

**“Competitors are our Friends, Customers the Enemy”:
Cartels, Corruption & WMD**

... By **S. K. Sadangi**

“Competitors are our friends, customers the enemy” : these were the words by which Michael Andreas, son of Chairman of Archer Daniels Midland Co.(ADM), USA, summed up his business philosophy before a small group of executives on a lazy afternoon of March,1994 inside a luxury hotel in the remote Island of Hawaii. Those who had assembled were no ordinary persons. They represented two giant Japanese companies, Ajinomoto Co. & Kiowa Hakko Inc., and the Korean food behemoth, Cheil Jedang Co. Together, they accounted for nearly the entire global production of an item called *Lysine*: an amino acid extracted from corn and used as an essential additive in breads, pork and poultry feed. The purpose of the gathering? - to sustain global lysine prices at artificially higher level while posing as rivals and competitors to the world outside so that their already enormous bottom line could be further fattened at the expense of countless customers.

What these gentlemen did not know was that Mark Whitacre, President of the Bioproducts Division of AMD and colleague of Michael Andreas, had switched on a transmitter hidden beneath his coat and was busy recording the pearls of business wisdom flowing from Andrea's lips. Unknown to them, Whitacre had long turned an informant to FBI, saddened by the crass manipulation of his employer in search of ever increasing profits. The tiny transmitter he was wearing on his skin for two long years had been provided by FBI to snoop on such price-fixation meetings that took place in different locations around the globe - like Tokyo, Paris, Mexico City, and Hong Kong - for reasons of secrecy.

Two years down the line, Whitacre's action would lead to the first ever successful prosecution of an international cartel by the U.S. Department of Justice in more than 40 years, a massive \$305 million fine for ADM Co. and jail terms for three high-ranking executives of the company. The blow-up of the Lysine-cartel would also reveal to the America public how they had been taken for a ride in what they pay for everyday food items ranging from orange juice to the bread on their breakfast table. During the entire process, Whitacre would turn increasingly psychotic, lose his whistleblower immunity and end up in jail for 8 years for not speaking the “*whole truth*” to FBI. The twists and turns of this international intrigue by a cartel of powerful corporations, its undoing by a top executive-turned-whistleblower like Whitacre and finally the self-destruction of the hero himself would be too attractive an opportunity to pass by for Hollywood who converts it into a 2009 blockbuster, aptly called, “**The Informant**”.

On 2nd March, 2010, half the world away from Hawaii, a similar meeting was in the progress in the Sahara Star Hotel of Mumbai. In attendance were representatives from 12 business houses of India who manufactured 14.2 Kg-steel cylinders, an item that affects the price of one of the most essential commodity for India's poor - the Liquefied Petroleum Gas or LPG. The purpose of the gathering? : To “discuss” bidding price for an up-coming tender for procurement of 105 lakhs of such LPG cylinders, to be opened on the next day by IOCL, an Oil PSU. The fact that the price of LPG cylinder were routinely being fixed by 50-odd companies came into light when Competition Commission of India (CCI), an institution created in 2002 to act as the fair-trade watchdog, investigated into their murky dealings revealing that the price for gas that you and I pay are artificially determined by this group. 48 out of the 50 cylinder makers were fined by CCI a total sum of 165 Crores of rupees for engaging in price-fixing, bid rigging, and market sharing. **Two years later, in**

2012, even more shockwaves rocked the life of Indian consumers. This time it was Cement - the stuff that goes into the heart of infrastructure and urban housing. It is also the stuff that determines the price of a decent 750 Square feet house, the lifelong dream of the great Indian Salaried Class. CCI found that 11 major Cement Companies had formed a collusive cartel to fix the price of cement at inflated level across the country and created artificial shortage by cutting down production. The fine imposed by CCI was a whopping Rs 6,307 Crores. Among the cartel were such household company names of India as Jaiprakash Associates, Ultratech Cements, Ambuja Cements and ACC bearing penalties of Rs 1,323.6 Crores, Rs 1,175.49 Crores, Rs 1163.91 Crores & Rs 1,147.59 Crores respectively.

