Scope of Beneficial ESG Collaboration under Competition Law in India

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Introduction

Traditionally, businesses have been run with 'shareholder primacy model', which views corporations as investor-owned, thus investors' interest is of paramount importance.[1]An example of the shareholder primacy theory model is *'the business judgement rule'*, which allows the management of a company to make crucial business decision keeping in mind the financial interest of the shareholders or investors.[2]Any discussion on non-financial matters was frowned upon in annual meetings and was never found worthy of any consideration.[3]The popular opinion has been such that the exclusive responsibility of a company's management is towards maximising the

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The Social Responsibility of Business is to Increase its Profits, THENEWYORKMAGAZINE (Sept. 21, 2023, 7:14 PM), https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html.

[2] Thomas Donaldson and Lee E. Preston, The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications,20,AMR 65, 75 (1995).

[3]Wesley Cragg, Business Ethics and Stakeholder Theory, 12, BEQ 113, 114, available at (2002).

returns of its shareholders and the same is constrained due to operation of law and respect towards conventional morality. This view has been supported by a famous shareholder theorist, Milton Friedman.[4]

Nevertheless, a change was seen in this view when scholars began to argue otherwise. Some contended that a corporation not only impacts its investor but also has an impact on other stakeholders, both positive as well as negative. The realisation that there is an involvement of interest apart from that of an investor in the running of a business, called for accountability to protect the interest of these stakeholders.[5]The Stakeholder theorists argue that everyone's interest ought to be counted by the management while conducting the affairs of the corporation.[6] This poses two significant questions: (a) why would the management be interested in catering to the interest of other stakeholders? i.e., what is the incentive?(b) what about the assumption that the primary obligation of the management is to further the interest of its investors?

Here comes the additional competition related question too, which is, if a corporation decides to cater to the interest of all its stakeholders, then it would increase the cost, which in turn would make it harder for it to compete in the marketplace and force it out of the market eventually. The

[4] *Supra Note 1.*

[5] Martin Lipton, Wachtell, Lipton, Rosen & Katz, The Friedman Essay and the True Purpose of the Business Corporation, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE(Sept. 21, 2023, 7:14 PM), https://corpgov.law.harvard.edu/2020/09/17/the-friedman-essay-and-the-true-purpose-of-the-business-corporation/.

[6] Wesley Cragg, Business Ethics and Stakeholder Theory, 12, BEQ 113, 114(2002).

basic premise on which the ESG mechanisms are formulated can find its genesis in the argument put forward by stakeholder theorists. It expects the company to consider certain externalities (like pollution) while making business decisions. This is precisely the reason why businesses refrain from voluntarily complying with the higher standards of ESG, unless these standards are followed across the industry. While mandatory compliance increases the cost across the companies in any industry, going beyond would increase cost of production and make the corporation non-competitive. Nevertheless, businesses are still motivated towards attainment of higher standards of ESG in order to attract investment because nowadays ESG is one of the parameters on the basis of which an investor makes the decision of investing in the shares of a company. The simple reason is that a company that looks after the interest of all its stakeholders are better run and thus attract long term investment.

With this preliminary framework in mind, this paper intends to highlight the challenges faced by businesses in ESG compliance with an anti-trust law analysis and understand if there is any enabling provision under the Competition Act 2002 to help corporations collaborate through agreements (cartel) or otherwise to collectively comply with the ESG requirements, which would help the country achieve its Sustainable Development Goals (SDG) and benefit the economy as a whole. The next part of this article outlines the ESG framework in India and further next would explore the scope of collaboration among companies to achieve higher standards of ESG within the competition law framework in India.

Environment, Social and Corporate Governance (ESG) Framework: An Indian Overview

The ESG framework in India has been ever evolving but it began to take official shape in 2009 when Ministry of Corporate Affairs (MCA) came up with a 'National Voluntary Guidelines on Corporate Social Responsibility'. The aim of this document was to enable the businesses to generate value and sustainability for itself and make positive contribution towards society through socially and environmentally responsible behaviour.[7]It is pertinent to note that one of the core elements enshrined in this document was 'care for all stakeholders' (and not shareholders alone).[8]As the word suggests, on the onset, the activities undertaken were supposed to be purely voluntary that the corporates would wish to do beyond the legislative requirements. The 2009 document was revised in 2011 to make it better suited to the Indian socio-cultural background. The 2011 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Businesses' (NVGs) expected to provide guidance to businesses on what constitutes responsible business conduct.[9]

In furtherance of the same, the Securities Exchange Board of India (SEBI) in 2012 made it compulsory for the top 100 listed companies to file a Business Responsibility Reporting (BRR) for ESG compliance. In 2015, the

[7]MCA, https://www.mca.gov.in/Ministry/latestnewsCSR_Voluntary_Guidelines_24dec2009.pdf(last visited Sept. 21, 2023).

