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Enforcement

Cartelization

# Need for Robust Economic Analysis In Competition Commission of India's Cartel Enforcement

By Saurabh Prabhakar

## I. Introduction

Parallel pricing by oligopolies continues to vex the Competition Commission of India (''CCI''). After the cement cartel investigation, parallel pricing by three airlines, Jet Airways, IndiGo Airlines, and Spice Jet, led CCI to impose penalties of over Rs. 250 crores (approximately $38.6 million) on the airlines for allegedly colluding to fix prices in their domestic cargo operations. Direct evidence of price-fixing by the three airlines was scant. But parallel pricing combined with tenuous information exchanges were sufficient for CCI to conclude that only collusion, and not rational oligopolistic behavior, could explain the airlines' conduct.

CCI erred in finding collusion here. A diligent economic analysis of the evidence here would have led to a different result. Granted, not all cartel enforcement requires economic analysis. Globally, price-fixing contacts among competitors are considered presumptively illegal—economic justifications notwithstanding. But when evidence of collusion is exclusively circumstantial, prudent cartel enforcement requires economic analysis to draw the right conclusions from that evidence, which often, Janus-like, points towards multiple explanations. This is especially true for oligopolistic markets as these markets often exhibit behaviors that in non-oligopolistic markets may not occur absent collusion. Indeed, CCI was not unaware of this possibility—it recognized that legitimate economic behaviors may explain seemingly collusive behavior.[1] Yet it swiftly dismissed economic justifications for parallel conduct, and entirely ignored economic explanations for information exchanges among competitors. Accordingly, CCI established a dangerously low evidentiary standard for finding collusion based on circumstantial evidence in oligopolies, which will be easily met regardless of any contrary economic explanation for that evidence. Consequently, CCI overstretched cartel enforcement in a manner that requires economically irrational behavior from businesses and may well make compliance with Indian competition laws a nightmare for them, especially those in oligopolistic markets. To avoid this catastrophe in future, CCI could learn from the jurisprudence of other jurisdictions, such as United States, to wisely prosecute cartels.

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## II. CCI Decision on Airline Fuel Surcharge Cartel

### A. The Complaint

CCI's investigation of the airlines was launched in response to a complaint by the Express Industry Council of India (''EICI''), a consortium of the accused airlines' competitors. Several large international express cargo companies, such as FedEx, DHL, and UPS are members of EICI. EICI accused five passenger airlines of conspiring, beginning May 2008, to fix FSC rates: Jet Airways, IndiGo Airlines, Spice Jet, Air India, and Go Airlines. The FSC was ostensibly levied by the airlines in response to record high fuel prices in 2008. EICI alleged that later when fuel prices dropped substantially, in-

[1] *See* Express Indus. Council of India v. Jet Airways (India) Ltd. & Ors., Case No. 30 of 2013, ¶ 115 (Competition Comm'n of India, Nov. 17, 2013), *available at* http://www.cci.gov.in/sites/default/files/302013.pdf .

stead of lowering FSC rates, the accused airlines in fact raised them. EICI complained that this behavior meant that the airlines were fixing FSC rates, to the detriment of consumers and EICI members.

On September 2, 2013, CCI ordered a Director General (''DG'') to investigate the allegations. On February 5, 2015, the DG submitted its report. On August 13, 2015, CCI heard arguments from the parties. On November 17, 2015, CCI delivered its opinion finding that three airlines—Jet Airways, IndiGo Airlines, and Spice Jet—had violated Section 3(1) of the Competition Act of 2002 by colluding to fix FSC rates. The remaining two, Go Airlines and government-owned Air India, were exonerated. CCI imposed penalties worth Rs. 151.69 crores on Jet Airways, Rs. 63.74 crores on IndiGo Airlines, and Rs. 42.48 crores on Spice Jet, based on their respective revenues.[2] It also directed all three airlines to cease and desist from indulging in anticompetitive practices.[3]

## B. CCI's Decision

An agreement begets an anti-competitive conspiracy. An agreement, CCI noted, is not limited to formal, written, and legally enforceable pacts; section 2(b) of the Competition Act broadly includes informal and undocumented arrangements, understandings, and concert acts.[4] An agreement may be tacit ''where the parties act on the basis of a nod or wink.''[5] Furthermore, an anti-competitive agreement, being illegal, is often reached in clandestine meetings conducted with minimal documentation.[6] An anti-competitive agreement, therefore, is rarely proven by direct evidence—rather it ''must be inferred from a number of coincidences and indicia which, taken together, may, in the absence of any other plausible explanation, constitute evidence of the existence of an agreement.''[7]

CCI's finding of price-fixing was based on three key pieces of evidence: (1) the parallel movement of FSC rates of the three colluding airlines; (2) the alleged communication of FSC rates between the colluding airlines; and (3) the inability of airlines to explain how they set their FSC rates.

