UNDERSTANDING CARTELS AND THEIR REGULATION IN INDIA

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"If you're caught with an ounce of cocaine, the chances are good you're going to jail... But evidently, if you launder nearly a billion dollars for drug cartels and violate international sanctions, your company pays a fine and you go home and sleep in your own bed at night... I think that's fundamentally wrong."[1]

- Elizabeth Warren

INTRODUCTION TO CARTELS

Firms operate solely with a motive of profit and in pursuit of this, these firms generally detest competition as it deprives them of their freedom in market activities like pricing and output. Therefore, competing firms in any market always have an incentive to coordinate their production as well as pricing with an objective of increasing their individual as well as collective profits. This is usually done by restricting the market output that eventually leads to a rise in the market price.

Collusion among independent firms in the same industry to co-ordinate pricing, production or marketing practices in order to limit competition, maximise market power and affect market prices is referred to as a "cartel".[2]

The Organization for Economic Cooperation and Development gave defined a hardcore cartel as:

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[1] https://www.reuters.com/article/us-banks-moneylaundering/regulators-look-to-punish-bankers-for-money-laundering-idUSBRE9260SQ20130307

[2] Canadian Economy Online, available at http://www.canadianeconomy.gc.ca/english/economy/cartel.html

"*An anti-anticompetitive agreement, anti-competitive concerted practice, or anti-competitive arrangement by competitors to fix prices, make rigged bids (collusive tenders), establish output restrictions or quotas, or share or divide markets by allocating consumers, suppliers, territories, or lines of commerce*."[3]

The Competition Act, 2002 prohibits anti-competitive agreements which cause or are likely to cause an appreciable adverse effect on competition in India and such agreements include horizontal agreements between competitors, including cartels. The Act defines the term 'cartel' to include an association of producers, sellers, distributors, traders or service providers, who by an agreement amongst themselves limit, control or attempt to control the production, distribution, sale or price of trade in goods or provision of services.[4]

The four categories of horizontal agreements prohibited under Section 3 include agreements which-

1. Directly or Indirectly determine sale or purchase prices.[5]
2. Limit or control production, supply, markets, technical development, investments or provision of services.[6]
3. Share the market or source of production or provision of services by way of allocation of geographical area of the market, types of goods and services or number of customers in the market.[7]
4. Directly or Indirectly result in bid rigging or collusive bidding.[8]

Cartels are usually a result of collusion in an explicit or an implicit manner. When cartel members formally meet with an objective to take decisions on controlling the market, the cartel is known as an explicit cartel[9] whereas the Competition Commission of India has

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[3] Recommendation of the Council concerning Effective Action against Hard Core Cartels, C (98) 35/FINAL, March 25, 1998
[4] Section 2(c), The Competition Act, 2002
[5] Section 3(a), The Competition Act, 2002
[6] Section 3(b), The Competition Act, 2002
[7] Section 3(c), The Competition Act, 2002
[8] Section 3(d), The Competition Act, 2002
[9] http://www.amosweb.com/cgi-bin/awb_nav.pl?s=wpd&c=dsp&k=collusion

held that even a nod or a wink is sufficient to establish the existence of an implicit agreement.[10]

It is important for a cartel to be profitable in order to encourage members to participate in it, given the fact that it is illegal in nature and has several risks associated with its very existence. Important factors considered by members for being a part of the cartel includes the possibility of detection by the law enforcement agencies and penalties imposed by them, gains associated with being a member of the cartel, costs of coordinating and monitoring the activities of the cartel and opportunities of establishing a control over the market.[11]

Cartels are usually of two types- International cartels and Domestic Cartels. International Cartel usually comprises of producers across different jurisdictions spread in various countries who agree to restrict the competition among themselves and regulate the market share, price fixing etc. An international cartel can also be a result of an agreement between private producers of a commodity across different countries and such a cartel is known as a Private International Cartel.[12] On the other hand, a domestic cartel refers to an agreement amongst the competing firms of the same sector in the same country regarding their operational strategy in the market.[13]

CARTEL CONDUCTS

There are normally four types of cartel conducts:

1. **PRICE FIXING**

Price fixing refers to an agreement on the price that is supposed to be charged from the customers. In addition to this, price fixing also includes:

- Agreement on increase in Prices
- Agreement on computation of prices
- Agreement to maintain a fixed ration of prices of non-competing products

