Cartels in India

Price parallelism + collusion = cartels

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Under section 2 (c) of the Indian Competition Act 2002 (the Act), the term "cartel" is defined as including "an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services".

A cartel is regarded as the most pernicious violation of competition law and is subject to the severest penalties. In general legal parlance, cartels are agreements which are formed in secrecy, which may or may not be in writing, between firms in direct competition with one another in the relevant market, which result in profits due to an unreasonable increase of prices by the cartel at the cost of exploitation of the customers.

As they are agreements formed in secret primarily between firms in direct competition with one another in the relevant market, cartels create an unfavourable effect on the market and are against the ethos of free and fair competition. Thus cartels refer to the illegal behaviour of competitors in which they work together (explicitly or tacitly) to regulate their market behaviour so as to restrict competition.

Anticompetitive agreements

Under section 3 of the Act, cartels are treated as anticompetitive agreements. According to section 3(1), "no enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India". Any agreement contravening that provision shall be void.

A wide range of agreements will be presumed to have an "appreciable adverse affect" on competition. Under section 3(3) of the Act, these are defined as "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; (b) limits or controls production, supply, markets, technical development, investment or provision of services; (c) share 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."

Power and leniency

Under the erstwhile Monopolies and Restrictive Trade Practices Act (the MRTP), the MRTP Commission could only pass cease-and-desist orders to stop the operation of any cartels. However, under the Act, the Competition Commission of India (the CCI) can (as well as making cease-and-desist orders) also impose heavy fines.

However, the Act has a leniency provision. This applies to any producer, seller, distributor, trader or service provider included in any cartel that has allegedly violated the Competition Act provisions regarding anticompetitive agreements and who makes a full and true disclosure in respect of the alleged violation. There are, however, four other conditions: (1) the disclosure must be vital; (2) the disclosing party must continue to co-operate with the CCI until the completion of the proceedings before the CCI; (3) the disclosing party must not have concealed, destroyed, manipulated or removed the relevant documents in any manner that may contribute to the establishment of a cartel; and (4) the disclosure should be made before the report of the investigation by the Director General, as directed by the CCI, has been received.

This leniency provision has proved to be a powerful tool in the detection and destabilisation of cartels. It has also encouraged parties to disclose a cartel's existence to the competition authorities.

Establishing a cartel

Three essential factors have been identified to establish the existence of a cartel, namely agreement by way of concerted action suggesting conspiracy; the fixing of prices; and the intent to gain a monopoly or restrict/eliminate competition (see *ITC Ltd v MRTP Commission* (1996) 46 Comp Cas 619).

Parity of prices coupled with a meeting of minds has to be established to prove a cartel. The test for concerted practice is that the parties have co-operated to avoid the risks of competition, and this has culminated in a situation which does not correspond with the normal conditions of the market. A cartel can be a result of either explicit agreements or implicit collusion. Explicit agreements occur when the cartel members actually meet to decide how to control the market. Because such collusion is illegal by law, such a formal agreement is very unlikely to be present.

Are profits a proof of collusion?

However, there is a very thin (and blurred line) of distinction between legitimate co-operation and illegitimate collusion. There is a fallacy that firms making high profits are involved in collusive behaviour. This may not be true as firms can make profits because of better efficiencies or other market factors such as sudden increase in demand, for example.

The UK OFT guidelines on the assessment of market power suggest that the following conditions need to exist before a firm can be held to be making excessive profits in an

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anticompetitive sense: (1) the profit should be substantially above the cost of capital and earned on a persistent basis; and (2) there is no evidence that new entry is likely to undermine such profits in the medium-term.

The existence of cartels depends on the peculiarities of the dynamics of each market. Some of the notable features of the market that favour collusive behaviour are as follows:

- **Inelastic demand of the goods**. Price elasticity of demand is defined as the measure of responsiveness in the quantity demanded for a commodity as a result of a change in price of the same commodity. It is a measure of how consumers react to a change in price. In other words, it is percentage change in quantity demanded by the percentage change in price of the same commodity. It is measured as elasticity, viz it measures the relationship as the ratio of percentage changes between quantity demanded of a goods item and changes in its price.