But unlike the architects of Lysine-Cartel in USA, none involved in the LPG Cartel or Cement Cartel of India went to jail.

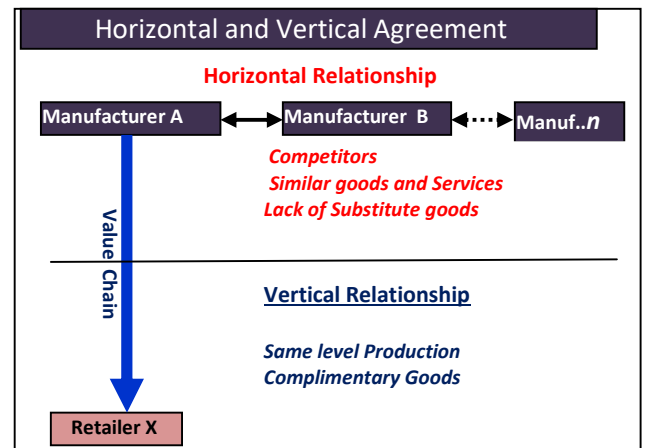
The reason: Under the Sherman Act of USA which regards Anti-competitive business behavior as both Civil and Criminal offence, the Competition Act, 2002 of India treats such activities as only Civil Offenses, to be punished with monetary fines. *Section 27(b)* of the Act stipulates that the maximum penalty for indulging in Anti-Competitive Agreements [Defined under *Section 3 of the Act*] or Abuse of dominant position [*Section 4 of the Act*] shall be up to 3 times of its profit for each year of continuance of such agreement or 10% of its turnover for each such year, whichever is higher. In fact while the Sherman Act of USA, regarded as the single most powerful Act to ensure the health of America's market economy, has been around since 1890, our Competition Act has come rather late in the day in 2002. It got some teeth only when cartelized behaviour was explicitly defined by way an amendment in 2009 through **Section 3** (Prohibition of Anti-competitive Agreements), **Section 4** (Prohibition of Abuse of dominant position). **Section 5** on Combination and Merger came into force in June 2011 - a full 20 years after India started her economic liberalization in 1991 by embracing LPG [Liberalization, Privatization and Globalization]

What exactly is a Cartel and how do they operate? Section 2(c) of Competition Act, 2002 defines "Cartel" as "*.. any 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*". Such agreements are also termed as "Horizontal Agreements" through which Cartels unleash their distortionary influence by agreeing to do one or more of the following anti-competitive behavior as defined under Section 3(3) of the Act:

- **Price fixing:** Price fixing occurs when two or more competing sellers agree on what prices to charge, such as by agreeing that they will increase prices a certain amount or that they won't sell below a certain price.
- **Bid rigging:** Also called collusive bidding. It can mean agreeing to submit identical bids. To pre-arrange who shall submit the winning bid, not to bid against each other, submit cover bids (voluntarily inflated bids), adopting common norms to calculate prices, specifying common terms typically for local, State, or Federal Government contracts.
- **Customer allocation:** Customer-allocation agreements involve some arrangement between competitors to split up customers, such as by geographic area, to reduce or eliminate competition by preventing new entrants.

Contrary to common perception that only Cartels comprising multiple members (manufacturing/trading identical goods & services and indulging in anti-competitive actions) can only be prosecuted under Competition Act, even a single company/entity can be prosecuted if he/she imposes, directly or indirectly, unfair or discriminatory conditions/prices in purchase or sale. This is called "Abuse of dominant Position" which is prohibited under Section 4(1) and 4(2) (a) of Competition Act. Such abuse can happen through "Vertical Agreements" which can one or more of the following form:

- Tie-in arrangement [Purchaser of goods A forced to also purchase goods B]. Recall famous Microsoft Anti-Trust where buyers of Windows-95 were also forced to buy Internet Explorer.
- Exclusive Distribution Arrangement [Restriction of Market or Production]
- Refusal to deal
- Resale Price Maintenance [Seller X to sell to Buyer Y on condition that Y resales it in price dictated by X]



