Maharashtra State Power Generation Company Ltd. (MAHAGENCO) & Gujarat State Electricity Corporation Limited (GSECL) v. Coal India Limited (CIL) and Ors*

(Abuse of Dominance)

Forum:

Competition Commission of India[1]

Legislative Provisions Referred:

Competition Act, 2002[2]

1. Section 4: Abuse of Dominance
2. Section 19: Inquiry into certain agreements and dominant position of enterprise
3. Section 27: Orders by commission after inquiry into agreements or abuse of dominant position

Parties to the Case:

This order was passed by CCI jointly disposing off the following listed three separate cases initiated against Coal India Limited and its subsidiaries.

1. Case No. 03 of 2012:

M/s Maharashtra State Power Generation Company Ltd. (MAHAGENCO) - Informant 1
M/s Coal India Ltd. (**CIL**)-OP1
M/s Mahanadi Coalfields Limited (MCL) - OP2

2. Case No. 11 of 2012:

MAHAGENCO- Informant 1
M/s Western Coalfields Limited (WCL)-OP 3
M/s Coal India Ltd. CIL- OP 1

3. Case No. 59 of 2012:

M/s Gujarat State Electricity Corporation Limited against (GSECL)- Informant 2
M/s Coal India Ltd. CIL- OP 1
South Eastern Coalfields Limited (SECL)- OP 4
(Opposite Parties collectively referred to as **OP**)

Facts of the Case:

The information in this case was filed under section 19(1)(a) of the Act by two state owned power generation companies in Maharashtra and Gujarat against CIL and its subsidiaries alleging contravention of the section 4 of the Act. They alleged that OP were dominant in the relevant market and were abusing this dominance primarily through the terms and conditions imposed in the Fuel Supply Agreements. Informants (1&2) were aggrieved by abusive conduct of OP in the manner that the OP 1 has drafted and amended Fuel Supply Agreements (FSAs) which were onerous and one sided and have been drafted without any proper consultation. It was alleged that CIL & Subsidiaries had contravened various provisions of the Act by imposing one sided and unfair clauses in the FSA which had caused huge losses to the power companies. It was further alleged that the provisions in the FSA were different for producers depending on whether they are from the public or private sector.

CCI found the existence of a prima facie case and directed the Director General (DG) to undertake a detailed investigation and submit its report. Further, CCI examined the grievances of the Informants in each of these cases and observing that their substance is essentially the same clubbed the investigation of three matters. The DG, investigated the matter and filed a common investigation report in these three cases.

Main Issues:

CCI adopted the well settled approach being followed in abuse of dominance cases in India. The three steps involved for analysing the alleged abusive conduct by CCI are: identifying the relevant market, ascertaining the dominant position and analysing whether the conduct was abusive.

Step 1: What will be the relevant market?

DG - DG noted that the *relevant product market* for the purpose of investigation in the present case was non-coking coal which is used as primary raw material by power producers for the generation of electricity. DG opined that as the condition for supply of coal in the entire country was uniform and homogenous as there are no barriers in terms of geographic location for the consumers, it was concluded that the *relevant geographic market* is

* 1. M/s Maharashtra State Power Generation Company Ltd. vs M/s Mahanadi Coalfields Ltd. & Ors. 2. M/s Maharashtra State Power Generation Company Ltd. vs M/s Western Coalfields Ltd. & Ors, 3. M/s Gujarat State Electricity Corporation Limited vs M/s South Eastern Coalfields Ltd. & Ors . Case No. 03/2012, 11/2012, 59/2012 available at, http://www.cci.gov.in/May2011/OrderOfCommission/27/592012.pdf (last accessed on 04/02/2014)

[1] Hereinafter referred to as 'CCI'.

[2] Hereinafter referred to as 'the Act'.

entire India. As a result, the *relevant market* in this case was determined by the DG as the production and sale of non-coking coal to the thermal power generators in India.

OP- OP submitted that DG's conclusion on relevant market is incorrect. It was submitted that the relevant market for the purpose of this case should be supply of coal globally.

CCI- found that that boilers of most Indian thermal power plants are designed keeping in mind factors like Gross Calorific Value (GCV), ash content, moisture content etc. and as such only domestic coal i.e., coal mined and supplied predominantly by OP in India can be used for firing the said boilers. Thus any other coal, including imported coal, has qualities markedly different to those of domestic coal, as a result of which imported coal ranging from only 15% to 30% can be used as fuel in thermal power plants at any given point of time, and that too, when blended with domestic coal in the specified proportion to obtain the requisite calorific value suitable to the design/ specification of the boilers used by Indian thermal power producers. It further observed that imported coal is more expensive than domestic coal. So far as the oil/ gas as substitute for coal is concerned, CCI noted that existing plants are mostly designed for coal besides the same are neither easily available nor cost competitive with coal. CCI reasoned that as the condition for supply of coal in the entire country is uniform and homogenous, hence the relevant geographic market will be entire India. Thus, CCI concurred with the delineation of the relevant market by the DG as production and sale of non-coking coal to the thermal power generators in India.

