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POLICY NOTE

AMENDMENTS IN REQUEST FOR PROPOSALS FOR TAX STAMPS, MONITORING & TRACKING SYSTEM ISSUED BY FEDERAL BOARD OF REVENUE

1. The Competition Commission of Pakistan (the ‘Commission’) is mandated under the Competition Act, 2010 (the ‘Act’) to ensure free and fair competition in all spheres of commercial and economic activity. Under Section 29(b) of the Act the Commission is empowered to review policy frameworks for fostering competition and to make recommendations for amendments to laws or policies that affect competition in the country.

2. This policy note recommends amendment to Clauses of the Request for Proposals for Tax Stamps, Monitoring & Tracking System (‘the RFP’)[1] issued by the Federal Board of Revenue in order to create a level playing field for all potential participants.

I. BACKGROUND

3. The objective of implementing track and trace system is expounded in the introductory paragraph to the RFP which reads as follows:

> *“In order to prevent leakage of revenue, under-reporting of production and sales, and to ensure proper payment of Federal Excise Duty (FED) and Sales Tax on the manufacture and sale of tobacco products, the FBR has decided to implement program for application and affixation of tax stamps on a range of product*

[1] An RFP outlines the bidding process and contract terms, and provides guidance on how the bid should be formatted and presented. A request for proposal for a specific program may require the procuring agency to review the bids to not only examine their feasibility but also the health of the bidding company and the ability of the bidder to actually do what is proposed.
FBR in the instant matter will follow a single state two envelope process as under PPRA Rules, 2004. The bidder shall submit one package with 2 separate envelopes marked ‘technical’ and ‘financial’ proposal. The procuring agency will first open and evaluate the technical proposals. The procuring agency will open publically the financial proposal for the technically accepted bids.

categories subject to excise taxes, to enable monitoring and tracking of production and sales".

4. Taxes on the tobacco industry are an important source of revenue for the Government and in the year 2015-16, the tobacco industry generated PKR 114.7 billion in sales tax and Federal Excise Duty ('FED'). Cigarettes alone constitute approximately 48 percent of all FED collections making it the single highest contributor[2]. Therefore stopping revenue leakage by means of an effective track and trace system is important for FBR.

5. Pakistan is also a party to the World Health Organization ('WHO') Framework Convention on Tobacco Control ('FCTC') since 2005. WHO FCTC was negotiated under the auspices of the WHO and aims at an internationally coordinated response to tackling tobacco consumption which includes tackling illicit tobacco trade[3]. Article 15.2 of WHO FCTC recommends that parties *"consider, as appropriate, developing a practical tracking and tracing regime that would further secure the distribution system and assist in the investigation of illicit trade".*

6. The salient features of the track and trace system, required by FBR, include:

   a. Serialized secure stamps on tobacco products. The solution provider will deliver coded stamps to the cigarette factories based on production volumes and schedule. On the production line stamp applicator machines (to be provided by the cigarette manufacturers) will affix the coded stamps on each cigarette pack, carton, shipping case and pallet. The solution provider would then provide devices to activate the stamps on the production line.
   b. Once the product leaves the factory premises the representatives of FBR would be equipped with mobile control devices to read the security feature(s) of the stamp to check whether the product is authentic/duty paid or not. The information would then be stored in the device and transferred to a central database.
   c. A specific Track and Trace information data center to be developed, installed and made ready to use (including all hardware and software requirements) under the supervision of FBR.

7. The solution provider will make all investments required (except for stamp applicator machines which are the responsibility of the tobacco companies) and then bill the tobacco companies who will then build it into the final price to be charged to the consumer. The amount to be billed (per stamp) would be determined by FBR.