[10] Rajasthan Cylinders and Containers v. Union of India, Civil Appeal No 4280 of 2014(1 Oct, 2018)
[11] Study of Cartel Case Laws in select Jurisdictions- Learnings of the Competition Commission of India, NLU Jodhpur & CUTS
[12] Gandolfo, G (1998), "International Trade Theory and Policy", Springer
[13] Chowdhury, J (No.5/2006), "Private International Cartels – An Overview", Briefing Paper, CUTS CCIER

- Agreements for elimination of or establishment of uniform discounts on commodity
- Agreements on extension of credit terms to customers
- Agreement to adhere to published prices
- Agreement not to sell unless pricing terms are met.[14]

2. MARKET SHARING

Market sharing refers to the division of the market among competitors either geographically by territories or by the customers. These agreements are restrictive in nature and leave no scope for further competition. This includes secret allocation of the specific territories to one another or agreeing upon the list of customers or clients to be allotted to each firm.

3. OUTPUT RESTRICTION

Under this type of cartel agreement, firms that provide the same type of product or services agree to restrict their production to a lesser value than their previous sale records. This is intended to create a shortage in the market and increase the value of those goods and services.

4. BID RIGGING

This type of cartel agreement involves collaboration amongst competitors in some way to restrict the responses to an invitation to a tender and is usually a combination of all the above-mentioned practices.

In the Act it has been defined as: "*Bid rigging means any agreement, between enterprises or persons referred to in sub-section (3) engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding.*" [15]

[14] Q. Rai and Saroliya, Restrictive and Unfair Trade Practices- Where Stands the Consumer? (CUTS, India, 2003).

[15] Section 3(3)(d), The Competition Act, 2002

Some types of Bid-Rigging agreements include the following-

- Sub-contract bidding where some bidders opt out of the bidding process under an agreement that some part of the bid will be allotted to them.
- Complementary bidding wherein some bidders submit bids that are either too high or contain unacceptable conditions in a manner that a pre-decided winner will get the contract.
- Bid Rotation wherein the competitors provide an opportunity to each of the members of being the lowest bidder and getting the contract in a pre-decided manner.
- Bid Suppression wherein some competitors do not participate in the bidding process so that a designated competitor's bid is accepted.
- Agreement among firms to submit common bid, thereby supressing the competition.[16]

Section 3(3)(d) of The Competition Act, 2002 declares that bid rigging has an appreciable adverse effect on the competition and it is always taken for granted that such an agreement is governed by the *per se* rule. Such agreements are largely successful due to the inherent compensation system amongst the cartel members wherein the bid winner has to compensate or award a sub-contract of the bid to its competitors. Often, the mere exchange of information between competitors before the award of a tender is enough to establish irrefutably that bid rigging has occurred.[17]

FACTORS NECESSARY FOR ESTABLISHMENT OF CARTELS

There are three necessary factors required to establish cartels. These include-

1. Raising of the price of the commodity or service above the non-cartel level without inducing substantial increased competition from non-member firms.
2. Expected punishment for formation of a cartel must be relatively lower than the expected gain.

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[16] Pradeep Mehta, Cartelist behavior is difficult to detect, The Hindu Business Line, New Delhi (Dec 26, 2007)
[17] Competition Law Gram (3/2006), "Constructing the Olympics: Why Colluding for Contracts May Land You in Jail", Lawrence Graham LLP, London, Vol. I, p.2

3. Costs related to establishment and enforcement of a cartel must be low relative to the expected gains.

Only if a cartel is expected to raise the price above the non-cartel level, the firms join.[18] An increase in price will bring an increase in revenue only if the demand curve facing a cartel is inelastic in nature. Since there is always an inverse relationship between the price and quantity demanded, increase in revenue is accompanied by fall in quantity demanded, further implying a fall in the cost of production.[19] To summarise, a rise in price brought about by cartel formation works in the case of inelastic demand as a rise in revenue accompanies a decline in total cost of production leading to a rise in profit levels. An inelastic demand curve in the long run requires the coincidence of the following three factors:

1. Close substitutes of the cartelised product in the market.
2. Larger market share of members of the cartel.
3. Barriers for entry into the market of the cartelised product.

