COMPETITION COMMISSION OF PAKISTAN
Government of Pakistan

DRAFT GUIDELINES

SECTION 4: PROHIBITED AGREEMENTS

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Contents

1. INTRODUCTION

1.1 The Competition Commission of Pakistan (the "**Commission**") is empowered under the Competition Act, 2010 (the "**Act**") to ensure free competition in all spheres of commercial and economic activity to enhance economic efficiency and protect consumers from anti-competitive behaviour.

1.2 The Commission's mandate as to the competition-related administration and enforcement extends to all markets in Pakistan, notwithstanding technical and economic regulation carried out by sector-specific regulators such as SECP, NEPRA, OGRA, PTA, and PEMRA as well as other regulatory and public authorities.

1.3 These Guidelines on Prohibited Agreements (the "**Guidelines**") have been issued by the Commission under Sections 28, 29, and 61 of the Act read with Regulation 41 of the General Enforcement Regulations, 2007 to explain the scope and application of Section 4 of the Act. They indicate the process which the Commission undertakes to give effect to the provisions of the Act and associated rules and regulations which prohibit agreements between undertakings and decisions by associations of undertakings that are restrictive of competition.

1.4 These Guidelines are not a substitute for the Act, or the rules and regulations made thereunder and have no binding legal effect. The examples in these Guidelines are for illustration purposes only. They are not exhaustive and do not limit the investigation and enforcement powers and activities of the Commission.

1.5 It is intended that these Guidelines should be of assistance to undertakings, their associations, and consumers. Readers are advised to carefully study the Act and to seek legal advice wherever necessary.

2. SECTION 4: PROHIBITED AGREEMENTS

2.1 Section 4(1) of the Act prohibits undertakings from entering into any agreement and associations of undertakings from making decisions in respect of the production, supply, distribution, acquisition, or control of goods or the provision of services which have the object or effect of preventing, restricting or reducing competition within the relevant market unless exempted under section 5.

2.2 An agreement or decision which is prohibited under Section 4(2) of the Act and which does not satisfy requirements laid down in Sections 5, 8 and 9 is automatically void by virtue of Section 4(3).

2.3 While evaluating a Section 4 infringement, the Commission conducts a detailed assessment of the agreement(s) or concerted practice(s) and applies a step-wise approach to assessing if an agreement or decision is anti-competitive in terms of Section 4, which includes but is not limited to:

i. Identifying the undertaking(s) or association of undertakings;
ii. Identifying the agreement(s) and/or concerted practice(s) and/or decision(s);
iii. Identifying the relevant market and/or related market(s);
iv. Assessing whether the undertaking(s) or association of undertakings have entered into an agreement or made a decision; and
v. Assessing whether the agreement or decision has the 'object' or 'effect' of preventing, restricting, or reducing competition in violation of Section 4.

Undertaking/Association of Undertakings

2.4 'Undertaking' as defined under Section 2(1)(q) of the Act means:

> *any natural or legal person, the governmental body including a regulatory authority, body corporate, partnership, association, trust or other entity in any way engaged, directly or indirectly, in the production, supply, distribution of goods or provision or control of services and shall include an association of undertakings.*

2.5 The key consideration in assessing whether an entity is an undertaking for the purposes of the Act is whether it is engaged in a commercial or economic activity, regardless of the legal status of the entity and the way in which it is financed. Thus the formal structure of the entity is not a factor in the identification of an undertaking for the purposes of the Act.

2.6 Associations of undertakings are also included in the definition of undertakings. Trade associations are the most common form of an association of undertakings but they may also take other forms. While trade and other associations generally carry out legitimate functions intended to promote the competitiveness of their industry sectors, undertakings participating in such associations may in some instances collude and co-ordinate their actions which could infringe the Section 4 prohibition.