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[2] Fiscal Policy Statement 2016-17, Ministry of Finance.
[3] http://www.fctc.org/about-fca/tobacco-control-treaty

II. ISSUE

8. It is noted at the outset that a track and trace system to curb illicit tobacco trade which, amongst other negative consequences, places fair businesses at a competitive disadvantage is a welcome step. Therefore, from a competition perspective implementation of the aforesaid system should be encouraged. Such a system should however, ideally operate independently of the tobacco industry (as per FCTC protocols[4]) with control of data center vested with FBR and the cost to be borne by the tobacco industry should not place a disproportionate burden on smaller manufacturers.

9. At the same time, public bodies where undertaking procurement or allowing concessions to private parties, should ensure maximum competition among eligible bidders to achieve best quality and price.

10. The Commission in its Order in the Matter of Show Cause Notice issued to Utility Stores Corporation of Pakistan (Private) Limited on complaint filed by Digital Research Labs (Private) Limited has stated that:

> "*…it is critical to ensure transparency, integrity, and a level playing field in the bidding process in order to maximize societal benefits and enhance economic efficiency as well as competitiveness in the overall market".*

11. In the abovementioned RFP, the Commission has identified several competition concerns which are identified and explained as follows:

    a. Profile of bidders;
    b. Proprietary verification devices;
    c. Requirement for investment; and
    d. Timelines

III. COMPETITION CONCERNS

PROFILE OF BIDDERS

12. The Commission's concern with respect to profile of bidders pertains to high turnover requirement, high capacity/volume requirements and an evaluation criteria that awards maximum points based on (a) projects implemented in number of countries and (b) volume

[4] Article 5.3 of WHO Framework Convention on Tobacco Control

of stamp production and capacity. These issues are discussed in further detail below.

Turnover & Capacity Requirements

13. Clause 4 of the RFP titled –Prospective Bidder's Profile requires :
    "The bidders (in the case of a consortium, at least the Prime contractor) will have to present consolidated yearly revenues above ***USD 100,000,000 (one hundred million).***

14. The Commission is of the opinion that annual turnover requirement of USD 100,000,000 restricts competition since only a few companies would meet the criteria. The provision for forming a joint venture ('JV') does not mitigate the concerns since the lead partner in the JV needs to have turnover of USD 100,000,000 with the insertion of the words "*in the case of a consortium, at least the Prime contractor"*.

15. Clause 4 further states: *The bidders should demonstrate that their in-house coded stamp production equipment's capacity is above* ***10 billion stamps per annum****"*.

16. As per FBR's estimates, the size of the Pakistani market is 85-90 billion cigarette sticks which translates to approximately 4 billion packs therefore, the annual requirement of stamps for Pakistan ranges from 4-5 billion annually. FBR's rationale for the requirement of production capacity of 10 billion is that it plans to scale up the system to cover other products as well and therefore, it needs to ensure that the prospective solution provider has the capability to meet this requirement.

17. This requirement of 10 billion excludes majority of firms from the tender because (a) globally only one firm meets the criteria based on the volume of business it has and (b) the requirement is in excess of the expected total demand.

18. Since both turnover and capacity criteria are mandatory we are of the view that the turnover and capacity requirements would potentially result in only one firm qualifying in the technical evaluation stage. As a result the bid quoted by it would likely be on the higher side as it would face no competition in the second stage i.e. financial proposal.

19. Ensuring that the winning party has solid credentials, capabilities and references is important however, the criteria should not be designed in such a way as to narrow down competition.

20. In the instant matter the impugned clauses have the effect of restricting competition and therefore the turnover and stamp production requirements, in Clause 4, may be revised downwards based on the current market size and a performance commitment obtained from the winning party to gradually scale up capacity to meet demand projections (for tobacco). It is also recommended that a fresh tender be floated when FBR decides to introduce the track and trace system for other products.

21. Alternately, the terms of the JV may be clarified so as to enable two or more firms to jointly meet the turnover and capacity/volume requirements.

Evaluation Criteria

22. The evaluation criteria (Clause 9.2) comprises a total of 100 marks broken down into the following: Bidder's experience – 35 marks; Government approved (certified) product monitoring system –15 marks; Features of the product monitoring system – 20 marks and Cost (Bidder's total price) – 30 marks.

