

# The Formalistic Approach to Competition Law: A Critical Examination Of Its Benefits And Limitations

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## Abstract

Formalism, is a traditional and ancient approach applied under competition laws to judge the conduct of the businesses. Under this method adherence to pre decided legal rules is made, without the necessity for case specific analysis. Conduct of a company if falls within the specified rules, shall be termed anti competitive without considering any pro competitive effect it may be having on the market. Formalism though liberated the decision maker from the need to consider non legal aspects and accorded uniformity, it has its own limitations and challenges. The drawback of formalistic approach is highlighted greatly in present times when competition has become tech driven. Rigidity associated with the rule is giving undesirable results leading to errors of judgement. Competition Laws while designed to curb unfair business practices having negative impact on market, also intent to promote competition. Inclination to formalism alone deprived the regulatory bodies to implement the other intent of the law. Effect based approach is the need of the hour. The new working regime of the business world requires nothing else than a balanced approach that facilitates healthy competition while preventing unhealthy business practices. Critics of the formalistic theory argue that strict adherence to formalistic approach stifles competition and requires a critical examination of the tenets of the doctrine in the context of present changed times, formalism as a theory cannot be ignored altogether, but needs to be applied with caution. This paper seeks to examine the theoretical framework of the theory and discuss its advantages as well as limitations. Through the analysis of cases, an attempt is made to contribute thought to the ongoing debate of exploring ways of balancing formalistic tenets according to the changing times.

## INTRODUCTION

Healthy competition and efficient market practices are prerequisites for economic growth of any country. In this respect, competition laws provide the necessary framework that looks into unfair business practices that may lead to inefficiencies in market economics. Competition Law is popularly understood as a law that prohibits unfair business practices, however the scope is not limited to just this, rather extends to ensuring fostering of innovation and promoting the welfare of the consumer. To determine whether a business activity is anti competitive or pro competitive, the competition law, looks at the

intend of the doer and the consequent effect on the competition (i.e. whether it supported competition or restricted it). To do this analyses, competition law applies two approaches: 1) Formalistic Approach and 2) Effect based Approach or Rule of reason. Both the approaches are applied under competition law to analyze whether a business activity can be termed as anti competitive or not. Much discussion has always revolved around the significance of these approaches and their effectiveness. Both the approaches have their benefits and limitations. No any one approach can be said to be superior to the other and based on the experience of competition law authorities, after dealing with various anti competitive practices, it be said that to better govern the market, a right proportion of both the approaches shall be necessary.

### What formalism means:

Formalism, in its literal sense implies, strict adherence to a given set of rules. Formalism has been regarded as a scarecrow under competition law. Its use has often not been supported by scholars and practioners. Formalism is understood as decision making constrained by rules. Since the doctrine of formalism, adheres to set rules only, it is also known as form based approach and lays emphasizes on adhering to the established framework of rules and guidelines. Formalistic approach focused on the letter of the law rather than on any other consideration be it economic or social. Decision making influenced by this approach, excluded any other consideration. For this reason it is also called as decision making constrained by rules. Formalism has been described, for instance, as the “endeavor to treat particular fields of knowledge as if governed by interrelated, fundamental, and logically demonstrable principles of science.”<sup>1</sup> (Lindeboom, 2022) The application of formalism led to the development of legal formalism. the legal theorist Roscoe Pound described the idea that law is a consistent, interdependent, and fixed system of rules, within which rules were to

be applied to concrete cases through deductive reasoning, as a formalistic construct of the lawyer’s mind: “the lawyer believes that the principles of law are absolute, eternal, and of universal validity, and that law is found, not made.”<sup>2</sup> Attempts have been made in history, to formalize law, but in vain. Rather legal formalism became an antithesis of “Interessenjurisprudenz and the Freirechtslehre, the libre recherche scientifique” and, most famously, American legal realism<sup>3</sup>. But use of formalism did not go away in law. One of the reason as to why formalism remain ed to be prevalent in law, is that the legal language is itself formal in nature. Formalism is inherent in legal language. This explains the formality of judicial decisions, which are made on pre commitments to forms. Thus came the concept of legal formalism.