First, CCI analyzed the movement of FSC rates in domestic cargo from May 2008 to November 2012.[8] On this basis, CCI concluded that ''whenever the FSC of one airline has gone up it was followed by the rest of the airlines simultaneously on several occasions.''[9] CCI concluded that collusion between the airlines was the only plausible explanation for the parallel price movements.[10] Notably, CCI disregarded the time-lags between the FSC rates increases by the airlines, evidence which the DG relied on to conclude there was no collusion among the airlines,.[11] CCI concluded that these time-lags were merely a facade: ''[t]he present case perfectly fits such stratagem where artificial lags and gaps were sought to be passed off and projected to envision a competitive scenario where none existed.''[12] It declared emphatically that ''it is the bounden duty of [CCI] to pierce this artificial veil and to examine the real behavior of the colluding parties;''[13] and for CCI reality was that the airlines had colluded.

Second, CCI also looked askance at communications, purportedly about FSC rates, between the competing airlines.[14] It cited several statements by airline officers that showed that airlines routinely received FSC pricing information of their competitors through common agents.[15] It noted that ''[o]ne of the elements that indicates concerted action is the exchange of information between the enterprises directly or indirectly.''[16] CCI called these communications as coordinated behavior because they eliminated or substantially reduced in advance any uncertainty in the airlines' actions that would have existed in the absence of information about their competitors' conduct.[17] Notably, the DG's investigation had failed to establish direct or indirect contacts or communications between the airlines about FSC rates.[18] Absence of such contacts—both an essential ingredient and a vital clue of collusive activity— should have cautioned CCI. But CCI remained unflustered—brushing aside this gaping hole in evidence, it found that regardless of direct contacts, these indirect information exchanges between competitors indicated concerted action by them.

Third, CCI was particularly concerned by the airlines' inability to explain how they set their FSC rates. At the onset, CCI noted that various factors formed the basis of FSC determination: fuel prices, market trends, pricing by competitors, USD-INR rate of exchange, operating costs, infrastructure, and manpower.[19] CCI also acknowledged that fuel prices were the main factor in FSC determination.[20] But CCI found that the airlines could not explain why on various occasions the FSC rates increased when fuel prices did not.[21] CCI further found that the airlines provided ''no data on cost analysis, evasive replies and no documents despite admitting to the fact that meeting/discussions took place with regard to FSC rate.''[22] Ultimately, the airlines' inability to explain how FSC rates were set was sufficient to establish collusion between the airlines despite the lack of evidence of overt contacts between them.[23]

Parallel movement of FSC rates among the airlines was, undoubtedly, the centerpiece of CCI's finding of collusion. Indeed, CCI's most flourishing rhetoric, such as ''it would be travesty of competition norms if such lag theory is countenanced by the Competition agency,'' and ''it is the bounden duty of the Authority to pierce this artificial veil,'' was used to support its finding that parallel movement of FSC prices was indeed collusion. To be sure, CCI alluded to the possibility of conscious parallelism: ''parallel behavior of competitors can also be a result of intelligent market adaptation in an oli-

[2] *Id.* at ¶ 132.
[3] *Id.* at ¶ 131.
[4] *Id.* at ¶ 111.
[5] *Id.*
[6] *Id.* at ¶ 112.
[7] *Id.*
[8] Case No. 30 of 2013, at ¶ 113.
[9] *Id.* at ¶ 115.
[10] *Id.*
[11] *Id.* at ¶ 114.
[12] *Id.*
[13] *Id.* at ¶ 114.
[14] Case No. 30 of 2013, at ¶ 120.
[15] *Id.* at ¶ 121.
[16] *Id.* at ¶ 120.
[17] *Id.*
[18] *Id.*
[19] *See id.* at ¶ 99.
[20] Case No. 30 of 2013, at ¶ 99.
[21] *Id.* at ¶ 101.
[22] *Id.* at ¶ 121.
[23] *Id.*

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gopolistic market.''[24] CCI even set a high bar for itself for inferring collusion based on indirect evidence: the totality of evidence should have *no plausible explanation* but collusion. But ultimately, CCI concluded that only collusion, in spite of the deficiencies and contra-indications in the DG's investigation, could explain the parallel movement of FSC rates.

