<u>Enquiry Report</u>

In the Matter of Complaint filed by M/s Lotte Pakistan PTA Limited against Engro Vopak Terminal Limited for Abusing its Dominant Position.

I. Background

1. This Enquiry Report is prepared pursuant to a formal complaint lodged to Competition Commission of Pakistan (hereinafter the "Commission") by M/s Lotte Pakistan PTA Limited (Lotte Pakistan) against M/s Engro Vopak Terminal Limited (EVTL) on August 17, 2010 under regulation 17 (2) of the Competition Commission (General Enforcement) Regulations, 2007 (hereinafter referred to as the "Complaint"). In its Complaint, Lotte Pakistan has alleged that EVTL is abusing its dominant position by charging exorbitant price for its handling and storage facilities and services.

2. Port Qasim Authority (PQA) entered into an Implementation Agreement with EVTL (then known as EPTL) on February 18, 1996 for setting up of integrated liquid chemical terminal and storage farm at Port Qasim and granted EVTL the exclusive rights for thirty years to handle and store all liquid chemicals and gaseous liquid chemicals entering the PQA area (hereinafter referred to as the Implementation Agreement"). EVTL also entered into an agreement with Lotte Pakistan (then known as ICI) to provide Jetty and Storage services for a period of 15 years vide an agreement signed between the both parties on April 04, 1996 for Reception Storage and Delivery of Paraxylene and Acetic Acid (hereinafter referred to as the "Storage Agreement"). Lotte Pakistan is aggrieved of the monopoly of EVTL created in its favour by virtue of the Implementation Agreement as it enables EVTL to charge exorbitant prices and abuse its dominant

position. The allegations leveled by Lotte Pakistan against EVTL appear to violate Section 3 of the Competition Act, 2010 (the "Act").

3. After receipt of formal complaint filed by M/s ABS & Co. on behalf of Lotte Pakistan the Commission initiated an Enquiry in accordance with Section 37(2) of the Act read with Regulation 17(2) of the Competition Commission (General enforcement) Regulations, 2007 in respect of alleged violation of Section 3 of the Act by EVTL. The Commission exercising its powers under Section 28(2) of the Act appointed Ms. Nadia Nabi as an Enquiry officer to investigate the matter as to whether (a) EVTL holds a dominant position and (b) EVTL has abused its dominant position, thereby, violating Section of the Act and prepare a comprehensive Enquiry Report.

II. Undertakings

4. Port Qasim Authority or PQA is a port regulatory authority established under Port Qasim Authority Act, 1973 for making all arrangements for the planning, development and management of Muhammad Bin Qasim Port at Phitti Creek and is an undertaking as defined in clause (p) of sub-section (1) of Section 2 of the Act.

5. M/s Engro Vopak Terminal Limited or EVTL is a joint venture between Engro Chemicals Pakistan Limited and Royal Vopak of the Netherlands engaged, inter alia, in handling and storage of liquid chemicals at Port Qasim and is an undertaking as defined in clause (p) of sub-section (1) of Section 2 of the Act.

III. Relevant Market

6. The relevant market comprises of product market and geographic market in terms of section 2(1) (k) of the Act. The relevant product market for the purposes of this Enquiry Report is a market for the supply of handling and storage services for liquid chemicals entering a port. These chemicals under consideration are specific kind of chemicals which are highly volatile and can vaporize to form an ignitable

mixture in the air and have other corrosive properties. These liquid chemicals are offloaded at a port through a chemical jetty to handle their specifications. Once off loaded they are then stored in purpose built storage farm. Therefore, the relevant product market for the services of handling and storage of highly toxic, explosive and corrosive chemicals, as mentioned above, comprises of a purpose built jetty and storage farm constructed to handle and store these specific kind of chemicals.

7. Determination of relevant geographic market is based on the important factors of supply-side substitutability and demand-side substitutability. Port Qasim Authority area has only one terminal i.e. EVTL for handling and storage of highly toxic, explosive and corrosive liquid chemicals by virtue of the Implementation Agreement. None of the other ports in Pakistan has any readily available appropriate arrangement like EVTL at Port Qsim for handling and storage of liquid chemicals with above illustrated chemical properties. EVTL in its submissions dated February 18, 2011 itself has admitted that the only offer made to Lotte Pakistan by Al-Rahim Terminal at KPT is not comparable to EVTL's facilities for the following reasons:

    i. Less storage capacity
    ii. Inappropriate design code
    iii. Tanks and pipes are not insulated
    iv. Tanks are not equipped with heating coils
    v. No slop handling facility
    vi. No safety arrangements
    vii. No automation system

8. Port Qasim has been developed to cater to different kinds of oil and chemical industry. In the master plan of Port Qasim there is a specific provision of jetties and storage locations for oil, chemicals, edible oil, molasses etc. Considering this aspect, customer of EVTL i.e. Lotte Pakistan made huge investments in setting up their manufacturing plants in the vicinity of PQA to avail handling and storage

facilities for its liquid chemicals that were only offered by EVTL and is, therefore, restricted to EVTL's handling and storage facilities.

9. Once having invested heavily in plant nearby Port Qasim, it is very difficult to switch to other facilities, if any, available at other ports due to environmental hazards and transportation cost and lack of availability of similar facility.

10. More importantly the Implementation Agreement obliges every consumer of EVTL's facilities to use chemical jetty and storage farm as an integrated facility. Such restriction abruptly denies the option of customers to avail any other storage facility, if any, available at other ports or any other part of Karachi. Hence, the relevant geographic market is the PQA area.

IV. Complaint

11. Lotte Pakistan in its formal Complaint filed before the Commission has made following submissions:

   a. In 1995 ICI Pakistan Limited (ICI) decided to set up a PTA Plant at Port Qasim Karachi to cater to the requirements of Pakistani Polyester Industry. This investment was not only to reinforce ICI's global leadership position but also aid Pakistani economy.

   b. The total cost of the Project was US $490 M, which is the biggest investment to date in Pakistan's petro-chemical industry. To set up the PTA plant ICI also had to invest in facilities that are generally provided to by Port Authorities in other countries.

   c. To facilitate its manufacturing process ICI also entered into the following partnerships

      - 15 years Take-or-pay contract with BOC Pakistan Limited (BOC) to procure nitrogen and hydrogen for the PTA plant
      - 15 years Take-or-pay contract with EPTL to procure chemical handling and storage facilities at Port Qasim, while EPTL was in the process of negotiating with PQA an exclusive concession for the storage and handling of chemicals.

d. The PTA plant was commissioned in 1998 however in 2000, ICI demerged it PTA business as an independent entity under the name of Pakistan PTA limited (PPTA). ICI and PPTA continued to remain subsidiaries of ICI plc of the United Kingdom. In 2001 PPTA was listed on three stock exchanges and was recognized as a company. In 2008 AkzoNobel acquired ICI Plc and consequently PPTA became a part of it. In 2009, Lotte, a pre-eminent international Korean group acquired PPTA from AkzoNobel. Consequently the name of the company was changed to Lotte PPTA.

e. On 18th February 1996 Engro Paktank Terminal Limited (EPTL) had entered into the Implementation Agreement with PQA to offer chemical terminal and storage farm facility on a BOT basis. By virtue of the Implementation Agreement PQA granted EPTL a 30 years concession to finance, insure, construct, test, commission, complete, operate, manage and maintain an integrated Liquid Chemical Terminal and Storage Farm in the PQA area. PQA also granted EPTL the exclusive right to handle and store all liquid and gaseous liquid chemicals (except for LPG) entering the PQA area. PQA expressly directed that customers using the jetty be obliged to store the product at the storage farm built by EPTL.

f. When the Implementation Agreement took place, ICI was negotiating with EPTL for a storage facility for Paraxylene and Acetic Acid imported by ICI for its plant's requirements. These negotiations culminated in the Storage Agreement (the "Storage Agreement") on 4th April 1996.

g. The Storage Agreement was to stay valid for fifteen (15) years during which EPTL was to provide ICI with services related to berth at Jetty, reception of products from the ships, their storage and delivery to ICI owned road tankers. By virtue of the Storage Agreement ICI agreed to pay EPTL a fixed amount of US $ 9.2 M per annum in addition to variable cost depending on the quantum of product stored.

