Working Party No. 2 on Competition and Regulation

TAXI SERVICES REGULATION AND COMPETITION
-- United States --

15 October 2007

The attached document is submitted by the delegation of the United States to Working Party No. 2 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 15 October 2007.

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1. In the United States, taxi services are regulated at the state or local level. The involvement of the Federal Trade Commission in this sector has focused primarily on efforts to assist deregulation in the industry, through reports and advocacy efforts, including 18 filings with various local authorities from 1984 through 1989. In addition, the FTC brought enforcement actions against two U.S. cities in 1984. The FTC’s major contribution is a staff report on taxicab regulation.\(^1\) That report was submitted to the Competition Law and Policy Committee in 1990 in connection with a round table discussion of this topic.\(^2\) The main conclusions of the report were that restrictions on entry (numerical limits, limits based on cab/population ratios, or public convenience and necessity requirements) did not appear to be supported by plausible theoretical arguments.\(^3\) Even in those situations where problems had arisen following a change to open entry,\(^4\) other regulatory responses (e.g., maximum price levels, physical reconfiguration of taxicab queues) would likely be more efficient responses to such problems.\(^5\)

2. As of 2007, the general description of the taxicab industry and taxicab regulation in the United States remains much as it was when Frankena and Pautler described it in 1984. That is, nothing dramatic has happened to alter the U.S. industry in the interim.\(^6\) Although the details of regulation vary from place

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\(^2\) The report described the various market segments that exist, including cruising cabs, cabs that wait for riders at taxi stands, radio-dispatched cabs, and cabs providing services under contract. The report also reviewed the history of taxicab regulation in the United States and described various types of regulation that existed in the taxi industry. These forms of regulation included entry restrictions based on the absolute numbers of cabs or the ratio of cabs to the city population, and requirements that entrants prove that their entry is necessary to improve public convenience. Typical regulations also fix the fares that can be charged or provide for maximum rates of fare. Most urban areas also regulate many other aspects of service and safety. The report also discussed many theories of market failure that might justify regulation of taxicabs serving cruising, cabstand, radio-dispatched, and contract segments of the market. As the authors note, special characteristics of the cruising and cab-stand segments (e.g., high bargaining costs and first-in/first-out queues) may make it difficult to induce price competition among the various firms. If so, maximum fare regulation may be required to achieve an efficient outcome. Competition in the other two segments would appear to be viable because shopping for lower fares should be possible at relatively low cost. In addition to an analytical examination of the market segments, the report reviewed the evidence of deregulation during the late 1970s and early 1980s in thirteen U.S. cities, focusing on Seattle, San Diego, Phoenix, Tucson, Berkeley, and Oakland.

\(^3\) In November 2003, the UK Office of Fair Trading (OFT) released a report examining the taxicab literature and the experiences with regulation in seven countries and 13 licensing areas in the UK (five of which recently experienced changes in regulation). The OFT concluded, similarly to Frankena and Pautler (1984), that “there is no clear economic rationale for quantity controls which appear to have been introduced in the 1630s primarily to prevent street congestion.” (p. 36). They recommended a policy of open entry, maximum fares with flexibility downward, and proportionate direct regulation of quality and service attributes. One theoretical paper, Cairns & Liston-Heyes (1996) argues that an entry restriction (in addition to a fare ceiling) is needed to reach the second best optimum, but there is an error in the profit function in that paper. No entry restriction is required given appropriate fare regulation.

\(^4\) Problems associated with entry occurred at cab stands as lines of waiting cabs lengthened, cabbies bickered over their places in the queue, and service refusals occurred if a passenger wanted a short trip. See the discussion (pp. 125-143) of the situations at airports in Seattle, San Diego, and Phoenix. Reports of similar problems at hotels are common. Where permitted, some hotels have used exclusive contracts to minimize effects caused disruptive taxi drivers.

\(^5\) Frankena and Pautler (1984) noted, “In marked contrast to the radio-dispatch segments, there have been many problems in cab stand market segments at airports following regulatory reform as a result of lengthening of the queues. These problems do not provide an argument in favor of entry restrictions, however. Rather, they suggest that there would be significant gains from either increasing fare competition at airports or imposing lower fare ceilings on airport taxi service. Fare ceilings could be reduced until the taxi queue shortened to the desired length.” (pp. 8-9)

\(^6\) For a detailed description of the industry, see Frankena and Pautler (1984, pp. 10-28 and especially note 21), Price Waterhouse (1993, pp. 4-5), and Gilbert et al. (2002). Perhaps the biggest change on the horizon is
to place, most major cities continue to regulate entry and fares in some manner, most also regulate the
types of service that can be provided (e.g., minimum number of cabs per company or association, 24/7
coverage of telephone requests, shared riding, conditions for service refusals, definitions of service areas,
required dispatch capability, required taximeters), vehicle and driver characteristics (e.g., cab age and
design, signs, no criminal background, knowledge of the city streets and landmarks, record keeping,
neatness, facility with the English language, and sensitivity training), and service quality (e.g., cab
(continued)

