Competition Law and Infrastructure

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The yet to be notified provisions of the Competition Act, 2002 relating to anti-competitive agreements, abuse of dominance and regulation of combinations, could when notified create issues with respect to current and contemplated infrastructure projects and activity in the infrastructure space. This article attempts to shed light on some of these issues.

The Need for Better Infrastructure

Over the past few years India's economy has been growing at nine per cent per annum. A growth rate second only to China amongst major economies. The Finance Minister of India has emphasised that in order to sustain an economic growth at the rate of nine per cent, India would be required to raise investment in infrastructure to eight per cent of its gross domestic product in the next five years, up from the current 4.6 per cent.

The consultation paper circulated by the planning commission notes that a massive US$ 494 billion of investment is proposed for the 11th plan period (2007-12). This investment would increase the share of infrastructure investment to nine per cent of Gross Domestic Product from five per cent in 2006-07. An increase of this magnitude would not be feasible without attracting the participation of private enterprises. Accordingly, the government has from time to time initiated many proactive measures like opening up a number of infrastructure sectors to private players, permitting Foreign Direct Investment ("**FDI**") into various sectors, and introducing model concession agreements.

Investment Orientation

The current foreign investment policy allows up to 100 per cent foreign investment in most sectors. Over a period of time, the government has relaxed or removed the caps in several sectors. For example, in the civil aviation sector, the FDI limit has been increased from 49 per cent to 74 per cent. Similarly, for construction development, 100 per cent FDI in four sectors, including construction-development projects has been permitted, subject to restrictions relating to minimum built-up area and minimum capitalization. Foreign direct investment of up to 100 per cent is allowed in infrastructure holding companies, albeit with a prior approval from the Foreign Investment Promotion Board.

The government has also been proactive in providing a platform to private enterprises in development of infrastructure through Public-Private Partnerships ("**PPP**"). The government of India has already proposed a 40,000-MW hydro power generation capacity, constructing dedicated freight corridors between Mumbai-Delhi and Ludhiana-Kolkata, modernisation and redevelopment of

21 railway stations, modernisation and redevelopment of 4 metro and 35 non-metro airports amongst others.

For determining the investment model, various factors including the degree of participation by the private enterprise, the nature of documentation, the risks involved and the legal framework are essential considerations. Typically, the investment models adopted in a PPP scenario include Build Operate and Transfer ('BOT'), where the private player would build the project, operate the project and after satisfaction of certain terms and conditions would transfer the project to the government and Build Own and Operate ('BOO'), where the private enterprise is permitted to build and own the project and manage the operations of the business. Other models such as Build and Transfer ('BT'), Build Lease and Transfer ('BLT'), Build Transfer and Operate, ('BTO'), etc., are also adopted for infrastructure projects.

The governing contract in the arrangement between the government and private enterprise that vests the rights of development and implementation of the project with a private enterprise is commonly known as the 'concession agreement'. These agreements are based on the need of the Government, and the model proposed for implementing the project.

A PPP model for an infrastructure project involves participation of various parties, and primarily the Government, which takes decision regarding implementation of the project, and the sponsors who undertake to implement the project. Based on the agreement, the sponsors normally float a special purpose vehicle for the implementation of the project. The sponsors/special purpose vehicles approach lenders and investors for financing the project, and at various stages enter into exclusive supply and distribution agreements for meeting the supply and distribution requirements of a project contemplated under the concession agreement.

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Watch-Dog Legislations

Though the government has liberalised its investment policies and statutory framework to promote trade, the government has also enacted legislation to ensure that equal opportunities are available to prospective bidders and sponsors, and protection is granted to market participants, making consumers the ultimate beneficiaries of such projects. Competition is essential for the healthy growth of industry. The Monopolies and Restrictive Trade Practices Act, 1969 ("**MRTP Act**") was enacted with the primary focus of curbing monopolies and preventing the concentration of economic wealth

in the hands of a few. In sync with a global shift away from curbing monopolies to promoting fair competition and curbing agreements through which companies may enjoy a dominant position in the market, the Competition Act, 2002 ("**Act**") was enacted to encourage fair competition and identify and punish businesses that may abuse market conditions to curtail competition.

The Act primarily comprises of provisions pertaining to Anti-Competitive Agreements, Abuse of Dominance, Regulation of Combinations and Competition Advocacy. At present, the provisions of the Act relating to anti-competitive agreements, abuse of dominance and regulation of combinations have not been notified. There are concerns on how the Act would apply to various transactions, and we summarise some thoughts on the impact of the Act on infrastructure projects in India.

Anti-Competitive Agreements

The Act stipulates that any anti-competitive agreement shall be void and prohibits an enterprise or a person from entering into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services that causes or is likely to cause an appreciable adverse effect on competition in India.

Section 3(3) of the Act prohibits anti-competitive agreements which directly or indirectly determines purchase or sale prices, limits or controls production, supply, markets, technical development, investment or provisions of services, shares the market or source of production of services by way of allocation of geographical area of market, or directly or indirectly results in bid-rigging or collusive bidding. These agreements are usually entered into between competing enterprises and are referred to as horizontal agreements. Horizontal agreements are presumed to be per-se anti-competitive, and therefore void.

