BEFORE THE
COMPETITION COMMISSION OF PAKISTAN

IN THE MATTER OF

The Institute of Chartered Accountants of Pakistan

(File No. 03/Sec-4/CCP/08)

Date of hearing: 28th November 2008

Present for ICAP: Mr. Moiz Ahmad, Executive Director
Mr. Shoaib Ahmad, Senior Manager Corporate and Legal Affairs
Mr. Faisal Kamal, Legal Advisor of ICAP

ORDER

1. At issue in this case is whether the fixing of minimum hourly charge out rates and minimum fee for audit engagements by the Council of the Institute of Chartered Accountants of Pakistan (hereinafter "ICAP" or the "Institute") violates Section 4(1) of the Competition Ordinance, 2007 (hereinafter the "Ordinance"). I affirm.

Factual Background

2. ICAP is an autonomous statutory body created under the Chartered Accountants Ordinance, 1961 (X of 1961) to regulate the profession of

accountants in Pakistan, and is an undertaking as defined in clause (p) of Section 2(1) of the Ordinance.[1]

3. The Competition Commission of Pakistan (hereinafter the "Commission") took *suo moto* notice of ICAP's Circular No. 09/2008 dated 13 August 2008 addressed to the members of ICAP. The Circular conveyed the decision of the Council of ICAP to approve the recommendations of the Technical Advisory Committee relating to the revisions of (Technical Auditing Release) ATR-14, which is in force since 1987 and prescribes the minimum hourly charge out rates and minimum fee for audit engagements based on the turnover of the company being audited (hereinafter "Minimum Fees"). The revised ATR-14 applies to all audit appointments made after August 31, 2008. The Circular also mentioned that failure to comply with the directives of the Council will "fall within the mischief of Part 4 of Schedule I of the Chartered Accountants Ordinance, 1961," which lay down the instances of "professional misconduct in relation to the members of the Institute generally."

4. On September 8th, 2008 the Commission wrote a letter to ICAP asking the latter to provide rationale for setting the Minimum Fees. ICAP replied *vide* its letter dated September 27, 2008. The contents of letter dated September 27th, 2008 were again submitted by ICAP at the hearing as written arguments dated November 27th, 2008.

5. The Commission found the rationale given by ICAP to set the Minimum Fees unsatisfactory and issued a Show Cause on October 20th, 2008 and set October 28th, 2008 as the date for hearing. ICAP requested adjournment twice and the hearing was conducted on November 28th, 2008.

[1] Section 2(1)p: "Undertaking" means any natural or legal person, governmental body including a regulatory authority, body corporate, partnership, association, trust or other entity in any way engaged, directly, or indirectly, in the production, supply, distribution of goods or provision or control of services and shall include an association of undertakings."

ATR-14

6. ATR-14 is a directive by the Council of ICAP wherein it sets the minimum hourly rates to be charged by partners and staff of accountant firms and sets the minimum fee for different audit engagements. ATR-14 is in force since 1987 and is revised from time to time. Until the revisions made in July 2001, the minimum rates/fees were only recommendatory in nature and the members were free to charge the fee as they like. However, the revision made in April 2003 changed the nature of prescribed minimum rates/fees from recommendatory to mandatory. ATR-14 of April 2003 in Note 2 to paragraph 3 stated: "in case of acceptance of an audit client by a practicing member for the first time the prescribed fee level shall be strictly observed." (Emphasis added). To enforce the minimum rates/fees, paragraph 10 stipulated: "At the time of quality control review, the reviewer will ensure the compliance of this ATR." Since then ATR was revised in March 2007, and more recently in July 2008.

7. The relevant portions of ATR-14 of July 2008 are reproduced here below for ease of reference.

> 3. The Council of the ICAP periodically reviews and prescribes minimum hourly rates, which it considers reasonable and compatible with the increase in the cost to complete the engagements and quality of professional standards to be observed by the practicing members of the Institute. The current minimum chargeable rates as prescribed by the Council of the Institute are shown below:
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> | | **Rupees (Per man-hour)** |
> |---|---|
> | Partner | 7,500 |
> | Qualified Support Staff: | |
> | Above 8 years | 5,000 |
> | 4 to 8 years | 4,000 |
> | Below 4 years | 3,000 |
> | Supervisor | 2,000 |
> | Senior | 1,000 |
> | Semi-Senior | 750 |
> | Junior | 500 |
>
> 4. The level of fee is to be mutually agreed between the auditor and his client, which largely depends upon the volume of work involved and estimated time to be incurred on the audit engagement. The Council whilst recognizing this principle is however, of the view that there has to be a minimum threshold of audit fee. To achieve the desired objective, the following minimum audit fee is prescribed (which may be increased by consent having regard to specific circumstances of an audit engagement).