Agreement(s) and/or Decision(s)

2.7 Section 2 (1)(b) of the Act defines "agreements" to include

> *[...] any arrangement, understanding or practice, whether or not it is in writing or intended to be legally enforceable.*

2.8 The application of Section 4 is not limited to formal contracts. Rather, it applies also to cooperation achieved through informal agreements, understandings, concerted practices or decisions of an association of undertakings. '*Agreement*' has a wide meaning and includes both legally enforceable and non-enforceable agreements, whether written or oral and includes so-called gentlemen's agreements. An agreement may be reached *via* a physical meeting of the parties or through an exchange of letters, circulars or telephone calls or any other means of communication. All that is required is that the parties arrive at a consensus on the actions each party will or will not take.

2.9 The prohibition also covers '*decisions*' by associations of undertakings. An association itself may also make certain decisions or perform actions which may be in violation of

Section 4. The main concern is whether the object or effect of the decision, in any form, is to influence the conduct or coordinate the activity of the members in some commercial matter. An association's coordination of its members' conduct in accordance with its constitution may also be a decision even if its recommendations are not binding on its members.

2.10 The fact that a party may have played only a limited part in the setting up of the agreement, or has not implemented it, or only partially implemented it or participated only under pressure from other parties does not mean that it is not a party to the agreement. These mitigating factors may, however, be taken into account upon calculation of a penalty. In cases of violation of Section 4, individual members of an association (undertakings) may be fined if the membership coincides with participation in the agreement. Where there has been a decision by the association in violation of the Act, the association may also be fined for such a decision.

2.11 Section 4 applies to all agreements between undertakings in the market, whether operating at a horizontal or vertical level. In general, horizontal agreements between competitors in the same market are per se violations of Section 4 of the Act. On the other hand, vertical agreements between undertakings operating at different levels of the market, generally have efficiency enhancing benefits that outweigh the potential anti-competitive effects. However, there may be situations where this is not the case.

Relevant Market

2.12 To assess whether or not undertaking(s) or association of undertakings are in breach of Section 4 of the Act, the Commission may first delineates the relevant market. The definition of a relevant market comprises of two dimensions: *the relevant product market*, and *the relevant geographic market*, which are defined under Section 2(1)(k) of the Act as:

> *[...] a product market comprises of all those products or services which are regarded as interchangeable or substitutable by the consumers by reason of the products' characteristics, prices, and intended uses.*
>
> *A geographic market comprises the area in which the undertakings concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring geographic areas because, in particular, the conditions of competition are appreciably different in those areas.*

2.13 While determining alleged infringement of Section 4 of the Act, the Commission will consider direct and indirect evidence that is relevant to the case at hand. Market definition, however, is only an analytical tool and not an end in itself. In other words, while investigating an alleged cartel, market definition is to be considered as such that is not required for substantiating the case. In addition to the relevant market, other related markets may also be taken into consideration on a case by case basis.

2.14 A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer by reason of the products' characteristics, their prices, and their intended use.

2.15 A relevant geographic market comprises the area in which the firms concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogeneous.

[For more detail refer to the Commission's Guidelines on Market Definition and Relevant Market]

3. PROHIBITED AGREEMENT(S) AND/OR DECISION(S)

3.1 Section 4(2) of the Act provides an illustrative list of such agreements and/or decisions which by their object or effect or both are prohibited. These agreements include *inter alia:*

a. *fixing the purchase or selling price or imposing any other restrictive trading conditions with regard to the sale or distribution of any goods or the provisions of any services;*
b. *dividing or sharing of markets for the goods or services, whether by territories, by volume of sales or purchases, by type of goods or services sold or by any other means;*
c. *"fixing or setting the quantity of production, distribution or sale with regard to any goods or services sold or by any other means;*
d. *limiting technical development or investment with regard to the production, distribution or sale of any goods or the provisions of any services;*
e. *collusive tendering or bidding for sale, purchase or procurement of any goods or services;*
f. *applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a disadvantage; and*
g. *making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to usage, have no connection with the subject of the contract.*

3.2 Under Section 4(2) of the Act, certain agreements or decisions by an association of undertakings engaged in cartel activity shall be deemed to have the 'object' of preventing, restricting or reducing competition within the relevant markets. If an anti-competitive 'object' is not found, the agreement or decision may still breach the Act if there is an anti-competitive 'effect'. The following sections provide an illustration of 'by object' and 'by effect' restrictive agreements and how the Commission investigates such potentially anti-competitive agreements.