3. The stringency of entry regulation can manifest itself in the value of taxicab licenses. In a
competitive, open entry market, the value of the right to serve the market would be zero. However, if the
right to serve is restricted, the value of that right is capitalized in the price of the license. A list of taxicab
license values for selected cities in the U.S. and elsewhere where transfers of the rights are allowed is
attached.8 The fact that license values are substantial in several U.S. cities (e.g., permits (corporate
medallions) for cabs serving downtown New York City recently auctioned for over $590,000 even though
the city has allowed over 900 new cabs to be added to the 1937 maximum of 11,787 in the last decade)
implies that entry restrictions have raised the rate of return in taxi service provision above that in other
lines of endeavor and that prices are likely higher and the number of trips lower than they would be in the
absence of regulation. Certain authors (e.g., Gallick & Sisk (1987) and Cairns & Liston-Heyes (1996))
have argued that these high license values provide a mechanism that ensures good behavior by the cab
drivers if the drivers fear the loss of the license in the event of inappropriate behavior. Frankena and

4. The next section considers three experiments with deregulation in the U.S., followed by a
discussion of lessons learned from the U.S. experience more generally.

7 In most cases the jurisdictional unit is a city or a county. In a few instances, regulation occurs at the state
level. Taxis serving airports are often regulated differently from those serving the surrounding area.
8 The list was compiled from readily available information and it does not represent a complete listing of
license values for all U.S. cities. Many cities restrict entry, but do not allow license transfers, so public information
on the value of the right-to-serve in those cities is not directly available. Even where the licenses are not transferable,
licenses are often leased to non-owner drivers for substantial fees. For example, the San Francisco Controller’s
Taxicab Industry Report (August 4, 2006, p. 6) reported that cab drivers in the San Francisco paid lease fees of
$1,900 per month for the right to serve the city. That fee would imply a transfer value of over $250,000. (The value
of a monthly flow of $1,900 for 30 years discounted at 8% would exceed $250,000).


1. Experiments with Deregulation in the U.S.

5. Since entry restrictions were adopted by most cities in the United States during the 1930s, at a time when many U.S. industries sought governmental protection from competition, experiments with taxicab deregulation have been infrequent. One exception was a period in the late 1970s and early 1980s when several moderate-sized cities altered their regulations to make entry less difficult.\(^9\) One major city, Washington D.C., has retained an easy entry policy (and its unique zone pricing structure) from at least 1970 through 2007.\(^10\) Since the late 1970s, however, there has not been a great deal of activity in taxicab deregulation and open entry among U.S. cities.\(^11\) Two of the leading examples of deregulation in the U.S. are provided by Seattle, Washington in 1979, and Indianapolis, Indiana, in 1994; the limited evidence regarding these cases is briefly discussed below.\(^12\) In addition we note the current efforts of Minneapolis, Minnesota to open entry in stages.

1.1 Seattle, Washington (1979)

6. Seattle opened entry and allowed fares to be set by individual firms in 1979. The effect of these changes on fares has been the subject of some debate. They may have led to a small (5%) net reduction in fares as radio-dispatch fares fell and taxi-stand fares rose. Other reports indicated no net change in fares.\(^13\) One effect that is not in dispute is the increase in service to cabstands at the airport due to the influx of additional cabs. This led to longer lines of taxis and dissention among cabbies. Price competition did not develop in part due to the first-in first-out queuing system often used at airports. In response to this problem, the airport imposed maximum fares and later disallowed additional entry. Still later, the County moved to an exclusive franchise system for the airport that continues as of 2007.

7. Although a 1980 survey of residents and visitors indicated a positive evaluation of taxicab service in Seattle immediately after the deregulation, Seattle and surrounding King County imposed a moratorium on new licenses and established fixed fares in 1984 in large part to avoid rate variation that occurred under flexible fares and to avoid the above mentioned airport queuing problems. Twelve years later, a 1996

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\(^9\) The 1970s experiences of several cities are recounted in Frankena and Pautler (1984, pp. 125-154). These same experiences (with a more negative interpretation of the results and some additional information on fares) are discussed by Teal and Berglund (1987) and Price Waterhouse (1993).

\(^10\) The District of Columbia’s cab system and its apparently relatively low prices are described in Frankena and Pautler (1984, pp. 83-89). DC taxicab prices are difficult to compare to those of other cities due to the unique zone-based system used in the District. The District’s taxicab regulatory system is a periodic subject of debate among local taxicab providers, businesses, and politicians.

