

COMPETITION COMMISSION OF PAKISTAN

ENQUIRY REPORT

(Under Section 37 of the Competition Act, 2010)

**IN THE MATTER OF COMPLAINT AGAINST
PAKISTAN ENGINEERING COUNCIL
FILED BY M/S SPI INSURANCE COMPANY LIMITED**

Syed Umair Javed | Maliha Quddus

Dated: 12 August 2015

BACKGROUND

1. The Competition Commission of Pakistan (hereinafter referred to as the '**Commission**') received a complaint from M/s SPI Insurance Company Limited formerly Saudi Pak Insurance Company Limited (hereinafter referred to as '**the Complainant**'), on 16 February 2016, against Pakistan Engineering Council (hereinafter referred to as '**the Respondent**' or '**PEC**') alleging that the Respondent has restricted insurance coverage of public civil works to only 'AA' rated insurance companies which places other insurance companies at a competitive disadvantage. [Copy of the complaint is attached as **Annex - A**].
2. The Commission on 17 March 2015 initiated an enquiry under Section 37(2) of the Competition Act, 2010 (hereinafter referred to as the '**Act**') and appointed Mr Syed Umair Javed, Joint Director and Ms Maliha Quddus, Assistant Director (hereinafter the '**Enquiry Committee**') to investigate the matter for possible violations of of the Act, and to submit a report to the Commission.
3. The Complainant states that it provides insurance coverage to various sectors including industrial, financial, commercial and construction services and it has been rated as 'A-' by the Pakistan Credit Rating Agency Limited (**PACRA**) which denotes strong capacity to meet policy holders' and contract obligations.
4. The Complainant further states that it has been issuing bid securities, performance bonds and third-party insurance etc. in favour of various public departments and entities such as CDA, NLC, PWD, FWO, NHA and others.
5. The Complainant alleges that it has been informed that it cannot procure business from public bodies as PEC has included a restriction in its standard bidding documents that performance security and bid security shall be provided by the contractor to the employer from an insurance company having a 'AA' rating.

6. The Complainant further alleges that the provisions of the standard bidding documents are conflicting. Apart from the abovementioned restrictions relating to bid security and performance security, other conditions of contract such as insurance of works and contractors equipment and mobilization advance do not impose any such restriction of 'AA' rating rather mention insurance as 'any other insurance company' or 'an insurance company acceptable to the employer'.
7. The Complainant issued a legal notice to PEC on 24 December 2014, however, PEC did not respond to the Complainant. The Complainant alleges that PEC has categorized the financial limits of contractors and operators so that almost everyone is allowed to participate in the construction business within its financial limits. Similarly, the clauses in contention provide the option for contractors to secure the bids against guarantees issued by banks, for which no rating requirements have been prescribed. The Complaint further contends that there is no such categorization of insurance companies which is a classic example of applying dissimilar conditions to equivalent transactions placing the other parties at a competitive disadvantage.
8. The Commission wrote a letter to the Respondent on 1 April 2015 asking it to respond to the allegations made in the complaint. [Copy of the Commission's letter is attached as **Annex - B**]. The Respondent submitted its response on 9 April 2015 noting that PEC was a statutory body constituted under the Pakistan Engineering Council Act, 1976, (the 'PEC Act'). It contended that as per the decision of the Executive Committee of National Economic Council (ECNEC) taken on February 2002, PEC prepared the '*Standard Form of Bidding Documents (Civil Works)*' in June 2007. It further contended that this document is applicable to all engineering works undertaken by the federal, provincial departments/organizations and district governments funded locally or through donor agencies. [Copy of PEC's letter is attached as **Annex-C**]
9. The Commission wrote another letter to the Respondent, on 12 May 2015, seeking further clarifications regarding its earlier response and the following additional information:

- a. From which provisions of the PEC Act or the bye-laws made thereunder does the PEC derive its power to impose conditions and requirements on insurance companies that provide guarantee\security\bonds to bidders of engineering works?
- b. When did PEC take the decision to impose the existing 'AA' insurance rating requirement for insurance companies that provide guarantee\security\bonds to bidder of engineering works?
- c. When did the ECNEC approve the existing 'AA' insurance rating requirement for insurance companies that provide guarantee\security\bonds to bidder of engineering works?
- d. What is the rationale behind imposing the 'AA' rating requirement on insurance companies? What outcome does PEC wish to achieve by imposing this requirement? Why has a similar requirement not been placed on other financial institutions providing similar products?
- e. Since the imposition of the 'AA' rating requirement by PEC, has the Insurance Association of Pakistan (IAP) approached the PEC regarding the issue?
- f. In the opinion of PEC, is there a way to achieve the same outcome mentioned in without imposing the 'AA' requirement?

[Copy of the Commission's letter is attached as **Annex - D**]

10. In its reply, received on 27 May 2015, the Respondent stated the following:

- a. The provisions of the PEC Act authorize PEC to prepare bidding documents which could be used all over Pakistan for major and minor contracts. This Act is itself silent on what is to be done in case of seeking guarantees and bonds against bid securities, performance and mobilization advances. As such PEC after

understanding and evaluating the practices followed world over keeps in view like for example the 'FIDIC' form of contracts which defines all the requirements, obligations, rights and liabilities of construction companies. The insurance companies fall under that pattern because bonds/guarantees are normally always sought either from banks or from them. The PACRA in Pakistan keeps the record of insurance companies and fixes limits for their performance which is also followed by PEC as guidelines.

- b. As mentioned above, the limits of insurance companies and their categories were kept in view at the time of preparation of tender documents and requirements of using an 'AA' category company came from there because that suited PEC. In engineering practices, the evaluation of system followed and better things done during the past are kept in view to ensure that in future unwanted things which are those which have not proved suitable in the past are avoided always.
- c. ECNEC approved the tender documents on 12 November 2007 and in these documents requirement of seeking bonds/guarantees from 'AA' rating insurance companies was also approved automatically.
- d. The rationale behind imposing the 'AA' rating requirement is ascertain the strength of the companies and their capability to perform, respond and ensure satisfactory outcome. The PACRA gives the details of rating companies ranging from A to AAA category which are self explanatory.
- e. The IAP did approach PEC but once the matter was explained to them, they did not then insist further on their issues.
- f. It is not possible to achieve the same outcome without imposing the limit of 'AA' category on insurance companies for seeking the bonds/guarantees from them.
[Copy of PEC's letter is attached as **Annex - E**]

11. The Commission also wrote a letter to the IAP on 1 April 2015, seeking their comments on the complaint. [Copy of the Commission's letter is attached as **Annex - F**]. In its response submitted to the Commission on 6 April 2015, IAP informed that it had taken up the matter regarding 'AA' rating of insurance company for issuance of performance security and bid security with PEC. A presentation was made by IAP before PEC where it submitted that all insurance companies authorized by the Securities and Exchange Commission of Pakistan (**SECP**) to conduct insurance business shall be allowed to be able to issue the abovementioned guarantees regardless of their credit rating. It was also noted that only 4 companies (12% of the total at that time) were meeting the aforesaid 'AA' criteria. [Copy of IAP's letter is attached as **Annex - G**]
12. IAP also referred the matter to SECP. The latter referred the matter to its Insurance Reform Committee which later published its recommendations on the matter. IAP noted that it had in November 2014 again requested a meeting with PEC however, despite repeated follow ups the meeting could not be held.

RELEVANT MARKET

13. This matters concerns the products offered by insurance companies to cater to the need of providing bid and performance related security on behalf of civil works engineering service providers to public sector authorities. These insurance products are substitutable, in terms of their characteristics and intended usage, by guarantees provided by banks to the same effect. Accordingly, the relevant product market under consideration is the market for bid and performance security for public-sector civil works engineering services.
14. The Enquiry Committee has not seen any factor, including legislation and regulations, that may vary the conditions of competition all over country with relation to the market for bid and performance security for public-sector civil works engineering services. Both insurance companies and banks are centrally regulated by SECP and State Bank of Pakistan (SBP) respectively. Therefore, the relevant geographic market is the whole of Pakistan.

