

COMPETITION COMMISSION OF INDIA

Case No. 45/2011

Informant: M/s. Savitri Leasing & Finance Ltd
D-91, Ambabari, Jaipur, Rajasthan

Opposite Parties: 1) Punjab National Bank (PNB)
HO, 7, Bhikaji Cama Place, New Delhi-66

2) PNB, 2, Nehru Place, Tonk Road, Jaipur -15

3) PNB, Raja Park Branch, Jaipur, Rajasthan

Order

Per R. Prasad, Member (dissenting)

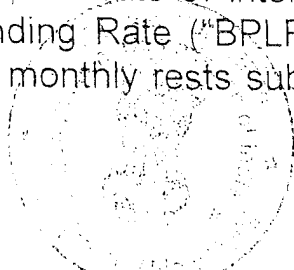
Order under section 26(1) of the Competition Act

M/s Savitri Leasing & Finance Ltd. (hereinafter referred to as 'informant') has filed the present information under section 19 of the Competition Act, 2002 ('the Act') alleging contravention of provisions of Section 3 and 4 of the Act by the Punjab National Bank, Head Office as well as two other branches at Jaipur (hereinafter referred to as OP1, OP2 and OP3).

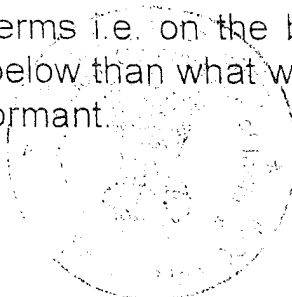
2. The case in brief:

2.1 As per the information, the informant is engaged in the business of purchasing, selling, developing and leasing of immovable property and has been availing banking services with OP3 since December 2004.

2.2 The Informant felt the need for credit facility in respect of a commercial complex, the construction of which was commenced in the year 2005 and thus approached the OP 3 and availed a term loan of Rs.8,70,00,000/- (Rupees Eight Crore Seventy Lac Only). According to informant, the rate of interest on the term Loan was Benchmark Prime Lending Rate ("BPLR") + 0.50% term premia - 2.50% i.e. 8.75% with monthly rests subject to reset clause after 3 years.



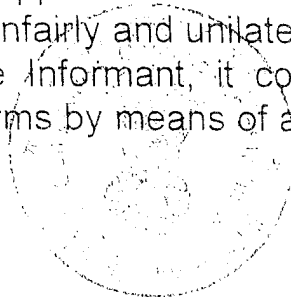
- 2.3 The loan was disbursed and repayment commenced form 06.10.2006 onwards.
- 2.4 The construction for the substantial portion of the aforesaid commercial complex was completed in October, 2006. The Informant vide its letter dated 19.01.2007 approached the OP3 to sanction an overdraft facility of Rs. 20, 00, 00,000/- (Rupees twenty Crore) against lease rent receivable in the next 10 years from the M/s Piramyd Retail Ltd., tenant of a portion of the said commercial complex and proposed to substitute the term loan by the overdraft facility and squaring off the term loan which was agreed by the OP3.
- 2.5 The OP3 granted an overdraft of Rs.14,25,00,000/- (Rupees Fourteen Crore Twenty Five Lacks only) against the primary security of lease rentals as per Lease Agreement dated 05.10.2006 entered into between the Informant and M/s Piramyd Retail Limited for 12 Years along with collateral security in form of equitable mortgage of the immovable property of the Informant. The rate of interest now, was BPLR+ 0.50 term premia % -2.25% i.e. 10.50% p.a. linked to BPLR. The BPLR was subject to change as per bank/RBI guidelines to be circulated form time to time and the Informant accepted the terms and conditions as prescribed in the second sanction letter dated 12.04.2007 vide its letter dated 12.04.2007.
- 2.6 The informant has submitted that after one year, OP3 sent a letter dated 15.02.2008 to the Informant stating that due to hike in the cost of funds the Bank has decided to raise the interest rate to 13.25% in respect of the overdraft of the Informant and accordingly EMI w.e.f March 2008 would be Rs. 21,70,275/- in place of Rs. 19,83,600/-. The Informant replied to the aforesaid letter dated 15.02.2008 stating that he would not be able to pay interest at more than the agreed rate of interest i.e. BPLR+ 0.50 term premia % - 2.25%.
- 2.7 The informant has alleged that from 21.03.2008 onwards PNB started charging interest at the rate of 13% and over 13% in subsequent months even when the rate of interest calculated as per the agreed contractual terms i.e. on the basis of BPLR during the same period was much below than what was being actually charged by the Bank from the Informant.