Horizontal Agreements

3.3 Horizontal agreements mean agreements between undertakings at the same level of production or supply, among other things, i.e. competitors in the same market. Section 4 of the Act characterizes certain business practices as *per se* violations of the Act by their very 'object'. A *per se* violation generally requires no further inquiry into the actual

anti-competitive 'effect' of the practice on the market or the intention of those individuals who are engaged in such practices. *Per se* violations are also known as hard-core cartel arrangements (horizontal arrangements) that seek to fix prices, allocate quotas, share markets, restrict output, and limit technical progress and investment, or bid rigging.

3.4 Since its inception in 2007, an overview of the Commission's decisional practice suggests that it has imposed significant financial penalties on undertakings involved in cartel arrangements. In certain circumstances, vertical arrangements may also infringe Section 4 of the Act and are treated as hard-core violations such as resale price maintenance mechanisms, tie-ins etc. Once an anti-competitive 'object' is shown, the Commission need not examine the anti-competitive 'effect' of the agreement.

Examples of horizontal agreements

Fixing Prices

3.5 Known as horizontal price-fixing, it is regarded as the most blatant and undesirable of restrictive trade practices under Section 4 of the Act. It involves competitors agreeing to fix, control or maintain prices of goods or services or distribution of goods or services. It can be 'direct' fixing of prices, where there is an agreement to increase or maintain prices at a certain level. It can also take the form of 'indirect' price fixing, where competitors agree to offer the same discounts or credit terms over the period of time. Price-fixing agreements do not have to be in writing; a verbal understanding, for instance at a trade association meeting or trade fairs or other social occasions, are generally regarded as sufficiently reflective of a price-fixing agreement. Moreover, while a decision by an undertaking(s) includes a decision by a trade association, the scope of application of competition law is not limited to any particular form of association. Irrespective of their apparent function, undertakings participating in such associations may in some instance collude and coordinate their actions, amounting to a contravention of the Act.

3.6 Thus it does not matter how the agreement was reached or whether it has been carried into effect. What matters is that the competitors have agreed to collude on pricing or similar restrictive trading conditions. Exchanging current or future price information may facilitate price fixing and thus is deemed to be *per se* violation of the Act.

Hypothetical Scenario – Fixing Prices
X, Y, and Z are the largest suppliers of home appliances in the market. The three companies collude to raise prices of certain products. Their distributors are used as a go-through for the secret pricing decision. The agreement between and among X, Y and Z amounts to cartelization and will be caught by Section 4 of the Act. **ABC as an association of pharmaceutical companies, issues recommendations as to prices, charges, discounts or facilitates the exchange of information on pricing or develops a strategy to raise prices. These will have the object of preventing, restricting and reducing competition in the market. The association's conduct will amount to price fixing, regardless of whether the same was put into effect by the members of the association.**

Sharing markets and/or customers

3.7 In market sharing agreement(s), competitors divide up or agree to share markets in various ways, such as geographical areas or size by type of customers, (for instance, business/non-business) and agree to sell their goods or provide their services to their agreed segment of the market. As a result, they abstain from competing for each other's allocated market segment. Consumers are affected as they would not be able to purchase for the best deals.

Hypothetical Scenario – Market Sharing
X, Y, and Z are the largest suppliers of refined petroleum products and lubricants. X, Y, and Z had agreed to refrain selling their products and operating their filling stations in each other's allocated segments of the market. Each undertaking's conduct would amount to a market-sharing agreement and hence cartelization under Section 4 of the Act.

Output restrictions

3.8 Output restriction involves agreement(s) between and among competitors to limit the production of goods or restrict the provisions of services which would otherwise be available in the market. By controlling the supply or production of goods or services, the cartelist are able to, indirectly, increase prices to maximize their profits.

Hypothetical Scenario – Output Restrictions
X, Y, and Z are the largest suppliers of refined petroleum products and lubricants. X, Y, and Z had agreed to restrict the sale of their products and operation of their filling stations in various districts. Each undertaking's conduct would amount to cartelization under Section 4 of the Act.