Cartels thus, are more likely to be formed in concentrated industries in smaller geographical areas with the market being small will have few firms, which in turn will have a larger market share. If a market consists of a small number of firms, producing a homogeneous good without close substitutes and characterised by an inelastic demand curve with no threat of entry, a cartel cannot succeed if members can and want to cheat on the agreement.[20] Thus, cartel agreements are easier to enforce if detection of cheating by members is easy.

However, the factors that lead to the formation of a cartel also help in the detection of cheating by its members and enforcement of the agreement. The four factors aiding in the detection of cheating are as follows:

- Lesser number of firms
- No independent fluctuation of prices
- Knowledge of the prices across the market
- Homogeneous products

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[18] Ibid 11
[19] Advanced Economic Theory, HL Ahuja
[20] CUTS (2001), "Competition Policy and Law Made Easy", p.8

These factors can be used as strong benchmarks by the competition authorities to prioritise their enforcement activities vis-à-vis cartels.

DETECTION OF CARTELS

The most challenging task for any enforcement authority is the detection of a cartel. Fighting cartels is practically and legally a demanding task because:

1. Cartels by their nature are secretive and the best of the efforts are made by the cartelists to conceal them from competition authorities.
2. The enforcement authorities require extraordinary power and authority in order to collect sufficient evidence to make a viable case against cartels.
3. Jurisdiction of the competition authorities is restricted and this acts as a restraint in investigation of overseas cartels.[21]

Furthermore, large firms may behave in a manner as if they had a cartel agreement without any formal meeting. Markets having an oligopolistic structure usually witness firms taking their rivals' actions into account and coordinate their actions despite the non-existence of an explicit cartel agreement. This resulting coordination is referred to as tactical collusion or conscious parallelism, which in most cases is not actionable under the Competition Laws. In almost every country having a competition law, the existence of an agreement needs to be proved in order to establish the existence of a cartel and parallelism serves as the perfect defence in such a scenario.

In order to confront the problem of tactical collusion, the courts in the US and Europe have devised a "*parallelism plus*" approach that requires proving the existence of factors that are beyond the firm's parallel behaviour in order to establish that an antitrust violation has occurred.[22] This approach was later adopted in Brazil as well. Although mere parallelism may not be sufficient to prove wrongful conduct, it does contribute in forming a suspicion of illegality.

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[21] Simon Bishop & Mike Walker, The Economics of EC Competition Law, Para 5.31, (Sweet & Maxwell, 2002).
[22] Paolo Buccirossi (2006). "Does Parallel Behaviour Provide Some Evidence of Collusion", LEAR – Rome <http://www.bepress.com/cgi/viewcontent.cgi?article=1027&context=rle>

In Brazil, the Secretariat for Economic Monitoring has developed a method to analyse the complaints submitted by taking into consideration the pricing behaviour as well as the profit margin. The investigation takes place in a three-fold manner as follows-

1. First, the profit margin tendency is verified. If profits decrease over a period of time, the market is considered to be competitive in behaviour and the complaint stands dismissed.
2. Second, it is necessary to analyse whether the marginal increase is linked to the reduction of price spread. If not, the case is dismissed.
3. Third, if there is such a margin increase, then it has to be verified whether the margin and price dispersion behaviour follow the same pattern within a state geographical area. If they do, the case is dismissed.

Thus, only cases where a margin increase linked to the reduction of price spread not following the official established price by the State, the investigations will be continued. [23]

FACTORS FACILITATING CARTELS

1. ROLE OF TRADE ASSOCIATIONS

The cost of creating and running a cartel becomes relatively low in the case of existence of a trade association since the cost of meetings becomes low and coordination of activities becomes easier. It is important for the CCI to monitor the behaviour of such trade associations and could even target individual members of such associations upon suspicion and offer them incentives like whistle-blower protection in order to get them to reveal the formation of such cartels.

