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THE REAL ESTATE PROBLEM: WHOSE JOB IS IT ANYWAY?

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The decision of the Competition Commission of India in 2011 that was upheld last year by the Competition Appellate Tribunal in DLF Limited v. Competition Commission of India [the DLF case] was an alarming insight into the exploitative practices rampant in the real estate sector in India. There has, since, been a demand for a real estate regulator, but the long-overdue Real Estate (Regulation and Development) Bill, 2013 is yet to see the light of day. This issue of the Law & Policy Brief examines the limitations of competition law in resolving the problem of information asymmetry in the real estate market, and emphasizes the need for a sector-specific regulator.

Since 2011, when the Competition Commission of India [CCI] laid bare the unfair practices of DLF Limited [DLF], there has been an increasing demand for a regulator for the real estate sector. Of most concern has been the impunity with which DLF could breach the terms of its agreements with the buyers, whether by building additional floors or unilaterally increasing the super area, reducing the common areas and increasing holding charges. The Real Estate (Regulation and Development) Bill, 2013 [the Bill], it is hoped, will restore the balance between the interests of the consumer and the promoter of real estate projects, in their transactions with each other. The idea of a real estate regulator, however, begs consideration of a separate (but related) question on the role that competition law ought to have played, and from now ought to play, in setting right any unconscionable practices in the real estate sector. This, in fact, is the question that is facing the Supreme Court of India in the appeal by DLF against the decision of the Competition Appellate Tribunal [COMPAT] – whether the CCI had jurisdiction at all in the matter.

In any liberal economy, competition is encouraged in the market for its ability to protect consumers by driving firms to provide goods and services at reasonable prices and terms; and, as the name suggests, competition law is intended to preserve and encourage competition in the market, with consumer welfare as its ultimate objective. A neoclassical conception of competition law would, therefore, exclude exploitative abuses (like the practices DLF Limited is guilty of) from its ambit, because these condemned practices, while bearing heavily on the consumers, have little effect on competition (for it does not harm competitors or their ability compete in the market). While the Competition Act, 2002 [the Act] envisages (and rightly so) a wider mandate for itself, the neoclassical framework of competition law can be useful to identify the appropriate regulatory response, from a policy perspective. Accordingly, in this piece, I caution against aggressive application of competition law in dealing with exploitative abuses, where such malpractice is a mere symptom of market failure; and argue that in such circumstances, the appropriate response lies in sector regulation focused on correcting the failings of the market.

Prohibition on Abuse of Dominance: For Competition or Consumers?

The exercise of market power is well known to have a detrimental impact on consumer welfare and, most often, social welfare as

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well. A monopolist has the power to reduce output and raise prices, which forces those consumers out of the market who have a lower willingness to pay, and extracts high prices from the rest. At the same time, monopoly power may also dull the incentives for innovation and efficiency in the market. Here, then, lies the justification for regulation, such as the Act, that seeks to protect competition and as a consequence, enhance consumer welfare. It is interesting, however, to consider whether activities that directly affect consumers but not competition itself, should be within the scope of competition law; or left to consumer protection law or sector specific regulation. While this piece argues in favour of the latter, it has also been suggested previously, in the context of the DLF Case, that a better remedy lies in consumer law (Parikh and Majumdar 2012, 250).

India, like the European Union, has a broadly worded prohibition against abuse of dominance that covers both exclusionary abuses (which harms competitors or their ability to compete) and exploitative abuses (which directly harm the consumer). The Sherman Act, 1890, the centerpiece of antitrust law in the United States of America, on the other hand, prohibits only monopolization or attempted monopolization, i.e. the willful acquisition or maintenance of monopoly, which is understood to exclude exploitative abuses. The reason behind this, in the words of the inimitable Judge Learned Hand, is that "the successful competitor, having been urged to compete, must not be turned upon when he wins". In other words, it is believed that the ability to exploit market power and extract monopoly profits provides enterprises with the incentive to compete effectively in the market; and to deprive them of this, will reduce their *ex ante* incentives to innovate and improve efficiency, in their efforts to compete.