Limiting technical development or investment

3.9 Competing undertakings may agree to restrict technological development (such as research and development) programs, including their inventions or impede investment into such programs. These types of restrictions which deprive consumers of innovative and quality products and services are strictly prohibited and may fall within the ambit of cartel activity.

Hypothetical Scenario – Limiting Technical Develop or Investment
X, Y, and Z are the largest manufacturers of automobiles. X, Y, and Z have agreed to refrain from investing into research and development, the introduction of new products, setting technology standards or adding production capacity collectively, to prevent other competitors from innovation, production, and sale of their products. Such arrangements are by object prohibited and amount to cartelization under Section 4 of the Act.

Collusive tendering/bid-rigging

3.10 Collusive tendering or bid rigging occurs when competitors agree (whether in writing or orally) on who should win a particular tender. To support such cartel member(s) that has been designated to 'win' the tender, others may refrain from bidding, withdraw their bid, or submit bids with higher prices or unacceptable terms and conditions. The cartel members may also agree amongst themselves to take turns to be the designated 'winner' or to reward other supporting member of the winning bid, for instance, by giving sub-

contracts to them. Consequently, the undertaking inviting the tender is likely to have higher prices than it would if the tender was competitive.

Hypothetical Scenario – Collusive Tendering/Bid Rigging
X, Y, and Z are the largest construction companies in the country. Y and Z agree with X to submit cover bids (uncompetitive in terms of prices, etc.) that are intended not to be successful and X wins the bid. **Another example is where X, Y, and Z agree that Y and Z will not submit a bid or will withdraw a bid previously submitted. This is known as bid suppression.** **Such bid rigging agreements are considered to have the object of harming competition and amount to cartelization and are prohibited under Section 4 of the Act.**

3.11 Apart from the above-mentioned hardcore cartel activities, competition in the market can be distorted, prevented or restricted in various other ways. For instance, competitors may agree, in particular, through their trade association, to setting up pricing guidelines or recommendations, setting technical specifications or design standards, joint purchasing or selling, and agreements to exchange information. The Commission is empowered to take action in all such circumstances where there is an appreciable effect on competition, i.e., where competition is harmed considerably.

Vertical Agreement

3.12 Vertical agreements mean agreements between undertakings, each of which operates at a different level in the production or distribution chain or where the product of one party is the input of the other. Such agreements (between buyers and sellers at different stages of the production and distribution chain) are prohibited if they have an anti-competitive object or effect.

3.13 If an agreement does not have an anti-competitive object, it may nevertheless infringe Section 4 of the Act if it has an anti-competitive effect. When demonstrating that an agreement has an anti-competitive effect, the Commission may consider not only any actual effects but also the potential effect that are likely to follow from the agreement.

3.14 For an agreement to have an anti-competitive effect on competition, it must have, or be likely to have, an adverse effect on one or more parameters of competition in the market, such as price, output, product, quality, variety, innovation, distribution, production, supply or purchase, among other things. Agreements can have such effect by reducing competition between the parties to the agreement, or by reducing competition between anyone of them or third parties. Certain hardcore restrictions with anti-competitive effect may include, among other things, price fixing, resale price maintenance, territorial or customer sale restrictions, non-compete obligations, restrictions on sales of particular competing products. The following examples provide a non-exhaustive list of vertical agreements which may attract Section 4 prohibitions.

Examples of vertical agreements

Agency Agreements

3.15 Under an agency agreement, one party (the principal) appoints another (the agent) to negotiate and/or concluded agreements, on behalf the principal, for the purchase or supply of goods and/or services. Both the principal and the agent can be legal or natural persons. The determining factor in assessing whether Section 4 is applicable to an agency agreement is the financial or commercial risk borne by the agent in relation to the activities for which an agent has been appointed. A genuine agency agreement, where the agent does not bear any financial or commercial risk, may fall outside the scope of Section 4. Such an arrangement is to be distinguished from a distributorship, wherein a distributor buys products from the manufacturer and/or the supplier and then resells them to third parties in its own name.