2. PUBLIC POLICIES

Policies of the government that make the prices readily available to all the interested parties or those that divide the market into small segments facilitate formation of cartels. [24] Although policies of the government are framed and implemented in a

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[23] DAF/COMP/GF/WD (2006). 37"Contribution from Brazil", Roundtable on Prosecuting Cartels Without Direct Evidence of Agreement, Global Forum on Competition

[24] Dayal, P and Agarwal, M (2006). "State Government Policies and Competition", Towards a functional competition policy for India, Pradeep S Mehta (Ed), CUTS International & Academic Foundation

manner that encourages competition among the firms, there is always a possibility for exceptions. An example of this is the policy of the government of India to give preference to local units under their procurement policy with preference being given to small scale sectors. However, this creates an opportunity for a cartel of local manufacturers, which may result in losses to the government.[25]

3. EXCISE POLICIES

In certain states, licenses for sale of liquor are auctioned, thereby restricting the competition to a small number of players, which further leads to cartelization and loss of government revenue. The governments in the state of Uttar Pradesh, Madhya Pradesh, Maharashtra, West Bengal, Andhra Pradesh and Kerala have come up with the lottery system of allocation to curb this collusive practice.[26]

4. GOVERNMENT POLICIES RELATING TO TENDERS

An important area of collusion under government procurement policies is construction contracts. All the projects are generally taken up by government agencies through the medium of contractors. Except in some cases, the works are awarded through a system of competitive bidding. The system of competitive bidding is sound. Notice inviting tenders, for a particular work, are published in newspapers. Bids are opened in front of all the bidders, and the lowest bidder is determined through a transparent system and awarded the work. However, there are cases wherein the contractors collude and that leads to exclusion of small contractors from the tender process, restricting competition and providing incentive to large competitors to collude.

The CCI has recently taken initiative to draw attention of the RBI to distortions in banking due to limited presence of private sector, high entry barriers for foreign banks and cartelization amongst the banks in setting interest rates. It has also hinted at banks working as cartels under the aegis of the Indian Bank Association in setting up interest rates for savings accounts.

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[25] : http://sify.com/finance/fullstory.php?id=14582443

[26] Ibid 24

A review of such policies, statutes and regulations from the competition perspective (this is referred to as 'competition audit' in several countries) should be undertaken with a view to remove or minimise their competition restricting effects. Proposed policies, statutes, regulations that impact competition should be subject to an impact assessment through an internal mechanism. Various states in India, should on their own, need to come forward to avail of the benefit of the expert advice of CCI in undertaking competition audit of their legislations, regulations and policies.[27]

ANALYZING CARTELS UNDER THE COMPETITION ACT, 2002

The word 'cartel' had not been defined by the courts or legislature before the enactment of The Competition Act, 2002. Before that, we had the Monopolistic and Restrictive Trade Practices Act,1969 to deal with restrictive trade practices i.e. "a trade practice which has or may have the effect of preventing, distorting or restricting competition".[28] In the case of Union of India & Ors v. Hindustan Development Corporation[29], the Supreme Court defined a cartel as "an association of producers who by agreement among themselves attempt to control production, sale and prices of the product to obtain a monopoly in any particular industry or commodity".

Furthermore, various categories of agreements under Section 33(1) of The MRTP Act, 1969 have been recognised as restrictive *per se*. Cartels, fall under clause (d) of the section, which states that "any agreement to purchase or sell goods or to tender for the sale or purchase of goods only at prices or on terms or conditions agreed upon between the sellers or purchasers, shall be deemed for the purpose of this Act, to be an agreement relating to restrictive trade practices and shall be subjected to registration as under Section 35 of the MRTP Act". However, parties could hereby continue with the restrictive trade practices unless directed by the MRTPC.

In the case of DG (IR) v. Modi & Akali Chemicals Ltd[30] , the petitioners failed to establish a cartel due to lack of a precise definition of cartels and interpretation under

[27] 2007, "Report of the working group on competition policy", Planning Commission, Government of India
[28] Section 2(o) of The Monopolistic and Restrictive Trade Practices Act, 1969
[29] 1994 CTJ 270 (SC) (MRTP)
[30] 2002, CTJ 459 (MRTP)

Section 2(o) of the MRTP Act. This gave rise to an important issue to be addressed that Cartels were not defined in the MRTP act and their only interpretation could be drawn from section 2 (o) as a restrictive trade practice.

In Alkali & Chemical Corporation of India Ltd. And Bayer India Ltd[31], the issue of Price parallelism as a defence against cartelised price fixation emerged that required separating price parallelism from cartelised price fixation. Furthermore, the MRTP did not impose any penalties as evident from Sirmur Truck Operator's case[32] and Truck Operators Union vs. Mr. N.C. Gupta & Mr. Sardar[33] wherein only a 'Cease and Desist' Order was passed against respondents for cartelized behaviour.