Schedule of Minimum Audit Fee:

Type of entity	Minimum Fee
Listed companies	
Turnover up to 500 million	250,000
Turnover over 500 million up to 1 billion	300,000
Turnover over 1 billion up to 5 billion	500,000
Turnover above 5 billion	1,000,000
Economically Significant Entities	
Turnover up to 1 billion	250,000
Turnover over 1 billion up to 5 billion	400,000
Turnover above 5 billion	800,000
Medium Sized Entities	125,000
Small Sized Entities	75,000

Notes:

i) The terms "Economically Significant Entities" (ESE), "Medium Sized Entities" (MSE) and "Small Sized Entities" (SSE) shall have the same meaning as defined in S.R.O.859(I)/2007 dated 21 August 2007 issued by the Securities and Exchange Commission of Pakistan pursuant to Section 234 of the Companies Ordinance, 1984.

ii) Considering the practical difficulties being faced by various practicing members in the determination of audit fee, the Council has decided that the prescribed minimum audit fee shall be charged without any exception. However, in case of an existing audit client, the present audit fee shall be enhanced to the aforesaid prescribed level over a period of two years with mutual consent provided it is not less than 75% of the prescribed minimum in the first year. Nevertheless, in case of acceptance of an audit client by a practicing member for the first time the prescribed fee levels shall be strictly observed. (Emphasis supplied)

5. Minimum Audit Fee in Certain Circumstances

For audit engagements of clients in the pre-incorporation / pre-operation stages or in case of sickness of the project or closed operations or discontinuation of business, the prescribed minimum audit fee chargeable by the practicing members shall be as under:

	Listed Companies/ ESEs	MSEs	SSEs
Minimum audit fee	Rs.75,000	Rs.50,000	Rs. 30,000

The exception in paragraph 4(ii) above shall apply mutatis mutandis to the above paragraph 5.

6. The minimum audit fee prescribed in paragraph 4 and 5 above is exclusive of the below mentioned additional services to be rendered by a statutory auditor under the Code of Corporate Governance and for any other certifications and the professional fee for such services shall be charged separately by mutual consent.

- Attend the Audit Committee Meetings of clients
- Issue a Review Report on Statement of Compliance with Best Practices of Corporate Governance
- Issue Review Report on half – yearly financial statements

• Special certification required by regulators over and above normal scope of audit

7. The minimum audit fee determined in accordance with this ATR shall not be less than the present audit fee of an existing client.

8. In case of joint audits, fee may be shared among the auditors as may be mutually agreed between them.

9. The fee may be reviewed annually to cover inflationary effects in costs.

10. The hourly rates and fee are exclusive of traveling and hotel expenses, out of pocket expenses and other incidental costs which would be reimbursable to auditors at actual.

11. In case of a religious or charitable institution or a company "not for profit", the practicing members may undertake to do the audit on a token fee or on an honorary basis.

12. At the time of quality control review, the reviewer will ensure the compliance of this ATR. (emphasis supplied)

This Directive supersedes ATR-14 (Revised) issued pursuant to the Council's decision of 30 March, 2007 and would apply to all audit appointments made after August 31, 2008.

Submissions by ICAP

8. ICAP submitted that according to Clause 11 of Part I of Schedule 1 to the Chartered Accountants Ordinance, 1961, a chartered accountant is guilty of professional misconduct if he:

(11) accepts a position as auditor previously held by some other chartered accountants in such conditions as to constitute undercutting.

In order to give effect to this clause, in 1987, ICAP began to deliberate upon ways to ensure that its members did not undercut each other, while simultaneously maintaining professional standards. Undercutting is a means by which, for instance, firms that can afford to take on auditing projects at a loss do so simply to capture business from other firms. This not only deters competition by driving smaller and medium firms out of the market, but also creates unhealthy competition among larger firms. Thus, the practice of undercutting and charging of extremely low fees is likely to adversely effect the quality of auditing services provided and will increase the risk of ineffective audits. This, in turn, can result in the publication of flawed or even misleading financial reports to the stakeholders.

That as a regulatory body for chartered accountants, this is a matter of grave concern for ICAP since inaccurate and misleading financial reports erode investors' confidence and create serious systemic risk for financial markets in the country. Therefore, the ICAP Council considers that it is imperative, and in the **public interest**, to ensure a minimum level of fees required to maintain an appropriate quality of audits and enable accountancy firms to retain staff that has the necessary knowledge, skills and training to perform effective audits. It was in this background that ICAP issued ATR-14, which aims to curb the practice of undercutting by ensuring that members charge the

minimum fee that would be required to provide professional auditing services. A minimum fee prevents firms from charging fees which will not cover the costs of the work required and thereby provide inferior and sub-standard auditing services.

