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Growing importance of the Competition Commission of India and impact of the Competition Law

Issues to be watchful of in the Indian Shipping and Maritime logistics industry

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A Point

The Indian Shipping and Maritime Logistics industry, characterized by high market fragmentation, sub-optimal modal mix and infrastructure bottlenecks faces newer challenges from the increased scrutiny of Indian businesses by the Competition Commission of India (CCI). CCI, formed under the Indian Competition Act, 2002 regulates competition in India and has the mandate to eliminate practices having an adverse effect on competition, promoting and sustaining competition, protecting the interests of consumers and ensuring freedom of trade in the Indian market. Over the past 5-6 years, the CCI has become more active and has already imposed fines of over USD 2bn on more than 350 companies operating in India[1]. Although there have been limited instances till date in the Indian shipping and maritime logistics industry where such penalties have been imposed, the emerging trend clearly indicates that the sector faces increased threat of regulatory scrutiny.

On the face of it, high market fragmentation should not warrant the attention of the CCI. However, it would be extremely risky to dismiss the threat of regulatory scrutiny merely because of high fragmentation and lack of apparent market power. In various cases that the CCI has investigated till date, it has more often than not, taken a very specific and narrow definition of 'relevant market' while applying rules of fair competition and choice to the customer.

Structurally, the Indian shipping and maritime logistics industry is characterized by the presence of varied players i.e. domestic vs. international, regional vs. national, type of services, integration levels, asset heavy vs. asset light models, to name a few. The structure of the industry and the increasing trend of the customer requirement of an end to end logistics solution necessitate the collaboration between different players. Any such collaboration could come under the scrutiny of the CCI if there are indications that customer interest is being compromised on account of such collaborations.

What can be construed to be anti-competitive?

Very simply put, anything that can have an adverse impact on competition in the 'relevant market' emanating from abuse of dominant position in that market by a market participant, whether individual or an organization, is construed as anti-competitive under the Competition Act, 2002 (the Act). The Act lays down certain principles and parameters that need to be applied while looking into any particular matter and the CCI is the body that has been given the power to apply these principles and parameters including power to investigate anti-competitive behavior. The penalties laid down in the recent past, have been quite stringent and can have an adverse financial impact on corporates found to be violating the Act.

Abuse of dominance

INR 1,773 crore fined on a coal mining company for fixing prices and supplying poor quality coal

INR 630 crore fine on a real estate company

INR 55 crore penalty on stock exchange for unfair pricing of financial instruments

INR 2,500 crore combined penalty on 14 car makers

INR 8 crore on a cable TV services company

Cartels/ Horizontal agreements

INR 6,307 crore worth fine on 11 cement companies

INR 318 crore fine on three pharmaceutical companies

INR 60 crore penalty on two pharma majors for indulging in bid rigging

INR 62.31 crore penalty on transport providers for corporate espionage

1 Source: http://www.business-standard.com/article/pti-stories/cci-recovers-just-0-74-of-rs-12-474-cr-fines-imposed-by-it-115022700766_1.html

# of View

CCI carries out the above duties by regulating anti-competitive activities that have been broadly classified under three large categories. These categories also form the main provisions of the Act.

- Prohibit anti-competitive agreements between enterprises
- Prohibit abuse of dominance and
- Regulate combinations

When specifically applied to the Indian shipping and maritime logistics industry, there could be multiple aspects where industry players need to tread cautiously so as not to violate the provisions of the Act. Some of the situations and important issues that need closer attention have been discussed in the subsequent sections.

I. Prohibit anti-competitive agreements between enterprises

The Competition Act essentially divides all agreements into two types i.e. Horizontal and Vertical wherein horizontal agreements are agreements between suppliers of identical goods or services and vertical agreements could be between suppliers of goods or services across the value chain. The shipping and maritime logistics industry, though highly fragmented, is characterized by the existence of both formal and informal arrangements between industry players to provide end to end logistics solutions. With the CCI increasing its levels of scrutiny and attention on this industry, companies need to exercise due caution while formalizing these arrangements. It needs to be noted that each of these situations need to be evaluated separately as horizontal agreements are presumed to be anti-competitive by the CCI while vertical agreements are subject to the "rule of reason". We have illustrated a few specific situations across these two types of agreements in the next section.

