



Privatization of motor vehicle inspection: Assessment in respect of the Fair Competition Act

23 November, 2001

1. Introduction

At a meeting on November 2nd, 2001 convened by the Honourable Minister Paulwell, which was attended by the staff of the Fair Trading Commission (FTC), and Ms. Sandra Myers of the Ministry of Transport and Works (MTW), it was decided that the FTC would conduct a detailed examination of the implications of the privatization of Motor Vehicle Inspection (MVI) to determine the extent to which the relevant licence can be accommodated under Section 17 of the Fair Competition Act (FCA).

Section 17(1) of the Act applies to—

“agreements which contain provisions that have as their purpose the substantial lessening of competition, or have or are likely to have the effect of substantially lessening competition in a market.”

According to subsection 17(3)—

“subject to subsection (4), no person shall give effect to any provision of an agreement which has the purpose or effect referred to in subsection (1); and no such provision is enforceable.”

According to subsection 17(4), subsection (3) does not apply to any agreement which the Commission is satisfied—

“(a) contributes to—

- (i) the improvement of production or distribution of goods and services; or
- (ii) the promotion of technical or economic progress,

while allowing consumers a fair share of the resulting benefit;

- (b) imposes on the enterprises concerned only such restrictions as are indispensable to the attainment of the objectives mentioned on paragraph (a); or
- (c) does not afford such enterprises the possibility of eliminating competition in respect of a substantial part of the goods or services concerned.”

In order to carry out the assessment, the staff of the FTC requested answers to a number of questions, as set out below:-

To understand the background on the privatization itself, the following question was asked:

1. *What are the key elements of the proposed system, including a breakdown of the types of investments and operations that will be carried out (for example, the implementation of monitoring standards, the introduction of a database of all cars inspected and the operations of the inspection stations)? Please indicate the activities, if any, that will require the involvement of any governmental agency or ministry.*

There are potentially several ways to operate the MVI service and not all of them require an exclusive licence for the inspection operations itself. In the UK, for example, the system operates by having a Vehicle Inspectorate, which supervises and grants licences to the 19,000 garages, which are authorized to inspect motor vehicles. To ascertain the justification for the proposed exclusive licence, the following question was asked:

2. *Why is an exclusive licence necessary to facilitate the investment?*

To assess the contribution which the proposed exclusive licence would make to “the improvement of production or distribution of goods and services; or the promotion of technical or economic progress, while allowing consumers a fair share of the resulting benefit” (as per Section 17(4)(a) of the FCA), the following questions were asked:

3. *Which of the above elements are new and/or improvements as compared to the current inspection system in place?*
4. *What are the benefits of the proposed system compared to the current system?*
5. *What criteria were used, and what process was undertaken, in choosing Mustang Ltd. as the recipient of the contract?*
6. *How will the inspection fees be set and how will future changes in the fees be determined?*
7. *Will any performance standards be set for Mustang Ltd.? If so, what are they?*
8. *What penalties, if any, will be imposed if Mustang Ltd. does not meet the required standards?*
9. *What factors or events could result in rising costs and delays in the start of the operations of the new system? Who would bear the risk of these unanticipated increases in costs and delays? Will such costs be passed to the consumers?*

Question (5) relates to the point that, if competition in the market is not available, the benefits to consumers are best ensured if there were competition for the market, i.e., a fair and transparent process to select the best operator. Question (6) assesses the possibilities of abuse of dominance and excessive pricing to the detriment of consumers. Questions (7), (8) and (9) assess the checks and balances in place to ensure that consumers are allowed a fair share of the benefits.