## C. Problems with CCI's Decision

CCI erred in finding that the airlines colluded to fix FSC prices. The DG's investigation and CCI's opinion had several blunders. For example, the DG failed to collect any evidence regarding exchange of phone calls, messages, e-mails, or other communication between the airlines—all these are crucial evidence in a cartel investigation.[25] Further, for example, CCI's conclusion that failure to show how FSC rates are set, without more, proves collusion among the airlines was weak at best. But the crucial omission in CCI's opinion was the near absence of economics analysis, especially in a cartel case that was built principally on parallel pricing behavior. CCI failed completely to assess the facts through an economic lens and support its conclusions with economic principles. For a relatively new competition watchdog who is responsible for policing the competitive landscape of the world's fastest growing economy, India, this is a grave omission—an error that raises serious doubts about the CCI's competence to adjudicate cartel cases.

### 1. Parallel FSC Rates was an Economically Rational Choice for the Airlines

CCI correctly stated the governing law; but its application was wrong. CCI correctly stated the legal standard for finding collusion based on only circumstantial evidence: the *only plausible explanation* for parties' behavior should be that they have entered into an anti-competitive agreement.[26] CCI correctly stated that the airlines operate in an oligopolistic market.[27] CCI correctly stated that the airlines exhibited parallel behavior.[28] But CCI incorrectly concluded that parallel FSC rate movement could only be explained by collusion.[29] This conclusion ignored rational economic explanations for parallel behavior by the airlines.

Follow-the-leader pricing plausibly explains the in-tandem movement of FSC prices. Follow-the-leader pricing, or conscious parallelism, is prevalent in an oligopolistic market and is legal. In *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, the U.S. Supreme Court explained that conscious parallelism is ''the process, not in itself unlawful, by which firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions.''[30] For example, if one firm reduces its prices and increases its sales at the expense of its rivals, the other firms will notice the loss in sales, identify its cause, respond by lowering prices and erasing the price-leader's advantage, and to halt the attrition of their sales.[31] Therefore, each firm loses revenue without a corresponding increase in market share. Conversely, if one firm increases prices without losing sales, then the other firms would be independently motivated to follow the price leader in increasing prices; the result would be increased revenues for each participant without the loss of market share—a win-win for all participants. In an oligopolistic market, therefore, follow-the-leader pricing or conscious parallelism is a perfectly rational economic choice.

Here, follow-the-leader pricing plausibly explains the in-tandem movement of FSC prices of the three airlines. Looking at the turnover of the three airlines is instructive: Jet Airways was clearly the market leader: turnover-wise, it is nearly three times bigger than IndiGo and four times bigger than Spice Jet.[32] Unsurprisingly, the movements of FSC prices from 2008 to 2012 show that IndiGo and SpiceJet always followed Jet Airways; all their FSC rate increase decisions were implemented after Jet Airways's decision. Also, IndiGo and SpiceJet always implemented the increased FSC after Jet Airways (except in May 2008 when FSC was first introduced). Therefore, an economically plausible explanation for the in-tandem FSC price movement is that the smaller airlines were following the market leader's pricing.

Additionally, because follow-the-leader pricing was profitable for the airlines, it was a rational economic choice for them. At least four reasons support this explanation. First, the FSC was introduced to deal with fuel price volatility, which it did effectively.[33] Second, because FSC revenue could be forecasted accurately, it was a useful tool to address operating costs in addition to tackling fuel price volatility.[34] Third, increasing the FSC was more profitable for the airlines than raising freight charges because unlike freight, FSC was not commissionable—that is, the airlines could pocket the increased profits without sharing them with their agents.[35] Fourth, because consumers had limited choices, FSC rates did not affect the demand of cargo space.[36] Therefore, once Jet Airways, the market leader, set its FSC rates, it was economically rational and profitable for the remaining two airlines to follow it.

Therefore, CCI incorrectly applied its own legal standard, under which the only plausible explanation for parties' behavior should have been collusion. CCI concluded that it was. But economics contradicts this conclusion. Follow-the-leader pricing, or conscious parallelism, was both an economically plausible explanation and an economically rational choice for the accused airlines. Accordingly, CCI failed to apply its own legal standard correctly because it ignored reasonable economic justifications for the parties' behavior.