23. Bidder's experience Clause 9.2A. 9.2B and 9.2C is further broken down into subclasses as reproduced below:

    9.2 A—1 If the bidder has applied a product monitoring system in any country before
    (a) If yes, in how many countries and for how many years (6 points if in more than 3 countries for 3 years).
    (b)The volume and capacity of the application (6 points if over 15 billion banderoles per year for different product categories).
    9.2 A –2 If the bidder has applied a product monitoring system for tobacco products and/or beverages in any country before (please specify)
    (a) If yes, in how many countries and for how many years? (4 points if multi-products in 3 countries for 5 years)
    (b) The volume and capacity of the application (4 points if over 15 billion banderoles per year for different product categories).

24. Track and trace for tobacco and beverages have been implemented in the following countries/states: California (implemented in 2005 and an estimated market of 1.2 billion packs annually), Turkey (implemented in 2007 the system is known as 'Turktrace' and applies to tobacco and alcoholic beverages i.e. 5.7 billion cigarette packs, 120 million bottles of wines and spirit and 1.4 billion tins and bottles of beer), Brazil (implemented in 2008 and known as 'Scorpios'. Brazil is one of the largest cigarette producers in the world

with an estimated production of 5.3 billion packs annually)[5], Kenya, Sudan, Morocco, Botswana, Rwanda, Albania, Georgia and Sudan.

25. A particular security printing firm having implemented the major track and trace systems in California, Turkey, Brazil, Kenya, Morocco, Albania and Georgia appears to be the only firm that meets the experience criteria mentioned above giving it an advantage over other competitors since the evaluation criteria focuses on number of countries and volume of banderoles.

26. According to a report by KPMG[6] companies providing track and trace solutions can be divided into two groups – security printing companies and IT/data processing companies (the reason for this is that the solution spans different technologies)[7]. The report notes that, based on the FCTC Protocol, a track and trace system essentially consists of: Generation of Unique Identification Numbers ('UIN'); Marking technologies for embedding the UIN at the unit and aggregate level. This could include Radio Frequency Identification ('RFID') tags, bar codes or a combination of the two and other forensic features; Creation of parent–child relationships (aggregation) to facilitate practical unit level tracking; Data to be captured; Recording of supply chain events and Data capture, transfer and exchange.

27. It is observed that marking technologies constitute just one part of the overall track and trace system but account for a disproportionate share in the evaluation criteria. With the inclusion of volume and capacity of stamps/banderoles, in the evaluation criteria apparently gives one particular firm an advantage over the others.

28. It is, therefore, recommended that the evaluation criteria in Clause 9.2A. 9.2B and 9.2C may also be revised accordingly or redesigned to include marks/points for other elements of the system such as the Data Management System and IT system or equivalent. Furthermore the terms of JV may be clarified so that one or more firms can jointly meet the criteria.

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[5] 'The use of Technology to Combat the Illicit Tobacco Trade—Coding, Verification, tracking and tracing of tobacco products and tax stamps' by Framework Alliance Convention – Fact Sheet. FCA works on the development, ratification and implementation of the international treaty, the World Health Organization (WHO) Framework Convention on Tobacco Control (FCTC). Extracted from file:///C:/Users/mquddus/Downloads/fact_sheet_technology.pdf

[6] Page 44, Track & Trace Approaches in Tobacco, KPMG, 2014.

[7] Ibid Page 42

PORTABLE DEVICES WITH PRELOADED VERIFICATION SYSTEM

29. Once the products leave the factory premises representatives of FBR would be equipped with mobile control devices that would be equipped to read the security feature(s) of the stamp to check whether the product is authentic/duty paid or not. The information would then be stored in the device and transferred to a central database. These checks could be randomly made at any point in the distribution chain from the factory premises to the final consumer.