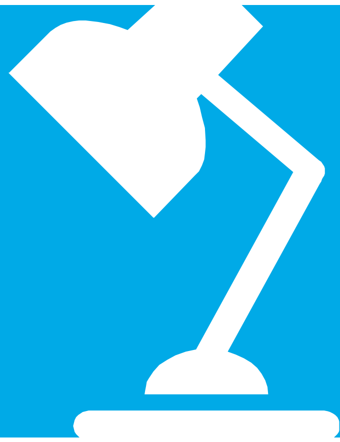
Horizontal agreements in the shipping and maritime logistics industry

a) Cooperation between market participants leading to bid rigging is presumed to be anti-competitive

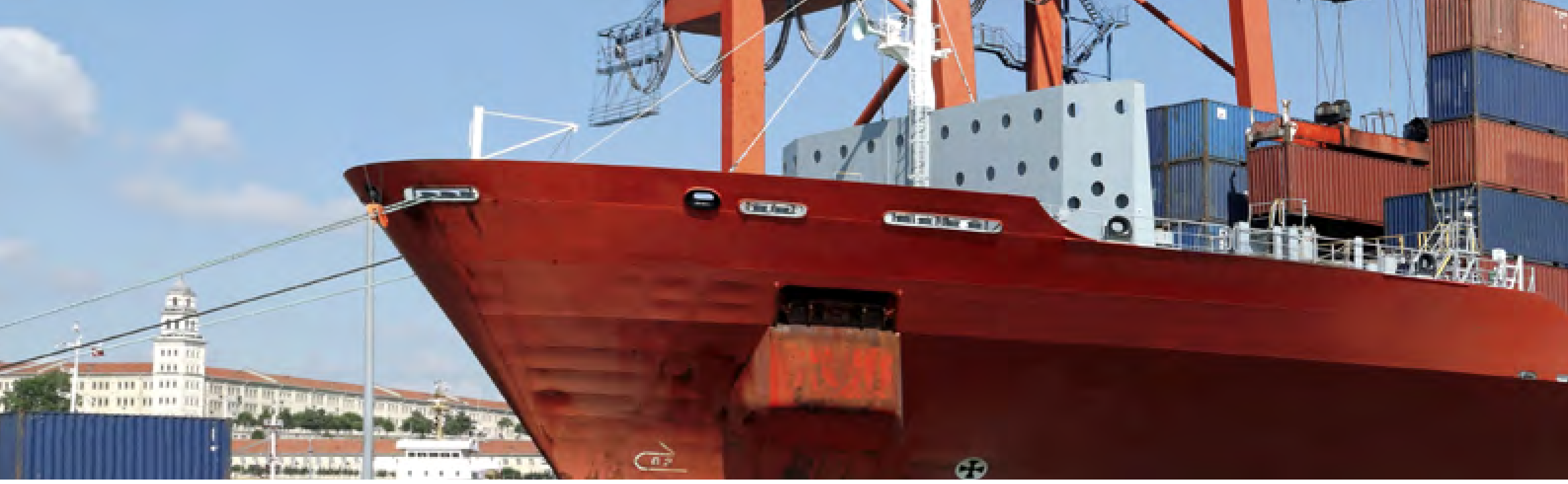
Given the nature of the industry there is significant interaction between market participants at industry forums. Despite being a fragmented industry, presence of loose consortiums/ alliances may lead to reduction in the number of bidders thereby increasing the risk of bid rigging. Collusive bidding, agreements to submit the lowest bid, not to bid against each other, submission of cover bids, bids won on rotational or geographical basis to restrict competition can all be considered as forms of anti-competitive agreement by the CCI. While there has been no instance of investigation of bid rigging in the shipping and logistics industry in India, the Competition Commission of Pakistan has fined four companies in a case involving collusive bidding for dredging at Pakistani ports.

b) Vessel Sharing Agreements (VSAs) are exempted from CCI's jurisdiction but are still regulated for anti-competitive clauses

On 5 February 2015, the Central Government, with the objective of promoting efficiency and productivity, exempted the Vessels Sharing Agreements of the liner shipping industry from the anti-competitive provisions of the Act, for a period of one year. However, companies are not allowed to engage in practices involving fixing of prices, limitation of capacity and allocation of market, and customers. Vessel sharing has however, only been made exempt in the liner shipping industry. For the tramp shipping industry, such agreements are not exempt from the purview of the CCI.



