6. A LAW AND ECONOMICS CRITIQUE OF ARTICLE 14 JURISPRUDENCE QUA PREFERENTIAL TREATMENT OF INDIAN PUBLIC SECTOR UNDERTAKINGS

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Abstract

Jurisprudence on the right to equality (Article 14 of the Constitution of India) in India has revolved around the twin test of reasonable classification and rational nexus of this reasonable classification to the object of the enactment. In so far as preferential treatment accorded to public sector undertakings is concerned, Article 14 jurisprudence evolved at a time when India followed a command-and-control economic structure with the Government having a pervasive role in all spheres of economic activity. The unique demands of the economy and the socialistic Mahalanobis model prompted the Courts to view preferential treatment of public sector undertakings as not only permissible, but also desirable in some cases. As a consequence, this preferential treatment was deemed to not violate Article 14 and public sector undertakings were allowed to grow into the slow-moving white elephants they are today partly because of receiving this preferential treatment from the State. However, that context changed in 1991 when India shifted towards a free-market model of economic activity. The free-market model demands fair competition and a level playing field for all economic actors, including those run by the Government. Given this new context, Article 14 jurisprudence needs to be re-thought from a law and economics lens to outlaw preferential treatment accorded to public sector undertakings so as to ensure a level playing field for all economic actors within a particular sector. Removal of preferential treatment of public sector undertakings will result in increased levels of competition, which in turn will increase the efficiency of the industry, make public sector undertakings leaner and promote innovation that will lead to sustainable long-term growth.

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Keywords: *Public Sector Undertakings (PSU), Article 14, economic reform, preferential treatment, law and economics.*

INTRODUCTION

The recent decision of the Hon'ble Supreme Court in *Coal India Ltd. v Competition Commission of India*[1] held that Coal India Ltd. ("CIL"), a central public sector undertaking ("PSU"), is bound by the provisions of the Competition Act, 2002[2] ("Act") and that the Competition Commission of India had jurisdiction to investigate and impose suitable penalties for anti-competitive/monopolistic practices. The Hon'ble Apex Court rejected arguments on behalf of CIL premised on the common good, monopoly status granted to CIL, and support for national policies, thereby according equal treatment to CIL and other private companies as far as the Act is concerned.

This decision prompts thinking on a larger issue of public importance that has implications for constitutional as well as commercial laws in the country, and a significant impact on the functioning of the free market economic structure India has embraced since 1991: Can differential regulatory treatment be accorded to public sector undertakings in comparison to private companies? Does the Parliament have the power to discriminate, or is Article 14 a bar on this power? Should the existing jurisprudence around Article 14 qua PSUs be re-examined with a law and economics lens to mould it for prevailing socio-political and market conditions?

These are the questions that this article shall shed light on. It shall proceed as follows: Section 2 traces the Parliament's power to create monopolies. Section 3 traces the jurisprudence of Article 14 and its impact on preferential treatment accorded to PSUs. Section 4 discusses the decision of the Hon'ble Supreme Court in *Coal India*[3]. Section 5 argues that jurisprudence of Article 14 needs to be rethought from a law and economics lens and the preferential treatment accorded to PSUs ought to be abolished. Section 6 concludes.

[1] (2023) SCC OnLine SC 740
[2] Competition Act 2002
[3] *Coal India* (n 3)

PARLIAMENT'S POWER TO ACCORD PSUs MONOPOLY STATUS

Article 19(1)(g) of the Constitution of India[4] guarantees Indian citizens the right to practice any profession, or to carry on any occupation, trade or business. This freedom can be curtailed by law that permits the State or a corporation owned or controlled by the State to carry on the said profession, occupation, trade or business to the complete or partial exclusion of all others.[5]

In effect, the State is empowered to create monopolies so long as they are in the public's interest. One such parameter of public interest is enshrined in Article 39(b) of the Constitution of India, that the ownership and control of the material resources of the community are so distributed as best to subserve the common good. State monopolies are usually justified on the ground that a centralised, leviathan approach to the ownership and exploitation of certain key resources of the country would best serve the common interests of the society. It is assumed that the State (and its instrumentalities), which operates for societal welfare as opposed to personal profit, will ensure that the said key resources of the country will be utilised in a manner that serves national interests.