Section 17(4)(b) states that the restraints imposed should be “indispensable to the attainment of the objectives mentioned on paragraph (a)”. In the case of the privatization of MVI, this implies that the terms of the licence should be no more restrictive than is necessary to allow the enterprise to contribute in the manner set out. To assess this criterion, the following questions were asked:

10. What level of investment is required from Mustang Ltd. and from the government, if any?

11. *What is Mustang Ltd.’s projected level of profits over the contractual period?*

Finally, to assess the possibility of introducing competition, if feasible, after the licence expires, the following questions were asked:

12. *Who will have ownership of the database and the data, during and after the contractual period?*

13. *What elements in the contract, if any, will enable the introduction of competition, where feasible, after the end of the 10-year period?*

2. Assessment

The above 13 questions were asked of the National Investment Bank of Jamaica (NIBJ) and the MTW in order to facilitate the assessment. Upon instruction from the Office of the Prime Minister (OPM), the NIBJ, who led the responses, provided the staff of the FTC with cabinet submissions on the matter. NIBJ had been instructed by the OPM to provide only the cabinet submissions and not to answer any questions. Information that was not already in the cabinet submissions was not to be made available. This was in keeping with a policy to maintain confidentiality. The documents indicated also that “no announcement should be made on the matter until the privatization was finalized.”

The following lays out the information gleaned from documents submitted. As can be seen, the staff of the FTC was able to obtain most information required from the cabinet submissions. Where information was not made available, it is indicated below.

1. *What are the key elements of the proposed system, including a breakdown of the types of investments and operations that will be carried out (for example, the implementation of monitoring standards, the introduction of a database of all cars inspected and the operations of the inspection stations)? Please indicate the activities, if any, that will require the involvement of any governmental agency or ministry.*

The proposed privatization would see Mustang Jamaica Ltd. (MJL) being granted an exclusive licence from the MTW for a period of 10-years for the operation of MVI in Jamaica.

Parties to the Agreement

The parties to the Agreement MJL as Licensee and the Minister of Transport and Works (the “Minister”) and the Island Traffic Authority (the “ITA”), which currently has

responsibility for motor vehicle inspection in the Island and which will continue to be ultimately accountable for the service.

MJL (the licensee) is a special purpose shell company, established in Jamaica as the result of a joint venture between MVISL and Ganzcorp Investments Inc, (dba Mustang Dynamometer). Mustang Dynamometer is owned by the Ganzhorn brothers and has no substantial assets or equity.

Ganzhorn Properties, an Ohio partnership of the owners of Ganzcorp Investments Inc and in which entity the substantial assets and equity of the partners reside is to serve as their financial guarantor that the licensee will perform as it has represented that it can.

Services offered

The privatized MVI will provide the following services at eight sites across the island and are to be paid for through the Permitted fee:

- Scheduled and regular inspection of all private and commercial vehicles;
- Emission testing limited to snap acceleration and idle test;
- Mobile inspection for compliance in co-ordination with the Police;
- Motor Vehicle damage reports (required by the police);
- A motor vehicle database.

There will be eight inspection stations instead of the fourteen that currently exist. These will be located in the following parishes:

Kingston	St. Ann
St. Andrew	St. James
St. Catherine	Westmoreland
Manchester	Portland

Except for the parishes of Portland, St. Ann and Westmoreland, the inspections are to be carried out at existing locations, which are to be upgraded in accordance with a standard plan to be approved by the Minister. The sites will be leased to the investors at nominal rates. All transactions pertaining to the inspection and registration of motor vehicles are to take place on site.

Involvement of other entities

The ITA has retained direct responsibility for weighing of vehicles and has made separate arrangements for periodic examination of taximeters. Police vehicles are subject to testing for fitness under the agreement. Military vehicles are exempt from testing.

Corollary agreements are contemplated with the Inland Revenue Department and the ITA to fix a protocol for the shared occupation of the Sites with the Licensee. The sites are to be provided at no charge to the entities. The entities will however pay for telecommunication services.

Leases in respect of the Sites are to be executed with the Commissioner of Lands. An escrow agreement is to be executed with an escrow agent/trust company to hold in safekeeping the source code critical to long term maintenance of any technology based contract.

2. *Why is an exclusive licence necessary to facilitate the investment?*

FTC was informed that exclusivity was required because the vehicle population in Jamaica is not large enough to support more than one operator.