Formalism is studied as against the concept of all things considered. Schauer, defined formalism as rule based decision making. Decisions are given to serve certain purposes and rules are the means to mediate between the two, so that the applicable rules when applied to the decision further the purpose. In any matter to be decided, there some considerations other than pure law, that may play a role in making the decision. Adherence to rules, prevents the judge from considering these considerations. (even excluding considerations which may be relevant in deciding the case). Formalism is therefore identical to “ruleness” and “rule-based decision-making. It is important to note here that formalism is not to be regarded as mechanical decision making. Even when adopting a formalistic approach to decision making, the decision aker nevertheless has to make some evaluative choices. Under formalism, Rule is understood as the “reason for the decision”. The just opposite of the theory of formalism is the concept of all things considered”. What is meant by all things considered? It is meant that while deciding a case considerations other than legal rules are also made, like factual circumstances pertaining to a particular case, the consequences of the decisions given, any belief, value or norms that may be relevant in

<sup>1</sup>Justin Lindeboom, “Formalism in Competition Law”, Volume 18, *Journal of Competition Law & Economics*, , Pages 832–880 (2022), <available at> <https://academic.oup.com/jcle/article/18/4/832/6582875>

<sup>2</sup> R. Pound, “*The Formative Era Of American Law*” 110–1 (1938), cited in B. Tamanaha, *The Bogus Tale About the Legal Formalists*, ST. JOHN’S LEGAL STUDIES RESEARCH , 29–30 (2008).

<sup>3</sup> *ibid*

deciding a case.

Important features of formalism:

- Relies on set legal rules and classification, as to what constitutes anti competitive practices like price fixing, market power so as to amount dominance.
- Provides clarity and uniformity. Businesses know in advance what activity shall constitute anticompetitive behavior. This reduces the risk of unintentional violations. Similar activities are treated alike, creating a sense of fairness.
- Though formalistic approach is liberating in nature(for it does not involve consideration of other factors), it can however at times lead to erroneous judgment because of rigid approach, to the extent negating any chance of an activity having a pro competitive effect, which may otherwise be having a anti competitive approach. The Relevance of Formalism to Competition Law

Formalism is a descriptive theory under competition law. It is not regarded as a legal theory for it nether lays down the criteria to determine validity or relationship between laws like positive laws or natural laws or other questions as relevant under the study of law. It only discusses about characterizes of legal reasoning. It is also not about statutory rules. Had formalism only been about legal reasoning, it would have not been relevant for any competition laws. The reason being that most of the competition laws are vague or like standards like norms, which themselves exclude very few considerations while considering a case. For example the provisions of section 1 of the Sherman Act 1890. It is contended that the provisions of the said section are so abstract that they can not be applied without taking into account the purpose behind the aperticular law.

Application of formalism and judicially crafted rules:

Judicially crafted rules serve as substantive legal tests. For example:

- a rule that “ a naked horizontal price-fixing agreement shall be a unreasonable restraint on trade (in U.S. antitrust law),

Purpose of law is to justice. An important question arises, can application of judicially crafted

rules, which are in essence formal in nature, (that is they may exclude other considerations while deciding a case) be followed at the cost that they may in some cases do injustice.? Will not such a strict adherence to formal rule, lead to injustice and defeat the purpose of law? Herein it is important to understand that while making any rule, the purpose behind making the rule is always kept in mind. No judicially crafted rule can have been made without considering the purpose behind making the rule and the rule in essence is expected to further the purpose it sought to achieve. Thus a per se prohibition that naked horizontal price fixing agreement shall be invalid is made and applied knowing the purpose behind it which is to enable healthy competition to prevail in the market. Such restrictions shall restrict competition. No substantive legal test in competition law has been created without taking into account one or more purpose.