15. Therefore, the relevant market under consideration is the market for bid and performance security for public-sector civil works engineering services in Pakistan.

ISSUES

16. Based on the facts stated above, the logical question before the Enquiry Committee is whether the decision by PEC to restrict public-sector civil work engineering service providers from procuring bid and performance security from insurance companies with a rating less than 'AA' is, *prima facie*, in violation of Section 4 of the Act.
17. In order to determine the answer to the question above, the Enquiry Committee will be pursuing the following lines of inquiry:
 - a. Whether PEC is an '*association of undertakings*' in terms of Section 2(1) (q) of the Act;
 - b. Whether the '*Standard Form of Bidding documents (Civil Works)*' prepared by PEC can be considered a '*decision*' by an association of undertakings in terms of Section 4 of the Act;
 - c. If yes, whether, the provisions *IB.15 (Bid Security)* and *10.1 (Performance Security)* of the '*Standard Form of Bidding documents (Civil Works)*' are anti-competitive in terms of Section 4 (1), Section 4(1) read with Sub-section (2) (a) and/or Section 4(1) read with Sub-section (2) (f) of the Act.

ANALYSIS

18. The issue of determining whether PEC is an association of undertakings in terms of Section 2(1)(q) of the Act is quite straight forward. The issue itself arises since PEC wears two hats. On one hand, is a statutory body that regulates the engineering profession. On the other hand, it is also a group of people in the similar trade i.e the

provision of engineering services. Accordingly, PEC is both a public body in terms of the PEC Act and an association of undertakings in terms of Section 2(1)(q) of the Act. The distinction at times is unclear and hence we need to look into the nature of the impugned action itself.

19. In determining whether the ‘*Standard Form of Bidding Documents (Civil works)*’ prepared by PEC is a decision by an association of undertakings, we refer to the Commission's Order **In The Matter Of Price Fixing Directive Issued By The Institute Of Chartered Accountants Of Pakistan** (ICAP)¹ where it was held that ICAP, a regulatory, professional body, is an association of undertakings regardless of its public law nature.
20. We use the same approach adopted by the Commission in its order regarding the July Directive issued by ICAP to establish whether PEC acted as an association taking an economic decision rather than a public body taking a regulatory measure. Under this approach the following two aspects need to be established:
 - a. That an overwhelming majority of the members of such a body taking the decision consists of undertakings as defined in Section 2(1)(q) of the Act; and
 - b. That the decision taken by such a body pertains to the sphere of economic activity.
21. We therefore, examine both the organizational composition of PEC and the nature of the decision. PEC is a professional body performing regulatory functions, and has been given its statutory mandate through the PEC Act. PEC's institutional structure is composed of two main organs: (i) the ‘Governing Body’ and (ii) the ‘Management Committee’. Section 9 of the PEC Act states:

¹ Available at <http://www.cc.gov.pk/images/Downloads/Order-%20ICAP.pdf>

"Governing Body:- (1) There shall be a Governing Body which shall be the principal executive authority of the Council for supervising and governing the affairs and functions assigned to the Council by or under this Act and bye-laws".

(2) The Governing Body, besides Registrar, shall be composed of the following sixty-five professional engineers registered with the Council with a minimum twenty years standing, namely:-....."

22. The Governing Body is composed of 65 members excluding the Registrar and includes 2 engineers nominated by the Federal Government, 1 each from Azad Kashmir and Gilgit Baltistan, 1 distinguished engineer nominated by each Provincial Government, 5 Vice Chancellors of engineering universities, 1 President or Chairman Association of Consulting Engineers, 1 President or Chairman All Pakistan Contractors Association or their nominee, 1 Elected President of the Institution of Engineers Pakistan, 40 engineers members to be elected, 1 elected President of Pakistan Engineering Congress and 1 nominee of the Federal Government.

23. Section 9A of the PEC Act concerns the Management Committee, it states:

"Management Committee.- (1) There shall be a Management Committee, to oversee working of the Secretariat to run the affairs of the Council in accordance with the provisions of this Act and bye-laws."