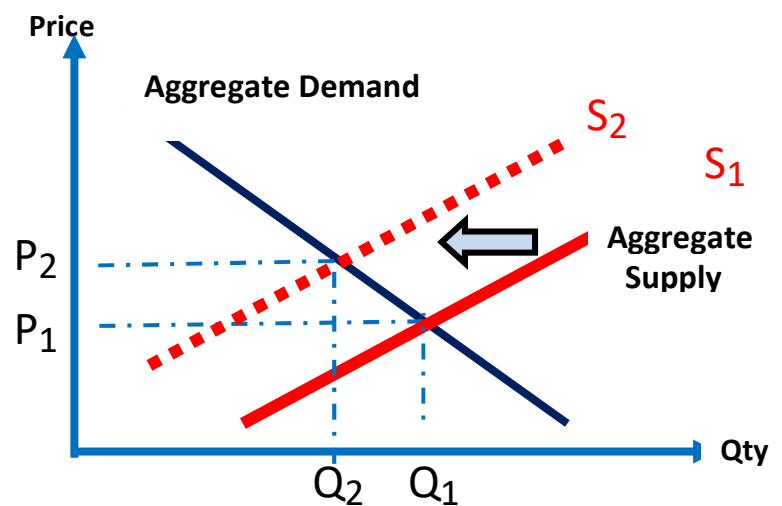
It is pertinent to note that "Agreement" between Cartels members referred under Section 3 need not be "formal" or "written" in nature. This is stated at the very beginning of the Act under Section 2(c). The existence of such agreement is often deduced by CCI from strong circumstantial evidence like Price Parallelism(Quoting equal rates or equal increase in rates), quoting inexplicable prices that defies business rationale, Market dominance, Concerted bidding behavior, Creating Barrier to entry, lack of substitute products etc. In fact, direct evidence in the form of written agreement among cartel members should not be expected at all. In the words of Lord Denning, possibly the most famous English Judge of 20th Century:

"People who combine together to keep up prices do not shout it from the housetops. They keep it quiet. They make their own arrangements in the cellar where no one can see. They will not put anything into writing nor even into words. A nod or wink will do. Parliament as well is aware of this. So it included not only an 'agreement' properly so called, but any 'arrangement', however informal"

[RRTA v. W.H.Smith and Sons Ltd.]

Since offense under the Act are "civil" in nature, charges under Section 3 (3) can be sustained on the principle of "preponderance of probability" or "liaison of intention" rather than on the strict premises of "evidence beyond reasonable doubt" required for criminal conviction. This is a major strength of Competition Act.

Why are Cartels so dangerous? Cartels hit the very soul of a market-driven economy by undermining “competition”. It is well known that the efficiency of market economy stems from prices of goods and services being determined by market forces rather than government regulation as was the case in earlier Command Economies. After the fall of Berlin Wall in 1989, most countries around the world including India abandoned their belief in government control of major sectors of economy and tilted towards a fully fledged market-economy model. But the vaunted efficiency of market-economy-model depends on one basic thing: “unfettered and unhindered competition” among market players. It is competition which ensures optimal pricing for goods and services leading to right resource allocation of economic resources. Neither the theories of free-market-evangelist like Milton Friedman (who advocated minimal government control in economy) nor that of John Maynard Keynes (who prescribed major governmental intervention to regulate business cycle) would work if “competition” itself gets artificially controlled or compromised. In absence of competition, the public monopoly of Command-economy simply transforms into private-monopolies or oligopolies. By attacking and undermining competition, Cartels act as **Weapons of Market Destruction (WMD)**.