During the said period of one year, the Director General (Shipping), the Ministry of Shipping and the Government of India will monitor such agreements and in case of any violation of the competition law, the matter may be referred to the CCI for investigation and subsequent penalty imposition. While this exemption provides flexibility to conduct business with efficiency, the principles of the competition law and CCI's jurisdiction will however apply on the business activities.



c) **Shipping conferences have made way for Consortium/ Alliances that may turn anti-competitive**

Historically shipping companies globally, operated under Shipping Conferences and coordinated at an industry level for (amongst other things) capacity planning, capacity allocation and price fixing. These Conferences that were earlier exempt by most Competition Regulators across different countries are now prohibited in most jurisdictions and have now been replaced by Consortia/ Alliances amongst global players. Such arrangements amongst industry players have typically been justified on account of high entry barriers due to huge capital investment involved, global nature of the industry, time lags between investment decisions and actual capacity addition as well as significant volatility in international trade flows leading to volatility in demand. The CCI may closely look for the following aspects of anti-competitive behavior in Consortia/ Alliance arrangements:

- Prevent shippers from using non-alliance companies through loyalty contracts and exclusive dealing contract – the exporter/ importer would get discounted freight rates in exchange for a commitment to use the vessel of that alliance/ consortium, which would be withdrawn if vessels from other shipping agencies are used
- Make operations of non-member shipping companies unviable through practices like predatory pricing and rate wars
- Share sensitive data like capacity expansion and pricing strategy between alliance members that may be considered as anti-competitive by the CCI

d) **Trade Associations may indulge in activities that restrict competition**

Trade/ business associations play a larger role in an open market economy by helping members raise issues in the industry's interest, before competent public authorities. Discussion and exchange of general information and knowledge between stakeholders in the logistics chain (namely carriers, shippers, ports, freight forwarders, custom house agents etc.) may bring in efficiency and improve productivity to benefit the industry as well as the final customer. However, sometimes trade associations may serve as a platform for activities that restrict competition. A fair number of the cartel cases brought by the CCI directly or indirectly have involved a trade association.

The CCI has, held in many cases, that a Trade Association should not be involved in the following activities:

- Price fixing and setting common terms and conditions of sale
- Unduly restrictive or mandatory membership rules
- Exchange of sensitive commercial information not available in the public domain
- Any discussion on capacity deployment and management or demand date of individual players

Vertical agreements in the shipping and maritime logistics industry

a) **Agreements between ports and service providers (logistics companies, equipment providers etc.) may have anti-competitive clauses**

The evolving ownership structure of ports and the logistics service providers in India, presence of international Consortia/ Alliances, strong regional and locational players, existence of labor unions in ports and port related infrastructure and significant market fragmentation necessitates formal agreements or broad arrangements across the logistics value chain. Some of the practices that could invite attention of the CCI and bring in regulatory scrutiny are:

- Restriction on volume discounts if vessels use another port
- Collusion with shipping lines and other service providers to fix prices for end consumers
- Bundling of services by a company operating both port and shipping lines
- Other issues like refusal to provide port infrastructure at par to all shipping companies, forcing minimum service quantities and exercising territorial exclusivity in collusion with shipping lines

b) Vertically integrated terminal and shipping line operators may deny services to downstream operators

There is an increasing trend globally where the same group owns terminals, operates shipping lines and also controls hinterland logistics services either through ownership or through alliances. In such instances if the terminal operator refuses or discriminates the provision of services to downstream operators like shipping lines and other service providers, it may be considered as an anti-competitive behavior. In India, the pricing in major ports is regulated by the Tariff Authority for Major Ports (TAMP). However, minor ports are not regulated by TAMP. In these unregulated ports, operators have to be careful while negotiating terms of agreements and fixing prices.

In addition, ancillary charges charged by liner operators tend to be fixed and are passed on to the shippers as terminal handling charges (THC) which are generally largely driven by Consortia/ alliance arrangements. In situations where THC may not reflect either the direct cost or the volume rebates that the liner may get from the port or the terminal operator, it may draw attention of the CCI and can create a significant challenge in complying with the requirements of the Act.