h. In recognition of the fact that EVTL was charging higher than international providers of similar Facilities, EVTL issued a letter to ICI stating that if at any time after 7 years and 6 months from the start date of Storage Agreement ICI received a bona fide commercial offer from a reputable international third party to provide services similar to being provided by EVTL on more favorable terms then EPTL would enter into good faith negotiations with ICI to revise the Tariffs under the storage agreement. Given the exclusivity offered to EPTL by PQA no third party was ever in a position to enter the arena and offer ICI better prices. Commitment made by EPTL was therefore meaningless.

i. When Competition Ordinance 2007 (2007 Ordinance) came into existence, ICI and its PTA business had not only demerged but both companies had also been acquired by AkzoNobel. By this time EPTL had changed its name to EVTL to reflect investment by Royal Vopak of Netherlands in the company.

j. To bring the Storage Agreement in conformity with changes in law, PPTA applied to the Commission for an exemption under section 4 of the 2007 Ordinance and was granted such for the entire term of the Storage Agreement to last till 4th November 2012.

k. A few months ago Lotte PPTA (after being acquired by the Lotte group in 2000) approached EVTL to negotiate a renewal of the Storage Agreement in accordance with the terms of the said agreement as the period of the agreement neared end.

l. In those negotiations Lotte PPTA emphasized that EVTL should lower the price of its services based on the following two reasons.

- Lotte PPTA has already Paid to EVTL up till 2009 an aggregate sum of US $133M including US $20M as variable charges and would have paid an aggregate sum of US $170M by the expiry of Storage Agreement in November 2012 as of when EVTL will have recovered sums far in access of the capital expended by them in setting up facilities for storage of Paraxylene and Acetic acid imported by Lotte PPTA.
- Prices being charged by EVTL continue to be far in excess of such services offered elsewhere in Asia as well as internationally (The current price charged by EVTL is US $ 25.60 per tonne of Px, while the price of similar facilities elsewhere in Asia is US $ 5.00 per tonne of Px)

m. In response of these negotiations EVTL has proposed to store Paraxylene and Acetic acid at US $ 21.00 per tonne of Px, which is still excessively high compared with international benchmarks.

n. EVTL is able to take this position and therefore dictate market terms by virtue of the exclusivity granted to it by PQA and the fact that Lotte PPTA has EVTL as the only viable option considering the nature required by Lotte PPTA for storage of the chemicals mentioned above.

o. EVTL has abused its dominant position in contravention of Section 3 of the Act by charging a price for its storage facilities which was far higher than the international or regional price of similar services. ICI had however agreed to pay this price because the specific storage and handling services it required at Port Qasim could only be offered by EVTL as it was the only company that had the permission to build such facilities at Port Qasim.

p. In consideration of services provided by EVTL under the Storage Agreement, Lotte Pakistan has up till 2009 paid EVTL an aggregate sum of US$133,000,000 including US$20,000,000 as variable charges. By November 2012 when the

Storage Agreement expires, Lotte Pakistan would have paid EVTL an aggregate of US $ 170,000,000. This amount more than adequately covers the cost that may have been incurred by EVTL in order to build facilities.

q. Despite this, EVTL is still adamant, on renewal of the Storage agreement, to charge a price which is significantly higher than the international prices. Whilst PTA producers elsewhere in Asia charge US$ 5 per tone of Px the best price that EVTL could offer was US $ 21 per tone of Px- and that too for few services as compared to similar facilities elsewhere.

r. Lotte Pakistan finds itself in a very difficult situation as it has no other option but to liaise with EVTL for the storage as no other party can invest in this sector due to express provisions of the Implementation Agreement. Option to use Karachi Trust Port is not viable for these kind of facilities because it would require transport of 1000 metric tones of highly flammable and hazardous chemicals on daily basis through crowded streets of Karachi which would pose a grave health and security risk to public and environment. Exercising this option would also raise the price of PTA due to high cost of insurance incurred in transport. Further, frequent strikes and unrest in the city may also adversely affect the transportation which in turn may result in shut down of the PTA plant. It was for these reasons that ICI had set up the PTA plant at Port Qasim.

s. EVTL's persistence in charging high prices is disruptive of competition in the market. If Lotte Pakistan is forced to pay high price it will not only constrain for expansion its operation but also would translate into a substantially higher cost for the end user.

V. Reply/Comments of EVTL

12. A copy of complaint was forwarded to EVTL to seek their comments thereon and the same were received vide letter dated October 25, 2010. Submissions made by EVTL in response to the Complaint are summarizes as under:

   a. EVTL was granted a concession to handle and store all liquid and gaseous liquid chemicals entering the PQA area by virtue of an implementation agreement (IA) in February 1996 after a competitive bidding process initiated by PQA in March 1995.

   b. Engro Chemical Pakistan as a joint venture with Royal Vopak (Engro Vopak) has invested US $115M in the terminal infrastructure, most recent being for specialized cryogenic tanks to facilitate ethylene in 2009.

   <u>EVTL's Performance as Chemical Terminal Operator</u>

c. Engro Vopak has invested in a specialized chemical jetty and storage farm of international standards in the PQA area. The company has been operating the Jetty and specialized storage facilities for the last more than 12 years with enviable safety records amongst its peers in Vopak Asia region. By the end of the 3rd quarter of 2010 EVTL has safely handled 9 million tons of chemicals and LPG, 1375 ships and 165,000 road tankers since its commissioning. The characteristics of these chemicals and LPG require specialized handling and excellent operational management.

<u>Tariff Issue with Lotte PPTA</u>

d. The effectiveness of the Implementation Agreement between PQA and EVTL was made subject to the Storage Agreement with ICI (now Lotte PPTA) signed in April 1996. Lotte PPTA has therefore incorrectly alleged that prices agreed to by ICI were a result of exclusivity granted to EVTL as they had the ability to fully explore all other options for import / storage of their chemicals, including building their own jetty.

e. Also when setting up its PTA plant, ICI strongly requested EVTL to proceed with the chemical terminal in anticipation of superior facilities and strong emphasis on safety, health and environment that were non existent at the time. ICI was also impressed with their Joint Venture partner who was the largest private terminal operators in the world and considered experts in the field.

f. EVTL only bid for the terminal project after ICI made a request as they neither wanted to construct their own terminal nor did they find the facilities available at KPT or Port Qasim in accordance with their requirements. Hence "monopoly" of EVTL was not the reason behind the Implementation Agreement or the tariff.

g. The Tariff eventually negotiated was an outcome of extensive negotiations with ICI and our subsequent exclusivity was a consequence of the Storage Agreement signed by them. So the situation is opposite to what Lotte PPTA has alleged.

h. To further elaborate importers who did not wish to use our terminal such as DSFL and RFL (importers of MEG prior to Implementation Agreement) and were obliged to do so after our Implementation Agreement was signed, went into litigation against PQA over a decade ago and we have not had any benefit of their business.

i. However ICI who also imports MEG for their polyester plant entered into a separate agreement with EVTL in 2002 and renewed the same in 2009 after the original 7 year term expired. It did not join other companies in litigation

j. The point being that quality conscious companies are willing to pay a premium for quality terminal services. If ICI requested EVTL to build the terminal it was for this reason.

k. Another point to be noted is that the terminal project was developed based on ICI's specifications including SHE requirements that then formed the basis of tariff eventually negotiated.

l. The way Tariff is calculated is such that an increase in storage utilization results in a decrease in Tariff. ICI had constructed the PTA plant on the basis that its capacity would soon double and as a result it proactively pursued EVTL to build extra storage tanks to cater for that. This cost was built into the tariff with ICI's consent. ICI however did not carry out the expansion that even if it carries out now would reduce its Tariff because of higher throughput and higher turns. For about the same revenue Lotte Pakistan can double the volume of product through EVTL terminal which would effectively render a tariff reduction by about 40 %.