24. The Management Committee consists of a Chairman, Senior Vice Chairman and 04 Vice Chairmen who are professional engineers elected by the Governing Body.

25. A majority of the members of the Governing Body i.e. 50 out of 65 are professional engineers engaged in providing engineering services to the public and private sectors which constitutes an economic activity. These engineers are therefore undertakings as per the definition provided in Section 2(1) (q) of the Act. Similarly all the members of the

Management Committee are engineers elected by the Governing Body. Since all the members of the Management Committee and a majority of the members of the Governing Body are undertakings, and further since the organization is involved in the governing of its undertakings, PEC can be considered an association of undertakings.

26. The second determination is whether the decision taken by such a body pertains to the sphere of economic activity or is characterized as the exercise of the powers generally exercised by a public authority e.g. prescribing ethical standards, ensuring procedural standardization, or serving a similar public purpose.
27. Provisions *IB.15 (Bid Security)* and *10.1 (Performance Security)* of the '*Standard Form of Bidding documents (Civil Works)*' pertain to the procuring of insurance services by public-sector civil works engineering service providers, or conversely the provision of bid and performance related insurance products by insurance companies, which can without doubt be characterized as an economic activity.
28. PEC has alluded to its public-law nature by relying on the perceived regulatory nature of the decision and its approval\endorsement of the Federal Government. As discussed ahead, the contentions by PEC are misplaced.
29. PEC contends that under Section 8 (p) of the PEC Act one of the functions of PEC is '*establishing standards for engineering contracts, costs and services*'. According to PEC the provisions of the PEC Act authorize it to prepare bidding documents which could be used all over Pakistan for major and minor contracts.
30. PEC states it was directed by the decision of the Executive Committee of National Economic Council (ECNEC), taken on 28.02.2002 to prepare a standardized bidding document. PEC stated that it was tasked to '*to prepare a set of country specific six bidding/contract documents to regulate the engineering profession in Pakistan*.' [Please refer to **Annex-C**].

31. It further states that on 21.06.2003 vide SRO 628(I)/2003 an amendment was made in the *Construction and Operation of Engineering Works Bye-laws, 1987* by adding bye-law 7(5) therein which states:

*"For award and execution of an engineering work, the relevant standard form of bidding or tender document prepared by the Pakistan Engineering Council shall be adopted". [Please refer to **Annex-C**]*

32. PEC contends that the bidding documents prepared by PEC were approved by ECNEC in its meeting on 12 November 2007 and notified by the Planning Commission, Planning and Development Division vide SRO 8(60)WR/PC/2008 dated 12.02.2008. It notified that:

'The following revised standard form of bidding/contract documents prepared by Pakistan Engineering Council (PEC) a statutory regulatory body shall be applicable to procurement of all engineering goods, works and services. The federal, Provincial Departments/Organizations and District Government will be responsible to implement the decision of ECNEC.' [Please refer to **Annex-C**]

33. The Enquiry Committee is of the opinion that PEC is confusing its regulatory powers and ECNEC/Planning Commission executive approvals in the domain of engineering standards to create a standardized bidding contract with the specific 'AA' credit rating conditionality imposed on insurance companies. Based on the plain and simple reading of the PEC Act, and the documents relating to approvals by ECNEC\Planning Commission, PEC, on the face of it, does not have any statutory or executive mandate to impose such conditions on its members or the insurance companies.

34. While PEC does have statutory power to create standardized engineering contracts, it does not have the statutory power to regulate bid and performance securities. PEC itself accepts this when it states that *'this [PEC] Act is itself silent on what to be done in case of seeking guarantees and bonds against bid securities, performances and mobilization*

advances' [Please refer to **Annex-E**]. PEC, like any other organization created by a statute, cannot create new powers for itself or expand its power on its own.

