

Competition Law Hotline

August 27, 2015

CCI GETS TOUGH ON PUBLIC SECTOR UNDERTAKINGS

- Competition Commission of India for the first time penalises Public Sector Undertakings for hampering the efforts of the Government in providing insurance coverage to economically weaker sections of society.
- A Public Sector Company whose shareholding is exclusively held by the Government of India may not constitute a single economic entity
- Solvency of public sector insurance companies considered a mitigating circumstance while imposing penalty.

BACKGROUND

The Competition Commission of India ("**CCI/Commission**") recently imposed a penalty of INR 6.69 billion on four public sector insurance companies for causing an appreciable adverse effect on competition in the health insurance sector.¹ The Commission held that the conduct of National Insurance Co Ltd, New India Assurance Co Ltd, Oriental Insurance Co Ltd ("**OICL**") and United India Insurance Co Ltd ("**UIICL**") (*collectively* "**PSICS**") was in contravention of Section 3(1) read with Section 3(3)(d) of the Competition Act, 2002 ("**Act**").

FACTUAL MATRIX

The Government of Kerala ("**Government**") had invited tenders for the implementation of certain health insurance schemes, Rashtriya Swasthya Bima Yojna and Comprehensive Health Insurance Scheme ("**Schemes**"). The successful bidder would be eligible to provide insurance under the Schemes for the period, 2010-13. In 2009, seven insurance companies had submitted tender documents. Out of the seven insurers that had submitted bids only OICL and UIICL had qualified for the financial round of the tendering from the technical round conducted by Technical Evaluation Committee, constituted by the Government ("**TEC**"). The bid submitted by UIICL was accepted since it was the lowest bidder.

An anonymous informant ("**Informant**") informed the Commission that PSIC's had rigged the bidding process envisaged by the Government. Further it was alleged that a cartel was formed by the PSICs and higher premiums were being sought by them for insurance services. The Commission directed the Director General to investigate the allegations made by the Informant.

DIRECTOR GENERAL'S REPORT

The Director General ("**DG**") based on its investigation held that the PSICs had colluded and manipulated the tendering process. The DG analysing the minutes of the Inter Company Co-ordination Committee meeting held on December 7, 2009 ("**ICCC meeting**"), observed that the PSICs had agreed that UIICL would secure the prime position in relation to the tender. The DG noted that UIICL emerged successful from the tendering process and entered into an agreement with the Government, to provide health insurance for the Scheme and had shared business with the other PSICs. It was noted that UIICL sought an increase in the price for insurance premiums from the Government. At the end of the first year UIICL invoked the exit clause contained in the agreement, since this request was turned down by the Government.

The DG also observed that during the tendering process for the subsequent years 2011-12 and 2012-13 the PSICs had quoted higher insurance premiums. UIICL had secured the prime positioning in the tendering process and was the successful bidder for both years. The DG held that the PSICs had formed a cartel and ensured re-tendering occurred every year during the period 2011-14 by invoking the exit clause in the agreement between UIICL and the Government in contravention of Section 3(3)(a) and 3(3)(d) of the Act.

ISSUES

Upon consideration of the DG report and the objection of the PSICs the Commission framed the following issues:

- Whether the PSICs constituted a single economic entity?
- Whether the conduct of the PSICs was in contravention of the provisions of the Act?

OBJECTIONS OF THE PSICS

The PSICs submitted that they constituted a "single economic entity" since they were wholly owned by Government of India. Further, their management was controlled by the Department of Financial Services. The PSICs contended that the arrangement between them was in the nature of capacity building to allow for co-sharing of risks and losses and the DG's conclusion was based solely on the copy of the minutes of the ICCC meeting whereas the decision taken during the meeting was not implemented nor was it approved by the General Managers of the PSICs.

The PSICs further submitted that a fair process was adopted by the Government and during evaluation of bids by the TEC the tenders of certain insurance providers had been rejected as they failed to meet the technical specifications. Private insurance providers could not secure the prime position since they had been disqualified. The PSICs clarified

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that since they faced heavy losses due to other public welfare schemes, higher premiums were being charged to re-cooperate such losses. Further based on past experiences the PSICs claimed that the quantum of claims received would outnumber the quantum of premiums received from the beneficiaries of the scheme. Therefore, providing insurance under the Scheme was economically feasible only if higher premiums were charged.