[24] *Id.* at ¶ 115.
[25] *See id.* at ¶ 24.
[26] Case No. 30 of 2013, at ¶ 109.
[27] *Id.* at ¶ 51.
[28] *Id.* at ¶ 115.
[29] *Id.* at ¶ 120.
[30] *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993) .
[31] Areeda, *Antitrust Law* § 1429 (1986).
[32] Case No. 30 of 2013, at ¶ 131.
[33] *Id.* at ¶ 97.
[34] *Id.* at ¶ 93.
[35] *Id.* at ¶ 106.
[36] *Id.* at ¶ 119.

### 2. CCI's Cease and Desist Order Requires Airlines to Make Economically Irrational Choices

The penalty imposed on the airlines brings the economic irrationality of CCI's decision into even sharper focus. CCI directed the three airlines ''to cease and desist from indulging in the practices which have been found to be anti-competitive.''[37] This cease and desist penalty (''injunction'') suffers from two problems. First, it demands economically irrational behavior from the airlines. This injunction is not only hopelessly vague in what it requires the airlines to do or not do, but it is also economically irrational. CCI's finding of collusions between the airlines was based on two findings: (1) airlines set the same FSC prices; and (2) airlines exchanged price information.[38] But in an oligopolistic market, the airlines can eventually, if not immediately, set the same FSC prices even without exchanging price information. Therefore, CCI's injunction amounts to requiring the airlines to refrain from parallel pricing. Put differently, to comply with the injunction an airline must refrain from taking into account probable pricing behavior of other airlines in determining its own FSC price. CCI is essentially prohibiting airlines from converging on a profit-maximizing price. Demanding such behavior is economically irrational and ensuring compliance is either virtually impossible or economically ruinous for the airlines.[39]

Second, CCI's injunction effectively orders the airlines to compete. To comply with the injunction airlines must refrain from parallel pricing—that is, they must set different FSC rates. Therefore, airlines must compete on FSC prices or else violate the injunction. For an antitrust regulator to demand such behavior is, to put mildly, problematic. Writing for the Seventh Circuit Court of Appeals, Judge Richard Posner warned against such overreach by antitrust agencies: ''[i]t is one thing to prohibit competitors from agreeing not to compete; it is another to order them to compete.''[40] Such behavior would give ''antitrust agencies a public-utility style regulatory role,''[41] which is typically meant to protect heavily regulated sectors against losses, and not for dictating how free market competitive enterprises should conduct business.

In short, regardless of how CCI's determination of collusion based on parallel movement of FSC rates is analyzed—establishing collusion or quashing collusion in future—it leads to the same conclusion: CCI's decision requires airlines to make economically irrational choices.

### 3. CCI's Decision is Tantamount to a Per-Se Prohibition of Communication Between Competitors

CCI concluded, based entirely on circumstantial evidence, that exchange of information between the airlines was conclusive proof of collusion. This conclusion is also economically problematic. To be sure, exchange of information between competitors, especially pricing information, in an oligopolistic market could facilitate collusion. But simultaneously, ''[t]he exchange of price data and other information among competitors does not invariably have anticompetitive effects; indeed such practices can, in certain circumstances, increase economic efficiency and render markets more, rather than less, competitive.''[42] Furthermore, gathering competitors' price information, which is consistent with independent competitor behavior, is different than exchange of information between competitors, which may facilitate collusion.[43] Therefore, holding mere indirect exchange of information between competitors as conclusive proof of collusion will create economic inefficiencies for businesses. CCI erred by creating a rule that essentially muzzles legitimate communication between competitors.

No doubt, distinguishing between benign and malicious exchanges of information between competitors is difficult. But discerning the quantity and quality of exchange of information can be instructive and can prevent detecting non-existent conspiracies. For example, US courts have found ''sporadic exchange of shop talk among field sales representatives who lack pricing authority'' is insufficient to establish collusion.[44] Indeed, such behavior is benign price-intelligence that businesses must gather for making informed decisions. But a sophisticated, elaborate, and well-supervised exchange of price data among competitors would establish collusion.[45] Of course, elaborate and sophisticated structures for gathering information, especially pricing, does suggests that something more sinister than routine business intelligence gathering is afoot. Finally, when the concern is price-fixing, then ''there must be evidence that the exchanges of information had an impact on pricing decision.''[46]

Here, CCI just did not have enough evidence on the quality and quantity of contacts between the airlines to conclude that a conspiracy existed. It did not identify who in the airlines exchanged pricing information: common agents, junior sales staff, or senior executives. The former two would have had little impact on the FSC rates. Furthermore, CCI's evidence that the airlines had indeed acted upon the pricing information was weak at best. In spite of these shortcomings, CCI's conclusion was categorical: dearth of direct evidence notwithstanding, exchange of pricing information was collusion. Such definitive pronouncements based on scant and ambiguous evidence could potentially chill economically sensible and legally acceptable information gathering by businesses that are necessary for making informed decisions.