II. Abuse of dominance

The CCI closely monitors not only the existence of dominant positions in the Indian market specific to every industry, but also the practices of the market players that may lead to the abuse of the dominant position. While the existence of a dominant position is not considered to be anti-competitive, the abuse of that (dominant) position is however regarded to be anti-competitive. The popular perception of the high degree of fragmentation within the Indian shipping and maritime logistics industry may however be immaterial as the CCI tends to define a dominant position in relation to the relevant market, which typically tends to be narrow and very specific. Firms exercising market power in the relevant market could potentially abuse their dominance giving rise to practices such as market foreclosure, predatory pricing and bundling - it is such behavior that tends to be monitored by the CCI.

The Competition Act prohibits exploitative as well as exclusionary abuse of dominance by any company (private as well as government), The Act defines dominance as a position of strength enjoyed by an enterprise in the relevant market which enables it to (i) operate independently of the competitive forces prevailing in the relevant market or (ii) affect its competitors or consumers or the relevant market in its favor.

Dominance per-se is not considered illegal by the Act. If a dominant firm engages in one or more of the below, it shall be considered abuse of dominance:

- Foreclosing competitors/ competition
- Unfair or discriminatory pricing/ conditions
- Limiting or restricting production of goods or provision of services
- Limiting or restricting scientific or technical development to the prejudice of consumers
- Predatory pricing
- Denial of market access to others
- Making conclusion of contracts subject to the acceptance by other parties of supplementary obligations that are unrelated to the original contract

The penalty levied on Dumpers Owners Association at the Paradip Port is a clear indicator of how the CCI approaches such matters. On 21 January 2015, for the first time in the history of Indian Competition Law, a penalty was imposed in the maritime logistics industry. The Dumper Owner's Association (DOA), a trade association of dumper and hywa (unloading) machinery providers for intra-port transportation of cargo at Paradip Port, was fined 8 percent of its average turnover (for the last 3 years) while the individual officers were fined 5 percent of their average income (for the last 3 years) for controlling the supply of dumpers and hywas at Paradip Port and fixing supply prices[2]. In this matter, the practice followed by DOA was construed to be anti-competitive by the CCI as DOA was the sole player providing these services at Paradip Port and it was regarded as a form of cartelization. This order is a clear example for players across the Indian shipping and maritime logistics industry that the CCI now has its attention on the industry and is monitoring the sector for anti-competitive practices.

III. Regulation of combinations

Mergers play an important role in shaping the market structure of any industry and it is no different for the shipping and maritime logistics industry. One of the powers conferred on the CCI in order to effectively monitor competition is to regulate the creation of a dominant position in India through mergers and combinations. Under these powers, all mergers and combinations in the Indian market subject to defined thresholds are required to be referred to the CCI for its approval. The CCI has the power to review each such combination and grant its approval or reject the same based on its evaluation of the effect such a combination can have on competition within the Indian market. The CCI may also grant approval subject to the fulfilment of certain conditions that in its view will help in mitigating the dominant impact that a combination is likely to have in the Indian market. The CCI can impose a penalty of approximately 1 percent of the total turnover of the merging parties in question, in case prior notification is not provided or due to improper filing of the combination. It is to be noted that the power of the CCI in this regard is only limited to the Indian market and its refusal in the Indian market/ conditional approval may have significant impact on the structure of the global combination. If Indian assets are a significant portion of the combination, the deal itself may be jeopardized.

While there aren't any noteworthy examples of combination in the shipping and maritime logistics industry that have undergone the approval process of the CCI, the case of the formation of P3 Global Alliance that went through the scrutiny/ approval of Competition Regulators across varied jurisdictions had a huge impact on the Global Alliance on account of the diverse approach adopted by the regulators across different jurisdictions. Such a mixed regulatory approach could have a significant impact on the commercial and financial aspects of such arrangements. We expect this trend to catch up in the Indian market once the trend of consolidation in the shipping and maritime logistics industry gains traction.

