Guidelines For Cartels\textsuperscript{1}

For
Competition Commission of India (CCI)

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Section 1
Introduction

Perfect competition\textsuperscript{2} is the most efficient structure of market wherein firms produce least cost output and charge marginal cost price. Here firms do not have any influence on price. In reality perfect competition having extreme assumptions of large number of firms, selling a homogeneous product is rarely found. Assumption of large firms may be accepted on some grounds but they have tendency to differentiate their product from the products of other firms. This gives a firm some command over prices and output simultaneously. Here firm can charge higher price and sell lower output and can earn higher profits. But here firms have put efforts to differentiate their product from others and advertise the product in the presence of competition. If these firms agree on reducing the competition, they have opportunity to save the efforts on differentiation and can charge even higher price. So it is in the interest of the firms to reduce the competition among them. Hence colluding to reduce competition is one of profitable business strategies of firms.

This was firm’s side. How does it affect consumers? If market moves from perfect competition to monopoly\textsuperscript{3} number of suppliers decreases, and so is competition in the market. Consumers face fewer choices, poor quality, and have to pay higher prices. As a

\textsuperscript{2}Perfect competition is the market structure wherein there are many buyers and sellers of product, the quantity of products bought by any buyer or sold by any seller is so small relative to the total quantity traded that changes in these quantities leave market prices unchanged, the product is homogeneous, all buyers and sellers have perfect information there is both free entry into and exit out of market.

\textsuperscript{3}At the opposite extreme to perfect competition is the monopoly. Here the assumption of many sellers is replaced by the assumption of just one seller. So it is concentration of market or economic power in one hand.
result of this consumers loose on one hand and producer gains on the other. Does these

 gains and loses equalize? It has been shown that monopoly leads to dead weight losses.
This is the loss born by the whole economy. This loss could comprise of lower output,
inefficiency in production, no incentive for firms to innovate as firms have no competition
to face.

As the agreement between firms to lower the competition is a profitable strategy,
they have tendency to collude. They earn profits at the cost of consumers. So such anti-
competitive agreements should be checked for the sake of consumers’ benefit.

To check these anti-competitive practices in Indian market, Indian govt. passed
Monopolistic and Restrictive Trade Practice (MRTP) Act, 1969. This act was enacted to
ensure that the operation of the economic system does not result in the concentration of
economic power in the hands of a few, to provide for control of monopolies and to prohibit
monopolistic and restrictive trade practices.

But MRTP Act focuses only on curbing the monopolies. It was not concerned
about the promotion of competition in the market. In MRTP Act having a dominant
position is bad i.e. it is dominated by deemed concept or per se\(^4\) concept.

The other problem is that an action or practice outside the shores of India may have
an anti-competitive effect on competition in the Indian market. But effects doctrine\(^5\) is not
provided for by MRTP Act. Further this Act was a tool to check only the public and
private sector monopolies and not to the Govt. department engaged in business. Further no
role is given to competition advocacy and it didn’t have any provision to impose penalty
on delinquent enterprise.

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\(^4\) Per se rule would mean that there would be very limited scope for discretion and interpretation on
the part of the prosecuting and adjudicating authorities.

\(^5\) This doctrine implies that even if an action or practice is outside the shores of India but has an
impact on competition in the relevant market in India; it can be brought within the ambit
of the Act, provided the effect is appreciably adverse on competition.
Due to these flaws in MRTP Act govt. of India enacted new a Act called Competition Act, 2002. However it is not functional till date, MRTP Act is still in operation.

Competition Act, 2002 does not take dominance as per se anti-competitive, but abuse or dominance is considered anti-competitive. It also gives space to “Rule of Reason” theory i.e. whenever it come to assess the abuse of dominance or market power or reason behind profitable increase in price by a dominant firm it gives due attention to gains or more precisely efficiency aspect of such action. Also it provides “effect doctrine”, is applicable to Govt. Departments engaged in business activities, gives important role to competition advocacy and has power to impose penalty.

Firms may collude through mergers, horizontal agreements, acquisition, amalgamation so on. One of the core enforcement area of the Act is horizontal agreements. A horizontal agreement is an agreement between competing firms; in the same industry which may result in competition problems where it causes negative market effects with respect to prices, output, innovation or the variety and quality of products. On the other hand, horizontal cooperation can lead to substantial economic benefits where it is a means of sharing risk, making cost savings, pooling know-how and launching innovations faster. i.e. these are the agreement between actual or potential competitors to restraints the rivalry between them. Subject of such agreements may include:

- Common pricing
- Common production quotas
- Information sharing

Agreement has been defined in the Act as follows:
‘Agreement’ includes any arrangement or understanding or action in concert:

i) Whether or not such arrangement, understanding or action is formal or in writing; or
ii) Whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding.

Hence these agreements need to be neither in writing and nor legally enforceable. An informal understanding is as good as legal formally written agreement for Commission to act.

In most of the cases these horizontal agreements take the form of cartel. Cartel is a group of legally independent producers who act together to fix prices, to limit supply or to limit competition. Cartel is different from monopoly as defined above-single seller market; however a monopolist may be guilty of abusing said monopoly.