7. This minimum fee is subject to periodic review and is based on the estimated number of hours each member of staff is likely to spend on a given project. It represents a best estimate of the minimum cost of carrying out an audit of the different sized entities mentioned in ATR-14, while maintaining an acceptable level of professional competence. It is worth noting that these minimum fees are not set at a level where any entity may be unable to afford auditing services, but at a level which ensures entities/companies requiring auditing services have a variety of firms to choose from and that each firm will provide it with quality services. The effect of this minimum fee is to increase the choices available to consumers and give them the confidence that if they engage an auditing firm they will receive a quality service. ICAP's members, particularly small and medium sized auditing firms have appreciated the measures taken by ICAP to protect their interests by preventing undercutting

8. The concept of setting a minimum fee is not unique to the accounting profession. For instance, Section 4 of the Companies (Appointment of Legal Advisors) Act, 1974 sets a minimum retainer fee that companies must pay to the lawyers. The State Bank of Pakistan ("SBP") and the Securities and Exchange Commission of Pakistan ("SECP") have approached the same problem from a different angle by creating a certified panel of auditors. Various entities that wish to have their accounts audited can only choose auditing firms on these panels. The aim is to maintain standards of professional excellence by only allowing certified firms to conduct audits.

9. Moreover, ATR 14 has been in place since 1987 and in all these years no complaints have been received either from the public or any government functionary against the fixing of a minimum fee even though the Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance, 1970 was in force.

The ostensible purpose of Section 4 of the Competition Commission is to prevent the restriction of competition in the market and to ensure that consumers are not exploited by cartels. The minimum fee set by ICAP promotes both these objectives – it increases competition by preventing undercutting and ensures that consumers are provided high quality services.[2] (Emphasis supplied).

9. The arguments raised by ICAP are summarized as follows:

i. To avoid undercutting;

ii. To ensure quality of auditing in the public interest, as charging of extremely low fees is likely to adversely effect the quality of auditing services (the aim is to maintain standards of

[2] Written Arguments on behalf of ICAP, dated November 27, 2008.

professional excellence by only allowing certified firms to conduct audits);

iii. Concept of setting a minimum fee is not unique to the accounting profession. For instance, Section 4 of the Companies (Appointment of Legal Advisors) Act, 1974 sets a minimum retainer fee that companies must pay to the lawyers;

iv. The State Bank of Pakistan ("SBP") and the Securities and Exchange Commission of Pakistan ("SECP") have approached the same problem from a different angle by creating a certified panel of auditors. Various entities that wish to have their accounts audited can only choose auditing firms on these panels.

v. ATR 14 has been in place since 1987.

I will address ICAP's arguments below.

Analysis

10. Section 4 of the Ordinance prohibits agreements or decisions which have the object or effect of preventing, restricting or reducing competition within the relevant market. Section 4 in relevant part is reproduced here below:

> 4. **Prohibited agreements**.-(1) No undertaking or association of undertakings shall enter into any agreement or, in the case of an association of undertakings, shall make a decision in respect of the production, supply, distribution, acquisition or control of goods or the provision of services which have the object or effect of preventing, restricting or reducing competition within the relevant market unless exempted under section 5 of this Ordinance.
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> (2) Such agreements include, but are not limited to-
>
> (a) fixing the purchase or selling price or imposing any other restrictive trading conditions with regard to the sale or distribution or any goods or the provision of any service;
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> (3) Any agreement entered into in contravention of the provision sub-section (1) shall be void.

11. Section 4 of the Competition Ordinance is similar to Article 81 of the Treaty of Rome, which is part of the EC Competition laws,[3] and is in

[3] Article 81 of the Treaty of Rome

congruity with Section 1 of the Sherman Antitrust Act of the United States.[4]

12. Prohibited agreements are analyzed, in the United States, under two categories of competitive analysis. "In the first category are agreements whose nature and necessary effects are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality –they are 'illegal *per se'*. In the second category are agreements whose competitive effect can only be evaluated by analyzing the facts peculiar to the business, the history of the restraint, and the reasons why it was imposed."[5] Similarly in the European Union, the Courts have held that for the "purpose of applying Article 81(1) there is no need to take account of the concrete effects of an agreement or decision once it appears that it has

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1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:
   (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
   (b) limit or control production, markets, technical development, or investment;
   (c) share markets or sources of supply;
   (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
   (e) Make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.
3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
   - any agreement or category of agreements between undertakings;
   - any decision or category of decisions by associations of undertakings;
   - any concerted practice or category of concerted practices,
   which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
   (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
   (b) Afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

[4] Section 1 of the Sherman Act, as set forth in 15 U.S.C. § 1 (1976 ed.), provides:

"Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal …"

[5] *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. 679 at 692, 98 S.Ct. 1355 at 1365, (1978). The rationale for *per se* rules in part is to avoid a burdensome inquiry into actual market conditions in situations where the likelihood of anticompetitive conduct is so great as to render unjustified the costs of determining whether the particular case at bar involves anticompetitive conduct. See, *e. g.*, *Arizona* v. *Maricopa County Medical Society*, 457 U.S. 332, 350-351 (1982); Under the usual logic of the per se rule, a restraint on trade that rarely serves any purposes other than to restrain competition is illegal without proof of market power or anticompetitive effect. *See also*, *Northern Pacific R. Co.* v. *United States*, 356 U.S. 1, 5 (1958).

as its object the prevention, restriction or distortion of competition,"[6] and consequently there is no need to define relevant market.[7] The agreement to fix minimum prices has invariably attracted *per se* condemnation by the Courts.[8]

13. The issue, whether fixing of minimum fee by a professional body for the provision of services violates competition laws, has been addressed by the courts in the United States[9] and the European Union among other jurisdictions with mature competition law regimes. We canvass representative cases from these jurisdictions.