\(^11\) Complete freedom of entry would destroy the value of the existing licenses and would therefore be vigorously opposed by incumbent service providers. This is likely a key reason for the retention of entry regulation in many areas. Many jurisdictions allow occasional increases in the number of cabs if population grows or other demand factors change. Many jurisdictions also provide a forum for incumbent providers to try to block the entry of new firms or the provision of additional cab licenses.

\(^12\) A general problem in examining the regulatory changes is the lack of comparable before and after evidence and a model of what the local taxi market would have been like had the change not occurred. This was a problem for evaluating the deregulatory efforts in the 1970s even though the U.S. Department of Transportation spent a great deal of effort trying to monitor the changes in various cities. That does not mean the information we have is useless, but it is far from perfect, and in many instances the information is largely anecdotal. As computer-based dispatch and metering systems become more widely used, hard data on various aspects of service quality may become more widely available for US taxi markets.

\(^13\) Zerbe (1983) indicated that radio-dispatch fares fell, but airport and taxistand fares rose, resulting in a small net decline in fares. For a description of Zerbe’s results and the Seattle experience, see Frankena and Pautler (1984, pp. 125-131). Teal and Berglund (1987, pp. 42-45) examined taxicab trade association survey data and concluded that fares did not change in Seattle following deregulation.
report indicated dissatisfaction with the taxicab industry among various groups, particularly the hospitality industry (hotels, conventions, tourism, etc.). The complaints centered on the independent (non-fleet) cabbies who reportedly provided poor service and were difficult to hold accountable for rule infractions. In 1997, the city and county introduced a wide range of new vehicle and driver testing regulations, and the city required that all cabs join a licensed association of 15 or more cabs. To induce monitoring of individual cabbies, each association is subject to a penalty system for violations by its drivers. As of 2007, Seattle taxicab licenses reportedly sell for as much as $175,000 each. The City and County recently declared any new taxi licenses to be non-transferrable.

1.2 Indianapolis, Indiana (1994)

8. In July 1994, Indianapolis, Indiana, deregulated taxicabs and allowed jitney and minivan operation as part of a broader market-oriented approach to city governance taken by a new city administration. As in many US cities, the airport was allowed to retain tighter controls on cabs. The city administration indicated that the deregulation was a success, pointing to increases in the number of cabs and the number of taxicab companies, a doubling of active cabs, fare reductions (newcomers cut fares by 7-10%), service improvements, reductions in customer complaints, and the granting of one new jitney license. Wages and profits fell. As in Seattle, many of the new cab drivers worked the airport queues and those queues reportedly remained long as of 1999.

9. The ultimate effect of the 1994 deregulation in Indianapolis is in dispute. The city administration through 1998 viewed it positively, while others portrayed it as a failure. The police officer in charge of taxicab complaints during the entire period indicated that the number of consumer complaints rose immediately after deregulation, but that complaint levels later declined below those during the more heavily regulated period, and that the complaints focused on fares, rather than service quality. On July 2, 2002, a new Indianapolis mayor proposed additional driver and cab owner requirements following complaints about inadequate service to tourists and residents.

1.3 Minneapolis, Minnesota (2007)

10. As of mid-2006, the city of Minneapolis restricted taxicab entry and fixed fares, and the value of a taxicab permit to serve the city was $25,000. The public convenience and necessity (PCN) portions of the taxi regulations also allowed incumbent taxi companies to block new entry. In October 2006, the Minneapolis City Council removed PCN regulation and moved to allow 45 new, non-transferable taxicab licenses to be added to the stock of 343 licenses each year until January 1, 2011, when limits on licenses would be removed entirely. At the same time, the city initiated new taxicab regulations involving

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14 See Avants et al. (1996).
15 For a description and history of the Seattle and King County taxicab regulations, see the King County 2006 Annual Taxicab Report, April 2007.
16 Jitneys provide transportation service for individuals along a semi-fixed route.
17 For a very positive description of the changes about one month after entry was allowed, see Editorial, Indianapolis News, August 4, 1994, and Moore (1998, pp. 50-53). Later press reports were less positive, reflecting either deteriorating performance or information from other sources. See, David Shaffer “Cab Deregulation: Competition or a License to Gouge? New Firms Hail the Equipment, but Older Firms Say Fares are Up, Profits Down,” Indianapolis Star, June 11, 1995, E-1; and Adam Ellick “Stuck in Idle: Cab Drivers Who Work Indianapolis International Have Found it Tough to Make a Living Since Airport Service was Deregulated Five Years Ago,” Indianapolis Star, Aug 22, 1999, E-1. The city administration still considered deregulation a success as of December 1998. (See December 10, 1998 letter from John Hall, Indianapolis Deputy Mayor to Hamilton Smythe, President, International Taxicab and Livery Association (the industry trade association) arguing that all the underlying goals of the Indianapolis deregulation had been met.)
environmental effects, wheelchair accessibility, and minimum company size. Disgruntled incumbent permit owners, who understand that the removal of restrictions would lower the value of the permits, sued the city on March 13, 2007 to block the increase in new cabs.