**Use of formalist rules and judge made rules are explained below**

**Table 1:** Comparative Analysis of Formalistic and Judge Made Rules

<i>Formalistic Rules</i>	<i>Judge made rules</i>
Goes by the text. Adopts literal approach. does not takes into account any factor or aspect, not expressly mentioned in law.	Framed when formalistic rules fall short of delving into the newer dimensions like technological changes, societal impacts etc. crafted to fill the gap and ensure justice prevails.
Applies the law according to its word, in its original sense without any ulterior considerations	Crafted when law is silent on any specific issues.
Importance given to earlier decisions. This enables uniformity in decision making No scope of judicial discretion. Example Law of Contract In disputes arising out of contracts, a formalistic approach is applied, sticking only to the terms of the contract. Law intends to uphold the intent of the parties entering the contract.	Aims at creating a balance, by introducing flexibility, when strict compliance to law shall lead to error in judgment, Example: Tort Law (Negligence) The principle of “duty of care” in tort of Negligence, is an example of a judicially crafted rule. Evolved overtime through case laws, helps courts to ascertain to when a party owed a duty to care avoid .

Formalism in law emphasizes on strict adherence to legal texts, such as statutes and constitutions, It excluded factors outside of the law . However, it often happens that legal texts are incomplete or ambiguous, making it difficult for the judge to deliver correct judgment. The importance of judicially crafted rules is reflected here. (also known as judge made laws or common law rules).

## Per se Rule and Formalism

The study of Per se rule and formalism, is significant under competition laws. Per se rule is regarded as a typical example of formalism. The application of per se rule prohibits the decision maker from considering any other factor, especially when deciding anti competitive nature of conduct of any business activity. in *Trans-Missouri Freight Association*, the U.S. Supreme Court applying the per se rule, under Section 1 of the Sherman Act, held that horizontal price fixing agreements are illegal even without proof of evidence. If the effect of the agreement has been to restrict trade and commerce, the agreement shall be declared to be anti competitive without looking into the intent of the agreement.<sup>4</sup> Later in *Trenton Potteries, Co.*<sup>5</sup>, the Supreme Court holding price fixing agreements anti competitive held that the mere fact that a certain agreement is price fixing in nature, it must be held violative of competition law, and no particular enquiry as to the effect of such price fixing agreement shall be necessary. Per se rule is thus an reflection of how formalism shall be applied while deciding cases under competition laws. Most common examples of per se rules are: 1) Price Fixing, 2) Market Division and 3) Bid Rigging.

## Per se Rule and Rule of Reason

The per se rule is contrasted against the rule of reason. The per se rule while is an example of form based rule or formalism, rule of reason is regarded as the equivalent of effect based approach though a term used in U.S. anti trust laws, the doctrine is used worldwide in all competition laws. The doctrine is regarded as opposite of formalistic approach and involves the principle of all things considered. What

4 United States .v. Trans-missouri freight Association, 166u.s.290,342(1897).

5 United States .v.trentonpotteries,co.,273u.s.392,397-8(1927)

can be said of the doctrine is that it seeks to balance the precompetitiveness and competitiveness of any business activity when determining about the anti competitive effects. In *Chicago Board of Trade*<sup>6</sup>, Justice Brandeis explained the rule of reason as follows:

“Every agreement concerning or regulating trade restrains, and the true test of legality is whether the restraint is such as merely regulates, and perhaps there by promotes, competition, or whether it is such as may suppress or even destroy competition. To determine this question, the court must ordinarily consider the facts peculiar to the business, 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 ,not because a good intention will save another wise objectionable regulation or the reverse, but because knowledge of intent may help the court to interpret facts and predict consequences.”

In *GTE Sylvania* the Supreme Court over ruling the *per se* illegality rule, in a vertical non-price restraining agreement, directed for a comprehensive inquiry into the case. Thus in this case circumstances relating to the case had to be considered and analyzed and weighed along the anti competitive effect it may have on the market.<sup>7</sup> There after in *Leegin*, case the Supreme Court once again over ruled the *per se* illegality rule. It was a case relating to Resale Price Maintenance. In this case the Court emphasized that when applying per se rule to vertical agreements, diligence must be involved to analyze the anti competitive effect on the market. The court further laid down various factors of pro competitiveness and anti competitiveness of agreements.<sup>8</sup>

The increasing use of rule of reason led to the debate as to the effectiveness of application of both the doctrines that is per se rule and rule of reason in determining anti competitive effects on the market. The question was which one of the two

6 Chicago Board of Trade .v. United States, 246u.s.231,238(1918).

7 Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 50 (1977).