14. The leading case on the issue at hand from the United States is *Goldfarb* v. *Virginia State Bar,*[10] wherein the U.S. Supreme Court held that the minimum fee schedule and its enforcement mechanism constituted price-fixing in that the schedule operated as a fixed, rigid price floor. The facts and holding in the case are summarized below:

> In *Goldfarb*, in 1971 petitioners, husband and wife, contracted to buy a home in Fairfax County, Virginia. The financing agency required them to secure title insurance; this required a title examination, and only a member of the Virginia State Bar could legally perform that service. Petitioners therefore contacted a lawyer who quoted them the precise fee suggested in a minimum-fee schedule published by respondent Fairfax County Bar Association; the

[6] Commission Decision of 24 June 2004 relating to a proceeding under Article 81 of the EC Treaty (In the matter of Belgian Architects' Association) at para 92 quoting Court of Justice in Joined Cases 56 and 58/64 *Consten and Grundig* [1966] ECR 429; *see also* Court of Justice in Case C-235/92 P *Montecatini* [1999] ECR I-4539, paragraph 122.

[7] Court of First Instance in Case T-62/98 *Volkswagen* [2000] ECR II-2707, paragraphs 230 and 231.

[8] *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 at 347 (1982). (we have not wavered in our enforcement of the *per se* rule against price fixing). "Once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it, it has applied a conclusive presumption that the restraint is unreasonable." Id. at 344. *Federal Trade Commission V. Superior Court Trial Lawyers Association*. 493 U.S. 411, 110 S.Ct. 768 (1990) (The ***per se*** rules also reflect a longstanding judgment that the prohibited practices by their nature have "a substantial potential for impact on competition.")

[9] *See, e.g.*, *Arizona v. Maricopa Cy. Medical Soc'y*, 457 U.S. 332, 102 S.Ct. 2466, 73 L.Ed.2d 48 (1982) (fact that doctors, rather than non-professionals, were parties to price fixing agreement did not exempt them from Sherman Act); *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. 679, 98 S.Ct. 1355, 55 L.Ed.2d 637 (1978) (difference between professional and other business services does not create a broad exemption under the Rule of Reason for learned professions); *Northern Cal. Pharmaceutical Ass'n v. United States*, 306 F.2d 379 (9th Cir.), *cert. denied*, 371 U.S. 862, 83 S.Ct. 119, 9 L.Ed.2d 99 (1962) (pharmacists had no defense to price fixing on ground it was done by professionals); *Mardirosian v. American Inst. of Architects*, 474 F.Supp. 628 (D.C.C.1979) (architects subject to antitrust laws); *United States Dental Inst. v. American Ass'n of Orthodontists*, 396 F.Supp. 565 (N.D.Ill.1975) (practice of dentistry and orthodontia does not fall outside the ambit of trade or commerce); *American Medical Ass'n v. Federal Trade Comm'n*, 455 U.S. 676, 102 S.Ct. 1744, 71 L.Ed.2d 546 (1982) (per curiam) (equally divided court affirmed 638 F.2d 443 (2d Cir.1980)).

[10] 421 U.S. 773, 95 S.Ct. 2004, 44 L.Ed.2d 572, 1975-1 Trade Cases P 60,355 (1975).

lawyer told them that it was his policy to keep his charges in line with the minimum-fee schedule which provided for a fee of 1% of the value of the property involved. Petitioners then tried to find a lawyer who would examine the title for less than the fee fixed by the schedule. They sent letters to 36 other Fairfax County lawyers requesting their fees. Nineteen replied, and none indicated that he would charge less than the rate fixed by the schedule; several stated that they knew of no attorney who would do so.[11]

The fee schedule the lawyers referred to is a list of recommended minimum prices for common legal services. Respondent Fairfax County Bar Association published the fee schedule although, as a purely voluntary association of attorneys, the County Bar has no formal power to enforce it. Enforcement has been provided by respondent Virginia State Bar which is the administrative agency through which the Virginia Supreme Court regulates the practice of law in that State; membership in the State Bar is required in order to practice in Virginia. Although the State Bar has never taken formal disciplinary action to compel adherence to any fee schedule, it has published reports condoning fee schedules, and has issued two ethical opinions indicating that fee schedules cannot be ignored. The most recent opinion states that 'evidence that an attorney habitually charges less than the suggested minimum fee schedule adopted by his local bar Association, raises a presumption that such lawyer is guilty of misconduct . . ..[12]

