and restricted down. The US antitrust policy of the hostile "per se" rule approach has now been changing to the moderate "rule of reason" approach. If we take the example of "tying" then in that case the US supreme court favored under Jefferson Parish[16] (the rule of reason in the with four judges in favor of a rule of reason), to a neutral position under the Microsoft III rule of reason approach.

U.S. v. MICROSOFT[17]

This case of Microsoft had a number of issues involved in it against the antic-competitive and anti-trust issues; this case clearly shows the changing approach of the court in United States over various conflicting issues. Here in this celebrated case the Court of Appeal has stressed upon the change in shift from the earlier stressed per se rule to the rule of reason approach, hence making it an important case in changing jurisprudence.

Facts:

The U.S. Department of Justice and 21 states raised a number of antitrust charges against Microsoft claiming that it had violated U.S. antitrust law by contractually and technologically bundling the Internet Explorer ("I.E.") with its Windows operating system. The alleged charges against Microsoft ranged from monopoly leveraging to monopoly maintenance and exclusive distribution. The District Court, applying the test under Jefferson Parish, held that the

[15] Tathagata Choudhury. Scrutinizing Non-Compete Agreements under the Indian Competition Regime
[16] Jefferson Parish Hospital Dist. No. 2 et al. v. Hyde,[466 U.S. 2 (1984)]
[17] United States v. Microsoft Corp., [253 F.3d 34 (D.C. Cir. 2001)]

combination of IE and Windows met the Jefferson Parish conditions and was therefore illegal. The Court of Appeals rejected the Jefferson Parish test and concluded that software platforms, such as Windows, should be subjected to a rule of reason balancing anticompetitive effects and efficiencies.

In particular the Court of Appeals held "that integration of new functionality into platform software is a common practice and that wooden application of per se rules in this litigation may cast a cloud over platform innovation for PCs, network computers and information appliances."

The court of Appeal challenged the District court's application of the modified per se rule under Jefferson Parish on two grounds:

- At the general level, that a per se rule was inappropriate in cases like, Microsoft III which raised a number of novel issues.

- The separate-product test of the modified per se rule was developed under Jefferson Parish could not be relied on in the Microsoft III case.

When we see the American jurisprudence of around 112 years, then we come across the specific omission of "per se" classification for such agreements from the Act, which is outstanding. This should especially surprise those proponents who are convinced as to the "per se" nature of this agreement. It is proposed that is not a mere matter of semantics that a "presumption" and not "per se" status is accorded to such agreements. The former warrants a limited scope for discretion, interpretation and analysis on the part of the prosecuting and adjudicating authority. This stance may be further elucidated on seeing the evolution of the "per se" rule in US[18].

The U.S. Sherman Act Section 1 effectively reads "every agreement in restraint of trade is declared to be illegal". This section has generally been interpreted to mean agreements which cause a restrain in trade in so much as the anti-competitive effect arising out of it overrides any pro-competitiveness justification. While this is the general standard, the US Supreme Court has also held that certain agreements are so unlikely to have any precompetitive effect that they are better condemned anti-competitive "per se" without any case by case inquiry into their net effect. If the "per se" rule does not apply, the general "rule of reason" persists. Under this test, the court analyzes each agreement to see its pro-completive justification. The plaintiff is offered a chance to prove the anti-competitive effect of the agreement either through direct proof or market power. If a plaintiff proves his share, the burden shifts to the defendant to show that the challenged conduct has a precompetitive justification outweighing the mischief. In simpler words the "rule of reason"

[18]Phillip Areeda, The "Rule of Reason" in Antitrust Analysis: General Issues

calls for an elaborate inquiry into the "reasonableness" of an alleged anti-competitive agreement whereas the "per se" rule condemns an agreement as anticompetitive on the existence of certain parameters without the need for further inquiry[19].

In part the justification for these "per se" rules is rooted in administrative convenience and clarity. The "per se" rule reflects a judgment that costs of identifying exceptions to the general rule so far outweigh the costs of occasionally condemning conduct that might upon further inspection prove to be acceptable, that is it is preferable not to entertain defenses to the conduct at all. Further, noticing the limitation of courts in ascertaining the economic implications of a conduct, a guideline was attempted to be created for a consistent line of action[20].

PRESENT STATUS OF BOTH THE RULES IN INDIA

Section 3 of the Competition Act 2002 has been enacted in order to bring in the different types of the Agreements which might be anticompetitive in nature as well as the anti-trust in nature. There are the two major types of the agreements in the competition Acts as in:-

Horizontal Agreements[21] [Section 3(3)]:-

Horizontal Agreements are agreements between two or more enterprises that are at the same stage of the production chain and, in the same market[22]. The best examples which can be provided for this type of the agreements are agreements between two suppliers dealing in the same products. However, in general, it is important to define the relevant markets. In order to be fitted in this type both the products must be substitute to each other. Being at the same stage of the production chain implies that the parties to the agreement are both (all) producers, or retailers or wholesalers. Under section 3(3) the following agreements are presumed to be anti-competitive[23]:

- Directly or indirectly determines purchase or sale prices;
- limits or controls production, supply, markets, technical development, investment or provision of services;
- 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;
- directly or indirectly results in bid rigging or collusive bidding;