At the same time, Article 19(6) imposes the condition of reasonableness on the restrictions that may be imposed by the State on the said right. What is considered reasonable would depend on the facts and circumstances of each case after taking into account the nature of business concerned and the prevailing practices of the said business.[6] Reasonable restrictions would include, under certain circumstances, total prohibition on the aforesaid freedom.[7]

When the State creates a monopoly in favour of a PSU, it creates a situation where the PSUs' incentives get skewed as a result of the lack of competition which otherwise ensures adoption of healthy practices by market participants. These incentives pertain to its pricing mechanisms, internal corporate governance, payments culture, human resource culture, etc. Even though this has a detrimental effect on the market, since the concerned

[4] Constitution of India Act
[5] Constitution of India, art 19(6)
[6] *Golak Nath v State of Punjab* (1967) SC 1643
[7] *Lakhan Lal v State of Orissa* (1977) SC 722

PSU is the only market participant which is otherwise bound to operate in public interest and is assumed to do so (being an organ of the State), Indian constitutional and commercial jurisprudence has been tolerant of this situation.

This has resulted in the general acceptance of differential treatment being accorded to PSUs in their functioning as participants in the free market. Constitutionally speaking, this differential treatment has received the Courts' imprimatur not only under Article 19(6), but also under Article 14.

JURISPRUDENCE OF ARTICLE 14 AND ITS IMPACT

Article 14 of the Constitution guarantees equality before law and equal protection of laws. The right to equality thus protects all persons against discrimination by the State.

However, the Courts have developed the reasonable classification test to enable the State to enact laws, rules, and regulations to govern specific sections of Indian society. While Article 14 prohibits class legislation, it does not prohibit classification based on reasonable grounds. In *Re: Special Courts Bill, 1978*[8] and *State of West Bengal v Anwar Ali Sarkar,*[9] the two conditions required to pass the aforesaid reasonable classification test were set out as follow:

(i) The classification must be founded on intelligible differentia which distinguishes persons or things that are grouped together from others left out of the group;

(ii) The differentia must have a rational relation to the object sought to be achieved by the statute in question.

Therefore, the Court's interpretation throughout has been that Article 14 does not envisage equal treatment of all persons no matter what the differences, but envisages equal treatment of all persons that are similarly situated.[10]

[8] (1979)1 SCC 380
[9] (1952) 1 SCC 1
[10] *Jagannath Prasad v State of Uttar Pradesh* AIR (1961) SC 1245; *Gauri Shanker v Union of India* AIR (1995) SC 55; *M Jagdish Vyas v Union of India* AIR (2010) SC 1596

The reasonable classification test has given the State the necessary constitutional leeway it needed to provide for differential treatment of PSUs. This power has been exclusively upheld by the Hon'ble Supreme Court in *Saghir Ahmed v State of UP*[11] and in *Jhangir v Union of India*.[12] Differential treatment differs from monopoly status accorded to PSUs in 2 key aspects:

(i) In cases of differential treatment, PSUs are expected to abide by a different set of rules and regulations while interacting and competing with other market participants acting in the exact same sphere who are subject to a different set of rules and regulations (often more stringent). On the other hand, in a monopoly, PSUs are the only entity acting in that particular sphere.

(ii) The power to grant monopoly status to PSUs emanates directly from Article 19(6), whereas the power to accord differential treatment emanates from Article 14 and the reasonable classification test. Differential treatment accorded to PSUs may not necessarily lead to some restriction on the private entities engaged in the same business or trade, but creates a distortion in the inter se dynamics of market participants as well as the market structure.

The differential treatment is often justified on the same grounds on which the monopoly status of certain PSUs under Article 19(6) is justified. Since it is assumed that PSUs, being organs of the State, operate for common societal benefit and not private profit, they are entitled to be regulated by a different set of rules to enable them to operate in a manner that would be best suited to achieve their goals. It is assumed that if they are regulated with the same set of rules as other private entities, they will not be able to achieve those societal interest goals.

Given this context, the decision of the Hon'ble Supreme Court in *Coal India*[13] becomes significant as it signals a departure from conventional Indian jurisprudence on the preferential treatment of PSUs.