Section 3(4) of the Act prohibits agreements amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, including tie-in arrangements, exclusive supply agreements, exclusive distribution agreements, refusals to deal, resale price maintenance, provided, such agreements cause or are likely to cause an appreciable averse effect on competition in India. These agreements are between independent enterprises at different stages or levels of the production chain in different markets and are referred to as vertical agreements. Vertical agreements are not considered per se void and are assessed from a legal and economic perspective to determine whether the restraint imposed promotes competition or suppress or destroys competition. Consequently, such agreements are subject to the 'rule of reason' test to determine whether the agreement is an anti-competitive agreement.

In a PPP model, the government enters into concession agreement with selected private partners (sponsors). Presently, these concession agreements provide for the terms and condition for accomplishing the infrastructure projects and the benefits to which the private participant is entitled. These concessions may be granted in the form of tax holidays, right to exclusive

supply and exclusive distribution, and the right to operate exclusively in a particular territorial jurisdiction.

With the enactment of the provisions relating to prohibition of anti-competitive agreements, there is a possibility that concession agreements may come in conflict with the provisions of the Act prohibiting exclusive supply agreement, exclusive distribution agreements or right to exclusive operation in a particular geographical area. Further, in the event the private partner is being permitted under the concession agreement, to enter into exclusive supply and distribution agreements for goods or services with other counterparties, it may be argued that the concession agreements are exclusionary or exploitative and tend to create vertical integration in the infrastructure sector. At present, it is unclear as to whether the government would rework the concessions in light of the Act.

The Act has a wide coverage and is equally applicable to the activities carried out by the government, which are commercial in nature and cannot be termed as sovereign function. Usually, in a PPP model the private participant has the right to operate the asset and receive the revenue arising out of the project. In India, the government discharges certain sovereign functions for the betterment of the society, and therefore, statutory provisions governing transactions which are commercial in nature are not applicable to the government while performing its sovereign functions. The nature of function performed by the government is determined contextually, and there is no definitive list of such activities. Therefore, without clear demarcation between sovereign functions and commercial activities, the extent of applicability of the Act to infrastructure projects remains an open issue.

Abuse of Dominant Position

By virtue of concessions under a concession agreement, a number of private enterprises would continue to hold natural monopolies in a particular market. This may also lead to the private participant (sponsor) being the preferred bidder for subsequent projects based on their credentials and experience, gathered to the exclusion of others. Consequently, private participants may enjoy a dominant position by virtue of this monopoly and the exclusivity enjoyed under a concession agreement. While a dominant position is not objectionable, an abuse of a dominant position is in contravention to the provisions of the Act.

The term 'dominant position' has been defined under Section 4 of the Act to mean a position of strength enjoyed by an enterprise in the relevant market in India, which enables it to (i) operate independently of competitive forces prevailing in the relevant market or (ii) affect its competitors or consumers or the relevant market in its favour.

An enterprise is considered to abuse its dominant position when it:

1. directly or indirectly imposes unfair or discriminatory conditions or unfair or discriminatory prices (including predatory prices) in the purchase or sale of goods, and provision of services); or
2. limits or restricts the production of goods or technical or scientific development relating to goods in a manner that is prejudicial to consumers; or

3. indulges in any practice that results in a denial of access to markets; or

4. makes the conclusion of a contract conditional on the acceptance by other parties of certain obligations which, by their very nature or according to commercial practice, have no connection with the subject matter of the contract; or

5. uses its dominance in one market to enter into other market.

Consequently, challenges to toll prices, bid qualification and operation and maintenance agreements based on the provisions of the Act may all be distinct possibilities.

Combinations

The Act also provides for regulation of combinations of enterprises. The Act also provides for a voluntary notification procedure where enterprises would need to notify the Competition Commission of India (**"CCI"**) prior to undertaking a combination (a term defined under the Act to encompass an acquisition, merger or amalgamation) above a prescribed threshold limit in India or overseas. Much has been written about the concerns with timelines prescribed under the Act. We also note that various assurances have been voiced that such timelines are merely caps and not targets, and hence should not cause undue delay thereby disadvantaging M&A activity in India. We will not add to the literature on this point.

The combinations that are broadly envisaged under the Act are as follows:

1. Any acquisition of control[1], shares, voting rights or assets of an enterprise,

2. Any acquisition of control over an enterprise where the acquirer already has direct or indirect control over another enterprise engaged in a similar field, and

3. Any merger or amalgamation.

Any combination that exceeds threshold limits as specified under the Act would be governed by the provisions of the Act. The threshold limits relate to the combined assets or turnover of the parties to a combination or such other parties as prescribed by the Act, and have been specified on the basis of the type of combination that is proposed to be undertaken. Further, the threshold limits specified for each combination are further distinguished depending on the turnover/assets in India and outside India. However, under the notification requirements in the Act, it is not clear as to whether the voluntary notification is to be made for each transaction (assuming multiple investments into shares of an infrastructure entity) or a notification once made and an approval once obtained would hold good for a subsequent increase in investment. Clarity on this aspect would lead to the evolution of transaction structures in the infrastructure space that obviate the need for repeated approvals.

