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Basis for penalty in competition law

The sanction for triggering market failure must be based on the entire turnover

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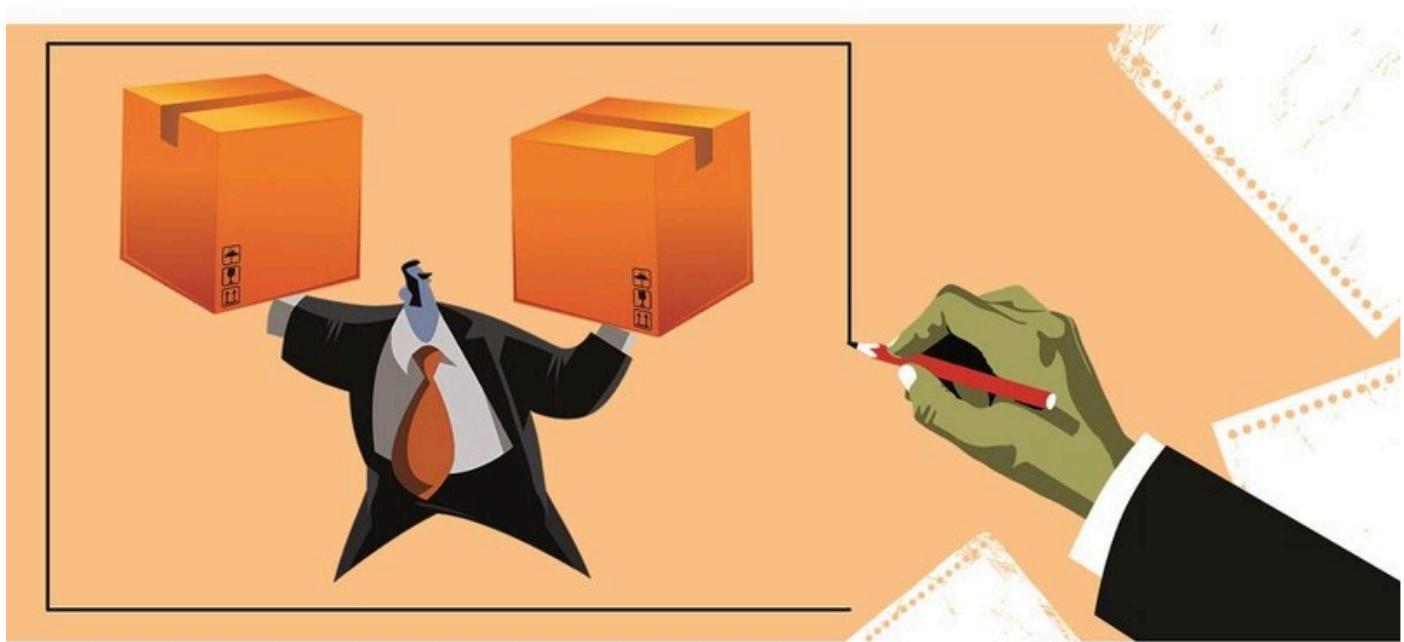


Illustration: Binay Sinha

The Competition Act, 2002, aims to defend the economy from enemies of competition. It prohibits anti-competitive agreements and abuse of dominant position. It empowers the Competition Commission of India (CCI) to impose penalties upon each person party to such an agreement or abuse. The CCI has the authority to impose a penalty of up to 10 per cent of the average turnover for the three preceding financial years. The Act defines "turnover" to include the value of goods or services sold. The CCI used to levy a penalty based on the "total" turnover of the offending person but within the ceiling of 10 per cent.