[11] AIR (1954) SC 723
[12] AIR (1989) SC 1713
[13] *Coal India* (n 3)

THE DECISION IN *COAL INDIA LTD. & ANR.* v *COMPETITION COMMISSION OF INDIA & ANR.*

The Hon'ble Supreme Court had to consider whether CIL and its subsidiaries were governed by the Act, irrespective of them being monopolies.

The Court undertook an extensive review of the law governing competition in India. It explored the history of the Monopolies and Restrictive Trade Practices Act, 1969[14] ("MRTP Act"), which was the predecessor of the Act. It noted that the default condition under the MRTP Act was that it did not apply to an undertaking owned or controlled by the government or a government company.[15]

Thereafter, it noted that coal, being a mineral of vital importance, was nationalised in terms of the Coking Coal Mines Nationalization Act, 1972[16] and the Coal Mines Nationalisation Act 1973[17] ("Nationalisation Act"). It noted the key provisions of the two legislations, as well as various amendments made subsequent to their enactment. It also noted that the Nationalisation Act was inserted in the Ninth Schedule to the Constitution until its removal in 2017,[18] which gave it special protection from attack on grounds of being violative of fundamental rights.[19]

The Court noted that the MRTP Act was thought to be insufficient in light of the changed economic circumstances of the country after the 1991 liberalisation reforms, and the Act came into being as a consequence. While doing so, it noted that the Raghavan Committee, whose recommendations formed the basis of the Act and the CCI, specifically stated that "the object of competition policy is to promote efficiency and maximise welfare. In this context, the appropriate definition of welfare is the sum of consumer surplus and

[14] Monopolies and Restrictive Trade Practices Act 1969
[15] *Coal India* (n 3), para 30
[16] Coking Coal Mines (Nationalisation) Act 1972
[17] Coal Mines Nationalisation Act 1973
[18] *Coal India* (n 3), para 39
[19] Constitution of India, art 31B

producer's surplus and also includes any taxes collected by the Government."[20] It also noted that Raghavan Committee had specifically noted that the monopoly status accorded to PSUs, except in sectors where security and strategic concerns still dominated, was abolished in 1991 and those sectors were open to private sector ownership and investment.[21]

After having delved into and setting out the historical context, the Hon'ble Supreme Court considered the scheme and provisions of the Act.[22] The Court proceeded on the basis that the Nationalisation Act was protected by Article 31B of the Constitution, and that the said law was giving effect to the policy of the State enshrined in Article 39(b) of the Constitution.[23] It noted that the general superintendence, direction, control and management of all the mines vested with CIL.[24]

The Court held that CIL is a person, engaged in activities relating to the production, storage, supply, distribution, and control of goods, and is thus an 'enterprise' as defined in Section 2(h) of the Act.[25] It noted that the only activity beyond the scope of Section 2(h) is that which is relatable to sovereign functions of the Government,[26] which was not the case with CIL. Next, the Court delved into what was meant by the term 'dominant position',[27] and concluded that by virtue of the monopoly in favour of CIL and its subsidiaries,[28] it occupies a dominant position in the market for coal mining.

After exploring the nature of functions performed by CIL, its duties under the directive principles of state policy, and the interplay between the Act and the Nationalisation Act, the Court concluded that bearing in mind the scheme of the Act and the language employed therein, the Act would prevail over the provisions of the Nationalisation Act. It concluded that subjecting CIL and its subsidiaries to the rigours of the Act would not

[20] High Level Committee on Competition Policy and Law, Report of the High Level Committee on Competition Policy and Law (2000), para 2.1.1
[21] ibid , para 2.6.4.
[22] *Coal India* (n3) para 54
[23] ibid para 75
[24] ibid para 77
[25] ibid para 79
[26] ibid para 80
[27] ibid paras 84-87
[28] Coal Mines (Nationalisation) Act 1973 ch II

detract it from achieving its objectives of subserving the common good as well as those enshrined in the Nationalisation Act. It held that it saw "no reason to hold that a State Monopoly being run through the medium of a Government Company, even for attaining the goals in the Directive Principles, will go outside the purview of the Act."[29]

Therefore, the Court set an important precedent in requiring a PSU to play by the rules applicable to all and not seek preferential treatment. The Hon'ble Supreme Court held so on two mains grounds:

i. CIL and its subsidiaries are 'enterprises' as defined by Section 2(h) of the Act, and are thus governed by its provisions; in fact, the Act departs significantly from the MRTP Act in respect of its applicability to government companies; and
ii. The Act overrides the provisions of the Nationalisation Act, and in case of any conflict between the two in respect of obligations imposed on CIL and its subsidiaries, the Act's obligations will prevail; adherence to the Act will not detract a PSU from attaining its objectives under the Nationalisation Act and Article 39(b) of the Constitution.

