



**BEFORE THE
COMPETITION COMMISSION OF PAKISTAN
IN THE MATTER OF
M/s. Fauji Fertilizer Co Ltd
&
M/s. Fauji Fertilizer Bin Qasim Ltd
(F.No. 8(576)/INV/CCAO/MCA/94)**

Dates of hearing: 29-11-2007 & 29-01-2008

Present

Mr. Khalid A. Mirza

Chairman

Mr. Abdul Ghaffar

Member

Mrs. Rahat Kaunain Hassan,

Member

Dr. Joseph Wilson,

Member

Mr. Zahir Riaz & Mr. Shahid Raza, of Orr, Dignam & Co., Advocates, Mr. Abid Maqbool, CFO, Mr. Asad Sultan Chaudhary, G.M Marketing & Mr. Inaam-ur-Rehman Siddiqui, Sr. Technology Manager of Fauji Fertilizer Co Ltd., and Mr. S. Aamir Ahsan, CFO/G.M Finance & Kh. Tasneem Murad, Finance Manager of Fauji Fertilizer Bin Qasim Ltd

ORDER

1. M/s. Fauji Fertilizer Company Limited ("FFC"), engaged in manufacturing, purchasing and marketing of fertilizers and chemicals including investment in other fertilizer and chemical manufacturing operations, is an undertaking

(hereinafter referred to as the "undertaking") within the meaning of Section 2(1)(m) of the Monopolies and Restrictive Trade Practices (Control & Prevention) Ordinance 1970 (hereinafter referred to as the "Ordinance").

2. M/s Fauji Fertilizer Bin Qasim Limited ("FFBL"), is an associated undertaking of the undertaking (hereinafter referred to as the "associated undertaking") in terms of Section 2(1)(b) of the Ordinance. The associated undertaking is also engaged in manufacturing, purchasing and marketing of fertilizers.

3. The combined market share of the undertaking and its associated undertaking was ascertained to be 47% in Phosphetic and 49% in Nitrogenous fertilizers which was more than 1/3rd of the fertilizer's product market and such situation, *prima facie*, constitutes unreasonable monopoly power as defined under clause (a) of sub-section (1) of Section 5 of the Ordinance.

4. Show Cause Notices No 14 & 15 of 2007-08 (primarily similar in substance) were, therefore, served on the undertakings on 30-08-2007 and they were required to show cause in writing by September 17, 2007. The Show Cause Notice in its relevant part reads as follows:

"3. *AND WHEREAS, the combined market share of the undertaking and its associated undertaking is ascertained to be 47% in Phosphetic and 49% in Nitrogenous fertilizers;*

4. *AND WHEREAS, the share of the undertaking and its associated undertaking is more than 1/3rd of the fertilizer's product market;*
5. *AND WHEREAS, such situation, prima facie, constitutes unreasonable monopoly power as defined under clause (a) of sub-section (1) of Section 5 of the Ordinance;*
6. *AND WHEREAS, unreasonable monopoly power is prohibited by the provisions of Section 3 of the Ordinance;*
7. *AND WHEREAS, the Monopoly Control Authority (hereinafter referred to as the "Authority") is satisfied that unreasonable monopoly power is injurious to the economic well being, growth and development of the country and it is necessary in the public interest to make appropriate Order under Section 11 read with section 12(1)(b)(i)&(iii) of the Ordinance;*
8. *NOW THEREFORE, you, M/s. Fauji Fertilizer Company Ltd, are hereby called upon to show cause in writing by September 17, 2007 as to why appropriate action under Section 11 read with Section 12(1)(b)(i)&(iii) of the Ordinance may not be taken against you.*
9. *If no reply to the Show Cause Notice is received within the stipulated period, the Authority shall proceed in the matter as provided under the law."*

5. In response to the Show Cause Notice, the undertaking submitted its letter dated 11-09-2007 requesting for extension which was allowed up to September 30, 2007 to respond to the Show Cause Notice.