The EU legislation on the other hand, does prohibit exploitative abuses, and requires that a monopolist act at all times, as if they were operating in a competitive market. Having said that, the focus of the regulatory effort in the EU has mostly been on exclusionary abuses; and of the limited cases on exploitative abuses, most deal with unfair pricing. There are only few cases on unfair and exploitative contract terms in the EU, for the reason that they have little or no effect on competition itself, although they implicate consumer welfare, and that most member states have their own rules under contract or tort law or have enacted consumer protection laws to deal with exploitative abuses.

The DLF Case and Market Failure

Section 4(2) of the Competition Act lists practices that shall amount to an abuse of dominant position, which includes the imposition of unfair or discriminatory conditions in the purchase or sale of goods or services. From the black letter of the law, it certainly seems, as the Director General, CCI argued in the DLF Case, and the CCI agreed, that it would be sufficient to establish that the enterprise had dominance in the market and had imposed unfair or discriminatory conditions. However, before arriving at a conclusion that there was abuse of dominance, there is one other aspect that may be worth considering - whether such unfair conditions were and could be imposed only by virtue of their dominance in the market. While this does not fall strictly within the scope of the Section 4(2) enquiry, it may be important to keep sight of this aspect, to ensure that competition law stays true to its purpose. In other words, the aggressive application of Section 4(2) without considering the reasons behind the problem of exploitative abuses in that market may lead to counterproductive results (by reducing the incentives for players to participate and compete).

The CCI order does address this point in the DLF Case, but only briefly, and rather unconvincingly. In response to the allegation that DLF could impose such one-sided conditions with impunity and brutal disregard of the consumer because of their dominant position, DLF argued that such terms were market practice and not a consequence of their market power. The CCI, however, dismissed this argument on the ground that DLF was a trendsetter in the market. While it may be true that DLF was the market leader that initiated these now-industry-wide practices, the fact that the rest of the players chose to emulate the leader, rather than strive to capture market share by offering housing on better terms, was indicative of a deeper malaise in the market, particularly considering that DLF held only 55% of the market share. In these circumstances, it seems that the abusive practices that arose in the housing market were not a consequence of lack (or exclusion) of competition in the market, but a failure of competition to act as a restraint on the producers. The CCI was quick to assume that in the face of any player yielding market power, the competitors will follow suit, rather than adopt a more consumer-friendly approach in order to capture a greater share in the market. To assume this however, is to belittle the role of competition in challenging the power of the abusive player and of competition law, to protect the ability of the competitor to do so. More importantly, it sidesteps the underlying problem that resulted in the failure of the market mechanism.

Here, it was, perhaps, the information asymmetry in the real estate market, which affected the ability of consumers to drive competition, resulting in a market failure. In other words, the consumers have insufficient information on the price and quality of products

available in the market and are thus, unable to make informed decisions. One may argue in opposition, that in a well-functioning market, the information gap would be bridged by the competitors, who would along with offering better terms, expose the exploitative terms of the dominant player. However, they are unlikely to undertake such effort, if the resultant benefits (in terms of profit and market share) spillover to the rest of the players in the market. Information asymmetry is particularly pernicious where consumers are unlikely to be repeat players, such as in the present instance. It is important to consider information asymmetry here, because if the consumers are unable to observe the difference in quality across the products (and make decisions solely based on the price), it creates an incentive for firms to distort quality downwards. These factors however, would be true of the real estate market, regardless of DLF's position of dominance; and so, one could argue that DLF (as well as the other developers) were exploiting the information asymmetry in the market, rather than DLF simply exploiting its position of apparent dominance.

Therefore, a finding of market failure cannot, in itself, justify intervention by the competition authorities. Rather, such a situation demands a deeper investigation of whether the market is likely to self-correct in the long run, to eliminate such abusive practices; and if not, the reason for the market failure and whether competition law is the appropriate tool to remedy a market failure of the kind observed. The reason behind the market failure must, therefore, become central to designing the appropriate regulatory response. Coming back to the DLF Case then, the exploitative abuses observed in the market appear to be only a symptom of the underlying information asymmetry; and here, penalizing the market leader, simply for being the leader, seems like a knee-jerk reaction that touches merely the surface of the problem at hand.