In the case of American Natural Soda Ash Corporation (ANSAC) vs. Alkali Manufacturers Association of India (AMAI) and others[34], extra territorial jurisdiction emerged as a new issue after it was held that held that the wording of the MRTP Act did not give the MRTPC any extra territorial jurisdiction. The MRTPC therefore could not act against foreign cartels or the pricing of exports to India, nor could it restrict imports. Such action could be taken only if an anti-competitive agreement involving an Indian party could be proved, and that too only after the goods had been imported into India.[35]

Cases like these led to the central government constituting The Raghavan Committee that enacted a new law i.e. The Competition Act, 2002. This act covered cartels under Section 3 i.e. Anti-Competitive Agreements. The Competition Act has a specific goal that is to prevent economic agents from distorting the competitive process through agreements with individuals or companies to exclude actual or potential competitors and also confers extra-territorial jurisdiction upon the CCI.

An important function of the Competition Commission of India is to exercise control over these agreements and their important aspects that may affect competition in the

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[31] Kumar, S.S "Cartels and Price Fixation: Worst type of anti-competitive practices".
[32] (1995) 3 CTJ 332 (MRTPC)
[33] (1995) 3 CTJ 70 (MRTPC
[34] (1998) 3 CompLJ 152 MRTP
[35] Haridas Exports vs All India Float Glass Manufacturers' Association, (2002) 6 SCC 600.

market. The Competition act lists certain factors that need to be considered to determine whether an agreement or practice would affect competition and includes the following:

- Barriers to entry of new firms in the market
- Impact on existing competitors in the market
- Accrual of benefits to consumers
- Improvements in production and distribution methods for goods and services.

The CCI is empowered to inquire into any alleged contravention of the provision either on *suo moto* basis or on receipt of information by any person, consumer or association or on a reference made to it by the Central or State Government.[36] Further, the leniency provisions also allow the Director General to undertake search and seizure by invoking sections 240 and 240 A of the Companies Act, 1956. The CCI is also conferred with the powers to grant interim relief[37], impose penalty[38] and grant any other interim relief along with powers to levy penalties for contravening its orders, making false statements or an omission to furnish material information.

CONCLUSION & SUGGESTIONS

From the discussion above, it is imperative that the Competition Commission of India is more empowered than its predecessor, The MRTPC. This is evident from the fact that the Competition Act, 2002 gives out an explicit definition of cartels, incorporates a leniency programme, has powers to impose fines against members of a cartel and has an explicit provision governing extra-territorial jurisdiction for actions that may have an impact on India.

Moving forward, private notifications or information systems are an important source that can aid in the discovery of cartels with the CCI ensuring that the identity of whistle-blowers is protected. The CCI, thus should try and maximise this channel to encourage sharing of information by parties. A toll-free helpline monitored by the CCI can also be one way moving forward.

[36] Section 19, The Competition Act, 2002
[37] Section 33, The Competition Act, 2002
[38] Section 27(b), The Competition Act, 2002

Furthermore, the CCI should take steps to further strengthen and implement its leniency programme with there being an immediate need for the CCI to establish its credibility in successfully investigating and prosecuting cartels. Improper enforcement of Competition Law has led to growth of cartels across the country being reported from time to time. This creates an opportunity for the CCI to investigate such cartels. Some practices adopted by the International Cartel Network can be helpful in this regard.[39] An efficient leniency programme could comprise of the following:

- The first member of a cartel must receive immunity from prosecution and leniency must be provided with a reasonable gap between the first member and subsequent ones to provide an incentive for the members to assist the prosecution.
- Maximum transparency with the applicants that enables them to know their position with respect to the proceedings.
- Confidentiality regarding leniency terms as well as identity of the applicant.

Sanctions need to be made stronger to serve as a threat in cases of future violations. Furthermore, the CCI must establish agreements with competition authorities beyond its jurisdiction for the purpose of enforcement of Competition laws.

The CCI must undertake routine analysis of trucking, cement, tyre industry, shipping, etc in India where cartels are historically most prevalent in order to prevent collusion. The CCI must develop an understanding to the public of the benefits of competition and broad-based support for a strong competition policy. It is only through demonstrable success can the public understand how it benefits from competition and what is stands to lose, if the enforcement is improper.

[39] ICN (2006). "Drafting and Implementing an Effective Leniency Programme", Anti-Cartel Enforcement Manual, Cartel Working Group – Subgroup 2: Enforcement Techniques