Demand for a product can be said to be very inelastic if consumers will pay almost any price for the product, and very elastic if consumers will only pay a certain price, or a narrow range of prices, for the product. Inelastic demand means a producer can raise prices without hurting demand for its product very much, and elastic demand means that consumers are sensitive to the price at which a product is sold and will not buy it if the price rises by what they consider to be too much.

In markets like oil and gas, cement, steel, power and other essential products linked to the automobile or construction sectors, where the demand is inelastic, there is greater scope for huge profits by price rise and collusive behaviour.

- **Small number of players in the market**. The number of firms in an industry is inversely related to the probability of cartel in that industry as it becomes cumbersome to monitor individual members. Further, the higher the number of players, the stronger the implication that there will be fewer profits accruing to each member of the cartel.
- **Higher barriers to entry**. In a market where there are low barriers to entry, it is generally difficult to sustain a cartel since the market is open for a new maverick player with greater efficiencies and low marginal cost which can undermine the cartelised price.
- **Stable demand**. A stable demand over a period of time encourages the formation of a cartel. In the event that the demand is variable, members would like to deviate from the cartel behaviour to get a larger share of the profits.

It is worth observing that while it may be easy to form a cartel, it can be harder to sustain it. A brief snapshot of the factors which favour the sustainability of cartels is set out below:

Price manipulation not price parallelism

The most crucial ingredient of cartelisation behaviour is collusive manipulation of prices by the competitors. A mere simultaneous movement of prices, especially for homogeneous products, is not by itself sufficient to prove a cartel (see *Re Alkali and Chemical Corporation of India Ltd, Calcutta and Bayer (I) Ltd, Bombay* RTPE 21 of 1981, Order dated 3/7/1984, *Association of State Road Transport Undertakings v Kar Mobiles Ltd*, 2002 CTJ 433 (MRTP).

Sometimes manufacturers raise their prices to match the leading players. Such a practice cannot be termed cartelisation. If a given competitor is placed in a price leadership position, then, if the price leader alters the price of its goods or services for reasons such as an increase in the cost of production or changes in the demand and supply position, most of the other competitors may follow suit. This cannot be said to be illegal because the behaviour of market participants is not based on any prior discussion or understanding.

In almost all countries, including India, more evidence is required than just parallel pricing to support a cartel prosecution. US and European courts have adopted a "parallelism plus" approach, which requires the existence of "plus factors" beyond merely parallel behaviour by firms in order to prove that firms have indulged in cartelisation behaviour.

Proving the cartel's existence

However, determination of the existence of a cartel by direct evidence is a Herculean job for the competition authorities.

While the formation of a cartel amounts to an anticompetitive trade practice, which is indisputably against the public interest, the existence of a cartel is seldom proved by direct evidence. Generally speaking, no express agreement showing its existence is ever found. It has to be proved by circumstantial evidence, and by setting up and proving a chain of events leading to a common understanding or plan. The underlying issue is what, at the minimum, constitutes that "meeting of the minds" which must be directly or circumstantially established to prove that there is a restrictive effect on competition.

Conclusion

Considering the fact that there are number of industry associations which have been formed to represent the industry and industry players before the regulators and government, it remains to be seen how the CCI treads the thin line between legitimate co-operation and illegitimate collusion for the determination of a cartel.

Factors	Effect
Small number of firms	Positive
High concentration index (C3) (C3 refers to the market share of the top three players in a relevant market)	Positive
High entry barriers	Positive
Inelasticity of demand	Positive
Homogeneous goods	Positive
Threat of legal sanctions	Negative
Large powerful buyers	Negative
Demand fluctuations	Negative