CASE STUDY 23 FEBRUARY 2014

# Diesel Loco Modernization Works, Indian Railways, Patiala, Punjab v. M/s Stone India Limited & Ors.* (Anticompetitive Agreements)

**Forum:**
Competition Commission of India[1]

**Legislative Provisions Referred:**
**Competition Act, 2002[2]-**
1. Section 3 – *'Anticompetitive Agreements'*
2. Section 27 – '*Orders by Commission after inquiry into agreements*'

**Parties to the Case**:
1. M/s Stone India Limited-West Bengal (SIL)
2. M/s Faiveley Transport Rail Technologies India Limited-Tamil Nadu (FTRTIL)
3. M/s Escorts Limited-Haryana (EL)

*{collectively the 'opposite parties' (OP)}*

**Facts of the Case:**
Diesel Loco Modernization Works ("**DLMW**") a unit of Indian Railways at Patiala, Punjab that undertakes repair and maintenance of diesel locomotives, regularly procures parts for locomotives by floating tenders in which Research Designs & Standards Organization ("**RDSO"**) approved vendors are eligible to bid.
The present case relates to the tender floated by DLMW for procurement of **feed valves** used in diesel locomotives. The total bids received by the Tender Committee were only from the three parties, where it was noticed that all the three RDSO approved vendors quoted exactly identical rates of Rs. 17,147.54 for the feed valves per piece. This rate was further found to be 33% higher than the last purchase rates. Suspecting a cartel, the Tender Committee recommended the matter to be intimated to the Commission who registered it as a *suo moto* case.

**Preliminary Finding:**
The commission noted that the conduct of the parties in quoting identical price, *prima facie* displayed *concerted action*. The act of quoting identical price not only *adversely affected the tender process* but also *prima facie showed that the tender process was manipulated*. Accordingly, having recorded a prima facie finding of contravention of the provisions of section 3 of the Act, the Commission passed an order under section 26(1) directing the Director General (**"DG"**) to undertake an investigation into the allegations of **bid rigging** and **cartelization** against the named parties.

**DG Investigation:**
It was observed by the DG that the opposite parties acted in concert in rigging the bid by quoting identical bids on the same date. Furthermore, the collusive action was strengthened from the past conduct of the parties where they were found to have quoted similar prices for the tenders of different zonal railways. Accordingly, the DG concluded that the opposite parties had contravened the provisions of section 3(3) (d) of the Act.

**Main Issue:**
**Whether the opposite parties have contravened the provisions of section 3 of the Act?**
Each party chose to contend the findings of the DG and sought to explain their conduct and price rationale for the tender, through written and oral submissions, to which the Commission delivered its final findings. These findings formed the basis for the CCI final order. The contentions of the parties (OP) and findings of the Commission can be divided broadly into the following issues:

**1. Price Collusion**

**OP**

- The opposite parties contended that the basic price of the feed valve was the supply price, based solely on commercial consideration and the costing of the respective products. The remaining components added to it were statutory taxes. The basic price of the product was dissimilar with other competitors

*Suo Moto case No. 3 of 2012 available at: http://cci.gov.in/May2011/OrderOfCommission/27/032012.pdf last accessed on 17/02/2014.
[1] Hereinafter referred to as 'CCI'.
[2] Hereinafter referred to as 'the Act'.

including the warranty and payment terms, thereby indicating that the price was not the sole component of a bid and meant that the bids were *ipso facto* different amongst bidders.

- The prices quoted by the various parties were openly displayed on the website and therefore the same were known to each other. The procurement system adopted by the Indian Railways relied on the last purchase price while negotiating with the lowest bidder which forces vendors to refer to the prices quoted by competitors to various zonal railways before deciding on their bid prices.
- Feed valves are a de facto commodity product. In such commodity markets there is inter-dependence amongst competitors while deciding on their prices. Such inter-dependence or price parallelism is a nature of an oligopolistic market and hence, is not *per se* illegal.

**Findings of the Commission on Price Collusion**

- Regarding the relation of prior prices quoted, the Commission found no ascertainable calculations or basis for quoting these prices stating that "*the only plausible explanation which may be drawn from the identical figure and lack of justification is that the rate was quoted to match the bid price of the other bidders acting in collusion and concert… There is no logical reason for such rivals to quote exactly the same price when they could have easily chosen to quote a lower price, even if by only one paisa, to win the bid.*"
- The Commission found that when all the opposite parties having their manufacturing unit located at different places i.e. Haryana, West Bengal and Tamil Nadu with different cost of production, it was not possible to supply the feed valves at identical unit price and neither was any justification nor explanation provided by the parties in this regard. In such a scenario, the Commission agreed with the findings of the DG that such facts and figures clearly evidence meeting of minds and concerted action taken by the opposite parties.