3. *Which of the above elements are new and/or improvements as compared to the current inspection system in place?*

The privatization of MVI will facilitate the institution of an efficiently operated and managed inspection service, which can provide for the safety of citizens and their property. This is to be achieved by ensuring that:

- Vehicles entering the country and using the roads are accurately accounted for in a sufficiently informed database;
- Inspection procedures are standardized, documented and based on objective pass/fail criteria;
- Vehicles are physically examined with the prescribed frequency;
- Vehicles are registered and licensed only on the basis of prescribed documentation and the opportunity provided for electronic verification of documentation presented;
- The police are able to ascertain independently and quickly the bona fides of the vehicle and driver in a road spot check;
- Insurance companies are able to verify independently and electronically the authenticity of documentation presented in support of requests for insurance cover.

The privatisation system is also expected to rectify the following shortcomings of the current system:

- Poor facilities which militate against the provision of a satisfactory service to the public;
- Corruption in the issuing of Certificates of Fitness;
- The bureaucratic, time-consuming process of obtaining Certificates of Fitness and road licenses for motor vehicles;
- The inadequacy of the record keeping system which prohibits the speedy retrieval of information, particularly for police investigation.

4. *What are the benefits of the proposed system compared to the current system?*

See response to Question (3) above.

5. *What criteria were used, and what process was undertaken, in choosing Mustang Ltd. as the recipient of the contract?*

In October 1996 NIBJ prepared a Request for Proposals to provide island-wide MVI. The entity was advertised both locally and overseas, eleven proposals were received, evaluated and ranked.

Cabinet in its Decision No 93 dated 6 October 1997 granted permission to NIBJ to commence negotiations with the highest ranked applicant, SGS Supervise Jamaica Ltd. The negotiations began in July 1998 and ended in December 1998 when SGS informed NIBJ that it was no longer interested in providing the service.

In January 1999 NIBJ obtained permission to invite the second ranked applicant, Motor Vehicle Inspection Services Limited (MVISL) for preliminary discussions. MVISL is a Jamaican company established by the employees of ITA for the purposes of providing the service.

In May 1999 MVISL submitted an updated proposal with Ganzcorp Investments Inc (dba Mustang Dynamometer). Mustang Dynamometer is incorporated in the State of Ohio, USA, and has technological and practical experience in motor vehicle inspection at international standards. In September 1999 the prospective investors put in place a bond representing 10% of the proposed capital investment as a precondition to negotiations. Negotiations commenced in earnest on 21 October 1999 with Mustang Jamaica Ltd. (MJL), a joint venture company formed between MVISL and Ganzcorp Investments Inc, (dba Mustang Dynamometer).

6. *How will the inspection fees be set and how will future changes in the fees be determined?*

A fee setting formula has been established to facilitate certainty in the pricing of the service. The Minister will pass the permitted fee into law by order as is presently done. The weighted average permitted fee is US\$26.20 in year 1 or J\$1153 based on an exchange rate of J\$44.0 to US\$1.00 and represents an increase of 42% over the present average of J\$842.0.¹

The price is deemed to comprise the following:

- (a) a foreign component being the amount required to service the company's foreign currency debt and
- (b) a local component being the balance of the price.

The price is to be held constant for three-year periods but adjusted at the end of each three-year period for USA inflation in respect of the foreign component and local inflation in respect of the local component. Earlier adjustments would be made where inflation during the three-year period exceeds prescribed levels.

¹ Note that the Jamaican currency has since dropped to approximately J\$47.00 to US\$1.00.

There would be a fee adjustment every three years, based on a breakdown of the local and foreign components of the costs, and these adjustments would require the approval of the MTW through the ITA.

Under the present structure there is no charge where a vehicle fails the inspection and has to be re-inspected. Under the proposed structure the fee for re-inspection, if more than one is required, is to be 50% of that charged for the first inspection. The first re-inspection will be free of charge only if done within 30 days of the first inspection.