6. The undertaking vide its letter dated September 17, 2007 once again requested for grant of time up to October 26, 2007 for submission of reply to the Show Cause Notice which was not acceded as absence of a senior official was not considered a sufficient reason for grant of extension particularly in the case of a company of the size of the undertaking.

7. The associated undertaking, in response to the Show Cause Notice, submitted its letter dated September 10, 2007 and letter dated September 28, 2007. It was submitted that the relationship between the undertaking and its associated undertaking did not have the effect of bringing about or maintaining or continuing unreasonable monopoly power within the meaning of the Ordinance.

8. The undertaking submitted that the term "monopoly power" under the Ordinance means the ability of one or more sellers in a market to set non-competitive prices or restrict output without losing a substantial share of the market or to exclude others from the market. In this connection, it is submitted that FFC/FFBL have not, at anytime, abused their market position. In particular:

- a. FFC and FFBL do not have the power to set non-competitive prices in the urea/DAP fertilizer markets.
- b. In addition to the ability to fix non- competitive prices, "monopoly power" 9 as defined in the Ordinance) also encompasses the power to restrict output without losing a substantial share of the market or to exclude others from any part of the market. In the case of FFC/FFBL, please note that there has been no instance of curtailment of production by either FFC or by FFBL in the normal course. Rather, far from seeking to restrict output, the capacity utilization of FFC and FFBL has consistently been in excess of design capacity. During 2006 urea production at FFC/FFBL plants exceeded design capacity by 0.441 million tons. FFC/FFBL, have always endeavored to operate their fertilizer plants at highest possible loads in order to make available high quality products to the farmers of Pakistan in sufficient quantity and have thus made an important contribution to the agricultural economy of Pakistan. Since the fertilizer industry as a whole is an import substitution industry, above-capacity operation has resulted in the following benefits to the farmers and the country:

- i. Ready availability of quality product at all seasons throughout the country.
- ii. Savings of a substantial amount of foreign exchange for the GOP on import of the equivalent amount of urea.
- iii. Saving of subsidy for the GOP of over Rs 5 billion as a result of the reduced import requirements due to over-capacity operation of FFC/FFBL plant.
- iv. As a result of the above-capacity operation of FFC and FFBL's plants, projected imports of 100kt for the next 2007-08 Rabi season are lower than would otherwise have been necessary.

9. The undertaking submitted that if (which is denied), Section 5(1) of the Ordinance is attracted in the present case, then, for the reasons set out, the relationship between FFC and FFBL is nevertheless in the larger public interest and falls squarely within the purview of Section 5(2) of the Ordinance as it contributes substantially to the efficiency of the production and distribution of goods, to the provision of services and to the promotion of technical progress, whose benefits clearly outweigh the adverse effect of any perceived absence or lessening of competition. The benefits would not have been possible, or else would have been reduced, but for the association between FFC and FFBL and the combined financial, organizational, technical, logistical marketing, human resource and other resources of FFC and FFBL, and inherent efficiencies and synergies which result there from.

10. Any action by the Authority against FFC/FFBL will be discriminatory without similar action against other groups in the industry whose new projects under implementation will give them an aggregate market share in excess of the statutory threshold for unreasonable monopoly power.

11. It was submitted that FFC is the only fertilizer company having comprehensive country wide marketing and distribution network. It would not be possible for FFBL to have such a wide network to cater for its 9.7% urea market share and 40% DAP market share. As a result, FFBL's products, in particular DAP, would not be available country wide and FFBL would have no choice but to follow a localized marketing/distribution strategy to the detriment of the public interest.

12. It requested for providing an opportunity of personal hearing in order to make further submissions and present further documents in support of its position at or before any such hearing and at any other time.

