



Competition Commission of Pakistan

Government of Pakistan

OPINION ON EXEMPTION OF REGULATORY DUTY ON IMPORT OF WARE POTATOES BY INTERNATIONAL FAST FOOD CHAINS FRANCHISEES

1. The Competition Commission of Pakistan (hereinafter the “Commission”) took *suo moto* notice of a news article appearing in The NEWS on 10th March, 2009 wherein Lahore Chamber of Commerce and Industry showed concern about the withdrawal of 25% regulatory duty vide SRO 106 (I)/2006 dated 3rd February 2009 to International Fast Food Chains (hereinafter “IFFC”) franchises operating in Pakistan on the import of ware potatoes, thereby discriminating local fast food chains and other local importers of ware potatoes, and placing them at a competitive disadvantage.¹

FACTUAL BACKGROUND

2. The Federal Board of Revenue (hereinafter the “FBR”) exercising its powers under Section 18 of the Customs Act, 1969 levied a regulatory duty at the rate of 25% *ad valorem* on the import of ware potatoes falling under the Pakistan Customs Tariff (PCT) code 0701.9000 of the First Schedule to the Customs Act of 1969, by issuing a notification SRO 77(I)/2009 dated 29th January 2009 (hereinafter the “SRO 77”). On 3rd February 2009, the SRO 77 was amended *vide* SRO 106 (I)/2009 by carving an exemption from paying 25% regulatory duty on import of ware potatoes by IFFC franchises operating in Pakistan. SRO 77, as amended, is reproduced here below for reference:

S.R.O. 77 (I)/2009 - In exercise of the powers conferred by sub-section (3) of section 18 of the Customs Act, 1969 (IV of 1969) , the Federal Government is pleased to levy regulatory duty at the rate of 25% *ad valorem* on the import of ware potato, falling under the PCT code 0701.9000 of the First Schedule to the said Act.

¹ Withdrawal of duty exemption for foreign fast-food chains demanded, The News, 10 March 2009

2. The regulatory duty shall not be levied on import of potatoes if imported by International Food Chains Franchise (IFFC) operating in the country.

3. The Competition Ordinance, 2007 (hereinafter the “Ordinance”) embodies fundamental principles of free competition which *inter alia* prohibit the application of dissimilar conditions on undertakings competing in a relevant market.² The withdrawal of regulatory duty on imports by IFFC franchisees and not by those of local fast food outlets impinges the fundamental tenet of competition law, *i.e.*, the provision of a level-playing field to all the competitors in a market. The Commission, therefore, took cognizance of the matter, and wrote a letter to the FBR on 9th April 2009 enquiring the rationale behind the imposition of regulatory duty on the import of ware potatoes and the subsequent withdrawal of the said duty to the extent of IFFC franchisees only. However, after waiting for the reply of the FBR for over a month, the Commission deemed it essential to conduct an open hearing in the matter in order to elicit the viewpoint of all concerned undertakings on the matter.
4. Notice for an open hearing, under section 29(c) of the Ordinance, was published in The News and The Dawn on 2nd June 2009, inviting all concerned parties to

² **3. Abuse of dominant position.**-(1) No person shall abuse dominant position.
(2) An abuse of dominant position shall be deemed to have been brought about, maintained or continued if it consists of practices which prevent, restrict, reduce or distort competition in the relevant market.
(3) The expression “practices” referred in sub-section (2) shall include, but not limited to-
...
(e) applying dissimilar conditions to equivalent transactions on other parties placing them at a competitive disadvantage;

4. Prohibited agreements.-(1) No undertaking or association of undertakings shall enter into any agreement or, in the case of an association of undertakings, shall make a decision in respect of the production, supply, distribution, acquisition or control of goods or the provision of services which have the object or effect of preventing, restricting or reducing competition within the relevant market unless exempted under section 5 of this Ordinance.
(2) Such agreements include, but are not limited to-
(d) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a disadvantage;

attend the open hearing on 11th June 2009. Invitations for the hearing were also mailed out to the following to institutions/undertakings:

- i. Member (Customs) FBR
- ii. Siza Foods (private) Limited
- iii. Cupola Pakistan Limited
- iv. Al-Najam Fried Chicken
- v. Pepsi-Cola International (private) Limited
- vi. Metro Cash & Carry (private) Limited
- vii. Makro Habib Pakistan Limited
- viii. Lahore Chamber of Commerce and Industry
- ix. Sialkot Chamber of Commerce and Industry
- x. Faisalabad Chamber of Commerce and Industry
- xi. Islamabad Chamber of Commerce and Industry
- xii. Rawalpindi Chamber of Commerce and Industry
- xiii. Karachi Chamber of Commerce and Industry

5. On 8th June 2009, FBR responded on the matter through a letter stating therein that change in custom duty structure is regulated through the provisions of Customs Act, 1969 by the Revenue Division after due approval of the Federal Government. The letter, however, did not address the question as to why regulatory duty on import of ware potatoes was withdrawn for IFFC franchisees.