The fee schedule was enforced through the prospective professional discipline from the State Bar, and the desire of attorneys to comply with announced professional norms, the motivation to conform was reinforced by the assurance that other lawyers would not compete by underbidding. This is not merely a case of an agreement that may be inferred from an exchange of price information, for here a naked agreement was clearly shown, and the effect on prices is plain.[13]

Moreover, in terms of restraining competition and harming consumers like petitioners the price-fixing activities found here are unusually damaging. A title examination is indispensable in the process of financing a real estate purchase, and since only an attorney licensed to practice in Virginia may legally examine a title, consumers could not turn to alternative sources for the necessary service. All attorneys of course, were practicing under the constraint of the fee schedule. The County Bar makes much of the fact that it is a voluntary organization; however, the ethical opinions issued by the State Bar provide that any lawyer, whether or not a member of his county bar association, may be disciplined for 'habitually charg(ing) less than the suggested minimum fee schedule adopted by his local bar Association . . ..' These factors coalesced to create a pricing system that consumers could not realistically escape. On this record respondents' activities constitute a classic illustration of price fixing.[14] (Emphasis supplied).

[11] Id. at 773. (footnotes and citations omitted).
[12] Id. at 776 -778.
[13] Id. at 781 & 782.
[14] Id. at 782 & 783.

15. The facts in *Goldfarb* case are identical to the case at hand:

i. Only a member of the Virginia State Bar could legally examine the title; similarly, audit services for Economically Significant Entities (ESEs), Medium Sized Entities (MSEs), Small Sized Entities (SSEs) and Listed Companies can only be performed by certified chartered accountants who are members of ICAP.

ii. The fees were based on the value of the property involved rather than on the quantum of work to be performed, similar to ATR-14 which prescribes fees based on the turnover of the company being audited rather than the quantum of work that needs to be performed.

iii. The violation of prescribed minimum fee schedule was considered as misconduct; similarly failure to comply with the directive of ICAP is considered professional misconduct.

iv. Attorneys were practicing law under the restraint of the fee schedule; similarly in the instant case, accountants are providing their professional services under the restraint of the directive by ICAP.

The above facts made the court in *Goldfarb* describe it as "*a classic illustration of price fixing*" as they "coalesced to create a pricing system that consumers could not realistically escape."[15] The facts in the instant case also do not allow the consumers (*i.e.,* ESEs, MSEs, SSEs, and Listed Companies) to get audit services outside of the pricing mechanism created by ICAP.

16. One of the main arguments adduced by ICAP in support of ATR-14 was that it was introduced to prevent undercutting. Part I of Schedule 1 to the Chartered Accountants Ordinance, 1961 lays down instances of "professional misconduct in relation to chartered accountants in practice." Clause 11 of part I states that a chartered accountant may be deemed guilty of professional misconduct if he "accepts a position as auditor previously held by some other chartered accountants in such conditions as to constitute undercutting." Section 240.1 of the Revised Code of Ethics for Chartered Accountants restricts the circumstances which may constitute undercutting. Section 240.1 in relevant part stipulates:

[15] Id..

> . . . chartered accountants in practice should be careful no to quote fee lower than that charged by chartered accounts in practice previously carrying out the audit unless the scope and quantum of work materially differs from the scope and quantum of work carried out by the previous auditor, as it could then be regarded as undercutting. (Emphasis supplied).

17. The concept of undercutting as mentioned in clause 11 of Part I of Schedule I to the Chartered Accountants Ordinance, 1961 or as mentioned in Section 240.1 in the Revised code of Ethic is not an issue of which the Commission has taken cognizance. I, therefore, do not intimate my views on it. However, note 2 to the paragraph 4 of the ATR-14 has broadened the scope of undercutting from "previously held" audit engagements to all new ones. Note 2 to paragraph 4 reads in relevant part as follows:

> [I]n case of acceptance of an audit client by a practicing member for the first time the prescribed fee levels shall be strictly observed.

This prohibits competitive bidding and therefore falls within the purview of Section 4 of the Ordinance.

18. Related to argument of undercutting (or competitive bidding) was the argument to ensure quality of auditing in the public interest, as charging of extremely low fees is likely to adversely effect the quality of auditing. These two arguments were addressed by the U.S. Supreme Court in the National Society of Professional Engineers case.[16]

19. Brief facts of *National Society* case are summarized here below:

> In 1972 the US Government filed a complaint against the National Society of Professional Engineers (Society) alleging that members had agreed to abide by canons of ethics prohibiting the submission of competitive bids for engineering services and that, in consequence, price competition among the members had been suppressed and customers had been deprived of the benefits of free and open competition. The complaint prayed for an injunction terminating the unlawful agreement.[17]
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> In its answer the Society admitted the essential facts alleged by the Government and pleaded . . . that the standard set out in the Code of Ethics was reasonable because competition among professional engineers was contrary to the public interest. [Testing, calculating and designing the most

[16] 435 U.S. 679, 98 S.Ct. 1355 (1978).
[17] Id. at 684.