While the decision in *Coal India*[30] rested primarily on the harmonious interpretation of the two statutes, certain observations made in the said judgement are pertinent for re-examining the larger issue of preferential treatment accorded to PSUs and re-thinking the jurisprudence on Article 14 in respect of the same.

ARTICLE 14 JURISPRUDENCE - TIME FOR A RE-THINK

Constitutional interpretation is always context driven. This is due to the wide nature of the language used therein and the need to ensure its relevance given changes in society, the economy, and technology. The existing jurisprudence on Article 14, with respect to preferential treatment to PSUs, has to be understood accordingly. Starting with the decision of the Hon'ble Supreme Court in *Saghir Ahmed*[31] and *Jhangir*[32], it developed during a period when India followed the planned economy model espoused by the

[29] *Coal India* (n 3) para 117
[30] *Coal India* (n 3)
[31] *Saghir Ahmed* (n 13)
[32] *Jhangir* (n 14)

Feldman–Mahalanobis model. The idea behind PSUs was formulated in the second five-year plan (1956-1961)[33] which focused on the development of the public sector and rapid industrialisation. In fact, the plan envisaged that the State would be exclusively responsible for the development of a large number of industries such as coal, iron and steel, heavy plant and machinery, heavy electrical, aircraft, electricity, etc.[34] This was the underlying socio-political and economic context in which the jurisprudence around PSUs developed.

However, that context changed in 1991. Wide ranging reforms were brought in, and the economic policy's focus shifted from India being a planned, command and control economy to transforming it to a regulated free market welfare state. It was a paradigm shift in India's economic regulatory framework.

Unfortunately, this paradigm shift was not acknowledged by the Supreme Court up until *Coal India*[35]. For example, the question of preferential status given to PSUs came up for the Court's consideration after 1991 in *Indian Drugs & Pharmaceuticals Ltd. v Punjab Drugs Manufacturers Association*[36]. Instead of acknowledging the new socio-political and economic context ushered in by the 1991 economic reforms, the Court stuck to past notions and upheld the preferential treatment of PSUs on the ground that the same was in "public interest". Again, in *Global Energy Ltd. v Adani Exports Ltd.*[37], the Supreme Court refused to strike down the exemptions granted to PSUs, holding that the same could not be equated with private companies and that the differential treatment is based on a rational criterion that cannot be faulted as discriminatory.

This changed with *Coal India*[38]. While the decision was not based on a jurisprudential re-think of Article 14, it acknowledged the new socio-political and economic context and potentially opened the door to re-evaluate the existing Article 14 jurisprudence with respect to preferential treatment of PSUs. The Court explicitly acknowledged that the

[33] Planning Commission, Government of India, '*Second Five Year Plan 1956-1961*' (1956)
[34] ibid ch 2, Sch A
[35] *Coal India* (n 3)
[36] (1999) 6 SCC 247
[37] (2005) 4 SCC 435
[38] *Coal India* (n 3)

current economic condition is in stark variance with that in existence during the formative years of the country's constitution:

"95. We have already noticed the report of the Raghavan Committee. We have also perused the scheme of the Act. We have culled out the consequences, which flow from the Nationalisation Act. The economic condition of the country at the time of its independence in 1947 stands in stark contrast to its condition at varying points of time thereafter. In the initial stages, for understandable reasons, particularly, bearing in mind the need for the State to be the prime mover of the economy, huge investments by the State had to be made. Public sector units became the arm for the State to realize its economic goal, which, at the earlier point of time, was to consist of building up the requisite infrastructure. The public sector units fulfilled more roles than one. Not only were the units to produce goods but they were also burdened with the goal of providing employment. The economic policy of the State had a distinct socialist flavour. No doubt, under the Five-Year Plans, what was contemplated was, a mixed economy. The economy was highly regulated. Out of sheer necessity, perhaps, taxation had to be maintained at high levels. From being a toddler, the economy slowly grew. As the life of the nation progressed, the aspirations of its people, not unnaturally, also expanded. The economic life of a nation can never be perceived in isolation. No nation can remain unaffected by the changes in the state of the world economy. Policies, which are suitable at a given point of time, are not cast in stone. Each generation of people have the right as also the duty to revisit economic policies which found favour with the past. The present cannot put posterity in chains. <u>Equally, the past cannot hold the present hostage to ideas which would then degenerate into what was once original and suitable into dogma which no longer can serve the people.</u>