This paper analyses how the Act treats cartel and suggests some guidelines to detect them. Cartels-form of horizontal agreement-tend to curb competition and are one of the most difficult to detect anti-competitive agreements as generally they work in secrecy. The fixing of prices, bids, output, and markets allocation by cartels has no plausible efficiency justification. Prevailing national competition policies are oriented toward addressing harms done in domestic markets and in some cases merely prohibit cartels without taking strong enforcement behavior.

There is view provided by economic theory\(^6\) that cartels are unstable by nature. This view explains that once the cartel is formed and they are agreed upon charging higher prices and selling quoted output, firms have incentive to sell more at that fixed higher price. As output sale increases in the market prices tend go down over the period and the motive of cartel formation is not met. But studies have found out that cartels are neither the relics of past nor do they always fall quickly under the weight of their own incentive problems. Empirical studies have shown that on average cartels survive over six to seven years. Even where cheating eventually undermines the cartel, consumers may have been burdened by years of increased prices, and enduring barriers to entry have often been created by strategic cartel behavior.

\(^6\) Given by prisoner dilemma
In competition literature, cartels are further categorized as hard core cartels to address the harm of price fixing, bid rigging, output quotas and divide market by allocating consumers more clearly.

This paper will first define cartels as given in Competition Act, 2002. Though in the Act the word hard core cartel has not been used but the Act includes all four forms of hardcore cartel that are suggested in the definition of hard core cartel given by OECD. In the next section, hard core cartels will be addressed. Further, characteristics of cartels relevant for the purpose of their detection will be analyzed. Some important questions; what make them to get together, how do they survive, and why should cartels be broken up will be discussed.

After that two factors will be suggested that commission should keep in mind while considering cartel detection. The paper will further highlight the conditions suitable for cartel formation. In section afterward, the four forms of hardcore cartels will be addressed separately. In the next section, the proviso about joint venture will be scrutinized. In the end leniency policy will be analyzed.

Section 2
Definition Of Cartel
Cartel has been defined, in section 2 (c) of competition Act, 2002 as under: “cartel” includes 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.

The key points in this definition are:

- Two or more agents
- Agreement between the agents
- Control or attempt to control

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7 Report on Hard Core Cartels for the Meeting of the OECD Council at Ministerial Level, 2000
As per the definition, for cartel to form two or more agents must come together. Most important dimension in the definition is that a cartel requires an agreement between firms. This agreement is generally in terms of formal or informal agreements among firms designed to reduce or suppress competition in the market. Thirdly, this association of agents must be able to control the production, distribution, and sale or price of, or, trade in goods or provision of services.

The objective of a cartel is to produce less at higher price i.e. more profit at less effort, injuring the interests of the consumers including other firms (whose competitiveness is harmed by cartelization) and Governments.

Section 3
Cartels In Competition Act, 2002

Under the Act, cartels form a part of anti-competitive agreements. This is explicitly provided in section 3 (3) thereof. Section 3 (3) declares that

“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, shall be presumed to have an appreciable adverse effect on competition.
“Provided that nothing contained in this sub-section shall apply to any agreement entered into by way of joint ventures if such agreement increases efficiency in production, supply, distribution, storage, acquisition or control of goods or provision of services.”

This proviso relating to joint ventures has been analyzed below.

In competition Act, 2002, hardcore cartel has not been defined explicitly; neither there is generally accepted definition of hardcore cartels. There is however a recommendation of the Organization for Economic Cooperation and Development on hardcore cartels. According to that recommendation, a hardcore cartel is:

“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”.

Thus Competition Act, 2002 includes all the four forms of hard core cartels given in the OECD definition of hardcore cartels. The definition given by OECD emphasizes on the expression “anti-competitive” which is repeated therein thrice. This means in OECD recommendations hardcore cartels are per se illegal, but Competition Act, 2002 provide one of the escape valves in the proviso. This means Competition Act, 2002 does take care of efficiency aspect even of cartel.

International Cartel

Though this word has not been used in the Act, Act does provide for effects doctrine. So competition has a role to play to handle the international cartel. Such jurisdiction is provided in the competition statutes of some countries. India is one such. Section 32 of the Indian Competition Act, 2002 declares that acts taking place outside India but having an effect on competition in India would in certain situations fall within the ambit of the Act. The extract of the said section is:
The Commission shall, notwithstanding that,—

(a) An agreement referred to in section 3 has been entered into outside India; or
(b) Any party to such agreement is outside India; or
(c) Any enterprise abusing the dominant position is outside India; or
(d) A combination has taken place outside India; or
(e) Any party to combination is outside India; or
(f) Any other matter or practice or action arising out of such agreement or dominant position or combination is outside India, have power to inquire into such agreement or dominant position or combination if such agreement or dominant position or combination has, or is likely to have, an appreciable adverse effect on competition in the relevant market in India.

Increasing trade liberalization, by increasing competition in formerly protected firms in domestic markets, have increased firms incentive to participate in cartels. These cartels undermine international integration and decrease the benefits of liberalization to consumers. International cartels may also undermine political support to liberalization if citizens believe that private barriers to trade are simply replacing government-created ones. International cartels may have different forms, but broadly we can classify them as follows:

Hardcore cartels are made up of private producers from at least two countries, which cooperate to control prices or allocate shares in world markets.