> economical and efficient structures and methods of construction is complex, difficult and expensive.] It was averred that it would be cheaper and easier for an engineer "to design and specify inefficient and unnecessarily expensive structures and methods of construction." Accordingly, competitive pressure to offer engineering services at the lowest possible price would adversely affect the quality of engineering. Moreover, the practice of awarding engineering contracts to the lowest bidder, regardless of quality, would be dangerous to the public health, safety, and welfare. For these reasons, the Society claimed that its Code of Ethics was not an "unreasonable restraint of interstate trade or commerce."[18]
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> Price is the "central nervous system of the economy,"[19] and an agreement that "interfere[s] with the setting of price by free market forces" is illegal on its face.[20] In this case we are presented with an agreement among competitors to refuse to discuss prices with potential customers until after negotiations have resulted in the initial selection of an engineer. While this is not price fixing as such, no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement. It operates as an absolute ban on competitive bidding, applying with equal force to both complicated and simple projects and to both inexperienced and sophisticated customers. As the District Court found, the ban "impedes the ordinary give and take of the market place," and substantially deprives the customer of "the ability to utilize and compare prices in selecting engineering services." On its face, this agreement restrains trade within the meaning of § 1 of the Sherman Act.[21]
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> We are faced with a contention that a total ban on competitive bidding is necessary because otherwise engineers will be tempted to submit deceptively low bids. Certainly, the problem of professional deception is a proper subject of an ethical canon. But, once again, the equation of competition with deception, like the similar equation with safety hazards, is simply too broad; we may assume that competition is not entirely conducive to ethical behavior, but that is not a reason, cognizable under the Sherman Act, for doing away with competition.[22]
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> The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain – quality, service, safety, and durability – and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers.[23]

20. In *National Society,* the Court held that canon of ethics prohibiting competitive bidding violated section 1 of the Sherman Act, and also addressed the "public interest" argument for ensuring safety by holding that "competition is the best method of allocating resources in a free

[18] Id. at 684 & 685.
[19] United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n. 59, 60 S.Ct. 811, 845, 84 L.Ed. 1129.
[20] United States v. Container Corp., 393 U.S. 333, 337, 89 S.Ct. 510, 512, 21 L.Ed.2d 526.
[21] 435 U.S. 679, at 692 (1978).
[22] Id. at 696.
[23] 435 U.S. 679, at 695 (1978).

market recognizes that all elements of a bargain – quality, service, safety, and durability – and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers."[24]

21. Note 2 to paragraph 4 of ATR-14, by strictly mandating the application of Minimum Fees impedes with the ordinary give and take of the market place, and substantially deprives the companies of the ability to make choices based on prices from among the audit firms. This in my view violates Section 4(1) of Ordinance and need to be condemned under Section 4(3) of the Ordinance.

22. At the hearing, the representatives of ICAP consistently maintained that minimum fees, which are based on the "estimated number of hours each member of staff is likely to spend on a given project,"[25] are essential to ensure quality. When asked whether ICAP has any mechanism in place that will ensure an auditor will put in certain "number of hours" for an audit engagement, the reply was in the negative.

23. For ensuring quality, ICAP has a Quality Assurance Board (QAB), which is composed of thirteen members. "The Chairman of the Board is a non-practicing and non Council member. The Board is represented by members from big and small firms and industry. It also includes three nominees from the Securities & Exchange Commission of Pakistan (SECP) and one from the State Bank of Pakistan (SBP)." [26] QAB has the mandate to "carry out Quality Control Review (QCR) of working papers relating to audits carried out by the firms." [27] Based on the QCR, QAB issues a final report to the firm and if the report is satisfactory, the firm will get "Satisfactory QCR Rating", which is necessary to perform audits of listed companies.[28]

[24] 435 U.S. 679, at 695 (1978).
[25] Paragraph 7 of the Written Arguments.
[26] http://www.icap.org.pk/web/links/0/qualityassuranceboard(qab)composition.php
[27] http://www.icap.org.pk/web/links/0/qcrframework(revised).php#Objectives
[28] Id.

24. ICAP enforce International Standard on Auditing (ISA) 220, *Quality Control for Audits of Historical Financial Information,* and ISA 230 *Audit Documentation,* etc. ICAP will be enforcing ISQC 1 (International Standards on Quality Control) with effect from July 1st 2009. ISQC 1 will "establish standards and provide guidance regarding a firm's responsibility for quality control of audits and other assurance and related services engagements," and will apply to sole practitioners as well.[29]

25. It appears from above that ICAP has sufficient quality control mechanisms in place. The representatives were asked to give the rationale for putting in the additional layer of quality control through Minimum Fees particularly in the case of audit of listed companies where only firms with Satisfactory QCR Rating can undertake the audit. The representatives were unable to provide any satisfactory reply to it. I fail to understand how minimum fees can add in assuring quality of the audit firms, who have undergone a rigorous quality control check and were granted Satisfactory QCR Rating by Quality Assurance Board. It seems that either there is an inherent distrust in the integrity of the auditors or the objective is to restrict competition by placing Minimum Fees.