8 Leegin Creative Leather Products .v. PSKS, Inc., 551 U.S. (2007), 17-9.

was better? The answer to this question is not easy. The per se rule is while criticized by some for being too rigid in approach and thus leaving chances to errors of judgment and ultimately curtailing healthy competition practices, the rule of reason approach is claimed by some as being too vague and ambiguous. The rule of reason approach is claimed to be unstructured, involving case to case analysis and involving a burden of proof, thus making it nevertheless formalistic in nature. However both the doctrines are used today under the competition laws to decide cases relating to anti competitive conduct of businesses.

## Benefits of Formalism in Competition Law

Use of Formalism offers benefits like predictability, efficiency, and enforcement clarity. The overall benefits of the doctrine can be enumerated as following:

### **Certainty and Predictability**

- With clear rules business are aware about what type of conducted is prohibited, enabling them to act within the legal boundaries.
- It also enables uniformity in application of law through out the country. Same rules shall have to be applies by courts worldwide when deciding effects of any business activity on the competition. It makes the system more predictable and removes fear of arbitrariness etc.

### **Easy Enforcement**

- No complex analysis is required. Case to case analysis is done way with, liberating the decision maker of hassels of procedural requirements of burden of proof. With certain activities termed per se illegal, the requirement to prove harmful effects on the market, is done away with.
- As what conduct shall be deemed to be anti competitive is already prescribed, rules are already laid down. No case specific analysis has to be done, all this leads to quick decision making.

### **Preventive of Anticompetitive Behavior**

- Clarity and stringency in rules, serve as strong deterrence for firms who engage in

anticompetitive conduct. Companies shall deter from engaging in practices like price fixing etc as they know that such activities are condemned on the face of it and that excuse whatsoever shall be entertained by courts.

- As laws are already clear, no exceptions allowed, businesses are obedient to comply with the established rules.

### **Reduces Enforcement Discretion**

- Formalism reduces the discretionary exercise by courts. Decisions have to be made on pre established rules, leaving no or very little scope for discretion. This reduces the chances of biasness and facilitates fair decision making.

### **Focuses on Established Harmful Practices**

- Formalism helps in addressing anticompetitive practices considered historically harmful, for example activities like cartelization, price-fixing. It leads to quick and effective enforcement.

### **Reduces Litigation Costs**

- Cost of litigation is substantially reduced as case is to be decided on pre determined rules, not requiring to invest time and money into conducting case specific enquiry

## Limitations of Formalism in Competition Law

Formalism, with its inbuilt advantages, suffered from some certain limitations. Limitations stem from rigidity to rule based approach. Below are enumerated some notable drawbacks of the doctrine:

### **Inflexible**

- Formalism rests on fixed, predetermined rules, that do not take into account complexities of market. For example, today the new emerging digital markets are posing a challenge to the application of this doctrine, for the digital markets are unique and unlike the traditional markets. Application of formalistic approach to present changed scenario of technology driven markets, shall lead to the occurrence of errors, type 1 and type 2 errors.



- No one size fits all. Formalism treats every market situation, business conduct in similar way. This may lead to over simplistic enforcement and may overlook behavior that may have harmful effect on one market and may not on another.

### **Over- or Under-Enforcement Issues**

- Over enforcement: Strict compliance to rules may lead to curtailing such practices which may otherwise not be anti competitive. This may result because rules under formalism do not accept any deviation.

### **Under enforcement**

- Conduct of businesses is analyzed based on pre determined rules. Strict adherence to such pre determined rules, without scope of any ulterior consideration, may not be effective to catch hold of such anti competitive practices which are subtle in nature and require deeper analysis, and not just superficial.

### **Focuses only on legality aspect, ignores economic effects**

- Formalism ignores the economic effects of a business activity. It only focuses on the legality of the particular business conduct. This results in ignoring the procompetitive effect on business like efficiency gains etc, and declaring the conduct anti competitive simply because it fits in the criteria of the rules.