Import and export cartels:

Export cartels are those where independent, non-state related producers from one country take steps to fix prices or engage in market allocation in export markets, but not in their domestic market. Here the conspiracy of action in concert does not involve any impact in the country where the cartel members are headquartered. In other words, an export cartel is made up of firms from one nation with an agreement to cartelize markets abroad. Export cartels fix prices or outputs in the participating members’ export markets but not in their home markets. On a global basis, the anti-competitive effects of export
cartels can be no better than a zero-sum game, in which one country’s exporters’ gain from monopoly rents are another country’s consumers’ losses. But on national basis it is a beggar-thy-neighbor policy, in which one nation’s gains is at the cost of other nation’s cost. So there is no good reason to exempt export cartels from the application of competition law. Generally, export cartels are exempted from the national competition laws in many countries.

In competition Act, 2002, export cartels have been exempted from the provisions relating to anti-competitive agreements. Section 3 (5) (ii) confirms it:

“The right of any person to export goods from India to the extent to which the agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export.”

Import cartel is one more form of international cartel, but here like export cartels members of import cartels belong to one country not to two or more countries. But this ‘one’ country is importing country. The members of import cartels form the cartels for the purpose of eliminating the importers from competing with cartels members. The import cartel after eliminating the competitors can regulate price, and other terms and conditions of goods and services that are imported into the home markets. These cartels hurt both the firms abroad who are trying to enter the home market as well as the home consumers who have to face distorted terms and conditions in dealing imported goods and services. Such cartels should also be checked at least for the sake of domestic consumers.

Competition Act, 2002 declares that the agreements specified above have appreciable adverse effect on competition. The obvious question is what constitutes an appreciable adverse effect on competition. Section (3) talks of agreements having appreciable adverse effect on competition but it do not answer above question.
Competition Act, 2002 has traced the whole concept of appreciable adverse effect on competition in section 19 (3) that read as follows:

“The Commission shall, while determining whether an agreement has an appreciable adverse effect on competition under section 3, have due regard to all or any of the following factors, namely:—

(a) Creation of barriers to new entrants in the market;
(b) Driving existing competitors out of the market;
(c) Foreclosure of competition by hindering entry into the market;
(d) Accrual of benefits to consumers;
(e) Improvements in production or distribution of goods or provision of services;
(f) Promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.”

Thus in assessing the appreciable adverse effect commission has to look on both sides; adverse effect as well as beneficial effects. First three points constitute adverse effects and last three constitute beneficial effects. After comparing the two sides, Commission can conclude whether a particular association of members or agreement between producers has appreciable adverse effect or not.

Cartels are effective only when they are able to create entry barriers or are able to drive the competitors out of the market. By creating entry barriers and driving the existing producers out of the market cartels reduce competition. In the absence of competition they can regulate price and output profitably i.e. charge higher prices and sell lower output so earn higher profits with less efforts.

On the other hand an agreement may not constitute cartels if this agreement is signed to expand the scale of production so that they can reap economies of scale or to be able to undertake research and development investment that needs large scale of investment. Such agreements lead to better quality or even new products, reduction in cost and so in prices. So consumers will be able to reap the benefits of good quality new
products at lower prices. Commission has to see both sides of an agreement and then decide whether the said act has an appreciable adverse effect or not.

Section 4

Characteristics Of A Cartel

Cartels function in secrecy. Economic theory predicts that cartels are unstable by nature as their members have incentive to cheat. To make the cartel successful members must take actions to counteract the incentive to defect. Such actions include mechanism to increase the cost to defection, making cheating more observable, making cheating more difficult to undertake, creating mechanism to punish cheating and so on. Cartel agreement can also include mechanisms that increase the return to cooperation, such as creation of barriers to entry. The longer a cartel operates the more likely that it will establish industry practices or barriers that facilitate anticompetitive practices in the future. So a barrier to entry is inherent in the nature of cartel, as an incentive not to cheat.

Barriers to entry created by the cartel, either through tariffs, in case of international cartel for example, patent pooling\(^8\) or distribution agreements will not necessarily disappear with cartel’s demise and may well limit future entry and stifle innovation. Firms may move beyond cartel conspiracies to outright mergers, achieving in essence a more stable and consolidated cartel. Therefore, in addition to the classic (static) deadweight losses, over time cartels are likely to distort resource allocation through other means.

Further cartels go to great length to cover up their actions. For instance, they use code names in addressing one another, meet in secret venues, create false covers for their meetings, use home telephone numbers to contact one another and give explicit directions to destroy any evidence of the conspiracy. Another general practice of cartel

\(^8\) a patent pool is an agreement between two or more patent owners to license one or more of their patents to one another or third party. A patent pool allows interested parties to gather all necessary tools to practice a certain technology in one place.
members is to minimize their contacts in the domestic soil and to conduct their meetings abroad. This is because of the fear of detection.

Another characteristic of cartels is that they frequently use trade associations as means of providing cover for their cartel activities, cartels are generally seen to have power to control prices effective almost immediately. Cartel members tend to meet on a periodic basis to fix prices. They may set a price range, establish a floor price or set a specific price. Price fixing often goes hand in hand with allocation of sales volume. Volume allocation agreements in conjunction with price fixing agreements are known to be effective in cartelization activity.