An Output-Restricting Cartel (Like the Cement Cartel detected by CCI or the OPEC oil Cartel) drives up Price by shifting Aggregate Supply Curve for a product left-ward

Although cartels can persist in diverse sectors of economy like import and export. But their pernicious effect becomes most visible in one particular sphere of economy: **The procurement sector**. They become especially destructive to economies of developing world who by nearly third of their GDP through Public Procurement by Federal, State and local authorities. As for India, the volume of Public Procurement is believed to be varying from 20% of GDP (As per WTO estimate) to 30% of GDP (OECD quick estimate). Thus with a 2014-15 GDP at \$2.1 trillion or Rs. 126 lakh Crores, even the lower limit of 20% takes Public Procurement to nearly Rs 25 lakhs Crores annually i.e. nearly 4 times the Income Tax collected from citizens and corporate in 2013-14. According to a meta-study in US, the average overcharging by American Cartels (domestic and international) is 25%. We can safely assume that to be the lower limit of Cartel-distortion in developing countries where competition laws are not as strict as the Sherman Act of USA.

So how much of Indian Public Procurement volume could be going out as undue gain to cartels? The answer will depend upon (a) how rational and pure our procurement system is and (b) how much of it is affected by cartel? To get an idea about (a) one need not go much farther than the first paragraph of the “Report on Public Procurement” authored by the ten-member high powered Committee . This committee had been constituted by Cabinet Secretariat in 2011 to study procurement in government sectors and for the purpose of creating a Procurement Law which India does not yet possess. The said paragraph reads as follows:

"In India, public perception about the quality, credibility and probity of public procurement is generally poor. There is a general feeling that corrupt practices abound, and the system is by and large inefficient and wasteful. A few high profile scandals that have erupted recently have further heightened public disenchantment and distrust of Government procurement systems. As a result, public procurement is often perceived as the soft underbelly of the governance structure."

And to guess about (b) i.e. the prevalence of Cartel in procurement, one may examine a particular sector like Railways which is second to only Defence Sector in procurement volume. In past few years, CCI investigation Again Chapter-11 of the same Report offers some insight in the following words:

"A quick review of the procurement practices followed in the Indian Railways suggests a system that has potential for respective, inefficient and costly outcomes which may lack in robust competition and transparency. It is, therefore, necessary to reform the ongoing procurement practices in the Railways with a view to promoting transparency, efficiency, economy and competition."

Analysis of vendor directory of 358 mechanical items for 2009-10 by the Committee showed that nearly 67% are procured from pre-approved panel having not more than 3 companies.

In fact past investigation by CIC into Railway procurement of PVC Flooring Sheet & ERC Clips show how bidders had acted in consort even going to the extent of filling up tender enquiries by a single agent. If there is still any doubt on the pervasiveness of cartels, let us turn to Page 103 of the Come Man Committee Report submitted very recently by Sri E.Sreedharan:

*"Committee heard views of senior officials- "Procurement is through Cartel only", "List of approved Sources and Cartels are synonymous" and "**there is no item in which there is no cartel**". Committee feels that vendors thus continue to fleece at will and bureaucracy remains satisfied that it has been doing its bit. Cartels not only result in purchases at unreasonably high rates but also in delay in finalization of purchases."*

So what should be done India? Perhaps we should follow what a 2004 - OECD Policy brief advocates:

"In our view, only a criminal sanction adequately expresses society's disapproval of naked horizontal agreements. A criminal sanction makes clear that these unambiguously harmful agreements are not merely technical infractions, but are morally wrong and simply will not be tolerated by a civilized society. These are crimes of deceit and fraud that cannot be justified by any business rationale or excuse. They are serious crimes that involve theft from consumers -- theft that is more egregious because the victims often don't even know they have been robbed. There is no reason not to treat these offenses as seriously as any other white collar offense."

Perhaps that is the reason why USA, after nearly a century of experience of anti-trust law, increased the prison term for cartel offenses from 3 years to 10 years after 2004. What can not be cured need not be endured any more.

Ref: Report of Dhal Committee on Indian Procurement, Report of One Man Committee, OECD Policy Brief No DAF/COMP(2004)39, Study on Cartel by Robert H. Lande, Baltimore School of Law and J.M.Connor, American Anti-Trust Institute, DOJ News Bulletins, CCI Website

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