m. With regards to the paragraph in the side letter mentioned in Lotte Pakistan's complaint with regards to renegotiation of tariff in case a reputable international third party offers similar facilities to Lotte at a lower tariff after 7 years and 6 months of the initiation of the Storage Agreement, it was a competitive offer agreed to by EVTL at ICI's request rather than the other way round as alleged by Lotte Pakistan so that ICI could have a chance to prove the tariff was high.

n. Charges paid by Lotte Pakistan in absolute terms provide only partial information as maintaining the facility at international standards requires recurring investments in people, equipment, systems. Stoppage in such investments would compromise the quality of services and could jeopardize the safety and integrity of the port.

o. Keeping in view the initial capital outlay, recurring operating and Maintenance expenses for the upkeep of the chemical terminal and the country risk involved, the returns on the project are extremely reasonable. GOP allows higher Internal rate of return (IRR) IPPs (15%), Wind Power (18%), Thar Coal (25%)) on the equity investment under its power policy to secure against a variety of variables such as exchange rate fluctuations. EVTL is afforded no such protection by the GOP. The actual returns from the project have also turned out to be significantly lower than the ones projected in the financial model provided in the Implementation Agreement.

p. Lotte Pakisan's claim of paying back initial investment of EVTL with highly attractive returns is misleading in that the return is being considered in absolute terms. By actual financial standards, projects are evaluated on the basis of measures such as Internal Rate of Return. Lotte Pakistan only referred to gross revenue while ignoring operating expenses, financial costs and corporate tax. Furthermore the actual returns from the project have been significantly lower than projected in the financial model provided in the Implementation Agreement.

q. Lotte Pakistan states that till the expiry of the current contract, EVTL would have recovered sums far exceed their initial outlay for setting the storage facilities and therefore the tariff they charge after renewal should be bare minimum. We do not see it as the right view as all commercial organizations seek return on investment to meet operational expenses and organization do not reduce their prices on depreciation of their plant. For example Lotte Pakistan plant would be fully depreciated by 2012, would then Lotte Pakistan based on its own proposition start charging its customers less (raw material cost + variable cost basis), as their revenue of USD 4 billion is significantly higher than their initial investment of USD 490 million. The PTA plant of Lotte Pakistan is over Rs 3B as of June 2010.

r. Despite this EVTL has offered significant reduction in its tariff post contract expiry and intends to pursue negotiations in good faith.

s. Lotte Pakistan is under no obligation to renew the contract. At Lotte Pakistan's request EVTL through a written formal proposal on January 1, 2010 offered them rates lower than the existing ones. Subsequently meetings took place between Lotte Pakistan and EVTL in which Lotte Pakistan clarified their expectations and strategy of no further expansion asking for a revised offer which was given to them on June 1, 2010. The Lotte PPTA team did not revert back to us with a counter offer.

  - The comparison with similar facilities available internationally is not correct as constructions costs in Pakistan are higher due to a variety of variables such as higher cost of importing specialized material and country risk. Furthermore Tariff calculations are based on throughput volumes, which the case of PTA plant as compared with their counter parts in other countries.
  - Furthermore as per Lotte Pakistan's own acknowledgement the quality and safety standards being offered at storage and handling facilities at Karachi port do not measure up in comparison with those of EVTL.

t. It is in view of these factors that EVTL could not offer tariffs comparable to regional market, but in two meetings with Lotte Pakistan options were discussed by which effective tariff could be reduced and a win-win situation reached, however Lotte Pakistan did not respond to our revised proposal of June 1, 2010 and instead took the step of contacting BOI and CCP.

u. The comparison provided by Lotte Pakistan in annexure D of complaint is not correct, in that it doesn't properly reflect other factors such as waiving $ 2m off its variable tariff by EVTL. Thus the actual reduction in June 1, 2010 proposal is more than 25%. Acetic Acid Tariff at Al Rahim is incorrect which should be about US $ 30 / ton based on the unsigned quote attached

v. EVTL's exclusivity has hardly any reliance to renewal of Lotte Pakistan contract as a few miles away at Karachi Port Trust jetties are available to unload chemicals. Storage facilities can be built and are already there allowing Lotte Pakistan the option to shift their businesses to KPT if they so desire.

w. Lotte Pakistan has provided quotes from Al Rahim Tank Terminal (Pvt.) Limited that is lower than EVTL proposal of June 1, 2010. There is no comparison between the services offered by EVTL and Al Rahim. EVTL services are far superior in quality as they follow international standards.

x. Lotte Pakistan admits if their raw material is imported at Karachi Port Trust, their transportation and insurance cost will increase. It means Lotte Pakistan saves significant cost in shape of transport and insurance premium besides hassle of transportation. In addition to this Lotte Pakistan can lay pipe from EVTL to their plant for transfer of chemicals which will result in significant savings to Lotte Pakistan.

y. Current tariff is less than 2.75% of the cost of production of PTA and has no material impact on the price of PTA to buyers in Pakistan. PTA is sold at international prices and not based on actual cost of production and reasonable return on investment. The matter is of a pure commercial one between the parties.

z. EVTL strongly rebuts the contention that it is acting in violation of Section 3 of the Act for the following reasons:

   i. EVTL is not dominant due to availability of other options for handling of its products, available to Lotte Pakistan. Karachi Port Trust is available and Lotte Pakistan has obtained offer from an operator there. The bulk of Pakistan's imports including dangerous goods are still made through Karachi Port Trust and recent construction of the link roads bypassing Karachi has eliminated the factor of safety.

   ii. Even if EVTL is dominant, intervention of the Commission is not required as Lotte Pakistan has other options available as mentioned above.

iii. The comparison between EVTL's proposed charges and that of other terminals in Pakistan and abroad is not appropriate for the reasons explained.

iv. There is no public policy or competition issue involved as this is a private contract, effects are which do not transcend into the public domain. EVTL's charges presently comprise only around 2.75% of the cost of production and will reduce further once new rates come into effect in December 2012. Thus there is negligible effect of the EVTL tariff on consumers of PTA who anyway are only 3 or 4 companies.

v. The Complainant is asking for two things from the Commission. First is removal of exclusivity and secondly fixation of charges. it is not the policy of the Commission to fix prices or tariff.

vi. It is not sufficient to merely make a comparison between tariffs being charged and costs of providing the services since the economic value of the service must also be taken into account.

vii. The Commission can intervene only if terminal operator is also involved in downstream market and is charging excessive tariff to Lotte Pakistan to its business uncompetitive versus its own. There is no such situation.

VI. Comments of Lotte Pakistan on EVTL's Reply

13. EVTL in its reply to Compliant, took a different stance on the factual position, in particular, in respect of tariff issues with Lotte Pakistan. Therefore, Lotte Pakistan's comments were invited vide letter dated December 03, 2010 and the same were received on December 13, 2010. Rebuttal of Lotte Pakistan is summarized as under:

a. It is stated by way of clarification that the investment of US$ 115,000,000 may, in the absence of any information provided by EVTL, be inferred as being the total investment made by EVTL from the inception of the project to date. Furthermore, any reference to this investment is irrelevant because the Storage Agreement was based on the capital cost originally incurred by EVTL which is much lower than the US$ 115,000,000 in setting up the facility.

b. It is pertinent to state that as per Lotte Pakistan's understanding, EVTL is charging its sister concern, EPCL, a tariff substantially more favorable than that it is charging Lotte Pakistan for comparable services to Lotte Pakistan under Storage Agreement.

c. It is denied that prices agreed to by ICI in 1996 were not due to the exclusivity of the Implementation Agreement. All prices under the Storage Agreement were negotiated in light of the underlying agreement between PQA and EVTL. Given that only EVTL had authority to construct and operate facilities at Port Qasim, ICI had no choice but to deal with EVTL and on the prices dictated by EVTL at the time. While it is theoretically plausible to argue that ICI had other options, practically this would have been entirely unviable due to the cost and time factor involved.

d. It is stated that the Storage Agreement does not state anywhere the formula for computing the tariff and Lotte Pakistan has been concerned for some time that the tariff being charged by EVTL is far in excess of the original understanding between both parties at the time of entering into the agreement. It is pertinent to mention that when Lotte Pakistan approached EVTL for clarification, it point blank refused to offer any help. It is also pertinent to mention here that even during the negotiation for renewal of the Storage Agreement; EVTL has refused to consider international benchmarks in price determination. Difference between international bench marks and EVTL's revised rates is substantial. In the absence of any information provided as to the basis of tariff, it would be considered admission on the part of EVTL that tariff is based on the actual capital cost of the facilities.