[8]*Ibid.*

[9]MCA, https://www.mca.gov.in/Ministry/latestnews/National_Voluntary_Guidelines_2011_12jul2011.pdf(last visited Sept. 21, 2023).

rule was extended for the top 500 listed companies[10] and in 2019, further extended up to top 1000.

In order to align the NVGs with 'Sustainable Development Goals' (SDGs) and the 'Respect' pillar of the United Nations Guiding Principles (UNGP),[11] the government in 2015 started the process of further revising the NVGs. After revision and updation, MCA, in year 2018, came up with new principles called 'National Guidelines on Responsible Business Conduct' (NGRBC) which sets forth nine core elements that are to be adhered to by the companies in order for them to achieve social, economic and environmental good governance.[12] The core principles are as follows: (1) businesses must be conducted with integrity, (2) goods and services to be provided in a way that it is sustainable, (3) promote the well-being of employees, (4) respect the interest of all stakeholders, (5) promote human rights, (6) make effort to protect environment, (7) businesses must act in responsible manner while engaging in influencing public policy, (8) promote inclusive growth and equitable development and (9) provide value to its customers in responsible way.

In as recent as 2021, SEBI came up with revised reporting requirement on ESG parameters in the form of 'Business Responsibility and Sustainability Report' (BRSR), which has replaced the BRR. This has been done by

[10] MCA, https://www.mca.gov.in/Ministry/pdf/BRR_11082020.pdf(last visited Sept. 21, 2023).

[11] OHCHR, https://www.ohchr.org/sites/default/files/Documents/Issues/Business/Intro_Guiding_PrinciplesBusinessHR.pdf(last visited Sept. 21, 2023).

[12] MCA,https://www.mca.gov.in/Ministry/pdf/NationalGuildeline_15032019.pdf(last visited Sept. 21, 2023

effecting an amendment in Regulation 34(2)(f) of SEBI (Listing Obligation & Disclosure Requirements) Regulation 2015 (LODR Regulations). The aim of new reporting requirement is to seek disclosure from listed companies on their performance against the nine principles mentioned in NGRBC. Reporting under each principle, is divided into essential and leadership indicators. While the reporting on essential indicators is mandatory, reporting on the leadership indicators is on voluntary basis.[13]

As per section 134(3)(m) of the Companies Act 2013, board of directors are mandated to attach a report on conservation of energy along with the annual financial statement submitted by the companies. Amended Regulation 34(2)(f) of SEBI (LODR) Regulations gives statutory backing to ESG enforcement in India. It is evident that the ESG framework in India is rather a recent phenomenon, but it is emerging stronger with every passing year. It started as a mere guideline which was expected to be taken up by the corporations on voluntary basis but now has a statutory backing. The consequence of these enabling provisions is that the companies are required to attach such reports regarding environmental and social accountability, along with the financial statements.

ESG Collaboration vis-à-vis Competition Law

The question that arises for academic deliberation is, whether the Competition Act 2002 has any enabling provision which makes the ESG compliances easier for companies (or 'enterprises' in terms of competition law)? The straight answer to this question is in negative but in the legal

[13] SEBI,https://www.sebi.gov.in/sebi_data/commondocs/may-2021/Business%20responsibility%20and%20sustainability%20reporting%20by%20listed%20entitiesAnnexure2_p.PDF(last visited Sept. 21, 2023).

regime answers are always to be sought in the 'greys' and not 'white or black'. Even though the competition law does not directly facilitate ESG compliance, but it does have certain provisions that might help the enterprises to pave their way to collaborate and coordinate within the legal boundaries. Before answering the former question, the preliminary question for consideration is, why is there a need for competing companies to collaborate to achieve ESG standards?

Why is Collaboration needed to achieve higher ESG Standards?

Generally, companies find no difficulty in complying with the minimum standards of ESG. But they hardly have any incentive to go above and beyond these minimum requirements. It is rather disadvantageous for them to strive to achieve higher standards. To illustrate, if an enterprise that uses coal to generate energy to run its machinery decides to switch to a cleaner fuel to reduce pollution, it would invariably have to increase the price of its products to offset the increased cost that it incurred to use the cleaner fuel. If this process is undertaken by just one enterprise, then its products will not be able to compete with other homogeneous or substitutable product in the same market due to the higher cost. This can be termed as the 'first mover disadvantage'. Now, to arrive at a solution to this problem, if the enterprises decide to collaborate with each other and collectively decide to use cleaner fuel, then the increase in product's price by all enterprises by virtue of the increase in cost of production, would not afford any disadvantage to any single entity.

