

Impact of Competition Law on Indian Real-estate Sector: An Analysis of Order against DLF

M.M. Sharma and Vaibhav Choukse*

On 12th August, 2011, the Competition Commission of India, vide an order, in Beldaire Owner's Association v. DLF Limited and Ors, has imposed a penalty amounting to Rs. 630 crores (INR 6.3 Billion) on DLF Ltd. for abuse of dominant position for imposing unfair conditions in the agreements entered into by the company with flat buyers. CCI has already started investigation against many real-estate company post DLF order. The article covers the analysis of CCI order and its impact on the real-estate industry along with the ambiguities in the order. The article also covers the best international practice adopted by various competition authorities in real-estate sector and the role of builders associations, as they can play a vital role in sensitising their member builders on the benefits of competition compliance. In many jurisdictions, even if a breach occurs, the degree to which an enterprise can demonstrate a genuine commitment to compliance with competition laws may be an important factor for consideration by the competition regulator while determining the severity of any penalties to be imposed. In many other countries, responsible builders associations prescribe standard pro-forma contracts that are less skewed.

Background

In the wake of economic liberalisation and widespread economic reforms introduced in India since 1991 and in its attempt to march from a "Command and Control" regime to a regime based on free market principles, India decided to replace its archaic Monopolies and Restrictive Practices Act, 1969 with a modern competition law, in sync with modern and internationally established competition law principles, in the form of the new Competition Act, 2002 (the Act). The Act, though enacted since 2003, remained under challenge before the Supreme Court and was amended in accordance with the directions of the Supreme Court in 2007. The Central Government notified selected portions relating to prohibition of "anti- competitive agreements" (Section 3) and "abuse of dominant position" (Section 4) on 20th May, 2009 and the portions relating to "regulation of combinations" (Section 6) i.e. regulation of mergers and acquisitions etc. has been notified with effect from 1st June, 2011. The provisions of the Act are all encompassing and cover all sectors of our economy, including the real estate sector.

On 12th August, 2011, a tectonic incident jolted the real estate industry. The Competition Commission of India (CCI), the competition regulator created under the Act, that is responsible for regulating competition in markets in India, vide an order, in *Beldaire Owner's Association v. DLF Limited and HUDA*¹ (the order) has imposed a penalty amounting to Rs 630 crores (INR 6.3 billion) on DLF Ltd. (DLF)

* * M.M. Sharma (former Registrar in CCI) Heads the Competition Law & Policy Practice in, Vaish Associates, Advocates; Vaibhav Choukse is an Associate in the Competition Law Team of Vaish Associates.

¹ 1 Ed.: MANU/CO/0044/2011: 2011 CompLR 0239 (CCI)

for abuse of dominant position for imposing unfair conditions in the agreements entered into by the company with flat buyers and directed DLF to “cease and desist” from formulating and imposing such unfair conditions in its agreements with buyers in Gurgaon and to suitably modify such unfair conditions within three months of the date of receipt of this order. The huge penalty imposed on DLF is calculated at the rate of 7 per cent of its average group turnover for the last three preceding financial years and is the heaviest ever imposed for any competition law violation in India so far. CCI in the said order has also advised the Centre as well as State Governments to come out with a regulatory framework for the realty sector. In a separate report published in the Media, CCI has also hinted at the possibility of initiating *suo moto* (of its own motion) investigations into the flat buyers’ agreements of other builders. In another event, the Maharashtra State Consumer Disputes Redressal Commission on 10th August, 2011 has ordered a Pune-based builder to pay a flat buyer Rs. 45 lacs for a flat he purchased for Rs. 6.5 lacs in 2001 but never received possession. The Commission has also reprimanded the builder for creating third party interest by selling the same flat to another buyer. Recently, in December 2011, on a complaint filed by flat owners of Jaypee Greens Noida, CCI has found a *prima facie* case of abuse of dominance against Jaypee Group and has ordered an investigation against the company. According to a media report², many other real-estate giants including Unitech, Parsvnath Developers and Omaxe Group might face the CCI investigation.

In the case before the CCI, it was alleged by the complainant i.e. Belaire Owner’s Association, Gurgaon that DLF has imposed “arbitrary, unfair and unreasonable conditions” on the apartment-allottees which amounted to abuse of its dominant position, in the so called relevant market for services of developer/builder in respect of “high-end residential accommodation” in Gurgaon. So what are these clauses that CCI found unfair and hence “abusive” in DLF’s Belaire project agreement in the order? There are as many as 16 of them:

1. Unilateral changes in agreement and suppression of terms by the builder without any right to the allottees.
2. Builders’ right to change the layout plan without consent of allottees.
3. Discretion of the builder to change *inter se* areas for different uses like residential, commercial etc. without even informing allottees.
4. Preferential location charges paid upfront, but when the allottee does not get the location asked for, he only gets a refund/adjustment amount at the time of last installment, and that too without interest.
5. Unilateral right of the builder to increase/decrease super area at its sole discretion without consulting allottees, which nevertheless are bound to pay additional amounts or accept a reduction in the area.
6. The proportion of land on which apartment is situated on which allottees have ownership rights shall be decided by the builder.
7. The builder continues to enjoy full rights on the community buildings, sites, recreational and sporting activities, including maintenance, with the allottee having no rights in this regard.