e. It is specifically denied that storage facilities are under-utilized which has resulted in a higher tariff as compared to elsewhere in the region. Since commencing its operation, Lotte Pakistan has exceeded the minimum level of throughput at all times that is required under the Storage Agreement. Even otherwise level of utilization is irrelevant as the Storage Agreement is a take-or-pay contract and provides for Lotte Pakistan paying minimum monthly payments based on maximum throughput. Lotte Pakistan has guaranteed EVTL these payments irrespective of its actual throughput and in this manner has reimbursed EVTL for much more than the capital cost incurred by it.

f. EVTL has resisted every effort by Lotte Pakistan to understand the IRR being charged by it under the Storage Agreement. EVTL's reference to GOP protection against various currency and interest rate risks for Independent Power Projects is fallacious in relation to the Storage agreement. The Storage Agreement is a dollar based contract and gives rise to US dollar cash flows with IRR which is much higher than the US dollar interest rates prevailing at any time since inception of the Storage Agreement to date, thereby eliminating any currency or interest rate risks.

g. EVTL optimized the jetty tariff not as special favour to Lotte Pakistan but because EVTL had other customers for using the same facilities as a result of which EVTL was obliged in terms of Storage Agreement to reduce Lotte Pakistan's tariff for the shared facilities accordingly.

h. Lotte Pakistan reiterates its claim that EVTL will have recovered its initial investment with high attractive returns by the end of the Storage Agreement. While EVTL accepts tariff computed by applying an IRR equal to capital cost gives rise to gross revenues but it fails to specify the IRR on the basis of which tariff was computed or indeed what the actual capital cost of project was. EVTL has failed to provide information which it is required to give under the Storage Agreement. As per the information now available to Lotte Pakistan, not only the actual cost of the dedicated facilities lower than the cost on which tariff has been computed but also that the IRR of over 25% is substantially higher than the IRR of 15% which appears to have been agreed with ICI. EVTL has already admitted that the GOP allows a higher IRR of 15% for IPPs etc. Therefore, EVTL is admitting that Lotte Pakistan is being charged an IRR (25%) which is not on the higher side but is exploitative. It is further stated that EVTL's contention that projects are evaluated on the basis of net return is correct. EVTL has however failed to establish the manner in which it has priced its own project. Nowhere in the Storage Agreement have the words "net returns" been used while referring to IRR- that clearly shows that the term IRR denotes gross and not net returns and EVTL's reference to net returns is irrelevant.

i. EVTL is charging US$ 26 per tonne under the Storage Agreement whereas operators of similar terminals in Europe, China and the Far East are currently charging in the range of US$ 4 – 7 per tonne. EVTL is trying to mislead and obfuscate the facts regarding reduced tariff proposed by the in negotiation for renewal of the Storage Agreement. The correct position is as follows:

   Paraxylene

   Existing tariff comprises:
   (1) Fixed component of US$ 19.7 per tonne, plus
   (2) Variable component of US$ 5.94 per tonne.
   Total Tariff: US$ 25.64 per tonne.

   As per EVTL's quotation of 1June 2010 the fixed and variable components have been combined to give a single number of US$ 21 per tonne.

j. It is stated that quotation from Al Rahim Tank Terminal (Pvt) Limited is in respect of a new facility which it will set up to meet Lotte Pakistan's and globally safety standards.

k. EVTL is charging a substantially lower IRR on the dedicated facilities set up for one of its sister companies, EPCL, within EVTL's existing premises for similar services being rendered to EPCL.

VII. EVTL's Rebuttal

14. Comments received from ABS & Co on behalf of Lotte Pakistan were forwarded to EVTL to seek their clarification. EVTL in its letter dated February 09, 2011 requested for extension in the date of submission of para-wise reply and later on, on February 18, 2011 submitted a detail rebuttal. Para-wise comments of EVTL are summarized as follows:

    a. EVTL terminal would not have been built without the Storage Agreement with Lotte Pakistan. It is incorrect to state that ICI funded the setting up of the terminal; rather all investment required to meet the requirements of ICI was funded by EVTL based on the Storage Agreement.

    b. It is correct that EVTL has made a total investment of Rs.5.5 billion to date.

    c. Following users other than Lotte Pakistan have been using the facility successfully based on availability of reliable, efficient and safe terminal operations:

        i. ICI Pakistan Ltd. (MEG imports)
        ii. Fauji Fertilizer Bin Qasim Ltd.
        iii. Engro Polymer & Chemicals Ltd.
        iv. LPG importers
        v. Dewan Salman Fibres Ltd. (now shut down)

       The benefits are apparent insofar as ICI (Polyester) who were importing their chemicals through KPT, actually shifted to EVTL's terminals and have been satisfied with the services received inspite of high charges paid to EVTL as compared to those at KPT.

       We categorically deny that Engro Polymer & Chemicals Ltd (EPCL) tariff is more favorable than Lotte Pakistan. It is a policy of EVTL that contracts with subsidiary or affiliated business are taken at an arm's length. EPCL's fixed tariff is over US$ 100 per ton with minimum guaranteed volumes of 72,000 tons. Whereas Storage Agreement with Lotte Pakistan does not provide for any change in fixed tariff rate even in case the import volumes increase i.e. in case Lotte Pakistan's throughput volume exceeds 280,000 tonnes per annum, Lotte Pakistan will be charged the same amount. This would have facilitated expansion of Lotte Pakistan's plant as projected by it and fourth tank was built in advance by EVTL in anticipation of capacity increase.

       In order to understand the tariff, one needs to understand the operating environment, country risk etc. EVTL handles dedicated products for dedicated customers which require dedicated facilities for such products. Cost of such dedicated facilities coupled with underutilization results in higher tariff.

d. It is denied that Lotte Pakistan made a decision to use facilities at PQA as KPT was very much available for construction of the required facilities and was evaluated by ICI at that time. EVTL was able to offer superior facilities which is why Lotte Pakistan entered into the Storage Agreement.

   Lotte Pakistan in fact is aimed to create pressure for negotiating commercial terms for duty protection from government and misrepresenting facts by giving impression that ICI v/s EVTL has created this infrastructure for Pakistan and has paid 3/4/5 times the investment by EVTL. Government of Pakistan can also claim that to a 200 MW IPP with a 30 years PPA and sovereign guarantees, it has paid over US$3.6 billion for a plant of worth US$175 million.

   References to international prices are irrelevant and it is also denied that the rates proposed by EVTL would make it uneconomical for Lotte Pakistan to renew the Storage Agreement. In fact Lotte Pakistan is not serious in negotiation for renewal of contract and using bullying tactics.
   The Implementation Agreement was signed based on master plan of PQA wherein jetties and storage locations for various categories of commodities (e.g. oil, chemicals, edible oil, molasses, containers, grains etc.) were clearly identified by PQA.

   The reason why rates for EPCL are lower than Lotte Pakistan is the nature of products and the facilities required for their handling and storage. As compared to EPCL, Lotte Pakistan require special featured tanks e.g. separate dedicated marine loading arms, fully insulated tanks and downstream pipelines, ship loading facility, separate slop tanks at jetty and shore, tank heating facilities etc. All these factors coupled with underutilization of facilities has resulted in higher tariff for Lotte Pakistan.