35. The Enquiry Committee is of the opinion that the 'AA' conditionality was imposed by PEC in time after ECNEC\Planning Commission gave principled approval for accepting PEC's role in putting forward a standardized bidding contract and the latter is thus insufficient to show any executive sanction. This opinion is based on several reasons. To begin with, despite being asked by the Enquiry Committee, PEC failed to provide any information or evidence indicating that a ministry or committee of the Federal Government approved the 'AA' conditionality imposed by PEC. Furthermore, the Enquiry Committee has seen evidence of instances where up till the year 2015, some public authorities were accepting bid and performance securities from single letter-rated companies, strongly indicating that the 'AA' rating condition was imposed much later than as is being claimed. Had the condition been imposed in 2007, as suggested by PEC, all public authorities should have been well aware of it. [Copies of the relevant documents are attached as **Annex-H**]
36. Regardless of the temporal aspect, even if there was appropriate executive sanction, it could still not have empowered PEC to issue such conditions as the latter is bound to act solely within the statutory powers give under the PEC Act.
37. The lack of any specific statutory power or executive sanction clearly indicates that the PEC was acting in its capacity as a professional body with respect to economic activity, and thus as an 'association of undertakings', rather than a regulatory authority when it took the decision to impose the 'AA' conditionality on insurance companies.
38. Now, a determination needs to be made whether provisions *IB.15 (Bid Security)* and *10.1 (Performance Security)* of the '*Standard Form of Bidding documents (Civil Works)*' are anti-competitive in terms of Section 4 of the Act.

39. Under provisions *IB.15 (Bid Security)* and *10.1 (Performance Security)* only those insurance companies that have a credit rating of 'AA' from PACRA/JCR are eligible to issue bid and performance security. The relevant clauses are reproduced below:

IB 15 Bid Security: 15.2 "The Bid Security shall be, at the option of the bidder, in the form of Deposit at Call or a Bank Guarantee issued by a Scheduled Bank in Pakistan or form a foreign bank duly counter guaranteed by a Scheduled Bank in Pakistan or an insurance company having atleast AA rating from PACRA/JCR in favour of the Employer valid for a period of 28 days beyond the Bid Validity date".

10.1 Performance Security: "...such Security shall, at the option of the bidder, be in the form of either (a) bank guarantee from any Scheduled Bank in Pakistan or (b) bank guarantee from a bank located outside Pakistan duly counter-guaranteed by a Scheduled Bank in Pakistan or (c) an insurance company having atleast AA rating from PACRA/JCR".

40. According to PEC "the rationale behind imposing the AA requirement is the strength of the companies and their capability to perform, respond and ensure satisfactory outcome. The PACRA gives the details of rating companies ranging from A to AAA category which are self explanatory".[Please refer to **Annex-E**].
41. There are currently 41 non-life insurance companies registered with the SECP out of which 5 have a credit rating of "AA", from PACRA or JCR. Under the rating scale of PACRA 'AA-' is below 'AA' if we were to include companies with an 'AA-' rating then the number of insurance companies increases to 7. The IAP in its submissions on the matter to the Commission has stated that in early 2011 when the matter was brought to its notice there were 38 non-life insurance companies registered in Pakistan out of which only 4 had an 'AA' credit rating.

42. The matter was also referred, by IAP to the SECP which in its ‘Insurance Reform Committee Report 2014’ noted that:

7.4 Bank limit assignments and prequalification by various public organizations

"There is also a need to make these banks and public authorities understand that an insurer licensed with SECP is already required under the Insurance Ordinance, 2000 to meet at all times the stringent requirements including but not limited to the paid-up capital, solvency, statutory deposit and adequate reinsurance arrangements which ensures a sound financial footing. Therefore, any such discrimination of denying business to licensed insurers without strong reasonable grounds is seen as unfair and unjustified." [Please refer to **Annex-G**].

