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Insight #2

Competition law dispute: Supreme court's interpretation of a vertical cartel

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In brief

Article 11.1 of the Law on Competition of Mongolia states that business entities are prohibited from entering into agreements or arrangements (cartels) intended to restrict competition. The law provides four types of anti-competitive agreements or arrangements (cartels), one of which is an agreement to fix the price of goods or products.

The law defines a cartel as an agreement between businesses but does not elaborate on the distinctions between horizontal and vertical forms. However, in its resolution dated 19 February 2020, the Supreme Court clarified the circumstances under which a cartel is considered horizontal.

Accordingly, this legal insight summarizes how the Supreme Court interpreted vertical cartels when resolving a competition law dispute.

Factual background

M LLC, a manufacturing company, entered into agreements with retail stores and supermarkets to set a uniform retail price for end consumers. The Authority for Fair Competition and Consumer Protection ("**AFCCP**") determined that this constituted unlawful price-fixing that restricted fair competition and imposed a penalty of MNT 1,209,682,136, calculated based on the legally prescribed fine of up to 6 percent of the previous year's sales revenue.

M LLC did not accept this penalty and filed a complaint with the First Instance Court of Administrative Disputes seeking annulment of the penalty decision.

Court Decisions

The dispute was reviewed by three-level courts. The First Instance Court upheld the claim of M LLC, while the Appellate Court and the Supreme Court concluded that M LLC had formed a cartel and violated the Law on Competition.

Decision of the First Instance Court

The court concluded that M LLC's actions, including agreeing in advance with stores and supermarkets on sales conditions, setting product prices and providing assurances to supply goods at lower prices, could not be regarded as conduct that violates the prohibition against agreeing on product prices.

Decision of the Appellate Court

The Appellate Court annulled the decision of the First Instance Court and ruled as follows:

- M LLC, as a manufacturer, is entitled to set the wholesale price of goods supplied to these stores, but fixing the retail price by contract created consequences restricting sales competition.
- Although fixing the retail price by contract may appear to create equal opportunities and uniform conditions for distributors, in legal terms it restricts their ability to compete independently in the market and reflects manufacturer's control.
- In competition law, a cartel formed between a manufacturer and its distributors is referred to as a vertical cartel, most commonly taking the form of a price-fixing agreement. This typically occurs when the manufacturer sets the retail price of its products or requires distributors to adhere to minimum or maximum price levels.

Supervisory Complaint to the Supreme Court

M LLC filed a complaint on the following grounds to the Supreme Court:

- Article 2 of the Law on Competition states that competition legislation consists of the Constitution of Mongolia, the Civil Code, the Law on Competition, and regulations adopted in conformity with such laws. These laws do not provide that a vertical cartel, as described in the court ruling, including a situation where a manufacturer sets the retail price of its goods, is prohibited. There is no regulation prohibiting a manufacturer from setting the retail price or stating that only the wholesale price may be set by the manufacturer.
- Specifying the retail price in the contract is not a restriction on competition among market participants but rather a practice intended to provide competing distributors with goods produced at the same cost on a non-discriminatory basis and, in turn, to offer lower prices to consumers.

Resolution of the Supreme Court:

The Supreme Court of Mongolia, after reviewing the supervisory complaint filed by M LLC, decided to uphold the ruling of the Appellate Court without any changes.

Summary of court decision:

Article 11.1.1 of the Law on Competition provides that business entities are prohibited from entering into the following agreements or arrangements (cartel) aimed at restricting competition: agreeing on product prices.

Although the legislator did not define cartel forms in detail, legal theory and international practice classify them as either vertical or horizontal. In this case, M LLC, as one contracting party (manufacturer or supplier), and the retail business entities, as the other contracting party, entered into agreements to set the retail price for supply to end consumers. As a result, distributors had no need to compete on price among themselves, which restricted competition. This is a resale price maintenance agreement (cartel), and there is no basis to reject the appellate court's ruling which clarified the content of the law in this regard.

Additionally, although the complainant argued that the purpose of the agreement was to guarantee low prices for consumers, the legislator prohibits all forms of price-fixing as unfair. Under the free-market principle provided in the law, low consumer prices must result from competition rather than from coordinated agreements (cartels). Therefore, the complaint cannot be accepted.

Thus, it is clear that a vertical cartel was formed between the complainant and the retail distributors, and the provision prohibiting the product price-fixing agreement under Article 11.1.1 of the Law on Competition has been violated.

Considerations

In relation to this dispute, the manufacturer entered into agreements with retail distributors and set the resale prices at which the products would be supplied to end consumers. In adjudicating the dispute, the court defined these arrangements as constituting a vertical cartel. Therefore, the Supreme Court regarded the supply agreements between the manufacturer and the distributors as an anticompetitive practice that is expressly prohibited by law.

Accordingly, it is essential to interpret anti-cartel regulations broadly and not confine them solely to agreements or arrangements between competing business entities. All businesses participating in the supply chain may fall within the scope of such regulation. In particular, special attention must be given to the fundamental principles and prevailing standards of competition law when identifying common forms of vertical price-fixing practices.

Contact us

For a deeper discussion on compliance with competition laws or any advice related to anti-competitive practices and activities, please contact us. If you would like to read the full court decision, click here.