In *Re: Excel Crop Care Limited*, the CCI imposed a penalty at 9 per cent of the total turnover. Since the statute was not clear whether the turnover was related to the product or the person, the apex court, in an appeal in this matter in 2017, adopted "relevant" turnover for imposing a penalty. It clarified that "relevant" turnover was the person's turnover pertaining to products and services affected by the contravention. For this purpose, it relied on two principles: (i) strict interpretation

— if two interpretations are possible — one that leans in favour of the infringer should be adopted; and (ii) proportionality, that is the punishment should be proportionate to the harm caused by the infringer. In *Re: Cartelization by public sector insurance companies*, the CCI imposed a penalty at 2 per cent of the turnover after considering the aggravating and mitigating circumstances. On appeal, the appellate tribunal computed the penalty based on “relevant” turnover, that is, gross premium received under the *Rashtriya Swasthya Bima Yojna*. The Competition (Amendment) Act, 2023, enacted on May 11, 2023, defines turnover for purposes of penalty to mean “global” turnover, that is the turnover derived from all the products and services by the person concerned. It mandates the CCI to publish guidelines to determine an appropriate amount of penalty for contravening the provisions of the Act. It further mandates the CCI to consider these guidelines for imposing penalties and provide reasons in the case of any divergence from them. This *prima facie* seems to have unsettled the penalty regime, or at least runs counter to the precedent laid down by the apex court. The two principles that influenced the apex court in favour of “relevant” turnover do not seem relevant after the amendment. Since the amended law does not enable more than one interpretation, there is no need to use the principle of strict interpretation. At the same time, it provides three levers to ensure proportionality, namely, the penalty can vary from zero to 10 per cent of the global turnover, depending on the gravity of the contravention; the guidelines shall guide determining the appropriate amount of penalty; and the order shall give reasons for awarding a penalty different from the appropriate one specified in the guidelines. This is the broad approach worldwide: Most competition regulators have the authority to impose a penalty linked to turnover, which ranges between relevant turnover and total turnover.

Global turnover has several advantages as compared to relevant turnover. First, there are situations where it is difficult to use relevant turnover for imposing a penalty. An example is the hub-and-spoke agreement, which the Amendment Act explicitly considers anti-competitive. A hub is typically not engaged in the same line of business as the spoke. Since its relevant turnover is nil, the penalty based on such turnover would be nil, encouraging the hub to contravene the law with impunity.

Second, determining relevant turnover is often complex and imprecise. An example is the abuse of dominance in health insurance. Should relevant turnover be determined in relation to health insurance, group health insurance, group health insurance for persons with disabilities, group health insurance for persons

with a specific disability, group health insurance for persons with a specific disability covered under a government scheme? The infringer would argue for a narrower definition of the product, driving the relevant turnover to a negligible amount. The competition authority would take the opposite view. This will only add to litigation.

There are two fundamental reasons why global turnover makes eminent sense for determining penalties. First, a law is as good as its enforcement. The effectiveness of enforcement depends on the probability of apprehension and conviction of the infringer and the level of sanction or punishment. A higher probability of conviction can assure compliance even at a lower level of sanction and vice versa. However, the probability of conviction is less in economic legislation like competition law because it relies on the rule of reason. Therefore, the level of sanction must be higher, justifying the use of global turnover for imposing penalties.

Second, competition law addresses market failure (misallocation of resources) arising from market power. Let us start with an economy in a state of equilibrium. If a person abuses market power to influence, howsoever small, the price and/or quantity of any product, howsoever narrowly defined, it triggers a process of resource reallocation. If it increases the price of A, resources move from B's production to A's production. This reduces the supply of B in the market, and consequently its price rises. Then resources move from C's production to B's production. This trigger settles down after moving resources across products and sectors, killing several enterprises on the way, and possibly creating new ones. This yields a new equilibrium, which is different from the initial equilibrium. The difference is the misallocation of resources, which the entire economy suffers. Thus, the impact of the abuse is not limited to the products or services underlying the contravention.

Abuse of market power is a sort of crime. It kills efficient firms, causes market failure, and, therefore, deserves a commensurate penalty. The global turnover of the entity responsible for abuse should be the basis of the penalty, while the percentage of turnover factors in proportionality in accordance with guidelines.

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