13. After promulgation of the Competition Ordinance, 2007, the Competition Commission of Pakistan (hereinafter referred to as the "Commission"), as successor of the Authority; for disposal of the Show Cause Notices, decided to fix the matter for hearing under the provisions of Section 11 of the Ordinance,

read with Section 59 of the Competition Ordinance, 2007 (hereinafter referred to as the Competition Ordinance).

14. The matter was, therefore, fixed for hearing on 29-11-2007 at Islamabad, vide hearing notices dated November 20, 2007.

15. On the date of hearing Mr. Zahir Riaz & Mr. Shahid Raza of Orr Dignam & Co., Advocates alongwith Mr. Abid Maqbool, CFO, Mr. Asad Sultan Chaudhary, G.M Marketing & Mr. Inaam-ur-Rehman Siddiqui, Sr. Technology Manager of the undertaking, and Mr. S. Aamir Ahsan, CFO/G.M Finance & Kh. Tasneem Murad, Finance Manager of the associated undertaking, appeared before the Commission and argued the case.

16. The counsel admitted that the associated undertaking is the only DAP producer in Pakistan and had dominant market position. [It was clarified to the Commission that the undertaking and the associated undertaking would justify that the acquisition contributes substantially to the efficiency of the production or distribution of the goods being produced by them]. The counsel requested for time to make detailed submissions to justify safe harbour for both the undertakings on the grounds of efficiency under Section 5(2) of the Ordinance. The Commission allowed time up to December 24, 2007 for making

these submissions. The Commission also decided to fix the matter after receipt of the said information.

17. The undertaking vide its letter dated December 19, 2007 submitted the paper to show that: (i) that there are substantial efficiencies and synergies involved in the two companies having a common marketing and distribution network; (ii) that the establishment of an independent marketing and distribution network by FFBL would result in substantial additional costs to FFC & FFBL, which will require to be passed on to the end consumer (the farmer), and that since any such independent distribution network is most likely to be focused on a limited area, the availability of FFBL's fertilizer products (in particular, DAP) across the country would be adversely affected.

18. The contents of reply of the associated undertaking submitted by it vide its letter dated December 24, 2007 in response to the Show Cause Notice was not different as compared to the earlier reply of the undertaking.

19. For disposal of the Show Cause Notices, the matter was fixed for hearing on 29-01-2008 at Islamabad vide hearing notices dated January 17 & 21, 2008.

20. On the date of hearing Mr. Zahir Riaz & Mr. Shahid Raza, Advocates/counsel, Mr. Abid Maqbool, CFO, Mr. Muhammad Munir Malik G.M.

Treasury & Planning, Mr. Asad Sultan Chaudhary, G. M Marketing & Mr. M. Abbas Riaz, Senior Finance Executive of the undertaking and Mr. S. Aamir Ahsan, CFO/G.M Finance & Kh. Tasneem Murad, Finance Manager of the associated undertaking, appeared before the Commission.

21. During the hearing the undertakings were informed that the Commission is not impressed with their submission to qualify for Section 5(2) i.e., the gateway provision. The Commission may, therefore, like to give another hearing to both the undertakings before passing an order under Section 11 read with Section 12(1)(b) of the Ordinance.

22. The counsel submitted that both the undertakings fully appreciate the concerns raised by the Commission and in order to address such concerns they were working on few proposals. Short adjournment was requested in order to formally tender such proposals before the Commission. The Commission, acceding to their request, adjourned the matter for February 6, 2008, subsequently on request of the FFC & FFBL the Commission further granted time to submit the proposal within a reasonable time.

23. Finally, M/s. Orr Dignam & Co, Advocates/counsel, vide their letter No. R/Senior Executive (Legal)/5316 dated March 10, 2008 submitted:

"Kindly refer to recent hearings in the matter.

Despite their corporate relationship, each of Fauji Foundation, FFC and FFBL have at all times maintained the highest standards of governance. Nevertheless, in order to further reinforce the transparency of their relationship and without in any manner admitting any liability in the matter, they have instructed us to submit on their behalf, without prejudice, that they will take, or cause to be taken, the following actions, and to request the Commission to kindly consider passing orders in terms thereof and to accordingly dispose of the captioned proceedings.

