

Competition Law Hotline

November 28, 2014

CCI STRIKES AT PRIVATE PLAYERS IN THE GAS INDUSTRY- PROBLEM STILL PERSISTS

- The Commission has taken a holistic view of the Gas Supply Agreement and struck down the unfair and discriminatory clauses and held conditions cannot be imposed unilaterally.
- The Commission held that even if disputes are contractual in nature, but indicates abuse of dominance by parties, it is within the scope of their realm.
- Yet another ruling imposing penalty, without providing the basis on which the penalty amount has been derived.

The Competition Commission of India ("**Commission/CCI**") in the case of *Faridabad Industries Association ("FA/Informant")* vs. *M/s Adani Gas Limited ("Opposite Party/Adani")* held that Adani had abused its dominant position in the concerned relevant market and imposed unfair conditions on its industrial customers in contravention of the provisions of the Competition Act, 2002 ("**Act**"). The Commission imposed a penalty of 4% amounting to INR 256 million on Adani and issued a 'cease and desist' order on them from imposing unfair conditions in its agreements. The Competition Appellate Tribunal ("**COMPAT**") has stayed the penalty imposed as well as modification of the gas sale contract order by CCI.

FACTUAL MATRIX

The Informant is a society registered under the Societies Registration Act 1909, with members primarily involved in a variety of industries including steel, alloys, medical devices etc. The Opposite Party is involved in the business of distribution of natural gas to a variety of customers including atleast 90 members of the Informant based on a Gas Sales Agreement ("**GSA**"). The Informant alleged the terms of GSA to be biased and one-sided, without any scope or flexibility to the members, who were solely dependent on the Opposite Party for the supply of natural gas. The Commission vide its order dated 27.12.2012 directed the Director General ("**DG**") to cause an investigation to be made into the matter and submit a report.

DG REPORT

The DG investigated the matter and submitted its report to the Commission, observing that in pursuance of Section 2 (r)¹ of the Act, the relevant market in the present case would be, "*market of supply and distribution of natural gas to industrial consumers in district Faridabad.*" It also concluded that the Opposite Party was in a dominant position in the relevant market as per Section 4 (a) of the Act.²

Based on a review of the GSA, the DG held that not all clauses amounted to abuse of dominant position by the Opposite Party - any irrational change or increase in the prices of natural gas supplied to the members of the Informant would not be reflective of the abuse of dominant position by the Opposite Party. However, the DG held that certain clauses in the GSA imposed unfair conditions in contravention of section 4(2)(a)(i) of the Act.

ARGUMENTS

Informant's submissions

The Informant mainly challenged findings in the DG Report with respect to– (a) what constituted abuse of dominance, (b) relevant clauses of the GSA including Clause 9.4, 10.6, and 11.2.4 as well as on gas pricing revisions.

The Informant firstly contended that to determine abuse of dominance, it needs to be ascertained whether clauses in an agreement directly or indirectly impose an unfair or discriminatory conditions in the sale of goods and not whether the dominant enterprise has, in practice, abused those clauses.

The Informant submitted that Clause 9.4 of the GSA (on quality), empowers the Opposite Party to issue a certificate without any preference to the certificate provided by GAIL. Similarly, the consumer did not have any right either to demand the certificate quality from the Opposite Party's supplier or to demand corroboration to the same.

With regard to Clause 10.6 of the GSA (*Measurement and Calibration*), the Informant argued that giving Opposite Party unfettered power to be the sole judge in the dispute clearly reflects abuse of dominance. It was also contended that the addition of '*future supplies and extension of infrastructure*' to the end-user price, to be undertaken by the Opposite Party itself is an unfair stipulation. In relation to fluctuation of prices, the Informant argued that any pricing in which the transmission charges are not persistent and alters with the sale price is inherently unfair.

Further Clause 11.2.4 (*Shutdown and Stoppage*) was also challenged because of the insertion of the words '*due to any reason whatsoever*' which clearly highlight the fact of unfair provisions. Informant alleged that the clause unfairly absolved Opposite Party from any liability due to its failure to supply gas.