7. *Will any performance standards be set for Mustang Ltd.? If so, what are they?*

MVIs at each site are to be provided within a queuing and inspection timeline of 18 minutes for each such inspection during the first year of operation of the term and thereafter for the remainder of the term within a queuing and inspection timeline of 15 minutes for each such inspection (inclusive of waiting for the inspection, inspection and delivery of the certificate of fitness or rejection report). Maintenance of the turnaround time is a fundamental term of the agreement.

The investors are also required to maintain system availability of 95%.

Extensive provisions have been made for the delivery of reports by the Licensee to the Minister during the Term of the Licence and for the Ministry to carry out audits and inspections to ensure compliance with the licence and the business plan. These provisions are captured in the Performance Criteria and the allowance for Quality Auditors.

8. *What penalties, if any, will be imposed if Mustang Ltd. does not meet the required standards?*

The only penalty for non-performance is the threat of termination of contract. One condition, amongst others, that would lead to the termination of the Agreement is the if MJL fails to meet the Performance Criteria. Termination of Agreement is therefore a penalty for not meeting the required standards. There is, however, no clarity on what would be considered a failure to meet performance criteria. How many instances of MJL taking, for example, more than 15 – 18 minutes for inspection would be considered a breach of contract? The execution of this penalty depends on the reports and assessments by the ITA.

There are no ‘intermediate penalties’ that are less extreme and less binary than the threat of termination of contract. Intermediate penalties could take the form of, say, free inspection for customers who have to wait for more than the required time (15 – 20 minutes) for the inspection of their vehicle.

9. What factors or events could result in rising costs and delays in the start of the operations of the new system? Who would bear the risk of these unanticipated increases in costs and delays? Will such costs be passed to the consumers?

There are no expected rise in costs that would be borne by any other party than MJL.

10. What level of investment is required from Mustang Ltd. and from the government, if any?

This information was not made available to the FTC.

11. What is Mustang Ltd.'s projected level of profits over the contractual period?

This information was not made available to the FTC.

12. Who will have ownership of the database and the data, during and after the contractual period?

All data captured through the system shall be and remain the sole property of the Minister of Transport and Works. Provisions are in place to facilitate the security of these data.

13. What elements in the contract, if any, will enable the introduction of competition, where feasible, after the end of the 10-year period?

On termination MJL is to immediately convey, assign and transfer or procure the conveyance, assignment and transfer of:

- All intellectual property rights including either a perpetual licence for the use of the software or a licence for at least 49 years;
- The Benefit of all contractual arrangements with third parties relevant to the continued performance of the Service;
- All proprietary and other rights in and title to the Equipment and Facilities;
- All leases, licences or titles to any of the Sites (including relevant easements and rights of way);
- Its interest in any property relevant to performance of the service.

The buildings, facilities equipment and system must be retained separate from the assets of the investors so that the transfer to the Minister and the continued effective provision of the Service is not encumbered by any third party security interests and accordingly:

- All facilities, equipment and the system to be used in connection with the provision of the Service must be the property of MJL and/or the GOJ;

- In the event of termination the Minister shall be entitled to immediate possession of the Sites and all assets of MJL required to provide the service;
- The Minister is to have an equitable remainder interest in the system, facilities and equipment owned by MJL. Immediately upon termination of the Licence all the titles, rights and interest of MJL will automatically be vested absolutely in the Minister;
- The Minister is to approve any charges or liens on any of the buildings, facilities, equipment or system.

MJL's Business Plan is to incorporate the financial structure and arrangements for financing of the project and this is to be submitted to the Minister before the Agreement is to become effective. It is to outline the complete pay-out and settlement of all debt financing for the entire project upon or before the expiry of the seventh year after the commencement of the service. The Agreement is predicated upon this representation by MJL.

The Minister is to approve any material contracts of supply and/or employment, which will extend beyond the expiry of the seventh year of the Agreement. Material contracts will have an individual value of more than \$10M or an aggregate value of \$20M.