2 Source: "CCI slaps INR 3.86 lakh on Dumper Owners' group at Paradip Port", Business Standard published 22 Jan 2015

The case of the P3 Case Global Alliance

On June 2013, Maersk (Denmark), CMA CGM (France) and MSC (Switzerland), announced their intention to form the "P3" Global Alliance. The parties are the three largest container-ship carriers in the world, in terms of number of vessels and TEU, according to the UNCTAD Review of Maritime Transport, 2014. The alliance entailed a long-term vessel sharing agreement on Asia to Europe trade, transpacific trade and transatlantic trade, and the creation of a network centre in England and Wales to deal with the operation matters of the alliance.

The US FMC gave its approval to the alliance on March 20, 2014 as it considered that the agreement was not likely, at that time, to lead to a reduction in competition which could entail "an unreasonable increase in transportation cost or an unreasonable reduction in transportation service under section 6(g) of the Shipping Act". Nonetheless, the FMC considered it was not possible to rule out the possibility that, in the future, circumstances could allow the parties to unreasonably restrict supply or increase prices. As such, Parties' reporting requirements were strengthened, so as to allow a close monitoring and timely intervention if required.

On June 3, 2014, the EC announced it had no intention, at that stage, to open proceedings regarding the P3 alliance, however stating it would keep a vigilant eye on the impact of the alliance on the competitive conditions in the market.

The Ministry of Commerce of China, MOFCOM, initiated merger proceedings concerning the P3 agreement on December 19, 2013 and it decided to further review the concentration on January 18, 2014. On June 14, 2014, after several rounds of potential remedies discussions, MOFCOM announced its objection to the joint venture. The decision followed concerns that the alliance would restrict competition on container liner shipping in the Asia-Europe trade as MOFCOM considered that the deal:

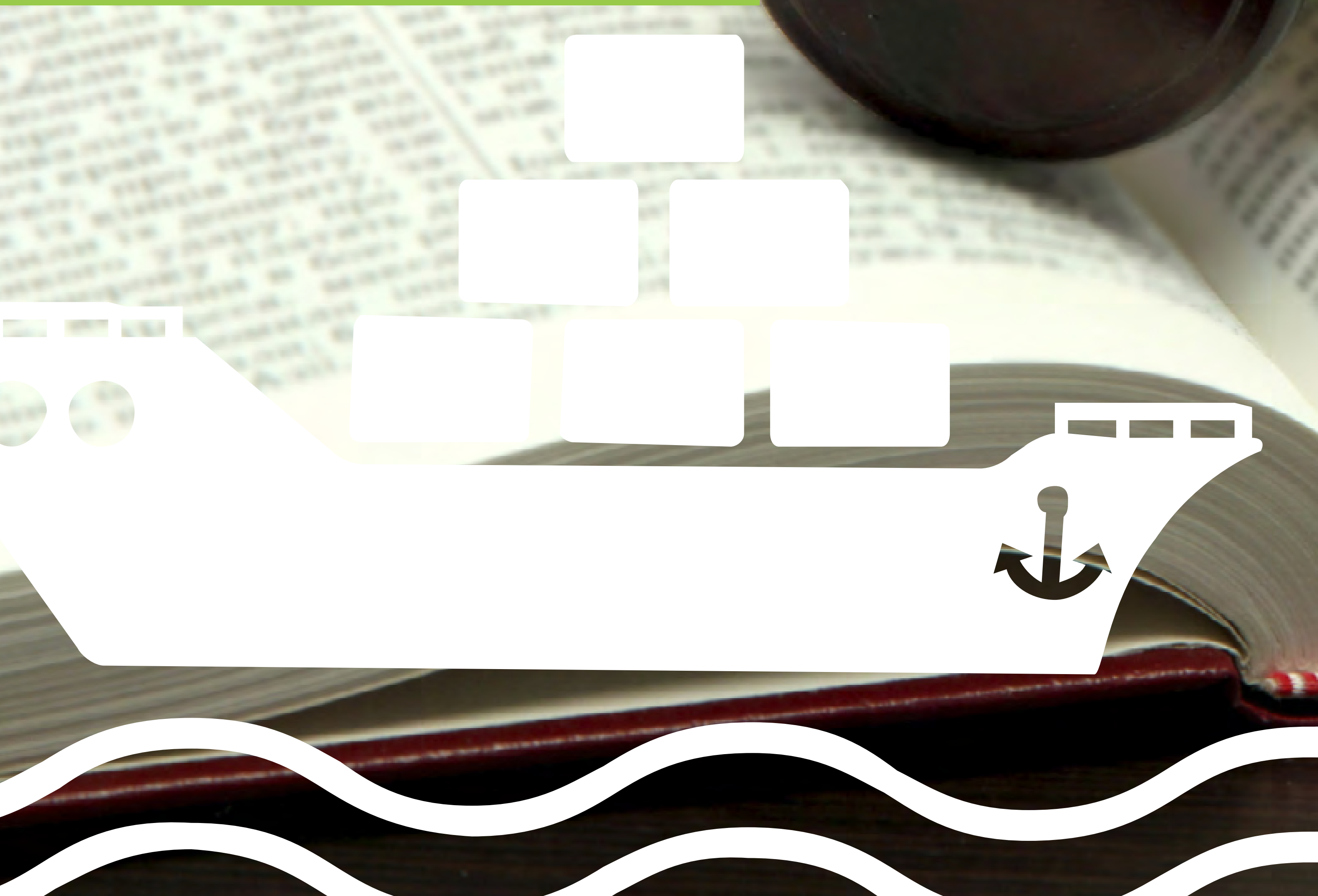
- Would create "a compact association different from the loose traditional shipping alliances in nature (…) based on vessel sharing agreements and accommodation swap agreements", with parties only retaining vessel property as the network centre would independently manage vessel operations;
- Would strengthen the parties' market power and allow them to squeeze rivals as P3 would account for 46.7% of capacity in the route;
- Would lead to a change from a "relatively segmented" to a "highly concentrated" market structure and strengthen barriers to entry;
- Would strengthen parties' bargaining power vis-à-vis cargo owner and ports.