Section 5

5.1 What Make Them To Get Together

The evidences show that cartels often were formed following a period of declining prices, but these price declines were not generally associated with macro economic fluctuations. They were the result of increasing competition and market integration. So commission have to be on vigil when there is declining trend in prices and severe competition in market, as these are the situation that form the basis for firms to get together as it is very difficult to get the evidence to prove cartel formation so commission has to be on vigil in advance.

5.2 How Do They Survive

The potential profit associated with successful cartelization create a financial rationale for firms to devise means to overcome the short-term incentives to deviate from a cartel agreement; to frustrate entry by new firms; and to prevent detection by competition authority. Some cartels have turned even to govt. policies to achieve their
ends; for example, international cartels may employ anti-dumping law, quotas, regulations, or govt. surveillance etc. They also employ a variety of private measures including vertical restraints, or use of a common sales agent, patent pooling, joint venture, and mergers. Here these are additional anticompetitive actions taken by cartels to create barriers to entry through mergers and joint ventures.

5.3 Why Should Cartels Be Broken Up

Cartels are particularly damaging form of anti-competitive activity. Their purpose is to increase prices by removing or reducing competition and allow the businesses to achieve greater profits for less effort to the detriments of consumers and the economy as a whole. As a result they directly affect the purchasers of the goods or services whether they are public or private businesses or individuals. Cartels also have a damaging effect on the wider economy as they remove the incentive for businesses to operate efficiently and to innovate. For the purchasers of their goods or services this means:

- higher prices
- poorer quality
- less or no choice

Detecting and taking enforcement action against the businesses involved in cartels is therefore one of commission’s main priorities.

5.4 Factors to be taken care of

Economic theory has got two implications for cartels. Theory identifies the incentives to sell above agreed quotas, or below market prices, as a source of instability underlying all cartels. This has implication for how govt. might allocate scarce resources, if one identifies which firms are most likely to be able to overcome the incentive to cheat and direct resources there.
It is difficult to set a deterministic relationship between firm structure and cartel success. Further the success or failure of a cartel is likely to depend on host of factors such as legal environment, demand for products, and terms of agreement and so on.

But a bound approach can be adopted here. This approach recognizes that there are certain necessary but not sufficient conditions for cartel success, which bound the circumstances under which successful cartelization can occur. Outside of the bounds for example entry may be too easy or coordination too difficult for a cartel to survive in a particular industry. Inside the bounds, cartel may succeed. This bound can be constructed by the factors that make cartel success possible, for example

- few seller in the market
- possibility of market allocation
- availability of substitute
- characteristics of good in question

In case market has few sellers, there is greater possibility that they may have tendency to collude as it is easy to handle few partners. In case it is easy to allocate the market profitably then competitors might have preference to have an agreement of market allocation. Case of international cartel can be referred here as national borders are a straight forward way to divide up international markets. As explained earlier, the ability to monitor competitors increases the likelihood of cartel success – and firms in an international cartel can monitor exports and imports, using published trade and customs data. If these heightened incentives to cartelize outweigh any difficulties associated with organizing a conspiracy among members that have different cultures or languages, then this is an argument for focusing resources on international cartels.

Section 6
Condition favorable to collusion

While collusion can occur in almost any industry, it is more likely to occur in some industries than in others. An indicator of collusion may be more meaningful when industry conditions are already favorable to collusion.
• **Few competitors:** Collusion is more likely to occur if there are few sellers. The fewer the number of sellers, the easier it is for them to get together and agree on prices, bids, customers, or territories. Collusion may also occur when the number of firms is fairly large, but there is a small group of major sellers who control only a small fraction of the market.

• **Product substitution:** The probability of collusion increases if other products cannot easily be substitute for the product in question or if there are restrictive specifications for the product being procured.

• **Product characteristics:** The more standardized a product is, the easier it is for competing forms to reach agreement on a common price structure. It is much harder to agree on other forms of competition, such as design, features, quality, or service.

• **Many small buyers making frequent purchases:** Repetitive purchases may increase the chance of collusion, as the vendors may become familiar with other bidders and future contracts provide the opportunity for competitors to share the work.

• **Communication channel between competitors:** Collusion is more likely if the competitors know each other well through social connections, trade associations, legitimate business contacts, or shifting employment from one company to another. Bidders who congregate in the same building or town to submit their bids have an easy opportunity for last-minute communications.

• **High entry and exit barriers:** if cost of entering and exiting the market is very high then it works as barriers to entry and protecting the firms already in the industry against the threat of potential competition. Here they have safe environment to collude and sell small output at higher prices.