The Minister is also to approve financing structures or arrangements pertaining to all assets used for the provision of the inspection service. Upon termination MJL shall:

- Procure the transfer of the telephone number for each site to the Minister or its nominee;
- Destroy all stationery used for the provision of the service;
- Hand over to the Minister all publicity, promotional and advertising material;
- Hand over all manuals and designs associated with the provision of the service and make available for 60 days at cost to the Minister its trained personnel or manager to assist with the hand over exercise;
- Notify in writing all relevant third party suppliers of goods, equipment or services, of the change in the management of the service and of the assignment of relevant contractual rights to the Minister;
- Advise the Minister in writing of all outstanding debts and liens related to the conduct of the business of providing the service and of the arrangements made for the settlement of the same;
- Render an accounting of all sums collected on behalf of or due from it to the Minister or any department or agency of the GOJ and immediately pay over all amounts;
- Commencing immediately upon termination MJL through its best efforts is to make the services of its employees, agents and consultants who are necessary for the continued provision of the service available to the Minister/ITA for 60 days or longer if reasonably required.

3. Conclusion

To summarize, the proposed privatization of MVI in Jamaica is assessed in relation to the FCA based on the criteria set out under section 17(4) of the Act. Specifically, the exclusive agreement would not be in contravention of the FCA if it is an agreement which the Commission is satisfied—

“(a) contributes to—

(iii) the improvement of production or distribution of goods and services; or

(iv) the promotion of technical or economic progress,

while allowing consumers a fair share of the resulting benefit;

(d) imposes on the enterprises concerned only such restrictions as are indispensable to the attainment of the objectives mentioned on paragraph (a); or

(e) does not afford such enterprises the possibility of eliminating competition in respect of a substantial part of the goods or services concerned.”

The MVI system as proposed appears to be beneficial to consumers:

- in the improvements that it will bring; and
- the performance criteria that MJL is expected to meet.

The choice of MJL was done by way of request for proposals, advertised both locally and overseas. MJL was chosen after being ranked second out of the eleven proposals that were received and evaluated (the first-ranked entity pulled out). The process, therefore, indicated a MJL is considered to be the best operator available to run the service.

The terms and conditions appear to protect the consumer interest, through the setting of performance criteria and fee structure. It should be noted, however, that the fee structure has both pros and cons from the perspective of the consumer. The benefit is that it is more or less fixed and rises in line with inflation. As a proportion of it (the exact proportion was not made available to the FTC) tied to the US inflation rate which tends to be significantly lower than the Jamaican inflation rate. However, that proportion is also tied to the US dollar. Depreciation of the Jamaican dollar could increase the cost to the consumer significantly. In other words, the fee structure takes away the risk of exchange rate fluctuations from the investor and puts it onto the Jamaican consumer. Nonetheless, the interests of the consumer should be protected, as any review of the fee levels requires the approval of the MTW through the ITA.

To that extent, the proposed exclusive licence appears to meet the criteria under subsection 17(4)(a) of the FCA.

It is, however, unclear as to why a more competitive system such as that in the UK where garages are franchised/licensed to carry out the inspection was rejected, if at all evaluated. The number of vehicles necessary to make each garage viable should not be prohibitively high, even with the relatively small vehicle population in Jamaica. There may be other reasons, for example, the modernization of the database system and other aspects of the operations may require a high level of investment (details of which were

not made available to the FTC) such that some exclusivity with guaranteed profits is necessary to incentivise the investment.

The FTC was also unable to evaluate if the restraints, in this case the length of contract (10 years) is or is not excessive, given the investments required, as no investment data was made available. Nonetheless, 10 years is a reasonable period, assuming that the investments are substantial.

In other words, while the FTC has not been able to fully assess the impact of the exclusive licence using the criterion under subsection 17(4)(b) of the FCA, from the limited information made available to it, it does not appear that the criterion of section 17(4)(b) is breached.

Finally, the transfer of all assets, including intellectual property and data, to the Government of Jamaica at the conclusion of the contract period, opens the possibility of introducing competition, if desired, after the exclusive period.

In conclusion, the proposed exclusive 10-year licence to MJL seems to meet the criteria set out under section 17(4) of the FCA. The agreement as it stands is not deemed to be in contravention with the FCA.