Source: "CCI slaps INR 3.86 lakh on Dumper Owners' group at Paradip Port", Business Standard published 22 Jan 2015

Penalties for Contravention

For contravention of Section 3 and Section 4 of the Competition Act, the CCI may impose penalties ranging from a nominal deterrent amount to substantial amounts such as three times the net profit of the contravening companies.

- Financial penalty on one or more enterprises may include (i) not more than 10% of last three years average turnover of the contravening company or (ii) In case of a cartel – three times of the amount of profit made out of the cartel
- Financial penalty may also be imposed on an individual as is evidenced by the Atos Worldwide vs. Verifone India case, where the CCI is considering penalizing the individuals involved
- The CCI may pass a cease and desist order or the order modification of agreements that are anti-competitive
- In case of combinations, the CCI may prevent combinations from going through if they are expected to appreciably affect competition



Awareness and proactive action towards compliance

While the Competition Act and the CCI only lay guiding principles and are not prescriptive, and the application of such principles are generally done on a case to case basis, the existence of clear solutions are therefore unlikely towards compliance with the requirements of the law. The lack of incidents penalized, also provides an insignificant precedent in an industry set to potentially observe a closer scrutiny by the CCI. The CCI looks at a wide range of information/ data sets including economic and financial data and not necessarily only the documentary evidence that may exist in the organization. In such a situation, awareness of the principles of the Competition law and a pro-active approach towards mitigating the risk of non-compliance is extremely important to avoid any penalties that may get levied on a market participant. These suggestions provided below could however be adopted in order to mitigate the risk of non-compliance to the Act.

1. Firms should fix internal protocols for decision making and information sharing with regard to sensitive financial and commercial information
2. Firms should create awareness and run regular training programs amongst all employees handling sensitive financial and commercial information.
3. Shipping companies and other players at ports should take proper caution while attending a trade association meeting and desist from discussing sensitive/ confidential matters pertaining to commercial/ financial matters of individual players. Ideally, they must raise their objection in writing against any such discussion that may happen. Lack of written objection and mere presence at such a forum can be considered as an approval in this type of situation.
4. A competition law due diligence should be conducted by firms that have a high market share or perhaps have exclusive rights at ports etc. so as to avoid anti-competitive clauses in agreements with suppliers, vendors and other market players.
5. Communication with competitors with regard to any business discussion should be limited/ restricted as well as recorded properly to mitigate any competition law risk.
6. Any pricing below the cost must have a sound economic rationality to justify its efficiency and business purpose.

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