• **No Mavericks:** mavericks firms are independent in terms of taking decision relating to price and output profitably. i.e. if firm increases price it does not face any threat of being out thrown by other firms charging lower prices.
Section 7

Hardcore cartels

The defined hard core cartels are operated in slightly different way, like price and output fixing happens generally in case where producer of same commodity fix price and output to be sold. Bid rigging happens in case where competitors have to compete for contract declared by say govt. to construct some public infrastructure or contract for procurement and so on. So they have to be dealt with slightly differently

7.1 Price Fixing

Price fixing is an agreement among competitors to raise, fix, or otherwise maintain the price at which their goods or services are sold. It is not necessary that the competitors agree to charge exactly the same price, or that every competitor in a given industry join the conspiracy. Price fixing can take many forms, and any agreement that restricts price competition violates the law. Other examples of price-fixing agreements include those to:

- Hold price firm.
- Eliminate or reduce discounts.
- Adopt a standard formula for computing prices.
- Maintain certain price differentials.
- Adhere to minimum fee or price schedule.
- Not advertise prices.

Identical prices may indicate a price-fixing conspiracy, especially when prices stay identical for long periods of time, prices previously were different, and price increases do not appear to be supported by increased costs. Further simultaneous elimination of discounts, especially in the market where discounts historically were given, is a suspicious action. Usually it is not so easy to detect. Apparent price differences can conceal collusion. For example, where firms agree on prices, the participants in a cartel may quote widely different list prices and offer different levels of discounts so that it is not immediately obvious that they have been colluding. Also, charging higher prices to
local customers than to distant customers and not advertising the prices is also subject to suspicion.

Analyzing price movements over time may be useful in detecting price-fixing cartels. In particular, any narrowing of the spread of different firms’ prices of a particular product may indicate an agreement between them to restrict competition. Here the difficulty is that prices will tend to be very similar and move closely together when markets are highly competitive as well as when firms collude. The fact that prices are same, even that they have moved together, is not sufficient to establish the existence of an agreement. Price fixing is generally considered more likely to occur where there are relatively few sellers in a particular market. This is because as described above, the smaller the group the easier it is to reach agreement on a coordinated course of action.

Warning signs of price-fixing can be as follows:

- Any evidence that two or more sellers of a particular product have agreed to price their products in a certain way, to sell only certain amounts of their products, or to sell only in certain areas or to certain customers;
- Large price changes by a number of sellers of very similar products, particularly if the price changes are of similar amount and occur at about the same time;
- A statement by a firm that it cannot sell to you because of an agreement with another firm that only the latter can supply you;
- Price movements which would not be expected in the prevailing circumstances, in the absence of some form of contact. For example, are prices increased by the same amount at the same time in a period of excess capacity. Has the spread of quoted prices sudden narrowed or are discount levels or structures suddenly changed?
- Price changes which, over time, reveal so regular and systematic a leader/follower situation as to be inexplicable in the absence of some kind of contact.
• The use of similar phrases or explanations used when announcing price changes.
• ‘Give away’ phrases such as ‘the industry has decided that margins must be increased to a more reasonable level.’
• Indications of exchanges of information.

7.2 Quantity limiting

Quantity limiting is an agreement among competitors to fix output quota or to lower the output. Sometimes firms do not have direct control on prices. By controlling supply they can control prices at higher level. So quantity limiting is an alternative to price-fixing cartel. The quantity limiting agreement may take the form of quoting the quantity for each member of the cartel. If every member is ready to sell not more than quoted quantity they will be able to limit the supply and create shortage in the market. This leads to automatic surge in prices.

7.3 Market sharing

Market sharing is one more alternative to price-control cartel; firms can attempt to achieve the same benefits. In market sharing cartel firms agree to divide the relevant market between them and agree not to sell in each other’s designated area, thereby enabling each to set prices knowing that the others will not undercut them. At its simplest, a market-sharing cartel may be no more than an agreement among firms not to approach each other’s customers or not to sell to those in a particular area. This may involve secretly allocating specific territories to one another or agreeing lists of which customers are to be allocated to which firm.

Market-sharing agreements may have two aspects. Firstly, firms may decide on the share of the market or level of business that each is to get. Secondly in order to achieve this objective they may then get together regularly to decide which firms will get particular contracts. This latter practice is known as bid-rigging or collusive tendering.
Participants agree some system for ensuring that contracts are shared out as planned between them while maintaining the appearance of competition.

The warning sign of market sharing could be as follows:

- Any evidence that two or more sellers of a particular product have agreed not to sell in each other’s territories
- A statement by a firm that it cannot sell to you because of an agreement with another firm that only the latter can supply customers in your area;
- Phrases such as ‘such a supplier should not have sold to you because it is not your territory.’

7.4 Bid Rigging

Bid rigging is an illegal agreement between two or more competitors and incompatible with the viability of competition in competition Act, 2002. It is a form of price fixing and market allocation, and involves an agreement in which one party of a group of bidders will be designated to win the bid and bidders keep the bid amount at a predetermined high level. It is often practiced where contracts are determined by bid, for example with govt. construction contracts. Bid rigging is part of horizontal agreement in competition Act, 2002 and is presumed to have an appreciable adverse effect on competition.

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.”

Section 3 (3) (d) of competition Act, 2002 declares that bid rigging is presumed to have an appreciable adverse effect on competition i.e. it is taken for granted that such agreement is governed by per se rule in the competition Act, 2002.
In this sense bid rigging can be regarded as a form of cartel that arises when contracts are awarded by competitive tenders, and where in members of cartel agrees with each other on who should win a particular contract and at what price.