The Act, rather than providing for a broad outline for scrutinising each combination on a case to case basis, provides a common threshold limit for all industries. This may be a cause of concern for sectors which are capital

1 "Control" includes controlling the affairs or management by—
(i) one or more enterprises, either jointly or singly, over another enterprise or group;
(ii) one or more groups, either jointly or singly, over another group or enterprise.

intensive such as aviation, infrastructure, petroleum refinery, etc. which require significant investment into assets. On the other hand, combinations by service sector companies, which normally do not have large asset sizes, may not be subject to approval of the CCI. A case could be made for a larger threshold limit with respect to infrastructure projects, as the current limits may create a need for repeated investment-related approvals under the Act.

Fact-Situation Analysis

With respect to combinations in asset and investment heavy sectors, it is interesting to note how such deals may have been analysed under the Act. In 2006, the buyout of Air Sahara by Jet Airways had raised concerns regarding triggering provisions of the MRTP Act, relating to abuse of dominant position. Jet Airways had proposed to acquire equity shares, preferential shares and the group loans of Air Sahara for a consideration of about USD 500 million. The Ministry of Company Affairs took the view that merely being in a dominant position does not amount to abuse of dominant position and thus clarified that the provisions of the MRTP Act would not be applicable to the said deal, a view that would be tenable under the Act as well. Under the MRTP Act, a monopolistic trade practice meant a trade practice that has or is likely to have the effect of maintaining the prices of goods or charges for the services at an unreasonable level by limiting, reducing, or otherwise controlling the production, supply, or distribution of goods or the supply of the services or in any other manner. The time taken to come to this conclusion was less than the 210 days prescribed as the waiting period under the Act.

However, the position might have been different if the provisions relating to abuse of dominant position under the Act were in force. Due to the asset size and the turnover of the companies, the acquisition would have required approval of the CCI, and would also have likely been scrutinised by the CCI to ensure that there was no cartel connotation in this instance. It is likely that this investigation would have delayed the completion date of the deal.

In the recent negotiations between Bharti, one of India's large telecom companies, and South African telecom company MTN, the structure proposed by Bharti was for MTN to acquire an equity stake in Bharti. This would have resulted in MTN holding 85 per cent of Bharti. MTN's counter proposal was to make Bharti a subsidiary of MTN. The negotiations seem to have broken down due to a disagreement on terms. If the provisions relating to abuse of dominant position and combination were in force, Bharti and MTN would have been required to seek an approval from the CCI, due to the fact that Bharti has the highest market capitalisation in the telecom sector and an approval would have resulted in an increase in its market capitalisation.

Close upon the heels of the Bharti MTN impasse, the Reliance Anil Dhirubhai Ambani Group ("**ADAG**") approached MTN and proposed a structure under which it would transfer its 66 per cent in Reliance Communication (RCOM), a public listed company, to MTN, in return for a 33 per cent stake in MTN. The proposed deal between RCOM and MTN would have involved an open offer by MTN to the public shareholders of RCOM. Under the

Takeover Code any acquisition above 15 per cent would trigger an open offer for a further 20 per cent from public shareholders. Therefore, the said transaction was proposed to be consummated in a two-step structure. The first step being the open offer to be made by MTN to the public shareholders of RCOM and the second step being a swap by ADAG of it RCOM shares for MTN shares, such that ADAG would hold 33 per cent of MTN, and MTN would hold 74 per cent of RCOM.

In the Bharti MTN fact situation, the timeline provided for notification and approval for a combination under the Act might have come into conflict with the provisions of the SEBI Takeover Code. The Takeover Code requires the acquirer to complete the public offer, including payment of consideration to the shareholders who have accepted the offer, within 90 days from the date of public announcement. However, the waiting period prescribed by the Act is 210 days. These two time periods are not consonant with each other, and though SEBI may not levy a penalty on the acquirer, such transactions would not be easy to complete.

Further, under the SEBI Takeover Code transfers inter se promoters are exempted. It is, however, uncertain whether approval of the CCI would be required for transactions that constitute an increase in shareholding by a promoter of a company including by way of such transfers, particularly where the promoters are not all part of the same group. It should be noted, however, that the Draft Competition Commission of India (Combinations) Regulations ("**Draft Regulations**"), provides that an acquisition of control or shares or voting rights or assets by one person or enterprise of another person or enterprise within the same group would not have adverse effect on competition.

Conclusion

Aspects of the Act that could be amended with respect to infrastructure projects would include the definition of combination and waiting and notification periods. Combinations as a definition could be more sector specific and less fact and need agnostic. Waiting periods under the Act, when juxtaposed with periods under other regulations should not make deal completion either inordinately delayed or penalty prone.

The opportunity to make Indian a shining beacon of development in these turbulent times is compelling. Appropriate amendments to legislations, and comfort from regulators could make investment and deal making in India speedy and efficient. The Act has been a surge in the right direction, and with some tweaking and proper implementation, could help rather than hinder activity in the infrastructure sector, which India both needs and deserves.

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