Exclusive Distribution/Supply Agreements

3.16 Exclusivity may be *de jure* as well as *de facto*. *De Jure* exclusivity is generally established where an express contractual term (such as single branding, non-compete covenant) obligates the buyer to purchase goods/services from a specific supplier and vice-versa. *De facto* exclusivity may be established in many forms. For instance, where there is no express contractual term, however, the buyer has strong incentives not the purchase or source goods/services from other suppliers. Other forms of *de jure* exclusively may include arrangements, where a dominant undertaking refuses to supply any buyer that is also supplied by a competing undertaking and/or where a buyer is obligated to buy a certain quantity from the supplier and such quantity is close to the buyer's total requirement. Different forms of exclusivity may result in anti-competitive foreclosure of other suppliers or other buyers in the market.

3.17 Where the manufacturer or supplier sells the contract goods to only one distributor in a particular geographic territory, it is known as an exclusive distribution agreement. Such agreements may limit intra-brand competition (i.e. competition among retailers or distributors of the same brand) and may raise competition concerns if there is no effective competitions from other brands i.e. inter-brand competition. Similarly, an arrangement may involve an exclusive customer allocation agreement, where the manufacturer or supplier sells its products to only one distributor for resale to a particular group of customers. The distributor is usually limited to its active selling to other (exclusively allocated) group of customers. Such agreements could be anti-competitive if there is no significant inter-brand competition.

Selective Distribution and Single Branding

3.18 Where the supplier restricts the number of authorized distributors and their possibilities of resale to non-authorized distributors, such an agreement between undertakings are known as selective distribution agreements. In cases of single branding, the buyer is restricted to placing all or most of its order with on supplier.

Franchise Agreements

3.19 Franchise agreements may contain production, distribution and/or licensing arrangements. In a production franchise, the franchisee manufactures products in accordance with the instructions/requirements of the franchisor and then sells them under the franchisor's branding. In a distribution or service franchise, the franchisee distributes or offer services under the business name and trademark of the franchisor and follows franchisor's instructions. In license franchise agreements, the licensor grants a license to selected

independent retailers, to use its trademark, brand name, or other intellectual property rights in exchange for some agreed upon payment in order to provide retail products or services.

4. EXEMPTIONS

4.1 While the parties are discouraged from entering into anti-competitive agreements, they may do so even if there is an anti-competitive effect. In such situation, the parties are obligated to apply for individual or block exemption under Sections 5, 7 and 9 of the Act. To qualify for exemption, the undertakings must prove that the agreement(s) substantially contribute to (a) improving production or distribution; (b) promoting technical or economic progress, while allowing consumers fair share of the resulting benefits; or (c) the benefits of that clearly outweigh the adverse effect or absence or lessening of competition. The onus of claiming an exemption lies on the undertaking seeking the exemption.

Individual/ Template Exemption

4.2 Undertakings can apply to the Commission for an individual/ template exemption which may be granted subject to conditions and obligations and for a limited period. It is up to the parties to demonstrate the claimed benefits according to the criteria set out in Sections 5 and 9 of the Act.

4.3 An individual/ template exemption can be canceled or varied if there is a material change of circumstances or there is a breach or non-compliance of an imposed condition.

4.4 An individual/ template exemption can be obtained by applying to the Commission on the prescribed form and after payment of the prescribed fee. Such exemption may be extended as stipulated under the Competition Commission (Extension in Exemption) Rules, 2007.

Block Exemption

4.5 The Commission may grant a block exemption to a particular category of agreements. For instance, a particular kind of distribution agreement in a particular industry may benefit from a block exemption. The benefit of a block exemption is that similar agreements can be examined at the same time, which allows the Commission to provide a better overall assessment of the anti-competitive impact and assessment of the claimed benefits, and may also relieve undertakings of having to submit separate individual applications.

4.6 A block exemption can also be canceled or varied if there is a material change of circumstances or there is a breach or non-compliance of an imposed condition.

5. PENALTIES AND LENIENCY

Penalties

5.1 Section 38 of the Act empowers the Commission to impose the highest penalties for violation of Section 4 prohibitions. The Commission can levy up to PKR 75 million or an amount not exceeding 10% of the annual turnover the concerned undertaking(s). For non-compliance, including willful abuse, interference or obstruction of the Commission's orders, notices, or requisitions, the Commission can impose a fine of up to PRK 1 million.