It may be argued that if we were to achieve higher standards of ESG and help the country achieve SDGs and support government fulfil its international commitments, collaborative efforts by all the stakeholders are required. Stakeholders include governmental bodies, companies, industry associations, civil society and members of the public. Industry associations and market leaders may play significant role in achieving the higher standards of ESG in their respective industries and facilitate collaborative actions from all involved.

Does Competition Law protect ESG collaboration?

Industry level collaborations to achieve higher and better standards of ESG might fall within the mischief of the competition law for twofold reasons: *firstly*, such collaborations would invariably take the shape of a horizontal agreement/cartelization among the enterprises which is prohibited undersection 3 the Competition Act 2002. *Secondly*, the ESG compliance might also result in significant increase in price which may fall within the scope of price cartel with potential appreciable adverse effect on competition and detrimental to the interest of the ‘present’ consumers.

As far as the second reason is concerned, the CCI is not much concerned with controlling the prices of a product in the market as role of CCI is seen as that of the ‘guardian of competition in the marketplace’ and not as a regulator of prices in the market. This view has been reiterated by the Supreme Court of India in its judgment.[14]Nevertheless, what might concern the CCI is the price/non-price cartelization by enterprises to implement the ESG framework under section 3(3) of Competition Act.

It may be argued that such a concerted action/cartel/horizontal agreement/parallelism could be protected under section 19(3) if it could be shown that the same is accruing benefit to the consumers[15] or improving

[14] Rajasthan Cylinders & Containers Limited v. Union of India, 2012 SCC Online SC 1718.

[15] Competition Act, 2002, § 19(3)(d), No. 12, Acts of Parliament, 2002 (India).

production or distribution of goods/services[16] or promoting technical, scientific and economic development.[17]When deciding about the legality of horizontal agreements under section 3(3), the CCI determines the appreciable adverse effect on competition (AAEC) by considering the aggravating[18] and mitigating factors.[19]Though the proof of mitigating factors might work in the favour of the cartel but it is hard to claim that the presence of theses mitigating factors will *ipso facto* lead to a presumption in favour of the concerted or collaborative efforts of the companies. Another question that can be posed is that whether the term ‘consumer’ u/s. 19(3)(d) is wide enough to include even the future consumers or is only restricted to the present consumers?

Further, it may be argued that such collaboration/cartel maybe protected under the proviso to section 3(3) of the Act which provides that if enterprises enter into an agreement *via* joint venture in order to increase efficiency in production, supply, storage etc. then the same would not be prohibited under section 3(3) of the Act.[20]The issue here would not be with regards to adducing evidence in the court to prove increased efficiency in production etc. as the same would still be relatively easier to prove but the problem is, how practical is it to expect the companies to enter into joint ventures with each other for ESG compliance?

[16]Competition Act, 2002, § 19(3)(e), No. 12, Acts of Parliament, 2002 (India).

[17]Competition Act, 2002, § 19(3)(f), No. 12, Acts of Parliament, 2002 (India).

[18]Competition Act, 2002, § 19(3)(a), § 19(3)(b), § 19(3)(c), No. 12, Acts of Parliament, 2002 (India).

[19]Competition Act, 2002, § 19(3)(d), § 19(3)(e), § 19(3)(f), No. 12, Acts of Parliament, 2002 (India).

[20]Competition Act, 2002, § 3(3) proviso, No. 12, Acts of Parliament, 2002 (India).

Another provision of the Competition Act which may protect collaborative concerted actions towards achieving ESG standards is with regards toa combination under section 20(4). There are certain factors that the CCI must consider while determining the AAEC like relative advantage through economic development[21] or if the benefit of combination outweighs the AAEC.[22] The limitation of this provision is again the same, how sound is it to expect the enterprises to enter into combinations (as defined in the Act) for ESG compliances?

It may thus be concluded through the above discussion that the current provisions under the Competition Act 2002 are far less sufficient to encourage collaboration at the industry level in order to achieve higher performance of ESG standards.

Ambiguity under the Competition Law

There are certain provisions under the Competition law that takes into consideration the positive impact on the competition, market or consumers or technical development that these ESG collaborations might have but the question is, does that absolve the enterprises from all liabilities under the competition regime? The answer to this is largely in negative.