96. …In the year 1991, the Nation was in a manner of speaking compelled to revisit its economic policy having regard to the precarious condition of its foreign exchange reserves. The permit raj, which involved acute regulation of economic activity by the State with all its attendant evils, cried out for reforms. A slew of

highly liberal reforms in 1991 set the stage for the Nation to make a paradigm shift." (Emphasis supplied)

Successive reforms over the last 3 decades have been ushered in towards meeting that end goal. One key characteristic of free and fair markets is equal treatment of similarly situated commercial actors. This extends beyond the applicability of competition law to PSUs. In order to have free and fair markets, it is necessary that regulations governing the behaviour of similarly situated commercial actors should be applicable to them equally.

What does this imply for the jurisprudence of Article 14 in respect of preferential treatment accorded to PSUs? If the current strand is to continue, then it would afford the State wide powers of discrimination between private actors and PSUs operating in similar sectors. This can have detrimental effects on the functioning of the market. If PSUs are accorded preferential treatment, and are thus not obligated to follow the same strict norms as private players, it creates incentives for private players to also not follow those norms. For example, if PSUs are allowed to follow a comparatively poor corporate governance model, then private players involved in the same industry will be incentivised to do the same. One, they will want to increase their competitiveness by following more relaxed norms, because following stricter norms involves certain costs. Second, by virtue of their interaction with the PSU in some commercial capacity, they will adopt similar modes of functioning that the PSU has established as a market practice. Finally, PSUs following relaxed norms have a signalling effect - they make it normal to deviate from the norm applicable to the rest. While these are all soft incentives, in a country where enforcement capabilities of the State are already limited, they can have a powerful effect on private players' willingness to flout norms applicable to them in order to follow an easier set of rules. Preferential treatment, which translates into lower costs or greater access to resources, unduly skews the market in favour of PSUs. This disruption, not prompted by technological innovation but statutory diktat, limits competition, investment, and research and development by private players. Consequently, the development of the market and the industry gets hampered.

Given that preferential treatment distorts the functioning of the free market and makes it inherently unfair, shouldn't Article 14 jurisprudence qua preferential treatment be re-evaluated from a law and economics lens? We argue that it should. By upholding the preferential treatment as reasonable classification merely because the entity in question is a PSU otherwise performing purely commercial functions, Article 14 jurisprudence continues to be shackled by the pre-1991 economic model. If the society is to truly adopt the free market model, then this jurisprudence ought to be re-examined. The 1991 reforms signal a marked shift in India's socio-political and economic context. The Constitution of India being a living document ought to be interpreted keeping in mind the country's prevailing context.

The Hon'ble Supreme Court's willingness to do so is evident from the fact that it has expanded the scope of Article 21 to encompass various rights not otherwise provided for in the Constitution. An example is the right to privacy.[39] This goes to show that Courts are willing to adopt newer, diametrically different strands of constitutional jurisprudence as societal context undergoes transformation.

There is no reason to limit that practice to matters of civil liberty. In fact, it is the need of the hour that the Constitution be interpreted keeping in mind the new paradigm of the post 1991 era. The existing jurisprudence is not only anachronistic but has the direct effect of undermining one of the key institutions of today's India, i.e., free and fair markets. Therefore, the Courts ought to take a negative view of the preferential treatment given to PSUs and hold it violative of Article 14. Till such time Article 14 permits preferential treatment, the presence of PSUs will continue having an artificially disruptive impact, often a negative one, on market structures. In post 1991 India, constitutional jurisprudence has to accept and propagate equal treatment to all market participants, irrespective of whether they are State owned or not. This has to be held true for PSUs acting in "public interest" or for the "common good", for otherwise they provide sufficient grounds for the State to accord preferential treatment to PSUs even when they are performing purely commercial, business functions. It is tautological to assume that PSUs, being State run entities, are acting in public interest and that this *ipso facto* entitles them