JUDGMENT AND ANALYSIS

Existence of a single economic unit

CCI noted that PSICs were wholly owned and supervised by the Central Government however all of them had placed separate bids in response to the tenders. It was admitted by the PSICs that decisions relating to submission of bids, determination of bid amounts, and business-sharing arrangements were taken at the company level without the approval or intimation of the Ministry of Finance. The Commission noted that there was no *de jure* or *de facto* control by the Ministry over the PSICs. Thus, the Commission rejected the contention that the PSICs constituted a single economic entity.

Bid rigging in violation of Section 3 of the Act²

The CCI was of the opinion that during the ICCC meeting conducted to discuss the provision of insurance for the Scheme in 2009, all the PSICs had agreed that UIICL would be allowed to rise to prime position in the tendering process and would allow the other PSICs to perform a certain portion of the contract ("**Agreement**").

The Commission upon consideration of the Agreement and the minutes of the ICCC meeting found that the decision taken with respect to financial bids submitted and business sharing arrangement for insurance services under the Scheme was implemented by the PSICs. Further, it noted that the PSICs had admitted that the minutes of the meeting was accurate and that it was signed by the General Managers/ Regional Managers of these PSICs.

The Commission based on a review of the internal communications, evidence in relation to the minutes and office notes found that UIICL at the end of each year invoked the exit clause strategically. UIICL citing unviability of contract as a pretext would seek an increase in the premium rates, leading to re-tendering for the subsequent year. CCI held that this demonstrated a clear bidding pattern. The PSICs also failed to provide any reasoning or establish that the Agreement did not have an appreciable adverse effect on competition. In light of these observations, CCI held that the PSICs had engaged in bid rigging in the years 2010-13 with UIICL being the pre-determined winning bidder. CCI held that the conduct of PSICs amounted to contravention of Section 3(1) read with Section (3) (d) of the Act. Further that UIICL had sub-contracted to an extent the right to provide premiums under the Scheme to the unsuccessful PSICs. Therefore, the actions of the PSICs were directly resulting in bid rigging.

CCI imposed a penalty of 2% of the average turnover of the PSICs in 2010-13 amounting to INR 6.69 billion under Section 27(b) of the Act. The penalty was determined on the basis of certain mitigating and aggravating circumstances. It was noted that the beneficiaries of the Scheme were families who were not financially well off and that the conduct of the PSICs hampered the efforts of the Government to provide insurance coverage to such families. CCI held that considering the crucial role played by the PSICs in providing insurance, the necessity for these PSICs to remain solvent constituted mitigating circumstances for the purposes of determining the penalty.

CONCLUSION

The PSICs contended that they were a single economic entity as their shareholding was exclusively held by the Government of India; however this defence did not find any merit before the CCI. This appears to run contrary to the approach taken by the CCI and the Competition Appellate Tribunal in *Exclusive Motors Pvt. Ltd vs. Automobili*

*Lamborghini SPA*³ wherein entities whose shareholding was almost exclusively held by a common parent company were held to be a single economic entity.

This order of the CCI has shed some light regarding the jurisprudence for the imposition of penalty which till date remained unexplained. The Commission may under Section 46 of the Act choose to impose a lesser penalty only in case it is satisfied that the party had made disclosures regarding the alleged cartelisation. The order indicates that CCI has considered the solvency of the PSICs to be a mitigating factor though the constraints on solvency were not specifically averred. It is pertinent to note that CCI following the trend in other developed jurisdictions⁴ has considered that where penalty would irretrievably jeopardise the economic viability of the company, penalty should be reduced.

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You can direct your queries or comments to the authors

¹ In *Re: Cartelization by public sector insurance companies in rigging the bids submitted in response to the tenders floated by the Government of Kerala for selecting insurance service provider for Rashtriya Swasthya Bima Yojna*, Suo Moto Case No. 02 of 2014.

² The Explanation to section 3, sub-section (3) of the Act defines "bid rigging" as "any agreement, between enterprises or persons referred to in sub-section (3) engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding."

³ Case No. 52/2012, Appeal No. 01/2013

⁴ Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003, accessible at [http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52006XC0901\(01\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52006XC0901(01)&from=EN)

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