30. Clause 7.4, of the RFP, lists the mandatory functional and technical requirements of the system and sub Clause 7.4.1.6 –'Offline verification tools' deals with authentication in the field. It states authorized personnel will be provided with "portable devices with pre-loaded verification application, or they might also be carrying a laptop or tablet PC attached to a specific reader. Sub Clause 7.4.1.6.3 further requires the 'single control device' to provide three simultaneous and combined functions.

31. It is observed that there are different technologies available in the market for authentication which can be broadly broken down into: (i) special handheld readers and (ii) smartphones/tablets attached with a special camera and a secure reader application[8]. Both these technologies perform the same functions whereas the special handheld readers are proprietary in nature. In order to enable greater participation in the tender it is recommended that FBR may amend Clause 7.4.1.6 and 7.4.1.6.3 to include the words 'or equivalent' or include option of smartphones with secure application as an acceptable solution.

REQUIREMENT OF INVESTMENT

32. Paragraph 11 of Clause 4 requires that:

> *"The bidder shall confirm that, within one year after signing of the contract, all the security tax stamps will be produced, coded & distributed from within the territory of Pakistan. Moreover, the bidder shall ensure at least 7.5 million dollars investment in Pakistan relating to Track and Trace system within 01 year after signing of the contract".*

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[8] https://authentix.com/industries/tax-stamps/ and 'Track & Trace Authentication System, F/O Security downloaded from https://ec.europa.eu/health//sites/health/files/files/falsified_medicines/2012-06_safety-features/fosecurity_en.pdf

33. The Commission is concerned that this stipulation precludes all international bidders without a current printing facility in Pakistan. Since, at present, there is only one security printing facility in Pakistan which is a JV between the Government of Pakistan and an international security printing company, other bidders would not be able to partner with this facility for production of stamps. Some parties have also expressed concerns over the quotation of a very specific amount of investment in the RFP which they believe has no basis and inhibits entry since it could be seen to favour a particular company.

34. Whereas we do not question the investment requirement completely, FBR may amend paragraph 11 of Clause 4 to include the necessary elements of the system for which investment is required i.e. stating investment requirements in kind. FBR may also, if it deems appropriate, provide suitable incentives for any greenfield investment.

TIMELINES

35. Clause 7.8—'Delivery Timelines requires the track and trace system to be fully implemented in 22 weeks (5.5 months). When queried, most of the potential bidders were of the view that the timelines for implementation are aggressive given the issue of purchase of stamping equipment by the cigarette manufacturers, the prototypes to be tested within 02 months from the contract date, and the large number of scattered production units. We refer here to the terms of reference of the Brazilian Track and Trace solution (Scorpios) where the application equipment for domestic production was the responsibility of the cigarette manufacturer and the total time for implementation was 07 months.

36. The Commission is of the view that the timeline restrictions may limit the ability of firms to participate in the tender. Therefore, it is recommended that the timeline for complete implementation may be extended in light of reasonable concerns raised by stakeholders and to ensure wider participation.

IV. RECOMMENDATIONS

37. Based on the foregoing, FBR may suitably amend the following clauses in the subject RFP:
    a. **Profile of bidders--** Clause 4: revision in turnover and capacity requirements for bidders. Clause 9.2A. 9.2B and 9.2C evaluation criteria may also be revised or redesigned to include marks for other elements of the track and trace system. In addition, the terms of JV may also be clarified to enable two or more parties to jointly meet the criteria laid down.

b. **Portable devices with preloaded verification system**-- Clause 7.4.1.6 and 7.4.1.6.3 may include the words ‘or equivalent’ or include option of smartphones.

c. **Requirement of investment**-- Paragraph 11 of Clause 4 may be amended to state investment requirements in kind and if FBR deems it appropriate, provide suitable incentives for any greenfield investment.

d. **Timelines--** Clause 7.8 timelines may be extended in light of reasonable concerns raised by potential bidders with FBR.

ISLAMABAD, MARCH 9, 2018