26. When asked, if there are precedents from other jurisdictions wherein association of auditors have prescribed minimum fees, the representatives were also unable to provide any. If other countries can "reasonably expect professional persons . . . when discharging their professional duties to act professionally [, which] must include, almost by definition, a refusal to do cut-rate work for cut-rate prices,"[30] why cannot we do the same in Pakistan? In fact, the Minimum Fees does not prevent unscrupulous auditors from offering poor-quality services, and it may even protect them by guaranteeing them a minimum fee.[31]

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[29] http://www.icap.org.pk/web/news-details.php?section=all&id=081031113742

[30] *Mortimer v. Corporation of Land Surveyors of British Columbia*, 35 B.C.L.R. (2d) 394, para 24 (1989).

[31] Commission Decision of 24 June 2004 relating to a proceeding under Article 81 of the EC Treaty (In the matter of Belgian Architects' Association).

27. The European Commission in its decision date 24 June 2004, involving minimum fee set by Belgian Architects' Association noted[32]:

> In any event, the [European] Commission takes the view that the establishment of a (recommended) minimum fee scale cannot be considered as necessary in order to ensure the proper practice of the architect's profession. The Association asserts that the scale may be useful in that it can act as a guideline for replies to questions from parties to the contract or from a court of law. The Commission considers that information on prices can be provided in other ways. For example, the publication of information collected by independent parties (such as consumer organisations) concerning prices generally applied, or information based on a survey, can constitute a more reliable yardstick for consumers and lead to fewer distortions of competition. The Association further claims that the scale is useful because extremely low fees may be an indication of practices that are manifestly illegal. The Commission would point out that the Association is not automatically informed of the fees demanded by architects, that extremely low fees are not in themselves sufficient proof of illegal practices, and that other elements have to be taken into account, which means that the Association can continue to perform its supervisory function without a fee scale. In addition, the scale does not prevent unscrupulous architects from offering poor-quality services, and it may even protect them by guaranteeing them a minimum fee. Furthermore, the scale may discourage architects from working in a cost-efficient manner, reducing prices, improving quality or innovating. For this reason, therefore, the decision establishing the scale cannot be excluded from the scope of the prohibition in Article 81(1). (Emphasis added).

28. ICAP averred that the concept of setting a minimum fee is not unique to the accounting profession. As an instance, it quoted Section 4 of the Companies (Appointment of Legal Advisors) Act, 1974 which sets a minimum retainer fee that companies must pay to the lawyers.

29. There is a distinction here. In the case of legal advisors, minimum fee is set by the legislature itself and not by any association of lawyers. This indicates that were the legislature intends to set the minimum fees for professional, it will either do it itself through an Act of the Parliament or by giving clear and specific powers to a regulatory body. ICAP does not seem to have the legal mandate to regulate or prescribe minimum fees. The counsel for ICAP asserted that power to prescribe minimum fee emanates from Section 27 (2) (kk) of the Chartered Accountants Ordinance, 1961.

[32] Id.

30. Section 27 empowers Council of ICAP to make bye-laws. Subsection 2 of Section 27 gives an exhaustive list of matters in which the Council of ICAP may make bye-laws. The bye-laws in order to become effective need the approval of the Federal Government. Nothing in the list provided by subsection 2 empowers the Council of ICAP to prescribe minimum fees which may be charged by chartered accountants. Clause kk of subsection 2 of Section 27 was added in Section 27 through the Chartered Accountant (Amendment) Ordinance, 1983. Clause kk empowers the Council to issue directives, which did not need the approval of Federal Government to become effective. Section 27 is reproduced here below.

> 27. **Power to make bye -laws. -** (1) The Council may, by notification in the official Gazette, make bye-laws for the purpose of carrying out the object of this Ordinance, and a copy of such byelaws shall be sent to each member of the Institute.
>
> (2) In particular, and without prejudice to the generality of the foregoing power, such bye-laws may provide for all or any of the following matters:-
>
> (a) the standard and conduct of examinations under this Ordinance;
> (b) the qualifications for the entry of the name of any person in the Register;
> (c) the conditions under which any examination or training may be treated as equivalent to the examination and training prescribed for the membership of the Institute;
> (d) the conditions under which any foreign qualifications may be recognized;
> (e) the manner in which and the conditions subject to which applications for entry in the Register may be made;
> (f) the fees payable for membership of the Institute and the annual fees payable by associates and fellows of the Institute in respect of their certificates;
> (g) the manner in which elections to the Council at the Regional Committees may be held;
> (h) the particulars to be entered in the Register;
> (i) the functions of Regional Committees;
> *(j) [the training of the students and suspension of the training of students for misconduct or for any other cause;]
> (k) the regulation and maintenance of the status and standard of professional qualifications of members of the Institute;
> **[(kk) the issue of directives to the members of the Institute on professional matter;]
> (l) carrying out of research in accountancy;
> (m) the maintenance of a library and publication of books and periodicals on accountancy;
> (n) the management of the property of the Council and the maintenance and audit of its accounts;
> (o) the summoning and holding of meetings of the Council, the times and places of such meetings, the conduct of business

thereat and the number of members necessary to form a quorum;