5.2 In case of continued violation of an order of the Commission, it can impose an additional fine of an amount of up to PRK 1 million per day till such time the violation ends. A failure to comply with the Commission's order or directions constitute criminal offence punishable with imprisonment for up to 1 year or with a fine of up to PKR 25 million, or both.

[For detail please refer to Guidelines on Imposition of Financial Penalties]

Leniency

5.3 Section 39 of the Act provides that:

> *(1)The Commission may, if it is satisfied that any undertaking which is a party to a prohibited agreement and is alleged to have violated, Chapter II prohibitions, has made a full and true disclosure in respect of the alleged violation, impose on such undertaking a lesser penalty as it may deem fit, than that provided in section 38. (2) Any exemption from a penalty or imposition of a lesser penalty shall be made only in respect of an undertaking that is a party to a prohibited agreement which first made the full and true disclosure under this section.*

5.4 The Commission encourages whistle-blowers. In return for the provision of cartel evidence and a commitment to abandon the cartel and Section 4 prohibitions, the Commission may grant full or partial concessions to such whistle-blowers.

[For detail please refer to the Competition (Leniency) Regulations 2016]

Reward Payment

5.5 The Commission also has in place a scheme of reward payment known as the "Reward Payment to Informants Scheme". The objective of the scheme is uncovering and taking action against cartel activity in particular, and all prohibited activities, in general.

The scheme involves the payment of rewards for an amount ranging from a minimum of Rs. 200,000 and a maximum of Rs. 5,000,000, calculated by reference to the usefulness of the information provided, the seriousness of the cartel detected, efforts made by the informant, and level and nature of the informant's contribution/cooperation. Furthermore, the reward shall be paid subject to the condition that the information provided by the informant is accurate, verifiable and useful in the Commission's anti-cartel enforcement work. The informant's identity shall be kept secret unless he agrees to give evidence in subsequent proceedings.

[For detail please refer to the Revised Guidelines on "Reward Payment to Informants Scheme"]

6. ADJUDICATION AND CONSEQUENCES OF INFRINGEMENT

6.1 The Commission may initiate an enquiry to assess the conduct of an undertaking which could potentially be engaged in conduct prohibited under Section 4 of the Act. An enquiry under Section 37 of the Act can be initiated through one of three methods:

a. By the Commission itself exercising its *suo motu* powers;
b. Upon a reference to the Commission by the Federal Government; or
c. Upon a formal complaint to the Commission by an undertaking.

6.2 If the enquiry indicates the *prima facie* violation of a Section 4 prohibition, the Commission will issue a show cause notice to the undertaking(s) concerned to provide an opportunity for hearing before adjudicating on the issue and passing an order under Section 31 of the Act.

6.3 Under Section 34 of the Act, the Commission is vested with the power to authorize any officer to enter and search any premises for the purposes of enforcing any provision of the Act, including Section 4. In addition, under Section 35 of the Act, an investigating officer of the Commission may by written order signed by any two Members, enter any place or building by force if necessary.

6.4 By virtue of Section 36, the Commission may by a general or special order, call upon an undertaking to furnish periodically or as and when required any information concerning the activities of the undertaking, which the Commission may consider necessary or useful for the purposes of the Act.

6.5 An undertaking or undertakings found by the Commission to be engaged in conduct amounting to a contravention of Section 4 of the Act, may, through an order, be subject to:

Remedial Orders: to take such actions as may be necessary to restore competition in the relevant market; and/ or

Financial Penalty: up to 75 Million Pakistani Rupees, or up to ten percent (10%) of the annual turnover of the undertakings that are involved in breach of Section 4 of the Act.

6.6 Under Section 32 of the Act, the Commission may also pass interim orders if it appears that the issue of a final order is likely to take time and serious damage may occur in the intervening period.

6.7 Undertakings may prefer appeals against final orders of the Commission before the Competition Appellate Tribunal (CAT). Appeals against orders of CAT lie before the Supreme Court of Pakistan.

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