Opposite Party-Submissions

Opposite Party raised a preliminary objection on the maintainability of the complaint on the ground that the issues

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raised by the Informant were contractual in nature and did not involve any issues of competition law. Opposite Party also challenged the definition of relevant market as stated by the DG and clarified that natural gas has a lot of alternatives in the same area, in Faridabad, as the purpose of all of these fuels are heating, chilling and electricity generation. Hence, natural gas was substitutable and the relevant market ought to therefore include substitutable products as well. With regard to clause 13.5, the Opposite Party submitted that the same was inserted to ensure timely payment of amounts and that payment were not withheld unnecessarily. Furthermore, there were recourses that were available to the customers such as clause 19 and 20 of the GSA pertaining to mutual consultation and arbitration.

With regard to termination, the Opposite Party stated that the new revised GSAs gave the right of termination to the customers as well and the reasoning for keeping the sole right to judge any claims under the force majeure clause was to prevent illegitimate claims as the opposite party has the expertise in the area.

ISSUES

CCI divided the issues into three areas and answered them accordingly. The three issues were-

1. What is the relevant market in the present case?
2. Whether the Opposite Party is dominant in the said relevant market?
3. If finding on the issue No. (ii) is in the affirmative, whether the Opposite Party has abused its dominant position in the relevant market?

JUDGMENT

1. Defining the “relevant market”

The Commission rejected the contentions of the Opposite Party on substitutability and held that the relevant market in the present case is the market of supply and distribution of natural gas to industrial consumers in the district Faridabad.

The Commission relying on the provisions of Section 2 (t) of the Act, held that to determine relevant product market various considerations such as physical characteristics or end-use of goods, price of goods or service, consumer preferences, exclusion of in-house production, existence of specialized producers and classification of industrial products are taken into consideration. The Commission agreed with the classification of users taken by the DG as consumers use natural gas for different purposes. Additionally, Commission noted that natural gas had distinct characteristics and although apparently similar to other forms of fuel, due to nature of gaseous form of fuel, natural gas was a distinct market from oils and other similar products. The Opposite Party contended that it supplied fuel to only 5% consumers in Faridabad while 95% consumers used alternate forms of fuel but Commission appears to have rejected this contention on the ground that the natural gas had unique features and application.

On the aspect of the relevant geographic market³ the Commission held that since state government of Haryana had authorised only one service provider in Faridabad, the Opposite Party to build and operate CGD network, thereby making Faridabad the relevant geographic market.

2. Dominance in the Relevant Market

The Commission, while considering the factors⁴ involved in the determination of dominant position, held that Opposite Party had 100% market share in the relevant market, being the only entity allowed to supply natural gas by the state government. Further the Commission noted that distribution of natural gas is regulated, as per the provisions of Petroleum and Natural Gas Regulatory Board Act, 2006 and regulations thereunder. The Regulations specifically provide for three years marketing exclusivity from the date of authorization to an existing CGD networks and five years from the date of authorization to a new CGD network from the purview of common or contract carrier, consolidating the dominant position of the Opposite Party. The factual scenario with respect to supply of gas with respect to market size, structure and presence of entry barriers reflects that Opposite Party enjoyed a dominant position.

3. Abuse of Dominant Position in Relevant Market

Clauses 9 and 10- Quality of Gas and Measurement and Calibration

With regard to clause 9 and 10 of the GSA, the Commission held that the Opposite Party is itself getting the gas from GAIL and the latter is providing the former a quality certificate for the same. The said certificate is readily available to the consumers, thereby allowing the consumers to corroborate the gas quality. The Commission rejected Informant's allegation on the ground that Informant was 'selectively' reading the GSA and considering that Opposite Party itself was a supplier and not producer of natural gas, the terms relating to quality, measurement and calibration were not unfair or unreasonable.

With regard to clause 11 (shut-down and stoppage of gas) of the GSA, the Commission stated that considering the overall commercial arrangement and based on a reading of the GSA as a whole, the clause was not unfair or unreasonable. The Commission noted that both parties would not be liable for 'indirect, incidental or consequential loss or damage or loss of opportunity of profits'. The Commission noted that this clause would have to read with Clause 21.5 which Informant had ignored. The Commission, on the point of fluctuation of prices, held that by virtue of peculiarities of the natural gas industry, a fixed formula for prices of the same would not be practical. Hence, variations on the price of natural gas supplied to the consumer do not amount to an unfair provision.