(p) the powers, duties and functions of the President and the Vice-President or Vice-Presidents of the Council;

(q) the functions of the Standing and other Committees and the conditions subject to which such functions shall be discharged;

(r) the terms of office, and the powers, duties and functions of the Secretary and other officers and servants of the Council;

(s) the rules of professional and other misconduct, and the exercises of disciplinary powers, and

(t) any other matter which is required to be or may be prescribed under this Ordinance.

(3) All bye-laws made by the Council under this Ordinance shall be subject to the condition of previous publication and to the approval of the Federal Government.

(4) Notwithstanding anything contained in sub-section (1) and (2), the Federal Government may frame the first bye-laws for the purposes mentioned in this section and such bye-laws shall be deemed to have been made by the Council, and shall remain in force from the date of the coming into force of this Ordinance until they are amended, altered or revoked by the Council.

31. In *Mortimer v. Corporations of Land Surveyors,*[33] the Supreme Court of British Columbia, Canada was seized with the interpretation of Land Surveyors Act. Section 4(g) of the Land Surveyors Act empowered the surveyors' professional body to pass by-laws with regard to "the tariff of fees" for professional services. The Court noted that monopolistic nature of legislation dictates strict interpretation. It held that:

> the "loose" language of s. 4(*g*), "the tariff of fees", can in no way be interpreted to mean "the minimum tariff of fees". To intend the latter, it would be necessary to use language such as "mandatory minimum tariff of fees". A failure to use such language leads to only one conclusion –that the legislature intended to provide only a suggested tariff– a fee guide as it were.[34]

32. A review of Section 27 of the Chartered Accountants Ordinance, 1961, and in light of *Mortimer* above, it is very clear that the impugned ATR-14 is *ultra vires* the mandate entrusted on the ICAP Council by the Chartered Accountants Ordinance, 1961.

[33] Mortimer v. Corporation of Land Surveyors of British Columbia, 35 B.C.L.R. (2d) 394, para 24 (1989).
[34] Id. paragraph 23.

33. ICAP further argued that "to maintain standards of professional excellence" the State Bank of Pakistan ("SBP") and the Securities and Exchange Commission of Pakistan ("SECP") have created a certified panel of auditors. I do not see certification done by SBP or SECP any different than Satisfactory QCR Rating done by ICAP. The relevant legislation empowered SBP and SECP to do that, and this is part of their supervisory role.

34. Finally, ICAP maintained that ATR-14 is in place since 1987 and no complaints were filed by public or government functionaries. It may be mentioned here that while ATR-14 is in place since 1987, the minimum fees were only recommendatory in nature till April 2003. It was only after April 2003 that minimum fees become mandatory. In the Belgian Architects' Association Case mentioned in Para 27 above, the minimum fee scale was in force since 12 July 1967, and caught the attention of the European Commission in 2002, after 35 years of its existence, when it was revised again. The European Commission imposed a fine of € 100,000.00 keeping in view the 36 years of infringement. (The minimum fee scale stayed in existence till 21 November 2003, when the EC Commission held it void under Article 81(1)). The notion of gaining legality through "prescription" is not applicable here.

35. In light of the above discussion, it is evident that ATR-14 violates Section 4(1) of the Competition Ordinance and is therefore void under Section 4(3) of the Ordinance.

36. The effort to broaden the definition of "undercutting" by including all new audit engagements through Note 2 to paragraph 4 of ATR-14 amounts to prohibiting competitive bidding, which violates Section 4(1) of the Ordinance and is therefore void under Section 4(3).

37. Given that ICAP has been engaged in improving the standards of profession, I am not inclined to impose any penalty on it.

38. ICAP is directed to inform its members through circular to withdraw ATR-14 from the Members' Handbook, Volume II, Part II Section C, and to publish notice of such withdrawal in two news papers, one of English and one of Urdu, of nation-wide circulation in a conspicuous fashion on or before December 19th, 2008, failing which a penalty of Rs. 300,000/- per day of infringement shall be recovered from ICAP under Section 40 of the Competition Ordinance.

39. It is so ordered.

(DR. JOSEPH WILSON)
Member

ISLAMABAD THE 4TH OF DECEMBER 2008.