6. On 9th June 2009, the Consumer Rights Commission of Pakistan submitted its comments on the matter, which are reproduced below:

- i. The Economic Coordination Committee of the Cabinet imposed a 25% Regulatory Duty on import of potatoes from India, during January 2009. Since Pakistan is self sufficient in potato produce, imposition of 25% regulatory duty goes against the spirit of fair and open competition. This practice has led to worst kind of cartelization in the past, whereby the consumers were often hit hard by the engineered price hikes of essential commodities. We feel that there should be no regulatory duty on such like consumer items so as to encourage consumer focused, healthy competition. Instead of imposing regulatory duty on consumer goods, the government should focus on encouraging and enhancing the local production with best possible quality control, storage facilities and supply chain.
- ii. The FBR has recently exempted IFFC from payment of 25% regulatory duty on import of potatoes. This is yet another

discriminatory and counterproductive step. IFFC which are already earning huge profits are likely to further dominate/frustrate the Local Fast Food Chains. Moreover, this will have a negative impact on local potato produce, without generating a healthy competition.

- iii. Foregoing in view, it is recommended that:
 - a. To encourage a healthy competition, there should be no regulatory duty on essential consumer commodities like sugar, flour, pulses, vegetable oil/raw material, onion, potatoes etc.
 - b. If imposition of regulatory duty is unavoidable due to some financial/technical reason, it should be applied across the board, without any exceptions. Accordingly, exemption of 25% regulatory duty to IFFC by FBR should be withdrawn and all the Fast Food Chains be afforded a level playing field to conduct their business.

7. An Open hearing on the matter was held on 11th June 2009, which was presided over by Member (Monopolies & Trade Abuses) of the Commission.

Representatives of the following undertakings attended the hearing:

- i. Cupola Pakistan Limited (KFC)
Represented by:
 - 1. Mr. Muhammad Usman Rafique, Manager Accounts North
 - 2. Mr. Jawad Akhtar, Manager Retail Development
- ii. Siza Food (private) Limited
Represented by:
 - 3. Mr. Nadeem Ashgar, Manger Import
- iii. Lahore Chamber of Commerce & Industry
Represented by:
 - 4. Mr. Hassan Tanveer Malik, Joint Secretary, Taxation & Regulatory Affairs
 - 5. Mr. Mazhar Elahi, Joint Secretary (R&D)
 - 6. Dr. M. Ejaz Sandhu, Director (R&D)
- iv. K&N's Foods (private) Limited
Represented by:
 - 7. Mr. Khalil Sattar, CEO
- v. Representatives of print and electronic media

8. Participants were given a brief introduction of the mandate of the Commission, particularly its powers under section 29(c) of the Ordinance to hold public hearing on any matter affecting the state of competition in Pakistan or affecting the country's commercial activities. Having explained the purpose behind the Hearing, participants were requested to express their views on the imposition of

regulatory duty on ware potatoes and its subsequent withdrawal only in favor of IFFC franchise.

9. Mr. Khalil Sattar, CEO of K&N's Foods (Private) Limited, submitted that there is no justification why FBR has withdrawn regulatory duty only in favour of IFFC franchise causing discrimination against the local fast food chains and placing them at a competitive disadvantage. He said that the SRO 77 sends a wrong signal to local enterprises. Foreign undertakings are already given incentives on the commencement of business in Pakistan but a constant incentive on the import of their raw material is discriminatory and causes economic and competitive injury to local business enterprises. He said that local enterprises have an apprehension that such benefits will be extended to other items as well which the Chamber of Commerce and Industry would like to protect. On inquiring whether local manufacturers and importers have approached the FBR on the issue, he stated that representation was submitted to the FBR; however no action to remove the exception granted to IFFC franchisees has been taken so far.
10. Mr. Mazhar Ilahi, Joint Secretary (R&D), Lahore Chamber of Commerce and Industry endorsed the point of view of Mr. Khalil and pointed out that there is no cogent reason for the withdrawal of regulatory duty in favor of IFFC and if at all such withdrawal was essential, rationale for it should have been provided in the SRO 77. He challenged the word "International" mentioned in the SRO 77 and expressed his concern that anyone can get an "international" status by opening a branch outside Pakistan. He submitted that such a discriminatory duty restricts healthy competition and harms local fast food chains, which constitute 70% of the fast food market.
11. Mr. Khalil added that competition is affected by supporting IFFC franchisees that are already strong market-players in terms of their goodwill and reputation. Mr. Khalil made the aforementioned submissions on behalf of local manufacturers and importers; however, he informed that his company is not directly affected by the

SRO 77 as it imports frozen and processed goods which fall under PCT codes 2004.1000 and 2004.9000.