**2. Anticompetitive agreement between OPs that ensured bid rigging**

**OP**

- The OPs maintained that since only 1 out of the 3 enterprises (i.e. SIL) was found to be the eligible bidder, the theory of cartelization fails since at least two or more parties are essential to constitute a cartel and there had to be an agreement amongst the suppliers/ bidders which leads to such cartelization. Furthermore, the DG had not been able to find evidence whereby meeting of minds amongst the opposite parties could be concluded.
- The cartelization allegation was baseless since there was no agreement at all between the opposite parties. If this were true the parties would not have offered materially different warranty and payment terms which were unique and had substantial value and financial implications. If there indeed was an agreement, even then it should still have been established that the agreement was executed with an intention to cause or was likely to cause AAEC.
- Making bids on the same day could not be attributed to any motive since most commercial transactions are executed on the last day and the time of submission was also different on the same given day. It was contended that '*Parallel behaviour cannot be a conclusive proof where other explanations for such parallel behaviour exist'*. Timing of submissions of bids could not be considered as evidence of collusion amongst the opposite parties.

**Findings of the Commission**

- The definition of "Agreement" under the Act requires any arrangement, understanding or action in concert whether or not formal or in writing or intended to be enforceable by legal proceedings. This definition is inclusive and wide and recognizes 'tacit agreements', such as the one in between the parties in the present case.
- The Commission observed that the absence of any plausible economic justification to refute the burden of proof on the OPs to prove they did not enter into anticompetitive agreements was in itself a very strong indicator towards a possible collusion amongst the bidders.

**Other findings of the Commission:**

The Commission defined the nature of bid-rigging and delineated the scope of the offence, holding that the conduct of the OPs in the current matter clearly demonstrated a text-book case of bid-rigging. The CCI clarified that "*Such entities do not participate in the bid process to actually compete with the successful bidder but submit 'complementary/cover/courtesy bids' only so that the procurement process does not get stalled due to lack of competition… Such bids are merely designed to give the appearance of genuine competitive bidding. Complementary bids tend to defraud procuring entities by creating a camouflage of genuine competition to conceal the inflated bid prices*".

The CCI observed that once it is established that agreement as listed in section 3(3) of the Act exists, it will be presumed that such an agreement has an

appreciable adverse effect on competition; the onus to rebut this presumption would lie upon the opposite parties. In this given case, the opposite parties could not rebut the said presumption. The Commission determined that the opposite parties were neither able to demonstrate how the impugned conduct resulted in benefits to consumers or made improvements in production or distribution of goods nor could they explain as to how the said conduct did not foreclose competition. These circumstances led the Commission to find the OPs guilty of price collusion and bid-rigging.

CCI further noted that direct evidence of action in concert rarely exists and in such situation the Commission has to determine whether those involved in such dealings had some form of understanding and were acting in co-operation with each other. In such cases, the Commission has to find sufficiency of evidence on the basis of benchmark of 'preponderance of probabilities and the anti-competitive agreement must be inferred from a number of coincidences and indicia.

The DG also examined the past conduct of these bidders with respect to the tenders invited by other railway zones and found that even though the production cost of the feed valves of the opposite parties were different, they quoted nearly identical price in the past in different zones of railway. Taking into consideration the past conduct of the three bidders, it was further established that the opposite parties were used to such practice of sharing the price data and had accordingly also resorted to similar practice of collusive bidding in the e-tender in the present matter as well. The CCI determined that the past conduct of the parties disallowed a lenient view for the first offence. It clarified that a distinction needed to be maintained between the '*first time contraventions*' and the '*first time established contraventions*'.

**Decision of the CCI:**

The CCI considered all the circumstances of the case, the DG investigation findings as well as the contentions of the opposite parties and held that by quoting identical rates the opposite party bidders had indirectly determined prices in the tenders and indulged in bid rigging and collusive bidding in contravention of the provisions of section 3(1) read with section 3(3)(a) and 3(3)(d) of the Act. Accordingly, the CCI imposed a penalty of 2% of the average turnover of each Company.

The Commission based its decision on considerations such as the quotation of identical prices despite the manufacturing units of parties being located in different geographical locations and at different costs of production, filing of bids on the same date and failure on the part of the opposite parties to provide any plausible explanation for any of the above and the past conduct of the bidders. This, the CCI determined, was sufficient to establish that the opposite parties had entered into an agreement to determine prices besides rigging the bid.

**Analysis of the Main Order:**

This decision of the Commission has demonstrated that Competition Law enforcement could occur at any stage of a transaction or a dispute or appeal thereof. While the actual tender went on to be resolved, renegotiated and fulfilled from amongst one of the parties to this investigation, the jurisdiction of the Commission was exercised nevertheless, to the extent of determination of AAEC. This demonstrates that even in the event of concluded transactions or settled disputes, if matters raise competition concerns, those concerns shall be met and resolved – the exercise of suo moto jurisdiction in this case is evidence of said intent of the Commission.

Most significantly, the order makes a clear distinction of the measure of mitigation that the Commission shall exercise for actions leading to AAEC. The distinction in this order between 'first time contraventions' and 'first time established contraventions' clarifies that merely the escape from punitive action for prior conduct of a party cannot be the basis for a mitigation of penalties in a subsequent order.

Importantly, the Commission lays down clear benchmarks for future determinations by clarifying the scope and extent of collusive/anti-competitive agreements to include undocumented tacit meeting of minds as well as making clear the nature of bid-rigging offences.

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