[19]Nikhil Parikshith, Demystifying the Rule of Per se and Rule of Reason in the Indian Context, June 2011
[20]ibid
[21]Nikhil Parikshith, Demystifying the Rule of Per se and Rule of Reason in the Indian Context, June 2011
[22] ibid
[23] ibid

VERTICAL AGREEMENTS[24] [SECTION 3(4)]

Vertical agreements, on the other hand, are agreements, between enterprises that are at different stages or levels of the production chain, and therefore, in different markets. An example of this would be an agreement between a producer and distributor. Vertical restraints on competition include:

- Tie-in arrangements
- Exclusive supply agreements
- Exclusive distribution agreements
- Refusal to deal

Raghvan committee report

On Horizontal Agreements: "Agreements are considered illegal only if they result in unreasonable restrictions on competition. Based on the U.S. law, this is tested on what is known as the "rule of reason" analysis. It is also required that the parties to the agreement are engaged in rival of potentially rival activities. A potential rival is one who could be capable of engaging in the same type of activity."[25]

The committee gave an illustrative list of agreements that must be subject to the "rule of reason"[26]:

- Agreements regarding fixing of purchase or selling prices;
- Agreements limiting quantities, markets, technical development or investment;
- Agreements regarding territories to be served and sources of supply;
- Agreements regarding dissimilar treatment of equivalent transactions with their trading parties that place them at a disadvantage;

The following kinds of horizontal agreements are often presumed to be anti-competitive[27]:

- Agreements regarding fixing prices. This would include all agreements that directly or indirectly fix the purchase or sale price.
- Agreements regarding quantities. This includes agreements aimed at limiting or controlling production and investment.
- Agreements regarding bids (collusive tendering). This includes tenders submitted as a result of any joint activity or agreement.

[24] ibid
[25] Supra 21
[26] Supra 21
[27] Supra 21

- Agreements regarding market sharing. These include agreements for sharing of markets by territory, type or size of customer or in any other way;

It has been stated indirectly many a times by the court through the decisions held in different cases that there is no as such provision of "per se rule" in the Indian competition law. The section 3(3) of the Act provides for the per se provision, but the same can be rebutted through the Section19 (3) of the Act. This was held in the recent case of Neeraj Malhotra V Deustche Post Bank Home Finance Limited (Deustche Bank) and ors, where the court clearly held that the although the per se rule is included in the section 3(3) of the Act is losing its significance with its interpretation with the section 19(3) of the Act as such. The section 19(3) provides with the indirect exception to this rule[28]. Here the majority came to the conclusion that there was no violation of section 3(3) of the act, although there were two of the dissenting judges. The learned dissenting member categorically stated that section 3(3) of the act lays down the rule of "per se". He came to the conclusion that the presumption under section 3(3) is rebuttable. Per se rule was criticized by the dissenting judge as the rule of "per se" prohibits the defendants/opposing parties from showing the pro-competitiveness of their actions. . He further states that the "presumption" only shifts the burden of proof against the defendants. The defendants can discharge this burden by taking refuge under section 19(3) of the act[29].

Hence we can state that with respect to the per se rules like United States Indian has also restricted the use of per se rule to a very limited extent and thus this is used by the court only in the issues like price fixings, cartels etc where there is no need much detailed investigation and no need to check the reasonableness as the act in itself is invalid and cannot be justified at any cost.

When it comes to Rule of reason, we can see that with the decisions of the court, we can see that this rule of reason has covered a long way and has been extensively used by the courts. The rule of reason has been slowly replacing the per se rule or we can say that it has limited the scope of per se rule to only a very few areas.

CONCLUSION

At the end of this project thus here it can be concluded that the rule of reason which is very elaborative in nature and it needs a lot of investigation and findings. Here if it is proved that the agreement in issue is not anti-competitive in nature then in that case there court will not take action against such agreements and that would be held to be valid one. On the other hand in case of "per se rule" the agreement is by its category it is held anti-competitive in nature. There the

[28] Neeraj Malhotra V Deustche Post Bank Home Finance Limited (Deustche Bank) and ors , Case No. 5/2009, 2010.
[29] Nikhil Parikshith, Demystifying the Rule of Per se and Rule of Reason in the Indian Context, June 2011

court does not need any reason to find out the reasonableness in the agreement, mere making of such agreements is sufficient to consider it anticompetitive. The examples for this are agreements like price fixing, cartel formation etc.

With the change in time the rule of reason is gaining popularity and the "per se rule" is losing its importance and the per se rule is now restricted only to a few categories of agreements rather than being a general concept which was used more often. The rule of reason and the per se rule both derived from the American competition law history and now the per se rule there has a very limited scope and trend is shifting to the rule of reason. The per se rule is now a very limited concept and the judges now emphasize on rule of reason and try to find out the reasonableness in the agreement in issue.

Hence when it comes to "rule of reason versus per se rule" then in that case there, we cannot neglect any of them, where the rule of reason aims at finding of the reasonableness of the agreement and involves a lot of investigation before declaring any of agreement to be anti-competitive and anti-trust in nature. On the other hand the per se rule just declares the agreement to be anticompetitive if it falls under the stated criteria then that agreement without the further investigation is declared to be anticompetitive. This saves a lot of time and the financial expenses involved in the lengthy investigation. Thus, both the rules here are essential and much needed to curb such anticompetitive agreements. But with the change in the globalizing world and the complications in the market the courts now a day's both in India as well as USA are relying on "rule of reason" and are restricting the application of "per se rule"