- 2.8 The Informant, thereafter, vide its letter dated 25.06.2008 objected to the hike in the rate of interest by the OP3 and written that it was unjust and illegal and asked the OP3 to charge interest at the sanctioned rate only and credit the account of the Informant with the excess interest charged till date.
- 2.9 The informant has submitted that OP3 completely ignored the request of the Informant and continued to charge arbitrarily hiked rate of interest from the Informant and never gave the Informant benefit of downward revision in rate of interest even when the BPLR was actually reduced by the Bank.

3. Allegations by the Informant

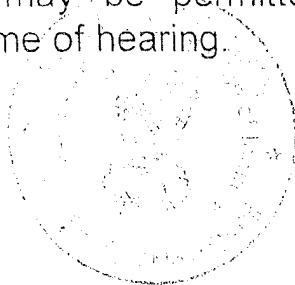
- 3.1 That he could not switch to any other bank or financial institution which may be offering better services, product or loan facilities to the Informant as the agreement has a penalty clause whereby the Informant has to pay pre-payment penalty in the event the loan is being switched to any other bank or financial institution. As per the Informant this falls within the purview of Section 3(1) of the Act. Consequently, the Agreement between the PNB and the informant is void under Section 3(2) of the Act.
- 3.2 The informant has alleged that Opposite Parties have abused their dominant position by way of imposing unfair and discriminatory interest rate and thus, violated the provisions of Section 4(2)(a)(ii) read with Sec 4(1) of the Act.
- 3.3 Allegation has been leveled that OP3, by providing for pre-payment penalty charges on switching over of the loan to any other bank/ FI, indulged in denial of market access to the informant and thus abused its dominant position as per Section 4(2)(c) of the Competition Act, 2002.
- 3.4 The informant has further alleged that PNB has unilaterally, hiked and has been charging higher rate of interest than the rate stipulated in the Second Sanction granted to the Informant without any kind of consent/ approval/ authorization by the Informant. Further, after the Bank unfairly and unilaterally modified the terms of the credit facility to the Informant, it compelled the Informant to accept such modified terms by means of abuse of dominant position



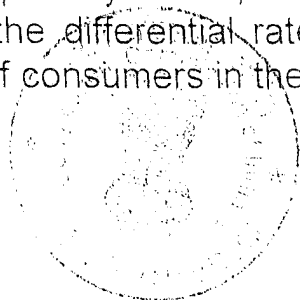
and anti- competitive agreement which is absolutely unjust, unfair and in contravention of the provisions of the Act.

4. Relief sought by the Informant

- 4.1^a To direct the Bank to change interest from the Informant only as per terms and conditions of the agreement based on the BPLR as may be revised by the Bank from time to time.
- 4.2 To direct the Bank to change the rate of interest applicable to the Informant only when there are corresponding changes i.e. increase or decrease in the BPLR.
- 4.3 To direct the Bank to cease and desist the practice of charging higher rate of interest to the old borrowers including the Informant and low rate of interest to the new borrowers.
- 4.4 To direct the Bank to decrease the interest whenever the rate of interest in the market/BPLR goes down.
- 4.5 To direct the Bank to adhere to the terms and conditions of the agreement and more particularly the spread agreed upon between the Informant and the Bank and not to change the spread without consent/ approval of the Informant.
- 4.6 To direct the Bank to correct/ rectify the unjustified charge of interest from original date itself so as to eliminate the cascading effect of the same.
- 4.7 To direct the Bank to compensate the Informant with the cost of legal proceedings including this case before Hon'ble Competition Commission of India.
- 4.8 To provide the Informant the opportunity of hearing before disposal of this case and may be permitted to urge other grounds/ contentions at the time of hearing.



- 5.1 The Commission considered the facts of the case in its meetings wherein the informant was given opportunity to explain the case before the commission.
- 5.2 I have carefully perused the information, the relevant documents annexed with the information, oral explanations made by the informant and other relevant materials available on record.
- 5.3 Though the subject matter of the information is a term loan, the issues involved pertaining to the differential rate of interest and pre-payment penalty are same as dealt with in several earlier cases pertaining to prepayment penalty in home loan cases. Both of these raise competition concerns which I feel a competition authority (CCI) should address. Moreover, the competition commission of India is duty bound to eliminate practices having adverse effect on competition, promote and sustain competition and protect the interest of consumers. Below is the brief of the competition concerns involved in the present case.
- 5.4 Banks increase / decrease rate of interest in line with the trend of prevailing Repo, Reverse repo, SLR and CRR rates. However, banks do not pass the benefit of reduction of the cost of the funds to the existing floating rate interest borrowers. At the same time new customers are lured with the lower rates. Thereby offering differential treatment to old and new customers. It is usual to impose higher interest on the existing borrowers because they are captive and cannot switch to other lenders due to steep switching cost imposed by the bank. Due to such terms and conditions in the agreement, the bank acquires a dominant position over the borrower [Sec. 19(4)(g) of the Competition Act]. This prevents the borrower from switching to other banks and leads to the bank exploiting the existing customers. Almost all the banks and housing finance companies levy pre-payment penalty and borrowers usually cannot withstand various onerous clauses including the one on prepayment penalty. Thus, levy of prepayment penalty clause coupled with the differential rate of interest by the banks leads to exploitation of consumers in the hands of banks.