### **Lack of adaptability**

- Formalism may lag behind in today's market scenario which is technology driven. Being supported by technology, markets today are dynamic and keep evolving. Traditional methods of doing business have changed and so have the methods of detecting unfair business practices, further making it difficult to analyze the anti competitive effect.

### **Rigid Categorization of Business Practices**

- The doctrine relies on pre decided legal parameters like price fixing, market divisions etc. such rigid does not reflect the various dimensions of business behavior. For example a business may be dominant even though it may

not be having a larger market base, this may happen owing to innovative business practices.

## **Case Analysis**

Some examples of Indian cases decided according to formalistic theory:

### **1. Cartelization**

These cases fall under the category of per se illegality. Any activity of price fixing undertaken implicitly, by group of business firms involved in same type of business activity, is deemed anticompetitive.

#### **CASE: Cement Cartel Case<sup>9</sup>**

##### **• Facts**

Allegations of cartelization were made against businesses involved in cement manufacturing. They were accused of limiting the supply of cement by indulging into price fixing and controlling the production. The competition commission adopting a formalistic approach held the businesses guilty for cartelization, without conducting any case specific analysis. The manufactures were fined by CCI. The decision was upheld by Supreme Court.

### **2. Bid-Rigging**

Bid-rigging, is a horizontal agreement which is regarded as per se illegal.

#### **CASE: Jet Airways Case:<sup>10</sup>**

##### **• Facts**

Airline Companies involved in cargo handling were accused of bid rigging.

- The conduct was treated as violative of section 3(3) of the Competition Act<sup>11</sup>. No detailed analysis

9 Builders Association Of India vs Cement Manufacturers' Association & others Competition Commission Of India ,Case No. 29 of 2010

10 Express Industry Council Of India vs Jet Airways (India) Ltd. & Others Competition Commission Of India Case No. 30 of 2013

11 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;

was done and penalties were imposed.

### 3. Automobile Spare Parts Case:<sup>12</sup>

Certain car manufacturers were involved in restrictive agreements, preventing other retailers from accessing spare parts and diagnostic tools. They were accused to abuse of dominant position and controlling the market. CCI adopted a formalistic approach, and laid focus on vertical restraints. Held that such restraints like exclusive dealing agreements, refusal to deal etc, fall under Section 3(4) of the Competition Act. and are inherently problematic without fully considering whether they had any pro-competitive justifications. CCI without any case specific inquiry held that such restraints are inherently anticompetitive and imposed large fines.

### 4. Dairy Cartelization Case<sup>13</sup>:

#### • Facts

The parties were found guilty of cartelization and fined accordingly. It was held by CCI that the nature of the agreement was sufficient to hold the parties liable for engaging in anti competitive conduct.

In the case Coal India Ltd, yet again the CCI focusing on restrictive contracting clause held Coal India liable for abusing its dominant position. This case too was an example of formalistic approach of deciding cases as dominant status of the company was mainly taken into account.

## Future Directions in Competition Law

Competition Law has undergone transformative changes inclining towards a more dynamic, effect based analysis. In the light of the changing market

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- (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

12 Shri Shamsheer Kataria vs Honda Sael Cars India Ltd. & Ors on 25 August, 2014

13 Indian Sugar Mills Association vs Competition Commission Of India & Ors on 10 October, 2023

dynamics, Competition Law is fast modifying and adjusting itself to the changes happening around it.

It is changing its methodology to determine anticompetitive conduct, by focusing on effect of the particular business practice. The overall impact of the conduct on consumer welfare, efficiencies achieved and innovative methodologies applied, are considered. Economic tools are increasingly being used to assess the business conduct for its anti competitive conduct even by Courts and the other regulatory bodies.

Emergence of tech giants like Amazon. Google and Facebook pose a challenge to the conventional competition laws. Regulating the digital platforms, digital markets and addressing the concerns like anti competitive conducts (abuse of dominance etc ) shall be the major concern of the competition laws. New legislations shall have to be introduced to tackle issues like data monopolization etc. <sup>14</sup>

Competition Law shall have to align its objectives with the Global Sustainability Goals such as environment protection, good corporate governance etc.