   One Paraxylene tank of 12000 cbm and one Acetic Acid tank of 2500 cbm remained unutilized throughout the period. The extra storage tanks were built at the request of Lotte Pakistan keeping in mind their future expansion which did not happen and is a business decision ownership of which should be taken by Lotte Pakistan and not pass the impact of that onto EVTL.

e. Lotte Pakistan's claim that EVTL has earned an IRR of over 25% is incorrect. It is repeated that amounts earned by EVTL under the Storage Agreement are not under discussion in this compliant.

f. Lotte Pakistan has relied in their compliant on a terminal in Korea to show the tariff for Paraxylene. We have confirmed that Korean terminal is basic and has no comparison with EVTL. Further, that Korean terminal is a distribution terminal and its services cannot be compared with the industrial terminal like that one EVTL has.

g. Comparison with international prices is not correct. If this reasoning is applied the banking sector in Pakistan enjoys 7-8% banking spread while in rest of world it is only 2-3%. There is rationale for this, just as there are reasons for differences in tariffs required by EVTL and tariffs charged in more developed economies.

h. Lotte Pakistan is not obliged to continue business with EVTL they can look for other options at KPT as they have claimed that they have received an offer from Al-Rahim Terminal at KPT. Further, construction of two bypasses has made transportation from KPT much easier. However, facilities at Al-Rahim Terminal are different form EVTL for the following reasons:

    i. Less storage capacity
    ii. Inappropriate design code
    iii. Tanks and pipes are not insulated
    iv. Tanks are not equipped with heating coils
    vi. No slop handling facility
    vii. No safety arrangements
    viii. No automation system

    If these special features are added Al-Rahim's cost and tariff will be double or almost comparable to EVTL's tariff. Further, we would like to reiterate that (price) competitiveness is determined by the total supply chain costs including land transportation , insurance costs, shipping costs etc, and that taking into account these costs at the KPT option will be comparable to the EVTL option. It is global phenomenon that prices are set on the basis of the competitiveness of the entire supply chain and being a part of a strong supply chain allows to demand some premium.

VIII. Issues

15. Whether the tariff structure mentioned in the Storage Agreement fails to disclose its basis/calculation and whether EVTL is charging exorbitant rate of tariff to Lotte Pakistan that amounts to unfair trading conditions imposed by EVTL on its customer i.e. Lotte Pakistan in violation of Section 3(3)(a) of the Act?

16. Whether EVTL has adopted a strategy of constructive refusal to deal with Lotte Pakistan in violation of Section 3(3(h) of the Act by quoting substantially high tariff charges without discussing its computation in negotiation for renewal of the Storage Agreement?

IX. Analysis

17. The concept of relevant market is central to determination of any allegation as to abuse of dominance as is the case in the instant matter. The term relevant market as provided in Section 2(1)(k) of the Act has two important elements which need to be given due consideration[1]. First element is product and second is geographical area. Determination of both elements is very crucial to assess the market share or behavior of an undertaking which enables it to hold a dominant position. For that certain factors are taken into account e.g. what products are interchangeable and substitutable for consumers depending on their physical characteristics, intended use and price. Similarly, which area is significantly important to be considered where undertakings involved in supply of goods and services face homogenous conditions in competing with each other.

18. Relevant market comprising product and geographical area for the purpose of this Enquiry Report has been discussed at length in paras 6 to10 above. Hence, product market is handling and storage services provided through a jetty and storage farm constructed to handle and store specific kind of chemicals and the relevant geographic market is Port Qasim area.

19. Having determined the relevant market, next step is to assess whether EVTL holds a dominant position in the relevant market. Definition of 'Dominant Position' is given in Section 2(1)(e) of Act and is reproduced below for ease of reference:

---

[1] "Relevant Market" means the market which shall be determined by the Commission with reference to a product market and a geographic market and product market comprises all those products or services which are regarded as interchangeable or substitutes by the consumer by reason of the products' characteristics, prices and intended uses. A geographic market comprises the area in which the undertakings concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighboring geographic areas because, in particular, the conditions of competition are appreciably different in those areas."

> Dominant Position of an undertaking or several undertakings in a relevant market shall be deemed to exist if such undertaking or undertakings have ability to behave to an appreciable extent independently of its competitors, consumers, customers and suppliers and the position of an undertaking shall be presumed to be dominant if its market share of relevant market exceeds 40%.

20. In Port Qasim Area which is the relevant market in the instant case only EVTL has the specialized jetty and storage farm to provide handling and storage services in respect of liquid chemicals having specific chemical properties. Right to construct and operate such facilities has been granted to EVTL on concessionary basis by virtue of the Implementation Agreement entered into by and between EVTL and PQA in 1996. This monopoly created in favor of EVTL through a concession agreement entails the essential constituents of definition of dominant position as given above.

21. United Brands V. Commission[2] in 1978 defined a dominant position as "a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it power to behave to an appreciable extent independently of its competitor, customers and ultimately consumers." Entry barrier created by virtue of the Implementation Agreement restricts competition in the relevant market and enables EVTL to behave independent of its customers as well.

22. Under the Act, it is not the dominant position, but its abuse which is prohibited under Section 3 which is reproduced in relevant context as under:

> 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.

---

[2] Case 27/76 [1978] ECR 207, [1978] 1CMLR 429; it has used the same formulation on several other occasions, e.g. in Case 86/76 Hoffmann –La Roche V Commission [1979] ECR 461, [1979] 3 CMLR 211, para 38.

> (3) The expression “practices referred to in sub section (2) shall include, but are not limited to-
>
> (a) limiting production, sales and unreasonable increase in price or other unfair trading condition.
>
> (h) refusing to deal.

23. Instances of abuse of dominance fall under two categories. One is exclusionary in nature and other is exploitative. Imposing unfair trading condition or refusing to deal by charging exorbitant prices squarely falls under exploitative abuse which directly targets consumers. The main grievance of Lotte Pakistan in its complaint is that EVTL is charging exorbitant prices for its services for the sole reason that it enjoys monopoly by virtue of a concessionary agreement which enables it to dictate its own terms.

24. EVTL set up a chemical jetty and storage farm in 1996 to handle and store liquid chemicals entering Port Qasim area in pursuance of the Implementation Agreement. In the same year of 1996, Lotte Pakistan entered into a fifteen (15) years take-or-pay agreement i.e. the Storage Agreement with EVTL under which it was to pay EVTL a fixed charge of US$ 9,200,000 per annum. In addition to fixed charges Lotte Pakistan also agreed to pay to EVTL a variable cost depending upon the quantum of Paraxylene and Acetic Acid stored by EVTL on its behalf. Lotte Pakistan had already paid to EVTL up till 2009 an aggregate sum of US$ 133,000,000 including US$20,000,000 as variable charges and is likely to have paid an aggregate of US$ 170,000,000 till November 2012 by the time the Storage Agreement expires. Apart from Lotte Pakistan following users have also been using EVTL’s facility successfully:

- ICI Pakistan Ltd. (MEG imports)
- Fauji Fertilizer Bin Qasim Ltd.
- Engro Polymer & Chemicals Ltd.
- LPG Importers

- Dewan Salman Fibres Ltd. (now shut down because of Group bank default)

25. EVTL claims in its submissions dated October 25, 2011 that total investment made to-date in respect of terminal infrastructure by the company comes to a total of US$ 115,000,000. Again in its submissions filed on February 18, 2011 EVTL reiterates that PKR 5.5 billion is the total investment made by it to-date on the terminal. On the other hand Lotte Pakistan claims that if US$ 115 million quoted by EVTL is an amount which reflects the total investment made by EVTL in terminal infrastructure so far, it has paid more than the investment of EVTL through tariff charges. By November 2012 when the Storage Agreement expires, Lotte Pakistan would have paid EVTL an aggregate of US $ 170,000,000. This amount more than adequately covers the cost that may have been incurred by EVTL in order to build facilities.

26. Lotte Pakistan also claims that tariff under the Storage Agreement was based on the understanding that it will be charged on the basis of the capital cost originally incurred by EVTL in setting up shared and dedicated chemical storage facilities and not on the total investment made to-date. According to Lotte Pakistan total cost incurred by EVTL to set up terminal infrastructure is US$ 80,000,000. In this way EVTL has recovered from Lotte Pakistan, by charging a high tariff, an amount much more than its capital cost as per understanding at the time of signing the Storage Agreement.