² “The Economic Times” dated 18th August, 2011.

8. The builder has sole discretion to link one project to other projects, with consequent impact on ambience and quality of living, with buyers having no right to object.
9. Allottees are liable to pay external development charges, without these being disclosed in advance and even if these are enhanced.
10. Total discretion of the builder regarding arrangement for power supply and rates levied for the same.
11. Arbitrary forfeiture of amounts paid by the allottees in many situations.
12. Allottees have no exit option except when the builder fails to deliver possession within the agreed time, but even in this case they get refund without interest, and that too only after the apartment is sold.
13. The exit clause gives the builder full discretion, including the right to abandon the project, without any penalty.
14. The builder has the sole authority to make additions/alterations in the buildings, with all the benefits flowing to the builder, with the allottees having no say in this regard.
15. Third party rights can be created without allottee's consent, to the detriment of allottee's interests.
16. Punitive penalties can be imposed by the builder for default by allottees, but insignificant penalty for the builder's default.

According to the order of CCI, DLF violated Section 4(2)(a)(i) of the Act, dealing with abuse of dominant position by, *inter alia*, imposing, directly or indirectly, "unfair or discriminatory conditions or prices with respect to the purchase or sale of goods or services." An appeal has already been filed by DLF Ltd. challenging the order of CCI. Competition Appellate Tribunal *vide* an order dated 9th November, 2011, stayed fine imposed by CCI on DLF Ltd. and asked parties to submit the draft modified terms of the builder-buyer agreement.

Analysis

The order of CCI in *DLF* case, imposing the highest penalty ever for competition law violation in India so far, is likely to have vast ramifications in the real estate Arena in India, which is already reeling under the effects of high inflation and increased home loan rates, which has further dampened demand from homebuyers. There are many projects where delays are beyond the control of developers and if regulators start imposing stringent measures, the sector will be negatively impacted. The *DLF* case might become a precedent for other such litigations to follow, which would pose a serious problematic situation for the industry.

The decision assumes significance because, firstly, it has for the first time in India that competition law has covered the "exploitative" nature of "abuse of dominant position" as the jurisprudence on abuse of dominant position mainly centered around the "exclusionary" abuses like predatory pricing or refusal to deal etc. which have an effect of excluding the competitors, secondly, the decision has a overlap with the well-defined concepts of "unfair trade practice", which hitherto have been deemed to be reserve for the Consumer Disputes, thirdly, the order has also exposed a largely prevalent industry practice of builders appropriating the funds raised from buyers for other projects, and finally, the decision shows that the CCI

continues to rely on international case law and jurisprudence, particularly those in US and EU , while deciding cases but there remains some ambiguity on the methodology used by the CCI for the computation of the penalty, in the absence of well-defined guidelines for imposition of such heavy monetary fines, unlike other jurisdictions. Given the highly complex definition of what constitutes a “dominant position” under Section 4 of the Act, which is not dependent only on market share, the builder fraternity will need to be careful while drafting “Flat Buyer Agreements” to ensure that such violations are not repeated so as to invite heavy penalty.

Competition Compliance: A Way Forward

The real estate industry should understand that the purpose of competition law is to preserve free and fair competition in the markets, which is in the interests of all companies operating in the industry and their clients as well. Competition is necessary to achieve economic efficiency and is one of the essential conditions of a free market economy. Competition encourages enterprises to be more efficient which reduces the cost of products and services. This, in turn, leads to reduction in prices and improves quality, thereby increasing the demand for the products and services. These universal principles apply equally to the real estate sector. The real estate industry must, therefore, agree to voluntarily commit itself to ensuring the highest standards of competition law compliance within the sector by adhering to the principles of fair competition in all of its business practices and to ensure that construction companies do not engage in conduct which is anti-competitive. The flat buyer agreements, therefore, also need to be redrafted in sync with competition law in general and in accordance with the provisions of the Act, in particular. For example, in the state of Maharashtra, all such agreements must conform to the model format prescribed under the Maharashtra Ownership Flats Act, 1963 (MOFA). Clauses 1 to 5, 8 to 13, and 22 of this model agreement are statutory and must mandatorily form part of the agreement. Other clauses can and should be negotiated between the builder and the flat buyer if we are to see any semblance of transparency in this area. In *DLF* case, CCI has defined the relevant market as “the high-end residential market in Gurgaon”. Similar “relevant markets” may exist in other parts of the Delhi NCR such as in Greater NOIDA as well as in other metropolitan cities in India and in case any association of the allottees of similar apartments were to file complaints with the CCI, it shall have to intervene again on the basis of the precedent of the *DLF* case and the builders may have to face similar penalties. The answer lies in introducing a voluntary in-house check of the clauses in the agreements entered or to be entered with the prospective clients/buyers to make the agreements competition compliant.