[39] *KS Puttaswamy v Union of India* (2017) 10 SCC 1

to preferential treatment. In fact, even the definition of "common good" has to evolve over time.[40] This was acknowledged by the Hon'ble Supreme Court in *Coal India*[41]:

> *"96. The expression 'common good' in Article 39(b) in a Benthamite sense involves achieving the highest good of the maximum number of people. The meaning of the words 'common good' may depend upon the times, the felt necessities, the direction that the Nation wishes to take in the future, the socio-economic condition of the different classes, the legal and Fundamental Rights and also the Directive Principles themselves. As far as the time dictated content of common good goes, it simply means that 'economics' itself not being bound in chains, but it is a dynamic concept. The attainment of common good would be dependent on the appreciation and understanding of a generation as to how economic common good is best achieved. The debate between the advantages and disadvantages of pursuing the policy of State intervention in economic policy which emasculates private enterprise and competition has almost reached its end. The advantages of a fearlessly competitive economy have been realized by the Nation. There is a backdrop to it. In the year 1991, the Nation was in a manner of speaking compelled to revisit its economic policy having regard to the precarious condition of its foreign exchange reserves. The permit raj, which involved acute regulation of economic activity by the State with all its attendant evils, cried out for reforms. A slew of highly liberal reforms in 1991 set the stage for the Nation to make a paradigm shift. As discussed in the Raghavan Committee Report, things moved further in the direction of attaining faster economic growth. The Act is a measure which is intended to achieve the same. The role which was envisaged for the public sector company could not permit them to outlive their utility or abuse their unique position."*

Today, given the new paradigm, the definition of "common good" has evolved to mean the development of the market in a free and fair manner so that individuals can participate in equal capacity. Only then can the societal interest of economic growth be

[40] *Samatha v State of A.P. & Ors.* (1997) 8 SCC 191
[41] *Coal India* (n 3)

achieved. Preferential treatment to PSUs goes against that objective. In fact, world over, the preferential treatment accorded to PSUs is limited to those performing sovereign functions.[42]

Given that this is the new context in which the Indian State, the economy, and the general public are acting, the interpretation of Article 14 should also be done keeping in mind this context. Otherwise, constitutional law will not grow as far as its applications to commercial issues are concerned, and the ability of Indian markets to grow will be stunted by pre-1991 philosophies. Rethinking the jurisprudence of Article 14 is a way for Indian Courts to respond to its critics that it lacks an economic and commercial perspective in its decision making.

CONCLUSION

The decision in *Coal India*[43] represents a possible breakaway from the past jurisprudence qua PSUs. Earlier decisions of the Hon'ble Supreme Court in respect of Article 14 and the preferential treatment accorded to PSUs originated and was developed in an era marked by extensive control exercised by the government in daily economic activities of individuals. That jurisprudence has to be understood keeping in mind this context.

However, in 1991, that context was flipped on its head with reforms ushering an era of the regulated free market economy. A free-market economy demands equal treatment and opportunities to all market participants irrespective of their size, goals, objectives, ownership, etc. Going forward, jurisprudence of Article 14 in relation to preferential treatment accorded to PSUs needs to change and existing jurisprudence needs to be eschewed. *Coal India*[44], though not in the context of Article 14, is a necessary step in that direction.

Courts need to declare preferential treatment of PSUs in commercial matters an unconstitutional practice. The only exception can be PSUs performing sovereign functions. This is based on the fact that the context in which Indian entities conduct

[42] *Report of the High Level Committee on Competition Policy and Law* (n 22), para 4.2.2
[43] *Coal India* (n 3)
[44] *Coal India* (n 3)

commercial activities has changed. The new context demands equal treatment no matter what. The definition of "common good" and "societal interest" has changed - it demands growth of robust, mature, inclusive and equal market structures so that India can grow unbridled by the shackles of the past. Given that constitutional interpretation is always context driven, Article 14 needs to be interpreted more liberally to protect private entities from preferential treatment given to PSUs. Only then will Courts be able to signal that they too are evolving and adopting a pragmatic, economics-based approach towards commercial disputes.