1. *No individual will be a director of both FFC and FFBL with the exception of (i) the Chairman; (ii) a Finance Director; and (iii) individuals representing institutions (other than Fauji Foundation and FFC) or minority shareholders.*
2. *Steps shall be taken to ensure that there are three independent directors on the Board of FFBL in order to ensure good corporate governance and transparency.*
3. *The Chairman of FFBL will not have a second or casting vote.*

The above actions are proposed to be taken within a period of two years from the date of any final order of the Commission with respect to this matter.

We are also instructed to request the Commission to allow the concerned parties to ask for a review of any Order to be passed by it, once market conditions in the fertilizer industry have changed, or based on any other factor justifying such review.

This letter supersedes any previous communication on the same subject matter.

24. Before we proceed to consider and deliberate upon the offer submitted on behalf of FFC & FFBL, we wish to record our appreciation for the undertakings as well as their counsel. The parties have exhibited positive and constructive approach towards handling of the subject issues and have been forthcoming in attempting to address Commission's concern rather than pressing legal cum technical grounds. The presence of the senior officers during the course of hearing is also reflective of responsible and concerned approach.

Similarly, the parties need to appreciate that the Commission is there to ensure growth of businesses on a level playing field and to enhance economic efficiency by ensuring free competition in all spheres of commercial and economic activity.

25. Since the undertakings have submitted that the offer letter supersedes any communications on the same subject matter, we would not delve into the merits and de-merits of the arguments and submissions made prior to the letter 10th March, 2008.

26. We now, therefore, proceed to examine whether the offer satisfactorily meets the concerns of the Commission. Our concern stems from the fact that Fauji group's market share in fertilizer products is more than 1/3rd of the domestic market. The Commission's primary concern is that the relationship between the associated undertakings which are competitors in the same market, must be maintained at an arms length to protect competition in the relevant market.

27. We note that the companies are integrated in the following manner:

Share Holding Pattern			
Fauji Fertilizer Company		Fauji Fertilizer Bin Qasim Limited	
Fauji Foundation	44.34%	Fauji Fertilizer Company (Holding Company)	50.88%
Insurance Companies	10.01%	Charitable Trusts	17.40%
Investment Companies	09.66%	Individuals	15.24%
Financial Institutions	05.52%	Mutual Funds	05.66%
Foreign Investors	06.21%	Others	10.82%
Individuals	12.71%		
Others	11.55%		
Total	100.00%		100.00%

Boards of Directors

1	Lt. Gen. (Retd) Syed Arif Hasan, HI(M), Chairman.	1	Lt. Gen. (Retd) Syed Arif Hasan, HI(M), Chairman.
2	Lt. Gen (Retd) Munir Hafiez, HI(M), Chief Executive & M.D.	2	Lt. Gen (Retd) Muhammad Akram, HI(M), Chief Executive & M.D.
3	Dr. Haldor Topsoe, Director	3	Lt. Gen (Retd) Munir Hafiez, HI(M), Director
4	Mr. Qaiser Javed, Director	4	Mr. Qaiser Javed, Director
5	Mr. Tariq Iqbal Khan, Director	5	Mr. Istaqbal Mehdi, Director
6	Mr. Khawar Saeed, Director	6	Brig (Retd) Arif Rasul Qureshi, SI(M), Director
7	Mr. Istaqbal Mehdi, Director	7	Brig (Retd) Rahat Khan,SI(M), Director
8	Brig (Retd) Arif Rasul Qureshi, SI(M), Director	8	Dr. Nadeem Inayat, Director
9	Maj. Gen (Retd) Muhammad Tahir, HI(M), Director	9	Brig (Retd) Aslam Paunwar Khan, SI (M), Director.
10	Brig (Retd) Rahat Khan, SI(M), Director		
11	Dr. Nadeem Inayat, Director		
12	Mr. Kamal Afsar, Director		
13	Mr. Tariq Bajwa, Director		

28. During 2006, the market share of FFC and FFBL in indigenous urea was 43.7% and 11.4% respectively, resulting in a combined market share of 55.1%. When imports of FFC and FFBL are taken into account, their market share aggregates 61.2%.