Step 2: Whether the OPs are dominant in the said relevant market?

DG – DG noted that sources of non-coking coal in India are mainly OP, M/s Singareni Collieries Company Limited ('SCCL') - a joint venture between State of Andhra Pradesh and Government of India and imported coal. Consequent upon analysis of the factors enumerated in Section 19(4) of the Act, it was noted that the consumers have huge dependency upon the OP as they do not have any other option in the market except the import. However, the imported coal as already noted earlier is not a substitute for Coal mined by the OP.

Furthermore in view of the provisions of the Coal Mines (Nationalization) Act, 1973 production and distribution of coal is entirely in the hands of the Central Government. Therefore, the question of supply-side substitution did not arise, due to the entry barrier imposed by the policy measures of the Government of India and the Coal Mines (Nationalization) Act, 1973. DG found that the opposite parties have no competitive pressure in the market and there is no challenge at the horizontal level against the market power of CIL and its subsidiaries. As a result, OP by operation of law has been vested with monopolistic power for production and distribution of coal in India.

OP- OP contended that they cannot operate independently of competitive forces or customers. They pleaded that they are faced with significant countervailing power exercised by some of their largest customers both directly and through government bodies. OP further contended that they do not enjoy any commercial freedom in deciding the customers and hence the question of dominance does not arise. They also contended that they are also constrained to act in 'Public Interest' as directed by the Supreme Court in Ashoka Smokeless case[3].

CCI- CCI observed that in view of the statutory and policy scheme, the coal companies have acquired a dominant position in relation to production and supply of coal. Mere fact that SCCL also produces coal for commercial sale in itself does not negate the fact that OP enjoy dominant position in the relevant market in as much as SCCL has a negligible presence in the relevant market. Further, imported coal cannot be a substitute as it has been used in small measure to blend with domestic coal. Although the New Coal Distribution Policy (NCDP) lays down that the power sector is to be supplied 100% of the normative requirement, OP has been able to decide the quantity as per its commercial feasibility. It was rightly observed that merely being a PSU and mention of social objectives in the Memorandum of Association (MoA) cannot be treated as a factor for ignoring other strong factors indicating the dominant position. Accordingly CCI observed that CIL is driven by commercial interests for supplying coal to the thermal power producing utilities under the FSAs. CCI concluded that CIL has sufficient flexibility and functional independence in carrying out its commercial and contractual affairs and the overarching policy and regulatory environment did not detract CIL and its subsidiaries operating independently of market forces and thus OP enjoys undisputed dominance in the relevant market.

[3] Ashoka Smokeless Coal (P) Ltd. v. Union of India, (2007) 2 SCC 640

Step 3: Is there any abuse of its dominant position in the relevant market?

DG- On analysis of the terms and conditions of FSA, DG concluded that OP had violated the provisions of section 4(2)(a)(i) of the Act by imposing unfair or discriminatory conditions in the relevant market.
The unfair and discriminatory provisions in the FSA related to:

a. Sampling procedure for existing PSUs and other power producers were different, without any reason for such discrimination.
b. Under Deemed Delivery Quantity ('DDQ') clause coal had to be accepted and paid for by the supplier regardless of the quality of coal supplied.
c. Charging the transportation and other expenses from the buyers on supply of ungraded coal was found to be unfair.
d. Putting a cap on compensation for stones for new power producers.
e. The provisions relating to review and termination of the agreement were found to be unfair and discriminatory.
f. Incorporating conditions in force majeure clause which are not normally treated as force majeure for new power producers

OP- OP submitted that, in the presence of proper and adequate remedies available in the contract, it is inappropriate on the part of the informants to have come to the CCI for addressing what is essentially a contractual dispute. It was pointed out that the Informants had also approached local courts/ arbitral tribunal seeking redressal on these issues and were therefore indulging in forum shopping. OP further contended that there has been dialogue and negotiation before signing of FSAs and that there has not been any one sided imposition of terms and conditions in the FSA as alleged by the informants. The process of engaging all the stakeholders has been continuous and was still on going when the Informants went to the CCI and have allegedly termed the conduct as abusive. It was argued that the clauses being challenged by the Informants or found by the DG to violate the provisions of the Act have never been invoked by OP and in any event, stand modified pursuant to the negotiations between the parties. Therefore, no prejudice has been caused to the Informants or as a matter of fact to other customers.