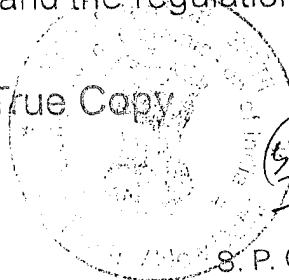


- 5.5 The prepayment clause reduces the chances of switching of the customers. The ability of the customers to switch the banks helps the competitors in offering benefits to customers. Any obstacle which reduces customers' ability to switch banks will correspondingly reduce the competitive pressure on banks. High switching cost may result in increased bank market power and enable the banks to extract a rent from the customers (higher interest rates for existing customers). High switching cost may also constitute barriers to entry as they seem to make it harder for new entrants to attract customers and therefore may discourage new market entry. Further high switching cost may discourage product innovation, as customers are captive and unable to switch to new products and services.
- 5.7 It is relevant here to mention the concept of 'after-market abuse' as enunciated by the U. S. Supreme Court in the case of Eastman Kodak Co. Vs. Image Tech. SVCS504 U.S. 451 (1992). In this case, U.S. Supreme Court was of the opinion that there were two markets viz a foremarket - market of photocopiers where Kodak was not a significant player, and an aftermarket - consisting of after sales service. The US Supreme Court held that in the aftermarket Kodak enjoyed monopoly power. The Supreme Court also held that a customer is "locked in" after the purchase of the equipment as the switching cost are high, the customer can then be subjected to abuse.
- 5.8 The act of levying the prepayment penalty by the Opposite party locks the borrower and prevents the borrower from switching. Switching cost results in increased bank market power and enables the bank to extract extra rent from the customers. This also denies this business to its competitors or new entrants who might be offering better terms or interest rate. This reduces the consumer welfare which is one of the duty of the commission as mentioned in section 18 as well as in the preamble to the Act. This may also hide inefficiencies in banks and distort allocative efficiency. This again defeats the objective of the Act. This may have negative effect on the economic development of the country.
- 5.9 It appears that the main aim of the opposite party is not to allow informant to switch to other institutions. This allows the opposite party to overcharge the informant than the new customer as well as more than the agreed terms. Because of this, competition between the banks is reduced and innovation too is discouraged.

This practice does not allow new banks / institutions with lower rate of interest to garner new busines. Therefore, by charging prepayment penalty, the banks/institutions are following anti-competitive practice which is having an appreciable adverse effect on competition in India. Thus the allegation by the informant that its loan agreement has a penalty clause in case he wishes to switch to another lender, prima facie is anti-competitive and attracts Sec 3(1) of the Competition Act, 2002 and said condition causes appreciable adverse effect on competition among lenders within India.

- 5.10 In view of the foregoing discussion, the allegation made in the information have substance in them. The practice of charging differential rate of interest from new and old customers and not passing on the benefit of rate of interest to the consumers are prima facie unfair and discriminatory. Being in dominant position, bank is exploiting its customers by levying the prepayment penalty. This gives reasons to believe there is prima facie possibility of contravention of Section 4 of the Act.
- 5.11 In view of above, Commission, at this stage is of the opinion that there exists a prima facie case to order the Director General to investigate in to the matter. The Commission, however, makes it clear that the observations made in this order are not final and shall not, in any manner, influence the investigating authority.
- 5.12 Accordingly, the Commission directs the Director General to conduct an investigation into the matter and to submit the report with in a period of sixty days from the date of communication of this order.
- 5.13 The Secretary is directed to send a copy of the order and information to the Director General in terms of the relevant provisions of the Act and the regulations made thereunder

Certified True Copy



S.P. Gahlaut
12/11/2011

S. P. GAHLAUT
Assistant Director
Competition Commission of India
New Delhi