27. Lotte Pakistan further pleads that the Storage Agreement does not state anywhere the formula for computing the tariff and Lotte Pakistan has been concerned for some time that the tariff being charged by EVTL is far in excess of the original understanding between both parties at the time of entering into the agreement. It is pertinent to mention that when Lotte Pakistan approached EVTL for clarification, it point blank refused to offer any help. Lotte Pakistan has also attached letters with its submissions dated December 13, 2010 which were sent to Chief

Executive Officer, EVTL to provide basis of fixed and variable monthly charges. Relevant part of these letters is reproduce as below:

Lotte Pakistan's Letter dated November 8, 2010 sent to CEO, EVTL

In terms of these emails Me Ali Aamir and Mr. Ashiq Ali had, on behalf of Lotte PPTA, asked you and Mr. Vijay Kumar to provide the complete basis of calculations of your monthly bills in respect of the Agreement for the Reception Storage and Delivery of Paraxylene and Acetic Acid. Specifically, they had asked you to provide the basis of the fixed monthly charge (including capital cost of project and the IRR applied) and the variable charge, by each component, as stated in the invoices issued and being issued by you to Lotte PPTA under the Storage Agreement.

We are very disappointed to note that despite our repeated requests you have failed to provide the necessary information. Your excuses for not doing so as stated in your previous emails are evasive, contradictory and dismissive. On the one hand you state that you do not have "any back up working right now" and that "such old files are not available" in your existing office. Whereas on the other hand you claim that as "EVTL office was located in PNSC building with the old offices of Engro Chemicals" it is not possible that all records have been lost in the fire that destroyed the PNSC building in August 2007.

EVTL's Letter Dated November 26, 2010 sent to CEO, Lotte Pakistan

The Agreement mentioned above was signed in 1996 and was negotiated by teams of ICI Pakistan and Engro Chemicals (now Engro Corporation) & Paktank (now Royal Vopak). Various components of tariff shown in the Agreement (and on our monthly invoice) were agreed between the two teams after lengthy discussion in which I am sure a number of factors agreed by two teams would have been considered. Upon a plain reading of the Agreement, the tariff is clearly specified; so now, after 14 years, to reopen the issue to understand the "background" to the setting of the tariff is pointless, especially as there are only 2 years left. Anyway the Agreement, legally binding between our two companies, does not envisage any re-openers.

However, and in any case, we regret to inform you that the financial model and basis of calculations for this project developed then is not available with EVTL, as already repeatedly conveyed to Lotte PPTA. We would expect that Lotte PPTA (ICI earlier) would have their own records to support the tariffs agreed between our two organizations.

28. To understand the tariff structure in a better way I perused the Financial Model submitted by EVTL to PQA before signing the Implementation Agreement and also the provisions of the Storage Agreement entered into between the Complainant and the Respondent. Clause 4.7 of the "Guidelines for the Preparation of BOT Proposals for Establishment of an Integrated Liquid Chemicals Terminal and Storage Farms" required EVTL to provide the following information:

  a. *Availability of finances for investment*
  b. *Method and sources of Financing*
  c. *Proposed debt equity ratio*
  d. *Repayment and interest terms of loans*
  e. *Estimated project cost including cost of construction, equipment, commissioning, financing cost and working capital and annual operating cost.*
  f. *Estimated tariff (this should be projected as accurately as possible)*
  g. *Estimated capital investment per year*
  h. *Financial statements and audited balance sheets of last three years*
  i. *Royalty and charges payable to PQA*
  j. *Rate of return of investment*
  k. *Likely charges and their implication on cash flow & profitability*

Financial Proposal

29. Capital Cost: Under Clause 2.1.1 (b) & (c) read with Annex 1 of the Financial Proposal the estimated capital cost of the project is provided as US$ 67 Million which will be expended in implementing the initial phase of the project that would run from the third quarter of 1995 to the first quarter of 1997.

30. Tariff basis and rate of return: Tariff has been calculated in Clause 2.3.3 read with Annex 16 of the Financial Model on weighted average basis taking into account all the different types of products to yield an 18% IRR.

    Tariff rates are based upon following variables

    - *Capital cost for required handling and storage*
    - *Nature of the product*
    - *Related operating cost*
    - *Product throughput and parcel size*

Financial Proposal in its Clause 2.3.3 states that the tariff structure has been calculated on the basis of 30 years BOT basis as per the guidelines. However it appears from the Annex 15 of the Financial Model that the IRR yield of 18% is based on projections for 16 years starting from 1995 and culminating in 2011 *(The working can be seen in the copy of financial model provided at Annex A).*

31. Returns/profits, as per the table given at Annex A. start generating in 1997 when the Storage Agreement between Lotte Pakistan and EVTL became operational and spans over the period of 15 years till 2011 that is the period of the Storage Agreement. It appears that rate of return basically targets one major client i.e. Lotte Pakistan at the time of commencement of terminal and most of the cost of infrastructure and applied IRR will be recouped during the period of the Storage Agreement.

32. However, it would be interesting to see that even though the "Guidelines for the Preparation of BOT Proposals for Establishment of an Integrated Liquid Chemicals Terminal and Storage Farms" required EVTL to provide accurate basis for charging tariff but EVTL provides in Clause 2.3.3 of the Financial Model that ultimate tariff structure will be determined between EVTL and its customer.

> *No throughput or return guarantees were provided to Engro by PQA or GOP and the ultimate tariff structure was to be determined after discussion between the JVC and customers.*

Storage Agreement:

33. Clause 8 of the Storage agreement settles terms of pricing between EVTL and Lotte Pakistan for duration of the agreement.

> As stated in clause 8.1
>
> ICI shall from the start date onwards pay EPTL in accordance with the tariffs, pricing structure, billing and payment conditions outlined and appended in appendix II of this agreement.

As per clause 8.2

The fixed components of annual charges payable by ICI shall be reduced pro-rata in any year to the extent (other than Force Mejeure) a material part of the services is not fully provided for any part of the yea. The same applied for the minimum amounts of the variable components payable by ICI.

As per clause 8.3

The tariffs in Appendix II are based on the rates of import duty, regulatory duty and sales tax therein stated with respect to the import of plant and equipment required to establish the facility. The Increase/decrease pursuant to the terms agreed will be passed on to ICI in revised tariffs

The gist of Tariff/pricing structure actually agreed upon between EVTL and Lotte Pakistan as provided in Appendix II of the Storage Agreement is provided below. The Tariff is divided into the following components along with their sub-categories

Fixed

- Fixed Tariff Component for Jetty Usage
- Fixed Tariff Component for Dedicated Facilities
- Fixed Tariff Component for Shared Facilities

Variable

- Variable Tariff Component for Jetty Usage
- Variable Tariff Component for Dedicated Facilities
- Variable Tariff Component for Shared Facilities

Fixed Tariff

a. Fixed Tariff Component for Jetty Usage

The details for this tariff component are provided in clause 11 of Appendix II of the Storage Agreement. It will be applicable for actual volumes handled provided that it is agreed and understood that Lotte Pakistan undertakes to make minimum payments to EVTL on the basis of a guaranteed minimum volume of 280,000 tonnes of aggregate products per annum.

b. Fixed Tariff Component for Dedicated Facilities

Discussed in clause 12 of Appendix II of the Storage Agreement this Tariff component will be applicable for and calculated over fixed annual volumes of 255,000 tonnes of Paraxylene and 25,000 tonnes of Acetic Acid divided over 12 equal monthly installments, regardless of whether actual volume exceeds or is less than the said volumes.

c. Fixed Tariff Component for Shared Facilities

Formula for fixed tariff components for shared facilities is provided at Annex B

Variable Tariff

a. Variable Tariff Component for Jetty Usage

Detailed under clause 14 of Appendix II of the Storage Agreement this tariff component will be applicable for actual volumes handled provided always that it is agreed and understood by Lotte Pakistan to make payment to EVTL on the basis of a minimum guaranteed volume of 157,000 tonnes of products for the first year, 176,000 tonnes for the next year and 196,000 tonnes from then onwards.

b. Variable Tariff Component for Dedicated Facilities

The conditions for this component of tariff are the same as the tariff component for Jetty and are detailed under clause 15 of Appendix II of the Storage Agreement.

c. Variable Tariff Component for Shared Facilities

Formula for Variable Tariff Component for Shared Facilities is provide at Annex C.