12. Mr. Muhammad Usman Rafique, representative of Cupola Pakistan Limited stated that they import processed potato chips for KFC restaurants, which fall under PCT code 2004.1000, therefore their company is neither benefiting from nor being adversely affected by SRO 77 and that they are paying regulatory duty on their imports as per the Customs Act, 1969.
13. Mr. Nadeem Asghar, representative of Siza Foods (Private) Limited also confirmed that they import processed potato chips for their McDonald restaurants covered under PCT code 2004.1000, therefore their company, too, is not affected by the SRO 77 and that they are paying regulatory duties on their imports as per the Customs Act, 1969.
14. Representatives of IFFC franchisees present in the hearing affirmed that the SRO 77 is, *prima facie*, discriminatory and that they have no objection if the benefit of zero regulatory duty given to IFFC franchises operating in Pakistan is rescinded by the FBR. It was further pointed out that the beneficiary of such withdrawal could be manufacturers of potato chips.

ANALYSIS

15. The SRO 77 was issued under Section 18(3) of the Customs Act, 1969, which gives the Federal Government power to impose a regulatory duty on all or any goods imported or exported, as specified in the First Schedule to Customs Act, 1969 by issuing a notification in the official gazette. The relevant parts of section 18 of Customs Act, 1969 are reproduced hereunder:

18. Goods dutiable.- (1) Except as hereinafter provided, customs duties shall be levied at such rates as are prescribed in the First Schedule or under any other law for the time being in force on,-

- (a) goods imported into Pakistan;

(3) The Federal Government may, by notification in the official Gazette, levy, subject to such conditions, limitations or restrictions as it may deem fit to impose, a regulatory duty on all or any of the goods imported or exported, as specified in the First Schedule at a rate not exceeding one hundred per cent of the value of such goods as determined under section 25 [or, as the case may be, section 25A].

(4) The regulatory duty levied under sub-section (3) shall –

(a) be in addition to any duty imposed under sub-section (1) or under any other law for the time being in force;

16. A mere perusal of section 18(3) makes it clear that the power to levy (or withdraw) a regulatory duty is to be exercised in relation to goods specified in the First Schedule to the Customs Act, which are either imported in or exported out of Pakistan. Power under section 18(3) can not be exercised on the basis of parties, *i.e.*, a regulatory duty is imposed or withdrawn on a good regardless of the fact who imports or exports it. The Federal Government cannot, at least under section 18(3) of the Customs Act, carve an exception from paying the regulatory duty for a select group of importers/exporters. SRO 106(I)/2009, amending SRO 77, is thus void *ab initio*.
17. Moreover, the regulatory duty of 25% *ad valorem* for import of ware potatoes by local importers substantially³ raises the price that they have to pay vis-à-vis IFFC franchisees. It is an established principle of competition law that where some purchasers had to pay “substantially more for their goods than their competitors had to pay”,⁴ an injury to competition may be inferred.⁵ Paragraph 2 of SRO 77, by exempting IFFC franchisees from paying 25% *ad valorem* regulatory duty on the import of ware potatoes, created dissimilar trading conditions by substantially raising the price of imported potatoes for local importer, is a source of injury to

³ A regulatory duty of 25% *ad valorem* will increase the price more than the regulatory duty paid, since sales tax (currently at 15%) is levied on the landed cost of an item. For example, if a bag of ware potatoes costs Rs. 100, the regulatory duty will be Rs. 25, so the landed cost of the bag will be Rs. 125. Sale tax at the rate of 15% will be levied on Rs. 125, which will make the cost of the bag for a local importer to Rs. 143.75, as opposed to import by IFFC franchisee, which will be Rs. 100, plus sales tax of Rs. 15 *i.e.* Rs. 115. The difference comes to Rs. 28.75.

⁴ *FTC v. Morton Salt Co.*, 334 U.S. 37, at 46-47, 68 S.Ct. 822, 828-829, 92 L.Ed. 1196 (1948).

⁵ See also *Falls City Industries, Inc. v. Vanco Beverage, Inc.* 460 U.S. 428, 435-436, 103 S.Ct. 1282, 1288-1289, 75 L.Ed. 2d 174 (1983).

competition, violates competition principles enshrined in the Competition Ordinance, and therefore should be withdrawn.

18. The representatives of IFFC franchisees (KFC and McDonald's) present at the open hearing stated that their undertakings are not benefiting, at least presently, from the exemption afforded to IFFC franchisees from the payment of 25% *ad valorem* regulatory duty on import of ware potatoes. One may say that if IFFC franchisees are not benefiting from the exemption then there is no competitive disadvantage for local importers. On the other hand, one could envisage that while IFFC franchisees may not be importing potatoes for their use, the fact that they are eligible to import without the payment of regulatory duty may invite unscrupulous managers to misuse the facility. For this reason, and those mentioned in paragraphs 16 & 17, it makes no sense to keep a discriminatory law on the books.

CONCLUSION

19. In order to ensure free and healthy competition in the market and to create a level playing field for all the market players, it is essential that all undertakings are treated at par. Therefore, it is recommended that regulatory duty on ware potatoes under PCT code 0701.9000 should be imposed equally across the board and that the amending notification SRO 106(I)/2009 be withdrawn so as to put SRO 77 back in its original form.

(DR. JOSEPH WILSON)
Member

ISLAMABAD, THE 19TH OF AUGUST, 2009.