Bidding and tendering are meant to buy goods at reasonable prices. Purchasers, who are often government entities, but who may also include private entities, seek to acquire goods and services by soliciting competing bids. Bid-rigging occurs, for example, when the competing suppliers conspire and agree in advance on the bids to be submitted by each, so as to control the outcome of the bid. By so doing the suppliers effectively raise prices, or keep prices high, and reduce or eliminate competition in the market place.

These agreements are successful because of inherent compensation system. The successful bidder has to compensate other members of the agreement to make his success possible in the terms of direct payment or by providing him a subcontract of the bid at cheaper terms and conditions than otherwise.

Bid rigging may take different forms as described above; they can be categorized in some in very common practices:

- **Subcontract bid rigging** occurs where some of the conspirators agree not to submit bids over to submit cover bids i.e. submission of voluntary inflated bids that are intended not to be successful, on the condition that some parts of successful bidders’ contract will be subcontracted to them. In this way they share the profits.

- **Bid suppression:** in the bid schemes, one or more competitors who otherwise would be expected to bid, or who have previously bid, agree to refrain from bid or withdraw a previously submitted bid so that the designated winning competitor’s bid will be accepted.

- **Complementary bidding,** also known as cover bidding or courtesy bidding, occurs when some of the bidders bid an amount knowing that it is too high or contains conditions that they know to be unacceptable to the agency calling for
the bid. Such bids are merely designed to give the appearance of a genuine competitive bid. They are not intended to secure the buyer’s acceptance of competition and letting the high priced bid win.

- **Bid rotation** occurs where the bidders take turns being the designated successful bidder, for example, each conspirator is designated to be the successful bidder on certain contracts, while his or her co-conspirators are designated to win other contracts. This is a form of market allocation, where the conspirators allocate or apportion markets, products, customers or geographic territories among themselves; so that each will get a “fair share” of the total business, without having to truly compete with the others for that business.

These forms of bid-rigging are not mutually exclusive of one another, and two or more of these practices could occur at the same time. For example, if one member of the bidding ring is designated to win a particular contract, his or her co-conspirators could avoid winning either by not bidding (“bid suppression”), or by submitting a high bid (“cover bidding”)

**Pattern Of Bid Rigging**

Collusive agreements like bid rigging are usually reached in secret with only participants knowing the scheme of conspiracy. But suspicious may be aroused by unusual bidding. Certain patterns of bidding would not seem to be in consensus with a competitive market and suggest the possibility of collusion. Such patterns can be described as follows:

- Do certain suppliers unexpectedly decline an invitation to bid
- Is there an obvious pattern of rotation of successful bidders? This pattern is more suspicious when same suppliers submit bids each time.
- Is there unusual high margin between the winning and unsuccessful bids
- Do all bids prices drop when a potential new bidder enter the market i.e. bids prices are dropped. When new player, who is not the member of cartel enter the market.
• Is the same supplier the successful bidder on several occasions in a particular area or for a particular type of contract? That is if contracts are won in a particular area by same supplier or a particular type of contract is won by one person again and again, this need not be due to the competition superiority of this bidder but they may be due to collusion.

• Are there one or more suppliers who continue to submit bids although they consistently fail to win a contract? This may be due to collusion between the competitors.

• Does a successful bidder subcontract works to competitors that submitted unsuccessful bids on the same project?

• Does company withdraw its successful bid and subsequently get work on subcontract from the winning bidder.

Suspicious Statements or Behavior

While the firms who collude try to keep their arrangements secret, occasional slips or carelessness may be a tip-off to collusion. In addition, certain patterns of conduct or statements by bidders or their employees suggest the possibility of collusion. Following statements and behavior may be suspicious:

• The proposals or bid forms submitted by different bidders contain irregularities such as identical calculations or spelling errors or similar handwriting, typeface, or stationery. This may indicate that the designated low bidder may have prepared some or all of the losing bidders’ bid.

• Bid or price documents contain white-outs or other physical alterations indicating last-minute price changes.

• A company request a bid package for itself and a competitor or submits both its and another’s bids.

• A company submits a bid when it is incapable of successfully performing the contract.

• A company brings multiple bids to a bid opening and submits its bid only after determining who else is bidding.
• A bidder or salesperson makes:
  o Any reference to industry-wide or association price schedules.
  o Any statement indicating advance knowledge of competitors’ pricing.
  o Statement that a particular customer or contract belongs to certain bidder.
  o Any statement indicating that bidders have discussed prices among themselves or have reached an understanding about prices.

While these indicators may arouse suspicion of collusion, they are not proof of collusion. For example, Bids that come in well above the estimate may indicate collusion or simply an incorrect estimate. These conditions are neither the necessary nor sufficient condition for collusion.

**Section 8**

**Joint Venture**

Section 3 (3) of the competition act, 2002 lists four types of anti-competitive agreements: price control, output control, bid rigging, and market allocation which is presumed to cause or likely to cause an appreciable adverse effect on competition. This section has a proviso, which could be an escape valve unless interpreted properly and invoked with circumspection.

This proviso implies that none of the four types of agreements governed by presumption rule will cover agreements entered into by the way of joint venture if they increase efficiency in production supply, distribution, storage, acquisition or control of goods or provision of services.