Why Competition Compliance?

Apart from causing a loss of reputation and adverse effect on the share valuation more so in the case of a public quoted company, competition law litigation also happens to be extremely expensive. The penalties and fines prescribed under the Act are very high and the Act also incorporates provisions, which, besides the liability on the company, the CCI may also fix personal liabilities on senior management in case of even unintended violations by the employees of the company. More than 110 countries around the world, including neighbors like Pakistan and China, have already implemented a competition law regime; some 20

more are in the process of doing so. Competition law compliance should, therefore, be at the heart of every business's risk management strategy.

It is therefore advisable that all companies should have a Competition Compliance Programme (CCP) in place, which is a multi-pronged tool to ensure compliance with Competition law and rapid detection in case of any unintended violation. It works on the principle that "prevention is better than cure". It is developed keeping in mind the specific requirements of an enterprise and has the following fundamental targets:

- Educating employees about the basic concepts of competition law and about such conduct that violate it.
- Creating a system, which will detect any anti-competitive conduct.
- Training the employees about the best practices for dealing with investigations by CCI, in case of an unintended violation.

An effective compliance programme would include imparting awareness and training to employees who may engage themselves or are exposed to anti-competitive conducts. The programme should provide for identifying possible violations so as to take pro-active, corrective and remedial steps. The effective compliance not only reduces the risk of contraventions, but also facilitates timely detection and can be useful in mitigating penalties by suggesting disclosure of information at the first opportunity. To make the programme really effective, a continuous review is essential. It also requires continuous backup from senior management, which should be visible and reinforced from time to time.

CCP as a mitigating factor for deciding penalties

The presence of a well-defined CCP in enterprises has been accepted as a mitigating factor in determination of penalty amounts by competition authorities in developed economies and CCI can be no exception. In many jurisdictions, even if a breach occurs, the degree to which an enterprise can demonstrate a genuine commitment to compliance with competition laws may be an important factor for consideration by the competition regulator while determining the severity of any penalties to be imposed. For example, in 2009, UK Competition Authority (OFT) imposed a hefty fine of GBP 130 million on 103 Construction Companies. 25 companies appealed against the fines imposed. The Competition Appellate Tribunal of UK, in March 2011, has reduced fines by 90 per cent in most cases as these companies were able to demonstrate that they had an in-house CCP. It is to be noted that the parties received discount in the penalties imposed proportionate to the percentage of their competition compliance program as a separate mitigating factor. However, "off the shelf" compliance programmes may not be useful and may do more harm than good. Compliance programmes must, therefore, be designed under expert advice and supervision and should be included in the company policy on a permanent basis.

Role of Builder's Associations: International Practices

Apex Builders associations can play a vital role in sensitising their member builders on the benefits of competition compliance. In many other countries, responsible builders associations prescribe standard pro-forma contracts that are less skewed. In Australia, for example, there are three major associations of builders, each of

which provides standard pro-forma contracts to the potential buyers for various kinds of contracts ranging from purchase of a new property to existing property to renovation of bathrooms and kitchen in order to reasonably protect the interests of home buyers. Recently, National Federation of Builders (NFB), a prominent builder's association in UK launched an industry-wide code of conduct. The code demands that UK construction companies meet the highest standards of competition law compliance and will form a mandatory part of the NFB's code of conduct for members. The trade and its Associations (especially when its members are rivals in market) need to take note of the "Do's and Don'ts". Similarly, under the Act, Trade Associations are not immune from the consequences of an antitrust infringement. As a matter of fact, inquiries are already going on against trade associations in other sectors such as tyres, cement, sugar etc. before CCI, for allegedly facilitating cartel like behavior amongst their members. Therefore, Apex trade associations of real-estate sector e.g. the Confederation of Real Estate Developers' Associations of India (CREDAI) and Builder's Association of India (BAI), as the widely recognised apex body for private real estate developers in India, which has played an important role in development of Indian real-estate industry, should also develop and adopt a competition friendly "Code of Conduct" for the betterment of its members.

Copyright © M.M. Sharma and Vaibhav Choukse