Data is a major asset for tech companies which allow them to exercise dominant position. Competition Law shall have to address the issues of data privacy and misuse of consumer data by dominant firms to use it to their advantage.

Rise of multinational companies makes it imperative for competition laws to seek international cooperation and coordination so that enforcement actions can be aligned with international standards.

## CONCLUSION

Formalism has been criticised by some for being incomprehensible, unclear and rigid. The doctrine adopts an exclusionary approach, studying the tenets of competition law in isolation, that is excluding sociology, theology, psychology and other sciences. But competition is a living and dynamic concept. Market dynamics cannot be studied with strict watertight compartments, for it involves changing societal preferences, consumer behaviours, business needs and the consequent requirement of law to regulate market behavior.

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<sup>14</sup> Digital Markets Act in the EU

The relationship of formalistic rules with that of legal doctrines is also not clear. Formalism though prefers strict adherence to pre determined rules and laws, in practice, it is not feasible to stick only to predetermined rules when deciding bad effects of anti competitive conduct of businesses. It is found in many cases, in order to determine rightfully whether by any business conduct, any harm has been caused to the market dynamics, a deep analysis of various facts associated with the case is required. Not only this, this analysis is further corroborated with a comparative analysis of formalistic rules with rules and principles of other literatures and sciences. The limitations of strict adherence to formalistic rules is felt more today when markets have been digitalized. Digitalization has changed the market dynamics and participants behaviours, be it seller or buyers. Traditional markets have been replaced with digital platforms. New business models have come up, and businesses apply today new business strategies, like innovation. Quality product alone is no more a attraction but how a product is sold, has taken prominence in determining market power for a firm.

Example, cash back policies, which were not known in business world, today find prominence. Consumers are attracted to such offers, and businesses acquire market base. Such strategies, though have a disruptive effect on market dynamics, but they may not have adverse effect on competition. Such practices are looked upon as innovative way of selling a product, coring upon the others, without harming the legal right to do business of the other competitors. Herein the torts law doctrine of Injuria Sine Damnum shall be appropriate to understand the effect of such business strategy on the other competitor. Competitors are free to adopt any such new strategy and compete with each other. If a formalistic approach is applied in such a case, it may declare such business strategy as anti competitive and thus void. But what has been found is that such innovative business styles have rather given a boost to competition. The new business modles, fitted with technological advancements, are able to upgrade themselves and come up with their own new styles of business offer, offering consumers with choice and convenience.(something which formalistic approach shall not consider). Under

such changed circumstances, strict adherence to formalistic approach shall impede the growth of markets.

Competition is evolving, and so shall have to Competition Law. It shall be necessary for competition law to adopt a flexible regulatory framework that balances consumer framework as well as innovative business practices. It shall have to sharpen its enforcement tools to by adopting newer tactics and approaches to judge business conduct especially as the business dominantly becomes tech driven. Traditional enforcement tools shall either lead to over enforcement or under enforcement errors, both unhealthy for a good competitive spirit. The Competition Law 2002 is a shift from earlier MRTP Act's formalistic approach. but much still needs to be done. A significant help in upgrading competition law enforcement tools shall be to coordinate with the international agencies and competition law authorities around the world. In an era of transnational business conduct, an uniform and synchronized competition rules shall be necessary to over come the problem of jurisdictional aspects. It shall not be over exaggeration also to say that that a new legislation especially for Digital Markets shall be a welcoming step. India has taken a step in this regard but much still needs to be done. <sup>15</sup>Indian Competition law too is shifting from strict adherence to formalistic approach evidenced in the Microsoft Case, wherein CCI evaluated into the effect of licensing agreement of Microsoft to determine whether it has anti competitive effect. It however does not mean that formalism as a doctrine shall losse or has lost its relevance in today's technological era. But it certainly has be modified or used along with the other emerging theories. Exclusionary principle of formalistic theory must give way to more flexible approach that suits the present changed time. The best way however is a balanced approach between both a formal approach and a reasonable approach.

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