34. From the foregoing, it appears that tariff structure given in the Storage Agreement is completely silent about the basis of the tariff even though Financial Model describes basis of tariff in general terms and leaves its final determination to arrangement between EVTL and its customer. EVTL has also failed to provide, in its submissions/rebuttal, any satisfactory answer to allegation leveled by Lotte Pakistan regarding computation of tariff (including capital cost and applied rate of IRR). Fixed and variable charges are based on the minimum guaranteed threshold of the volume as the contract between the parties is a take-or-pay agreement. However, what is the basis on which these charges have been calculated, the Storage Agreement remains silent about this. Therefore, the rate of return is also difficult to ascertain from the tariff structure given in the Storage Agreement. No finding can be made with regards to the IRR associated with the tariff charged to Lotte Pakistan.

35. The Storage agreement is going to expire in 2012. Both parties have entered into negotiations for renewal of the Storage agreement as per the contractual terms agreed between them which require that both parties shall enter into negotiation for the renewal of the Storage Agreement thirty months prior to expiry/termination of the said agreement. The new tariff proposed by EVTL in the negotiation for renewal of the Storage Agreement comes to US$ 21 per tone for Paraxylene as reflected in its letter dated June 01,2010 sent to Chief Executive Officer of Lotte Pakistan. Whereas currently EVTL is charging tariff for Paraxylene at the rate of US$ 26 per tonne. In view of scenario mentioned in paragraphs above, when the capital cost of the infrastructure has been recovered with reasonable profits, a major amount of tariff should have been reduced for agreement to be renewed but this is not the case here. Further, the customer is again aggrieved that new tariff does not explain its basis or calculations. For the

simple reason that customer is entirely dependent on services of EVTL and there is no other option available to its customers to avail facility for storage of its chemicals, such practice of EVTL amounts to constructive refusal to deal with its client by imposing unfair trading condition on it.

Volume/Throughput

36. According to the terms of pricing in the Storage Agreement, fixed tariffs are calculated based on Lotte Pakistan delivering a minimum volume of 280,000 tonnes. EVTL's claim that they would not have established the terminal had Lotte Pakistan not persuaded them implies that Lotte Pakistan was to be their major customer.

37. Keeping in mind that Lotte Pakistan was the only major customer at the time of signing the Implementation Agreement, volumes projected in the Financial Model appear to be arbitrary at best giving rise to a higher percentage of IRR. Therefore, all calculations made on such whimsical assumptions in the Financial Model to PQA also appear to have an unrealistic pretext. The point of Lotte Pakistan being EVTL's major customer is further emphasized under the sub-head 'Customers of the Facility/Forecast of Throughput' of the executive summary of Financial Model where EVTL makes the following submission:

> The following assumptions have been made while developing the throughput forecasts for the initial phase:
>
> - Requirements of ICI's PTA Plant of 400 KT per annum
> - Requirements of new additions / expansions in polyester fibre plants
> - Some selected chemical such as 2-EH, Ortho Xylene, Methanol, etc., which may shift from Karachi Port to Port Qasim
> - Initially this facility would handle 400,000 tons/year of chemicals rising to 2,000,000 tons/year over a period of several years.

What is left unclear is whether this expectation of 2000,000 tons/year of throughput is mainly dependent on ICI PTA (Lotte Pakistan) or the additions/expansions in polyester fiber plants. It is also questionable as to what

should be the reasonable rate of return in such projects? and how PQA ensures on this account that customers are not charged monopoly prices?
(Volumes projected by EVTL in the Financial Model submitted to PQA can be seen at Annex D)

38. EVTL claims that their rate of return is less than 18% as projected in the Financial Model. Naturally if Projections had come out true EVTL would be making three times the profit of what they are making now. Even though EVTL has not provided any evidence as to what rate of IRR it is recovering currently. Since volume/throughput is a variable in determining IRR. In the absence of surety of expected clientele that can bring reasonable throughput it would be a very subjective approach to project such huge profits. As already it has been mentioned above that EVTL has projected skewed figures of volume under the Financial Model when it was a known factor as mentioned by EVTL itself that Lotte Pakistan, few new addition/expansions in polyester fiber plants and some expected shifting business from KPT could be possible customers of EVTL.

39. If we take an average of profit margins which is the ratio of profit after taxes over earnings/revenue, it comes out to a very healthy 46%. Profit margins are an expression of the amount of competition prevailing in a business. Very competitive industry for instance is marked by shrinking profit margins. Take the example of telecommunications in this regard, as the number of telecom operators increased the profit margins went down for the existing players. A high profit margin typically indicates one of the following two scenarios

    - A company is offering a proprietary good and service that lacks substitutes and therefore commands a premium for its offering.
    - A company operates in an industry such that it has monopoly or is part of an oligopoly over a particular type of good or service

Going by the definition of EVTL the former seems true as they believe they offer a specialized service that their client Lotte Pakistan cannot find elsewhere. Circumstances, however, reveal that since the project required huge investment and was granted by PQA exclusively to EVTL on a 30 year BOT basis, entry into this market is prohibited to all but EVTL and being the sole operator it has acquired monopoly in this particular business which appear to enable it its own terms and conditions.

X. Findings

40. From the foregoing, it appears that Lotte Pakistan has already paid to EVTL up till 2009 an aggregate sum of US$ 133,000,000 in terms of fixed and variable components of tariff. Whereas the capital cost projected by the EVTL in the Financial Model submitted to PQA come to US$67 million and the total investment made in the infrastructure to-date is US$115,000,000 as claimed by the EVTL. Tariff structure claimed to be calculated on the basis of 30 years (concession period) actually appears to have been projected in the Financial Model to yield an IRR of 18% within the span first 15 years. Basis of the tariff even though have been described, in general terms, in the Financial Model and have been left to be determined finally between the customer and the Undertaking. However, the Storage Agreement does not reflect any such basis of the tariff and EVTL has also failed to provide, in its submissions/rebuttal, any satisfactory answer to allegation leveled by Lotte Pakistan regarding computation of tariff (including capital cost and applied rate of IRR).

41. Therefore, it appears that EVTL which was given exclusive rights for thirty (30) years has recovered not only the capital cost as projected in the Financial Model submitted to PQA but also the total investment made so far in the project within the span of early 15 years from a single customer i.e. Lotte Pakistan by charging exorbitant charges. On the other hand customer has no other readily available option in the relevant market to avail handling and storage facilities as the Implementation Agreement grants the Undertaking concessionary rights to the

exclusion of any other possible competitor. Under such circumstances, rent seeking from a captured customer, *prima facie*, results into abuse of dominant position by imposing unfair trading conditions on the customer in violation of Section 3 (1) and 3(3) (a) of the Act.

42. From the foregoing, it appears that rate quoted by EVTL in negotiation for renewal of the Storage Agreement reflects the same approach as taken by EVTL previously at the time of signing of the Storage Agreement. EVTL has failed to provide any satisfactory answer to objections/allegation leveled by Lotte Pakistan regarding basis of tariff. Moreover, capital cost of the infrastructure has been recovered with reasonable profits; a major amount of tariff, therefore, should have been reduced for agreement to be renewed but this is not the case here. Having determined that the customer is entirely dependent on services of EVTL and there is no other option available to it, such practice of the Undertaking to impose unfair conditions for renewal of the Storage Agreement, *prima facie*, amounts to constructive refusal to deal with its customer in violation of Section 3(3)(h) read with sub-section (3)(a) of Section 3 the Act.

43. It is doubtful that terminal was constructed to develop the port and serve the public interest or to cater the needs of one particular customer and capture it to seek rent. Exclusivity was not granted to EVTL to construct a facility for handling and storage of Lotte Pakistan's chemicals only. Such facility/infrastructure could have been built even otherwise. EVTL claims itself in its submissions dated October 25, 2010 that the effectiveness of the Implementation Agreement was made subject to the signing of the storage Agreement. If Lotte Pakistan had not agreed the terms, EVTL would have not constructed the terminal and the Implementation Agreement would have lapsed. It further states that EVTL only bid for the terminal project after being approached by ICI. It is clear from the aforementioned that terminal was set up on the persuasion of ICI (Lotte Pakistan) and could have been built even if exclusive rights were not granted as Lotte Pakistan had a take-or-pay agreement with EVTL which guarantees a minimum

volume to be maintained by the customer and a secured return in form of fixed charges. Under such circumstances grant of exclusivity or closure of market for thirty years becomes redundant.