29. The undertaking submitted that the market share of FFC and FFBL has decreased in recent years and will reduce even further by early 2011 following commissioning of the Fatima Fertilizer Company Ltd and ECPL plants. FFC/FFBL's

market share would have already been reduced further had the Fatima Fertilizer Company Ltd commenced production as scheduled in 2006. It was further submitted, that in 2011, it is anticipated that FFBL's market share in urea will reduce to 9% and that of FFC to 34.2%.

30. Assuming that the shares of FFC & FFBL are reduced as anticipated, even then, these two undertakings together will constitute 1/3rd of the total goods in the relevant market as envisaged under Section 5(1)(a) of the Ordinance (and also per se a dominant position in terms of the new law, the Competition Ordinance, 2007 i.e. holding 40% of market share).

31. FFC has at present around 51% of share holding in FFBL and out of 9 directors of FFBL 7 directors are same as those who are also on the board of FFC. These are Lt. Gen. (Retd) Syed Arif Hasan, Chairman, Lt. Gen (Retd) Munir Hafiez, Mr. Qaiser Javed, Mr. Istaqbal Mehdi, Brig (Retd) Arif Rasul Qureshi, Brig (Retd) Rahat Khan, and Dr. Nadeem Inayat. All these directors, do not necessarily represent FFC while being on the board of FFBL. However, it is difficult to envisage as to how with such overwhelming majority of common directors conflict of interest can be avoided and the highest standards of governance achieved as claimed by both undertakings- let alone maintained.

32. Firstly we will deal with the undertaking's desire to continue with the common chairman, while, voluntarily surrendering the right of 'casting vote'. The appointment of chairman unlike the appointment of chief executive or auditors etc, is not a statutory position. The chairman is chairman of the Board and is also required to preside over general meetings. The chairman primarily enjoys the right of casting vote and in addition to this power under the Companies Ordinance, 1984, he has power to bring discussion on any question to a close, power to adjourn the meeting if it is necessary in his opinion, and like any other member, he has an ordinary vote.

33. There are two key positions at the top of every public company- the running of the board and the executive responsibility for the running of the company's business. The chairman's role in securing good corporate governance is crucial, as he is not only responsible for working of the board but also to ensure that all directors are enabled and encouraged to play their full part in the activities of the undertaking. Given the importance and particular nature of the chairman's role it should, in principle, be always kept separate from that of chief executive and it is comforting to note that these positions are not clubbed in the present case. If the two roles are combined in one person it represents a considerable concentration of power which may have its own adverse effects.

34. While no rationale has been provided in the letter as to why the common chairmanship be allowed, we are willing to let this arrangement continue provided, as stated, the chairman of FFBL shall not exercise his right to cast vote and additionally this position of common chairman shall not be clubbed with the position of CEO (in FFBL). However, we must add that the Commission would have no objection to allow the undertakings to have common chairman, with the right to cast vote, if and when the FFBL decides to appoint an independent chairman. It is pertinent to mention that one of the reason for agreeing to the appointment of the common chairman is also because appointment of three independent directors on the board has been proposed, which in our view, to some extent, at least, will serve as a tool to achieve 'good governance and transparency'.

35. However, the role of independent chairman needs to be appreciated as it is important in two respects. First, an independent chairman can bring to the board a healthy level of skepticism and independence by encouraging constructive debates rather than the desire to find consensual resolutions to issues, which more often than not, is a compromise. Second, he can ensure that every board resolution is put to a vote to ensure that it is will of the majority and not of the dominant owner.