## III. Consequences of CCI's Economically Erroneous Cartel Enforcement

Overzealous enforcement of competition laws can cripple competition. Mistaken inferences in price-fixing

[37] *Id.* at ¶ 128.

[38] Case No. 30 of 2013, at ¶ 113, 120-21.

[39] Donald Turner, *The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 669 (1962).

[40] *In re Text Messaging Antitrust Litig.*, 782 F.3d 867 (7th Cir. 2015).

[41] *Id.*

[42] *United States v. U.S. Gypsum Co.*, 438 U.S. 422, 443 n. 16 (1978) .

[43] *See In re Baby Food Antitrust Litig.*, 166 F.3d 112, 126 (3d Cir. 1999) .

[44] *Id.* at 125; *see Krehl v Baskin-Robbins Ice Cream Co.*, 664 F.2d 1348, 1357 (9th Cir. 1982) .

[45] *Am. Column & Lumber Co. v. United States*, 257 U.S. 377, 409-10 (1921); *United States v. Am. Linseed Oil Co.*, 262 U.S. 371, 389-90 (1923).

[46] *Id.* at 125; *see Krehl v Baskin-Robbins Ice Cream Co.*, 664 F.2d 1348, 1357 (9th Cir. 1982).

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cases based entirely on circumstantial evidence ''chill[s] the very conduct competition laws are designed to protect.''[47] Academics have warned that such questionable decisions interfere with competitive markets. Donald Turner, in his influential article on conscious parallelism, found that oligopolies setting profit-maximizing price in light of all market facts is *vitally* necessary to make competitive markets function as they are supposed to function.[48] Forcing oligopolies to adopt economically absurd business practices, such as outlawing parallel pricing, will have counter-productive consequences. An oligopoly will mutate into a monopoly when businesses are forced to eschew profit-maximizing behavior. For instance, a smaller player in an oligopoly—such as Spice Jet here—may decide to exit the market rather than adopt unprofitable prices, and therefore, render the market more concentrated and possibly strengthen a dominant player, such as Jet Airways. Hence, CCI's benevolent attempt to quash (non-existent) cartels may prove malevolent for competition.

In CCI's defense, correctly construing parallel conduct is hard: authorities globally have been perplexed in designing evidentiary standards to determine whether parallel conduct stems from collective or from unilateral decision making.[49] For oligopolies, setting evidentiary standards is even harder.[50] But CCI can still learn from experiences of other jurisdictions. The plus-factor jurisprudence from U.S. courts is well-established and informative. The U.S. Supreme Court's famously observed that ''conscious parallelism has not read conspiracy out of the Sherman Act.''[51] Therefore, U.S. Courts developed the legal rule of ''parallelism plus,'' under which they look for additional economic circumstantial evidence collectively referred to as ''plus factors.''[52] To effectively use ''plus factors,'' former Federal Trade Commission Chairman, William Kovacic, has proposed ranking plus factors in terms of their probative value.[53] Plus factor jurisprudence, for example, may add the critical missing ingredient to CCI's analysis and opinions: economic analysis.

India is currently the world's fastest growing economy. Prime Minister Modi has unleashed ambitious programs such as Make In India and Startup India to bolster economic growth. For benefits of economic growth flow to the consumers, competitive markets are imperative—these competitive markets require a robust competition law regime to thrive. But CCI's economically unreasonable and inconsistent enforcement of competition laws may stifle economic growth. Hopefully, CCI will learn from the experience of other global competition agencies and develop an economically sound competition law regime. Indeed, India's economic growth depends on it.

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[47] *See Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986).

[48] Turner, *supra* note 39, at 666.

[49] William E. Kovacic et al., *Plus Factors and Agreement in Antirust Law*, 110 MICH. L. REV. 393, 395 (2011).

[50] *Id.*

[51] *Theatre Enters. Inc., v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 541 (1954)

[52] Jonathan Baker, *Two Sherman Act section 1 dilemmas: parallel pricing, the oligopoly problem, and contemporary economic theory*, 38 ANTITRUST BULL. 143, 174-75 (1993)

[53] William E. Kovacic et al., *Plus Factors and Agreement in Antirust Law*, 110 MICH. L. REV. 393, 398 (2011).