The scheme of section 3(3) is such that once it is proved to the CCI that there exists a horizontal arrangement, there is a presumption of AAEC. Though this presumption is rebuttable, thereby shifting the onus of proof on to the enterprises that have entered into the horizontal arrangement, to prove that there is no AAEC, or mitigating factors as set out under section 19(3). The problem with this scheme is twofold: firstly, this would mean that

[21]Competition Act, 2002, § 20(4)(m), No. 12, Acts of Parliament, 2002 (India).

[22]Competition Act, 2002, § 20(4)(n), No. 12, Acts of Parliament, 2002 (India).

irrespective of the intention behind forming the horizontal arrangement, the same would always be subject to the scrutiny of CCI. Secondly, the application of mitigating factors is to the discretion and satisfaction of the CCI, in each case, creating uncertainty of the process.

The current competition law framework is not only insufficient but also uncertain and ambiguous which functions as a barrier in the pursuit of ESG collaboration. The logic is rather straightforward, what would incentivise the corporations to engage in such ESG collaborations if the same would mean extra litigation expense for them and coming under the scrutiny of a regulator which it would ordinarily try to avoid.

So, in order to bring about clarity and certainty to the competition regime in facilitating the ESG collaboration, Parliament may amend the statute to create specific exemption.

Facilitating Beneficial ESG Collaboration: The Way Forward

It is clear from the above discussion that currently competition law lacks any facilitative framework to incentivise the companies to collaborate for ESG compliance and attainment. The need of the hour is to broaden the scope of exemptions under the Competition Act, 2002 in order to make it suitable for ESG collaboration. In order to facilitate the process, the CCI may be authorized to issue guidelines for grant of exemption to ESG collaborations under the mitigating factors u/s 19(3) or alternatively the government may bring an amendment to the present statute and provide for required exemptions(similar to the 'joint venture'[23] and 'export cartel'[24]

[23] *Supra note 20.*

[24] Competition Act, 2002, § 3(5)(ii), No. 12, Acts of Parliament, 2002 (India).

exemption)for 'beneficial collaboration for ESG' so that the companies are motivated to abide by the highest level of ESG compliance.

Similar efforts for instance, have been made in the United Kingdom, where the Competition and Markets Authority (CMA) has come up with a draft document which explains as to how competition law applies to the 'sustainability agreements' among companies.[25] The document acknowledges that there may be circumstances in which collaboration between companies need to be protected under the competition regime for environmental sustainability. To encourage collaboration entered among enterprises to mitigate the climate change, the same may be exempted.

While broadening the scope of exemption in India and making provision for beneficial collaboration, it is to be kept in mind that this collaboration should in no way lead to fixing of market prices or other essential elements of a cartel. The horizontal collaboration should only be exempted to the extend necessary, where it is promoting the industry to adhere to ESG norms like switching to a cleaner fuel or limiting the use of chemicals in textile or cosmetic industry or minimizing the use of plastics in offices or educational institutions etc. The companies should be free to determine their own prices or the quantity of the goods or services or the geographical areas to do business within etc.

It is pertinent to note that the draft document of UK also proposed down certain condition under which an exemption may be granted to the

[25] Gov.uk,https://www.gov.uk/government/publications/environmental-sustainability-agreements-and-competition-law/sustainability-agreements-and-competition-law#:~:text=The%20CMA%20recognises%20that%20collaboration,other%20illegal%20anti%2Dcompetitive%20behaviour (last visited Sept. 21, 2023).

environmental sustainability agreements, meaning thereby that it is not a blanket exemption. The exemption may be granted only if the following conditions are met: (1) benefit to production, distribution, economic progress etc., (2) indispensability, (3) consumer receives fair share of benefit and (4) without elimination of competition.[26]

It is argued that while carving out an exemption in the Indian Competition Act 2002 for beneficial collaboration for ESG purposes, similar checks and balances may be carved out. It would be up to the CCI to adjudge whether the case falls within the exemption or that all the condition set out in the revised Act are fulfilled.

To conclude, the Act must facilitate beneficial collaboration but without making any compromise on the price fixing or limiting production capacity. There must be no adverse directions given by the association/cartel to any of the individual companies for non-abidance with the agreed ESG norms. If the same is allowed to take place, then it would go against the very nature of the competition law regime in India.

[26] Gov.ukhttps://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1139264/Draft_Sustainability_Guidance_document__.pdf(last visited Sept. 21, 2023).