36. Having allowed common chairmanship in terms of the conditions stated above we now move to the aspect of having an individual as a common director who holds the office of a finance director. At the outset, we must express our disappointment to FFC & FFBL for even proposing such a condition. The Commission finds it unacceptable. This is so because the Finance Director has a significant role in developing corporate strategy. He is very often the only main board executive director, apart from the Chief Executive whose remit extends across all the divisional boundaries. To accept such a condition would taint the very objective of these proceedings, and in our view, it rather clouds the real intent of the undertakings i.e. "to reinforce transparency" in their associated relationship.

37. However, the Commission welcomes the step towards the appointment of the independent directors on board of FFBL and expects that such measure would be implemented in its true intent and spirit. The purpose of identifying and appointing independent directors is to ensure that board has the strength to exercise its judgment for the exclusive benefit of the company. Such exercise of judgment ought not be affected by real or perceived conflict of interest. It is the obligation of the board to determine that such directors meet the requisites of "independence" established by the board.

38. Reference to an independent director is usually made in the context of independence from the management as the board of directors supervises the management. No director should qualify as independent, unless the board

positively determines that such director has no material pecuniary relation (apart from receiving director's remuneration, if any) or transactions with the company, its promoters, its management or its subsidiaries which in the judgment of the board may affect independence. Once the independent directors are appointed by the board these independent directors may nominate independent directors for the next term subject to affirmation of "independence" by the board in the same manner. In terms of what is stated above the offer for appointment of three independent directors on the board of FFBL is also accepted by the Commission.

39. We now refer to the condition where no individual will be Director of both FFC & FFBL with the exception of the Chairman, individuals representing institutions (other than Fauji Foundation and FFC) and minority shareholder. While, we consider such condition as an enabling provision to serve the objective of these proceedings we would accept this condition with some variance, namely, that no individual should be a director of both FFC & FFBL, with the exception of (a) the Chairman, (b) individuals representing institutions (apart from FFC, Fauji Foundation & any of its associated group of companies) and (c) minority shareholders. This would pre-empt issues of conflict that may directly or indirectly arise out of common directorship.

40. It needs to be appreciated that initiation of the proceedings by the Commission under the Ordinance and FFC & FFBL's interface with the Commission during the course of hearings eventually led the parties to come forward with a proposal that substantially, addressed the concerns of the Commission for bringing transparency in the functioning of the associated undertakings in order to protect and enhance competition in the relevant market.

41. For reasons recorded in the Order, the Show Cause Notices No 14 & 15 of 2007-08 issued to FFC & FFBL are to be disposed off in terms of the following:

1. No individual will be a director of both FFC & FFBL with the exception of (a) the Chairman, (b) minority shareholders (c) individuals representing institutions other than the Fauji Group of Companies including but not limited to FFC & FFBL.
2. The Chairman of FFBL will not have a second or casting vote nor shall he hold the office of the Chief Executive Officer. So long he is also the Chairman of FFC.

3. In order to ensure good corporate governance and transparency, FFBL shall take necessary measures to ensure that there are three independent directors on its board in terms of paragraph 38.
4. The Commission is agreeable to the proposed time period for the implementation of the aforesaid actions i.e., within a period of two years from the date of this Order as this appears to be reasonable.

42. In view of the foregoing, FFC & FFBL are directed to submit an undertaking, within a period of three weeks for and on behalf of their Boards (alongwith copies of relevant board resolutions), assuring the Commission that due compliance with the terms of this Order will be ensured. Furthermore, the undertakings are hereby also required to report and confirm due compliance of this Order within two years from the date of this order.

Order passed and signed on 29th day of April 2008 at Islamabad.

(Khalid A. Mirza)	(Abdul Ghaffar)	(Rahat Kaunain Hassan)	(Dr. Joseph Wilson)
Chairman	Member	Member	Member