XI. Recommendations

44. Due to the importance of adequate infrastructure services such as water and power supply, a need for growth in industry and quality of life and given the budgetary constraints the governments have increasingly sought participation of private entities by granting them concessionary rights. Although these projects under concessions have far reaching effect on economy and quality of life of people. However, it is pertinent to mention here that exclusivity granted under a concession agreement sanctions an extreme market power to the concessionaire that is often prone to be abused and can have an adverse effect on the economic growth. In the instant case it appears that monopoly created through the concession agreement encourages EVTL to dictate its own terms and conditions on which it provides services for the reason that it does not face any competition whatsoever. This un-competitive environment may pale the investment in petrochemical industry and also increase the cost of raw material that will cause the stakeholders to suffer.

45. PQA has failed to show due vigilance in granting concession rights to EVTL to provide handling and storage facility in Port Qasim Area. Knowing the fact that EVTL has been given exclusive rights and market has been closed for new entry for thirty (30) years, it has adopted abortive practice to evaluate and monitor the project. Port Qasim Authority should also be enquired as to what measures were taken by it to ascertain that on what basis tariff is being charged to customers? Whether the volumes and profits projected in the Financial Model appear to be arbitrary? Whether the IRR applied is reasonable? and is in line with the risks involved in a particular sector.

46. It is recommended that, in light of the above, proceedings be initiated under Section 30 of the Act against EVTL for, *prima facie,* violation of Section of Section 3(1) read with it sub-sections (3)(a) &(3)(h) of the Act.

Nadia Nabi
Joint Director

Annex-A : (Proposed Financial Model To PQA)

ANNEXURE 1

INTEGRATED LIQUID CHEMICAL TERMINAL & STORAGE FARMS
ENGRO - PAKTANK
CASH FLOWS

(Million Rupees)

	1,995	1,996	1,997	1,998	1,999	2,000	2,001	2,002	2,003	2,004	2,005	2,006	2,007	2,008	2,009	2,010	2,011
Inflows:																	
Profit Before Tax			(107)	350	450	560	688	1,326	1,730	2,083	2,635	3,338	4,076	4,728	5,386	6,087	6,854
Add: Accounting Depreciation			72	134	156	163	302	361	366	375	542	554	568	568	568	568	568
After Tax Interest Cost			185	328	376	335	593	633	368	305	475	356	246	167	116	75	32
After Tax Forex Loss			30	55	68	64	110	121	75	65	94	73	51	35	25	16	5
Total	0	0	180	867	1,055	1,122	1,693	2,441	2,538	2,828	3,746	4,312	4,941	5,498	6,096	6,747	7,463
Outflows:																	
Capital Expenditure	323	1,533	1,479	594	109	3,336	1,393	136	222	3,984	294	354	0	0	0	0	0
Recurring Capex			9	11	12	21	27	29	32	44	48	52	56	61	65	70	75
Current Tax			1	3	6	7	9	12	64	199	429	706	986	1,257	1,506	1,741	1,992
Increase/(decrease) in W Capital			26	22	10	27	34	31	14	39	43	23	24	22	24	27	30
Total	323	1,533	1,516	640	137	3,394	1,462	206	331	4,265	814	1,135	1,066	1,339	1,590	1,838	2,097
Net Cash Flows - Rupees	(323)	(1,533)	(1,336)	227	918	(2,269)	231	2,232	2,208	(1,437)	2,932	3,176	3,875	4,158	4,506	4,909	5,367
Net Cash Flows - US DOLLARS	(9.5)	(43.9)	(36.6)	6.6	21.2	(48.6)	4.6	41.4	38.1	(23.1)	43.8	44.1	50.1	50.0	50.4	51.0	51.8

IRR (USD)	18%

Annex - B: (Fixed Tariff For Shared Facilities)

$T_{fixed} = P_{fixed} * 280000 / (280000 + VOL_{OT})$

Whereby

T_{fixed} = Actual fixed shared facility tariff payable by ICI for the year

P_{fixed}= Agreed fixed shared facility tariff as above

VOL_{OT} = Actual volumes (in tones) achieved by EPTL for the year for all its customers other than ICI, making use of the shared facilities

VOL_{OT} until 31 December 2000 will be actual volume (in tones) achieved by EPTL, thereafter VOL_{OT} will be

For the year 2001: 387,000 tonnes
For the year 2002: 554,000 tonnes
For Succeeding years: 720,000 tonnes

Again the charge will be based on U.S dollars and converted as above. Also this component of Tariff will be calculated over fixed annual volumes handled of 255,000 tonnes of Paraxylene and 25,000 tonnes of Acetic Acid and divided over 12 equal monthly installments per year.

Annex - C: (Formula for Variable tariff for shared Facilities)

$T_{variable} = P_{variable} * ICI_{Vol} / (ICI_{Vol} + VOL_{OT})$

Whereby

$T_{variable}$ = Actual variable shared facility tariff payable by ICI for the year

$P_{variable}$ = Agreed variable shared facility tariff as above

ICI_{Vol} = Actual volumes (in tonnes) of ICI for the year, or 280,000 tonnes in the event ICI volumes exceed 280,000 tonnes.

VOL_{OT} = Actual volumes (in tonnes) achieved by EPTL for the year for all its customers other than ICI, making use of the shared facilities

ICI_{Vol} will be greater of actual volume achieved by ICI or respectively 157,000 tonnes in 1998, 176,000 tonnes in 1999 and 196,000 tonnes in subsequent years

If ICI's own throughput volumes exceed 280,000 tonnes per annum, ICI will be liable to the same charge as on 280,000 tonnes thus reducing per ton charge payable.

VOL_{OT} until December 31, 2000 will be the actual volume handled and from then onwards

Year 2001: 387,000 tonnes

Year 2002: 554,000 tonnes

Succeeding years: 720,000 tonnes

In the event actual volume achieved by EPTL exceed those defined hereinabove, actual volume number will be used

This component of Tariff for shared facilities will be applicable for actual volume handled, provided always it is agreed and understood by ICI that it will make minimum payments to EPTL on the basis of a guaranteed minimum volume of 157,000 tonnes during the first year of operation, 176,000 tonnes for the second year and 196,000 tonnes for subsequent years of operation.

Annex - D: (Volume/Throughput Projected in Financial Model)

ANNE[illegible]E - 2

INTEGRATED LIQUID CHEMICAL
TERMINAL & STORAGE FARMS
ENGRO - PAKTANK
KEY ASSUMPTIONS

		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
ANNUAL THRUPUT	TONS			281,000	857,500	928,000	951,000	1,248,750	1,588,500	1,615,500	1,647,500	1,947,000	1,993,000	2,037,000
TARIFF PROFILE	USD / TON			30	31	31	32	33	34	34	35	36	37	38
CAPITAL EXPENDITURE	Million USD	10.0	46.9	41.4	15.7	2.8	75.3	29.6	3.1	4.6	67.6	5.1	5.6	0.7
STORAGE CAPACITY	(000) CU.M		0	74	48	3	4	52	57	5	7	43	9	10
CUMULATIVE STORAGE CAPACITY	(000) CU.M		0	74	122	125	129	181	238	243	250	293	302	312
RS / DOLLAR EXCHANGE RATE		32.5	34.94	37.56	40.37	43.40	46.66	50.16	53.92	57.96	62.31	66.98	72.01	77.41
ELECTRICITY CONSUMPTION	KW / H			56	85	88	89	122	144	145	150	190	192	194
ELECTRICITY RATES PER KWH	RS / KWH			3.44	3.78	4.16	4.57	5.03	5.53	6.09	6.70	7.37	8.10	8.91
WATER CONSUMPTION	GALLONS			64,000	96,000	96,000	105,600	153,600	192,000	195,840	201,720	269,890	280,690	[illegible]
WATER RATES PER 1000 GAL	RS/1000 GAL			85	85	85	85	85	85	85	85	85	85	85