In other words, the presumption that an agreement falling within one of the four types of cartels listed in section 3(3) of the act would have an appreciable adverse effect on competition, does not hold good in case the agreements relate to a joint venture that increases efficiency in production supply etc. Determination on whether such an
agreement will have an appreciable adverse effect on competition will have to be made by CCI on the rule of reason basis.

A joint venture is not defined in the Act. In competition literature it can be defined as follows:

A joint venture may be defined as an activity in trade or commerce carried on jointly by two or more persons, whether or not in partnership. It could also be an activity carried on by a body corporate formed by two or more persons for the purpose of enabling those persons to carry on that activity by means of joint control or by means of their ownership of shares in the capital of that body corporate.

The condition for an integrated operation between two or more separate firms to be joint venture can be summarized as follows:

- The enterprise/body corporate is under control of the parent firms, but the parent firms are not under related control.
- Each parent makes a substantial contribution to the joint enterprise/body corporate
- This body corporate exists as a business entity separate from its parents.
- The joint venture creates significant new enterprise capability in terms of new productive capacity, new technology, a new product or a new entry into market or an entry by the parents firms as a joint venture in new market.

Broadly, joint venture includes all cases where firms collaborate to carry a particular activity that each firm might otherwise perform alone. But for the sake of precision joint venture can be defined as participating firms agreeing by contract or otherwise to combine, other than merger, going beyond ad hoc co-operation i.e. they agree to run a business rather than simply agreeing to make a business decision in common.
According to section 3(3) of the competition act, 2002 joint ventures that increase efficiencies in production supply etc will not be treated as anti-competitive activity. Enterprises may, without interfering with the process of competition agree upon improved methods of production or distribution leading to efficiency in costs. Such agreements would be outside the ambit of section 3 (3) of the Act. This merely implies that such agreements will not be regarded as presumed violation of section 3 (1). They need to be subjected to rule of reason.

To sum up, two basic requirements for agreement to be outside the ambit of per se rule are:

- The agreement should be in form of joint venture
- It should increase efficiency in production, supply etc. of goods and services

There are no doubt some cases where participants agree to perform through a joint venture something which would not or even could not be undertaken by each participant acting alone. Except for such cases, joint ventures will involve some loss of actual or potential competition. It follows that an adequate competition policy towards joint ventures should consider both their pro-competitive and anti-competitive effects.

Assessing a joint venture’s pro-competitive effects essentially involves considering the static and dynamic efficiencies obtained through co-operation to develop and perhaps produce new products, processes or means of distribution. Good example of such joint ventures is those set up to reap important economies of scale through common production of inputs accounting for a minor portion of the parents’ total costs.

As for anti-competitive effects, assessment would normally begin by examining the terms of a joint venture’s founding agreement(s) including: the governance structure adopted; the joint venture’s duration; and the nature and extent of assets transferred to the joint venture versus those retained by the participants. The principal focus of this
analysis would be to ascertain the degree to which the participants retain the freedom, ability, and incentive to compete with the joint venture and/or each other. Any exclusivity clauses affecting third parties would also deserve attention. Assuming that inter-party competition will be constrained in some way, the investigation may have to be broadened to include making a formal market definition, estimating concentration levels, and considering the significance of any barriers to entry.

Clearly the above analysis should not apply to joint venture aiming at price fixing, output reductions, or market allocations. Scares enforcement resources should not be expended assessing what is simply a hardcore cartel.

Compared with a merger, a joint venture might be easier, quicker and cheaper to arrange, and permit a more flexible, hence efficient joining of forces. It could also be less commercially risky and easier to undo than a full-fledged merger. Mergers are aggregation of two or more already existing firms. So here the test is whether dominant position is created or strengthened. On the other hand, joint venture is a new enterprise. So here the test is whether there is prevention, restriction or distortion of distortion of competition.

Section 9
Leniency Policy

Since cartels are secrete horizontal agreements and observations show that the successful prosecution of cartels typically requires evidence supplied by at least one co-conspirator, commission has to make an incentive scheme to encourage the cartels members to expose the cartels.

Further as in criminal jurisdiction, there are generally provisions for pardon, wholly or partly, in respect of offences perpetrated, if the guilty admits his or her offence and turns as an approver to bring home the guilt of others the Act also provides for incentive
to walkout of a cartel and make a discloser of vital information regarding the actions of the cartel.

The leniency policy exploits the incentive compatibility problems faced by cartels. These programs—which offer reduced penalties to qualifying firms that come forward with evidence of cartel conduct—induce members to defect from cartel agreements. These programs have also been motivated by the observation that the successful prosecution of cartels typically requires evidence supplied by at least one co-conspirator. Section 42 provides leniency policy that read as follows:

“Power to impose lesser penalty

46. The Commission may, if it is satisfied that any producer, seller, distributor, trader or service provider included in any cartel, which is alleged to have violated section 3, has made a full and true disclosure in respect of the alleged violations and such disclosure is vital, impose upon such producer, seller, distributor, trader or service provider a lesser penalty as it may deem fit, than leviable under this Act or the rules or the regulations:

Provided that lesser penalty shall not be imposed by the Commission in cases where proceedings for the violation of any of the provisions of this Act or the rules or the regulations have been instituted or any investigation has been directed to be made under section 26 before making of such disclosure:

Provided further that lesser penalty shall be imposed by the Commission only in respect of a producer, seller, distributor, trader or service provider included in the cartel, who first made the full, true and vital disclosures under this section:

Provided also that the Commission may, if it is satisfied that such producer, seller, distributor, trader or service provider included in the cartel had in the course of proceedings,—
(a) not complied with the condition on which the lesser penalty was imposed by the Commission; or
(b) had given false evidence; or
(c) the disclosure made is not vital,

And thereupon such producer, seller, distributor, trader or service provider may be tried for the offence with respect to which the lesser penalty was imposed and shall also be liable to the imposition of penalty to which such person has been liable, had lesser penalty not been imposed.”

On reading the section, it becomes clear that the Act is not clear on leniency policy. It states that if the party discloses the required information up to the level of satisfaction of commission, it will be charged lesser penalty. By how much less is not specified here. Since cartels are formed in secrecy and it has been observed that the successful prosecution of cartels typically requires evidence supplied by at least one co-conspirator leniency programme is a key tool to detect cartel infringements. So its effectiveness should be gained to optimum level.

The objective of anti-cartel laws is to deter, and where necessary punish, firms who engage in this undesirable act. A cartel typically involve secret agreements between firms, the objective of these agreements is to secure pecuniary gains for cartel members, and sustaining the cartel requires careful attention to crafting incentive compatible agreements between firms. Keeping these characteristics of cartel in mind, we can say that a group of firms will be collectively deterred from cartelizing a nation’s markets if that countries’ anti-competitive authority is expected to fine them more than the gains from participating in the cartel. By how much fine should exceed gains is debatable. Theoretically, a cartel agreement reduces the costs of its members. But simultaneously it reduces the welfare of consumers. If cost to members of cartel agreement is reduced considerably compared to a perfectly competitive benchmark, the formation of cartel could be welfare improving. But in the absence of such cost reduction, the net harm to consumers should be the matter of concern to the commission. So, fines should be based
on peculiar gains to members of cartel or reduction in consumers’ welfare, which ever is higher.

But is it enough to fine the members of cartel. Let us see following explanation:

Assuming that firms are risk neutral; the fine is based on the pecuniary gains from cartelization which is equal to G; and the probability of the antitrust authority detecting and punishing the cartel equals \( p \), then commission can fine the firms involved in cartelization \( f \) that equals or exceed \( (G/p) \). This will provide necessary collective deterrent.

An important insight is that even though cartel agreements are typically secret—and so the probability of detection and punishment \( p \) is low—so long \( p \) is positive there exists a fine that will collectively deter cartelization.

Jurisdictions differ considerably in whether they impose criminal penalties in cartel cases. In particular, few jurisdictions permit the incarceration of business executives responsible for cartelization. Although, the criminality of cartel behavior has considerable implications for international cooperation and evidence sharing. Firstly, incarceration involves costly losses in and re-allocation of output: managers’ productivity is less during their period of incarceration. If these were the sole considerations, then incarceration would be a less desirable alternative to fines. However, given the low probability of punishing a cartel and the sizeable gains from engaging in such behavior, the minimum fine that would deter a cartel may in fact bankrupt a firm or its senior executives. Bankrupting a firm that has engaged in cartel behavior could actually reduce the number of suppliers to a market, resulting perversely in less competition and higher prices. Furthermore, personal bankruptcy laws bound from below what corporate executives can lose from anti-cartel enforcement. Incarceration may provide—through the loss of freedom, reputation, social standing, and earnings—the only remaining means to alter the incentives of corporate executives. This argument is particularly important because the use of stock options in executive compensation
packages provides very strong incentives to senior executives to maximize firm earnings and stock market value.

Secondly, incarceration is needed to reduce or eliminate the expected harm caused by repeat offenses. There may be legitimate concern that executives who have successfully arranged explicit agreements to carve up a market will, after the cartel is broken up, attempt some other form of anti-competitive practices. The imposition of fines alone may not induce a firm’s shareholders to replace the offending executives, especially if the latter can convince shareholders that the fine was a cost of doing business and that the benefits from implicit collusion (which they expect to secure in a market that is well known to them) will soon be recovered. Here a clean break with past is needed, with incarceration simultaneously removing the relevant executives from their posts and acting as a threat to incoming senior executives not to attempt re-cartelization.

Conclusion

Cartels are anticompetitive per se in almost all the jurisdictions because of their inevitable adverse effects. For the same reasons cartels are presumed to have appreciable adverse effect on competition in Competition Act, 2002 i.e. it also takes for granted or believes that cartels exert appreciable adverse effect. But Act, 2002 also provides for safety valve in form of joint venture inter alia to avoid investigation. In case of joint venture commission works according to rule of reason theory. This means commission does take care of efficiency part of horizontal agreements like cartels that are per se illegal in other jurisdiction. But cartels are no doubt harmful to competition and observation has stated that for successful investigation of cartels at least one member of cartel should be ready to expose the cartel, for this purpose Commission has to make its leniency policy more effective.
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