43. IAP further argues that although the requirement of ‘AA’ rating applies to bid security and performance security, and not to mobilization advance guarantee bond and insurance of works and contractors' equipment, this creates a glass wall for insurance companies which do not have an ‘AA’ rating. This is because contractors would like to place their risk with companies which can meet all their bond requirements. This view was reiterated by the Complainant.
44. Under the ‘*Standard Form of Bidding Documents (Civil Works)*’ guarantees/bonds for can either be provided through banks or insurance companies however, it may be noted that there is no criteria for ‘AA’ or any credit rating for banks.
45. PEC in its response had indicated that while preparing the bidding documents it had followed international standards for example the Federation Internationale des Ingenieurs-Conseils (FIDIC) form. The Enquiry Committee has examined the pertinent

clauses relating to performance security in the FIDIC Yellow Book² and FIDIC Red Book³ for. The Yellow Book sub-clause 4.2: Performance Security states:

"..If the Performance Security is in the form of a bank guarantee, it shall be issued either (a) by a bank located in the Country, or (b) directly by a foreign bank acceptable to the Employer. If the Performance Security is not in the form of a Bank Guarantee, it shall be furnished by a financial entity registered, or licensed to do business, in the Country".

46. Sub-clause 4.2-Performance Security in the FIDIC Red Book is identical to the abovementioned clauses of the Yellow Book. FIDIC's general clauses on insurance (in the Red and Yellow Book) were also reviewed and there were no conditions placed regarding the rating of insurance companies. The Enquiry Committee is of the opinion that none of the international standards purported to have been followed by PEC include any conditions whatsoever on the rating of insurance parties for engineering contracts.
47. The 'AA' rating requirement on insurance companies, therefore, affects competition in two complementary ways. First it reduces to a great extent the choice available to public-sector civil works engineering services providers when it comes to procuring bid and performance security. Furthermore it ousts a vast majority of insurance companies from being able to compete in the relevant market. This is evident from the sharp decline in number of insurance firms that remain eligible to compete in the market. Consequently, the cost of procuring insurance based bid and performance security increases leading to inefficiency in the market.
48. Second, it puts the insurance companies having credit rating of less than 'AA' at a comparative disadvantage vis-a-vis comparable banks. PEC has imposed no such credit

² FIDIC Yellow Book: Conditions of Contract for Plant and Design-Build-- For Electrical & Mechanical Plant, and for Building and Engineering Works, Designed by the Contractor.

³ FIDIC Red Book: Conditions of Contract for Construction--For Building and Engineering Works designed by the Employer.

rating restriction on banks for providing bid and performance guarantees. As both insurance companies and banks provide similar services, the restriction on the former puts them at a disadvantage in terms of competing in the relevant market.

49. PEC contends that the object of imposing condition of 'AA' credit rating is to ensure that only those insurance companies that have adequate ability to meet their obligations provide the bid and performance guarantees. This rationale is unacceptable for several reasons. First, the insurance sector is already regulated by SECP which has standards and procedures in place to guard against risk-averse behavior of insurance firms. Second, the publically available credit rating of any insurance company is itself a check on the company's ability to insure beyond its ability. Third, if the relevant public sector organization is not satisfied by the insurance coverage provided, it can reject the bids on its own without the intervention of PEC simply by looking at the insurance companies third-party credit ratings. PEC itself admits that the PACRA ratings are 'self-explanatory'. Finally, while credit ratings are also available for banks, no such restriction has been applied to them, clearly showing the weakness of PECs argument. In the opinion of the Enquiry Committee, the only outcome of imposing the condition is its negative effect on competition in the relevant market.

CONCLUSION & RECOMMENDATION

50. Based on the discussion above, the Enquiry Committee is of the opinion that the restriction imposed by PEC on insurance companies not having an 'AA' rating is a decision of an association of undertakings that has the *object and effect of preventing, restricting, reducing, and distorting competition* in the relevant market, which *prima facie* is in violation of Section 4(1) of the Act.
51. The decision also amounts to a *restrictive trading condition* which *prima facie* constitutes a violation in terms of Section 4(1) read with Section 4(2) (a) of the Act.

52. Finally, by allowing banks to provide guarantees without requiring them to hold a specific credit rating, the PEC has also imposed *dissimilar conditions to equivalent transactions*, which is also *prima facie* a violation in terms of Section 4(1) read with Section 4(2) (f) of the Act.
53. The Enquiry Committee recommends that in view of the *prima facie* violation of Section 4 of the Act, the Commission initiate proceedings against PEC under Section 30 of the Act.

Syed Umair Javed, Joint Director
Enquiry Officer

Maliha Quddus, Assistant Director
Enquiry Officer