CCI- CCI observed that FSAs were essentially drafted and amended by the OP on its own and without any meaningful consultation with other stakeholders. On the issue of grade slippage the investigation revealed that in the model FSA for new power producers this provision of re-declaration was removed by OP. CCI observed that such a dual regime is ex facie discriminatory and OP have not been able to justify the reason on any intelligible differentia for such discrimination.
The CCI opined that the provisions for sampling of coal are ex facie discriminatory between PSU and private producers. CCI observed that FSA does not impose a strict liability upon the OP to supply only the agreed grades but only mentions about making adequate arrangements to assess the quality and for providing monitoring mechanism to prevent loading of ungraded coal. However if the ungraded coal is loaded and transported, there is no provision for compensation and the buyer is to bear all the expenses on transportation, royalty and taxes etc. The CCI observed that the OP have failed to justify or explain as to why the buyer should be saddled with the expenses for the ungraded coal, which is supplied in breach of the agreed quality of coal in FSA.
The CCI held that capping of compensation to 0.75% of the total quantity of coal supplied for oversized coal/ stones was ex facie unfair being not based on actual quantity or any other reasonable basis besides being discriminatory between new and existing power producers. CCI observed that a bare reading of the provisions of force majeure events listed in the FSA reveal that the same are so widely worded that the only inference which can be drawn therefrom is that the same were put by a dominant party to the agreement to dilute its commitment for supply of coal.
The CCI concluded that OP has been resorting to unfair and discriminatory conduct by inserting different clauses in FSAs with PSU power producers vis-a-vis new private producers.

Decision of CCI:

CCI, agreeing with the DG, found CIL and its subsidiaries to be in contravention of the provisions of Section 4(2)(a)(i) of the Act for imposing unfair/ discriminatory conditions and indulging in unfair/ discriminatory conduct in the matter of supply of non-coking coal to power producers. CCI ordered CIL to undertake the following measures:

a. Cease and desist from indulging in the conduct contravening the provisions of the Act
b. FSA clauses found to be in contravention to be suitably modified, ensuring that the stakeholders are consulted before such modification
c. CIL should ensure that parity between old and new power producers as well as between private and PSU power producers is maintained

While considering the quantification of penalty, the contention of CIL that its behaviour is constrained by various factors, including countervailing power exercised by the stakeholders including the Presidential Directive, significant social costs and obligations, its inability to choose its customers and quantum of coal to be supplied to these customers, pressures faced to roll back price increases etc., were taken in to consideration by the CCI as mitigating factors. Considering these mitigating factors involved in the case, the CCI imposed a penalty of 3% of the average turnover of the last three years of the OP, which amounted to approximately Rs. 1773.05 crores.

Analysis of the Order:

The effects of various anti-competitive factors identified in the coal sector on the rest of the economy are widespread and create systemic risk. The power sector which was an integrated structure as a public utility in India is now unbundled into three or four components, each independent in terms of functionality, corporate structure and contribution within the value chain. CCI rightly observed that anti-competitive conduct in the production and supply of coal to power producing utilities has serious cascading effects on the entire economy. Market inefficiencies adversely affect growth and lead to high tariffs which get passed onto end consumers.

This is the first order of the CCI against a public sector company and thus endorses the principle of *competitive neutrality* enshrined under the Act. The fine in this case is the CCI's highest fine for abuse of dominance till date. However, the fine accrues to the government as it needs to be deposited into the consolidated fund of India. More importantly, imposing fines on a government owned enterprise by another government body (competition authority) can be regarded as a smokescreen, given that the fines would find their way back to treasury, which can still pass back to the enterprise[4].

This order also touches on certain other important aspects like that of fairness of contracts and objectives of levying penalty. The CCI formulated a test to determine the "fairness" of contracts and held that[5] *"Rawlsian principles for justice postulate equitable enforcement of contracts, where the rights and obligations of the parties are balanced and do not favour one party to the contract… 'unfairness' emanates from the fact that CIL is in a position to influence the terms and conditions of the contract and has inclined them in its favour, and there has been an attempt to formulate the contract with unequal non-benign effect on the buyer*."

In some cases, the Competition Appellate Tribunal (COMPAT) had directed the CCI to record reasons and to consider appropriate aggravating and mitigating circumstances prior to imposition of a penalty. In the instant case, CCI while noting that imposition of penalty depends upon the mitigating and aggravating circumstances of the case observed that[6] "*twin objectives behind imposition of penalties are: to impose penalties on infringing undertakings which reflect the seriousness of the infringement; and to ensure that the threat of penalties will deter both the infringing undertakings and other undertakings that may be considering anti-competitive activities from engaging in them.*"

As observed by CCI in this case, Coal India did not enjoy full commercial freedom as its business is constrained by directions from various government agencies. There can be cases where public enterprises might not be fully independent in their decision making and they have to balance between public interest and profit objectives. Despite being covered by competition laws in many countries, there is some apprehension over whether competition law should be blind to whether the firm is state owned or privately owned.

Experts on the subject are of the opinion that the real solution lies not in the hands of CIL but with the policy makers as is evident from the CCI order which essentially mandates a complete reformation of the sector and infusion of competitiveness. Further CCI in this order rightly observed that there is an imperative need to carry forward reform momentum by restructuring the coal sector by introducing more number of players which will inevitably reduce the dominance of any one player and can facilitate competition.

Prepared By: Saket Sharma, CIRC

[4] Mehta, Pradeep S; 'Tailoring competition laws for state-owned enterprises', The Financial Express, Feb 17, 2014, Available at www.financialexpress.com/news/tailoring-competition-laws-for-stateowned-enterprises/1226585/0 (last accessed on 22/02/2014)

[5] Para 251 of the CCI Order

[6] Para 257 of the CCI Order