COMMENTARY

Vertical agreements: should they be exempted from section 34 of the Competition Act?

A. Introduction

1. Vertical agreements, under the Competition Act (the "**Act**"), are agreements between two or more undertakings each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services.

   An example of a vertical agreement is a distribution agreement between manufacturers and retailers.

2. In Singapore, Paragraph 8(1) of the Third Schedule to the Act provides that the prohibition on anti-competitive agreements under section 34 (the "**Section 34 Prohibition**") does not apply to vertical agreements, unless the Minister makes an order to the contrary.

3. Not all countries employ such an exemption for vertical agreements in respect of anti-competitive agreements. Countries such as China prohibit vertical agreements to varying degrees.

4. In this commentary, we consider whether vertical agreements should continue to be exempted from competition laws on anti-competitive agreements in Singapore.

B. Advantages and disadvantages of vertical agreements

5. Vertical agreements may result in economic benefits such as increasing market efficiency. For example, distribution agreements enable manufacturers to limit the number of distribution outlets which they transact with. This reduces the parties' distribution and transaction costs, thereby making the overall distribution system more efficient.

6. On the other hand, vertical agreements may also have the effect of lessening competition. For instance, vertical agreements may contain clauses which restrict a particular distributor from selling competing products. This may prevent competing suppliers from entering the market.

C. Approaches to regulating vertical agreements

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7. Different countries have different approaches to regulating vertical agreements.

8. Singapore lies on the liberal end of the spectrum. Paragraph 8(1) of the Third Schedule to the Act exempts vertical agreements from the Section 34 Prohibition (although vertical agreements are not exempt from the prohibition against the abuse of a dominant position, otherwise known as the "**Section 47 Prohibition**"). In contrast, the anti-competitive prohibition in other countries such as China applies to all vertical agreements (subject to certain exemptions).

D. <u>Should vertical agreements continue to enjoy exemption from section 34 of the Act?</u>

9. One of the main reasons vertical agreements are exempted from the application of section 34 of the Act is that such agreements are generally accepted as producing a net economic benefit.

10. Further, the exemption provides certainty for undertakings, which do not have to determine whether their vertical agreements contravene the Section 34 Prohibition. Undertakings need only consider whether their vertical agreements will contravene the Section 47 Prohibition.

11. However, as mentioned earlier, not all vertical agreements are necessarily beneficial to competition. In recent years, some practitioners have expressed doubts concerning the justification for the section 34 exemption for vertical agreements.

12. In a situation where two undertakings enter into a vertical agreement, and neither of the undertakings enjoys a dominant position in their respective markets, the agreement would not fall within the scope of the Section 34 Prohibition or the Section 47 Prohibition. However, such a vertical agreement may still have an anti-competitive effect (say, on production or distribution levels) in Singapore.

13. From a policy standpoint, it can be argued that the Competition Commission of Singapore ("**CCS**") should be allowed to examine such agreements on a case-by-case basis to determine whether they contravene the Section 34 Prohibition, rather than providing a general exemption for vertical agreements which may inhibit the

CCS's exercise of its powers.

14. Furthermore, in practice, it is not always easy to ascertain whether an agreement is a horizontal or vertical agreement.

15. Take, for instance, the example of an airline selling plane tickets through a third party travel agent, but which also sells the same tickets directly to consumers. The airline has an agreement with the agent which provides that, as a condition for selling the tickets through the agent's website, the airline shall not offer the tickets at a price below the price offered by the agent.

16. For the purposes of the agreement, the parties operate at a different level of the production or distribution chain, and the agreement is likely to be construed as a vertical agreement under the Act. However, the two parties are, from another angle, also competitors offering the same product or type of product.

E. Concluding remarks

17. As markets and businesses grow more complex, so too will the competitive effects of vertical agreements. Competition laws will have to evolve to meet this increasing complexity. Lawmakers will have to consider whether the section 34 exemption for vertical agreements is still relevant in today's context.

18. If you require advice regarding a vertical agreement or on competition law in general, please feel free to contact our Mr Tan Tee Jim, *S.C.* at 6557 4615 (DID) or tanteejim@leenlee.com.sg.