However, the Commission observed that the fact that the Opposite Party had no obligations to pay interest on any amount that is to be reimbursed to its customers is fact that leads to the conclusion that the particular clause, 13.7 with respect to interest payments, was an unfair condition and this was in contravention of the provisions of section 4(2)(a)(i) of the Act.

With regard to clause 17 (expiry and termination), the Commission endorsed the view of the DG which held that termination of contract by the Opposite Party on account of failure to off-take 50% or more of the cumulative DCQ by the buyer during a period of 45 consecutive days as against the longer period available to the Opposite Party from GAIL, amounts to imposition of unfair conditions in contravention of section 4(2)(a)(i) of the Act. The Commission also stated that the revised GSA's may not have any consequence in relation to the allegations which date back prior to

such amendments, thereby making the same subject to the extent of quantifying penalty.

The Commission also struck down other clauses in relation to *force majeure*, to the extent that the Opposite Party had the right to be the sole judge on any application of force majeure and MGO payment obligations on the customers as being in contravention of section 4(2)(a)(i) of the Act.

As a result, the Commission ordered that:-

- Opposite Party to cease and desist from indulging in the conduct which has been found to be in contravention of the provisions of the Act.
- GSA to be modified in light of the observations and findings recorded in the present order.
- Considering the totality of facts and circumstances of the present case, the Commission decided to impose penalty on the Opposite Party at the rate of 4% of the average turnover of the last three years which amounted to INR 256 million.

ANALYSIS AND CONCLUSION

In the Coal India Case, the Commission had observed that contracts could be unconscionable when a party with superior bargaining power was in a position to dictate terms. This present ruling, reiterates the principle articulated by CCI in the Coal India Case and clarifies that terms which are unfair will be struck down. The present ruling is noteworthy as it considers the GSA as a whole and rejects Informant's selective interpretation of clauses of the GSA and will benefit *bona fide* parties. Although Commission has given a 'cease and desist' order, its application is on a very limited point and has substantially, rejected the challenges made by the Informant.

This judgment is one more in the long list of cases where the Commission has imposed huge amount of penalty and COMPAT has granted stay, pending disposal of the appeal. The Commission in its series of judgments has failed to provide any legal or economic basis for imposition of penalty though COMPAT had specifically in the past ruled on the need to provide reasoning and relevant turnover for imposing such penalty, yet no jurisprudence has been created on the same.

With the growing amount of competition litigation penalty being imposed to keep a check, it is high time that jurisprudence on penalty and commercial angle to these issues are clarified so that companies are well aware about the consequences and risks involved before entering into any such agreements.

Secondly on the issue of unfair and arbitrary terms being imposed in the agreements, *per se* they may not appear to be unfair however the requirement is to analyse them in the right context-both legally and commercially, position of parties, bargaining power and circumstances in which the same were agreed upon between the parties to determine its true effect.

Subject to COMPAT's ruling, Commission's observations on agreements in the energy sector are likely to have far-reaching consequences given the de-regulation and removal of price-controls in oil and gas sector.⁵ With such developments, disputes on price-controls will be minimized and ancillary provisions, as examined in the present case, will be subject of review more often.

Given the Commission's views on how terms are negotiated, companies must be careful about terms that are imposed on other contracting parties since this has a bearing on the legality of a clause. Additionally, terms and conditions which are unilateral, peremptory and subjective in nature, can be struck down by CCI, even if such clauses have not been given effect to.

The Commission unfortunately did not deal with a very valid objection taken by the Opposite Party, namely, the disputes raised relate to an agreement and hence, were contractual in nature. However, it would appear that if such disputes relate to clauses of an agreement which are indicative of abuse of dominance or an anti-competitive spirit, irrespective of other rights and remedies, the Commission will examine such a complaint.

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You can direct your queries or comments to the authors

¹ "Relevant market" means the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets

² Section 19 (4) of the Competition act, 2002

³ "relevant geographic market" means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services, are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas

⁴ market share of the enterprise; size and resources of the enterprise; size and importance of the competitors; economic power of the enterprise including commercial advantages over competitors; vertical integration of the enterprises or sale or service network of such enterprises; dependence of consumers on the enterprise; monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise; entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers; countervailing buying power; market structure and size of market; social obligations and social costs

⁵ <http://profit.ndtv.com/news/commodities/article-government-ends-diesel-controls-raises-gas-prices-681133>

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