While information asymmetry may potentially affect competition in the market, it is not usually considered to be within the domain or interest of the competition authorities, for it is a demand-side problem (Ehlermann and Marquis 2007, 544-545). For such a problem, *ex ante* regulation in the form of disclosure norms and specifications of minimum standards, seems like the more appropriate response, in comparison to an *ex post* imposition of a penalty on the market leader alone. The ineffectiveness (or at least insufficiency) of competition law as a remedy, in this circumstance, is illustrated by the fact that many complainants facing similar problems in the real estate sector were turned away by the CCI because the developer in question was not a market leader (and therefore, not within the powers of the CCI). The real need therefore, seems to be for a regulatory move that applies across the board, to all the players in the market.

The Bill is thus, a crucial piece of legislation, which will likely fill the void that the response under competition law has left behind, in improving the situation of the consumers. It hits at the very heart of the problem in the real estate market; and is therefore, likely to be more effective. That apart, economic regulation (i.e. regulation that controls *inter alia* pricing, terms of sale and marketing practices) of the sort contemplated by the Bill, is usually considered to be the domain of the sector regulator rather than the competition authority, for being both *ex ante* and an ongoing process (Dabah 2011, 115; CUTS International 2008). The fear with regulation is usually that it may raise the quality, and therefore the price, to a standard that is above the level demanded by the average consumer; thus, depriving many of affordable housing options. The other apprehension that is often expressed is the possibility that the regulator may be captured by the industry. Whether these fears prove to be true of the Bill and the Real Estate Regulatory Authority is however, to be seen. In any case, these fears do not take away from the need for regulation itself, and only raise certain points that must be borne in mind while designing regulation.

There remains the question of whether the competition authorities should be precluded from intervening in the market. There is no doubt that one must be circumspect in wielding the power to impose *ex post* penalty, for the possibility of causing irreparable damage to the market, and unwittingly create incentives for inefficient behaviour (Ehlermann and Marquis 2007, 498). It is for this reason also, that the EU has shown self-restraint in hauling up cases of exploitative abuses, although empowered to do so.

The decision in DLF Case, for instance, must have come as a blessing in disguise for the remaining players in the market, who could continue to offer housing at lower prices with hidden, abusive conditions; but without the fear of retaliation from either the CCI (who can only regulate dominant players) or DLF (who will now be compelled to charge higher prices for providing more balanced, consumer-friendly contracts). This suggests a mismatch between the problem at hand and the response, in the DLF Case. One may argue in the converse that, DLF could invest in resolving the problem of

information asymmetry in the market, both by publicizing their improved practices and exposing the malpractices of their competitors, which would compel the other players to also stop their exploitative abuses. However, this is unlikely, considering that DLF would rather invest in distinguishing its own product, than exposing the one-sided contractual terms of each competitor (because DLF would not be able fully internalize the benefits in the latter case). In addition, the information asymmetry along with the general belief that all the developers provide unfair terms is likely to reduce incentives for the other players to improve the quality of their product, if they are unable to distinguish their product as superior in the market. Lastly, even if the market players were to invest in distinguishing themselves, or disparaging others, one would expect the prices in the market to increase, to reflect this investment, which would reduce consumer surplus. All of this again, brings us to ponder on the appropriateness of competition law, in tackling the problem at hand.

Conclusion

Competition law certainly holds the key to stimulating and protecting competition in the market, but may not always hold the answer to a failure of the disciplining mechanism presumed to be inherent in a competitive market. Therefore, it is important to be circumspect in the application of the Act to situations where the exploitative, abusive practices depict a problem other than that of dominance. This is illustrated by the real estate market, where the underlying problem of information asymmetry in the market continues unaddressed, despite the intervention of the CCI in the DLF Case. That many consumers have been left without remedy highlights the limitations of competition law, while also stressing the need for *ex ante* regulation, and a sector regulator who can regulate across the board.

That apart, if we are to follow the DLF Case to its logical end, one likely result is that the remaining players desist from competing effectively in order to be able to exploit the consumers without consequence under the Act. This undermines the very purpose of competition law, while severely compromising consumer welfare, both directly and indirectly. Therefore, this should serve as a warning against aggressive application of Section 4(2) to exploitative practices. While it is certainly hard to take exception to the well-intentioned efforts of the CCI to protect the consumer, one must consider the full implications of such a decision and Section 4(2) of the Act for the future, before rushing forward to laud their efforts.

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