11. These are only three of the many examples of deregulation within the U.S. The experiences across the United States with taxi services deregulation offer insight that can be helpful for future efforts. The next section considers these lessons.

2. Lessons from the U.S. Experience

12. Reviews of the effects of deregulation experiences in the United States indicate that: 18 (1) the number of cabs and cab companies rises and, therefore, employment opportunities and the number of cab hours of service rise; (2) the bulk of the new entrants are individual drivers who serve taxi-stand markets that do not require radio-dispatch capability; this leads to longer queues of drivers at those locations where waiting times for riders was always low; 19 (3) new radio-dispatched companies occasionally begin operation, but that is not the norm; and (4) little service innovation is evident. Fares may fall slightly in the radio-dispatch segment of the market, 20 but problems with an absence of price competition will occur at airports and taxi stands if maximum fares are not reduced sufficiently or competition is not viable due to first-in-first-out queuing.

13. The U.S. experience has not provided a clear example of the benefits of deregulation on taxi fares - relatively little changes in terms of fares. This may be because the few cities that have experimented with deregulation have not been those in which the pre-deregulation equilibrium was particularly far from that which would have existed in a deregulated environment. It may also be due to the fact that price competition does not develop among the many individual cab drivers who enter and serve taxi-stand markets. In addition, price cutting may be unprofitable because: (1) repeat customers may be uncommon in the taxi market, leading to little incentive to cut price to draw future business, and (2) on-time arrival may be the most important characteristic to repeat phone-hail cab riders, making price a relatively unimportant characteristic (so long as the price is within the realm of reason). 21

14. A key lesson from the U.S. experience is that when deregulation is attempted in the future, administrators of the change will have to pay more attention to ensuring that price competition can be

18 See Frankena and Pautler (1984), Teal and Berglund (1987), Price Waterhouse (1993), and Schaller (2006). Because no one has good data for pre-and post-deregulation comparisons of similar situations across jurisdictions, the field experiments have provided less information than one might hope.

19 Changes in customer waiting times in the radio-dispatch portion of the market were documented in only one case, San Diego, where a small reduction in average waiting time from 10 to 8 minutes occurred. The UK OFT (2003) reported waiting time declines in open entry cities in England, p. 30.

20 In the U.S., fares may have fallen a small amount in the radio-dispatch segments of certain deregulated cities (Seattle, Indianapolis, and Sacramento), but even those effects are in dispute. See Teal and Berglund (1987, pp. 42-46). Other international experience may provide a counterpoint to the U.S. evidence where fare reductions were not common. The New Zealand evidence reported by Gaunt (1998) and Soon (1999) indicates that fares in major cities might decline by as much as 20 percent due to deregulation of entry. The effect of deregulation on fares is important. If open entry coupled with fare flexibility below a cap does not result in fare reductions or waiting time reductions for riders, then the increased cab use might well be characterized as pure waste. Reducing maximum fares might then be the appropriate response. In addition, the 2000 open entry experiment in Dublin, Ireland, may provide a better test in a city where taxi service is relatively important.

21 Empirical estimates do not imply, however, that customers are unresponsive to price. The responsiveness to price as measured by the elasticity of demand for taxi rides has been estimated to be slightly inelastic (falling in the -0.8 to -1.0 range). See Frankena and Pautler (1984, pp. 162-165). See Schaller (1999) for a more recent (and lower) estimate (-0.22) based upon New York City cabs serving Manhattan.
developed at the taxi-stand and airport locations, or that such locations are handled differently from the radio-dispatch segment. Examples from the U.S. suggest that regulating the two differently can be beneficial. Two prominent examples of this type of reform took place in Phoenix, Arizona, and Sacramento, California, where easier entry was allowed, but airport service was regulated and downtown hotels were allowed to contract for exclusive service with taxi companies if they wished to do so. This approach reportedly allowed these cities to ameliorate airport and taxi-stand problems that were associated with open entry in other cities.\footnote{Price Waterhouse (1993, p. 17). A system in which exclusive contracts and property rights play a large role in fostering incentives to maintain appropriate quality levels is discussed and promoted in Klein et al. (1997).} Phoenix continues to be one of the two large U.S. cities that allow entry. Phoenix also has flexible fares. The status of the Sacramento experiment with open entry is unclear. The city instituted an entry moratorium in 2003. Whether the use of exclusive contracts is the best approach to solving the taxi-stand problems is open to debate. Exclusive contracts can help solve the problems associated with unaccountable independent drivers, but it does not directly improve price competition at the queues (unless pricing is made part of the contract) and may not be the approach that would maximize the welfare of taxi riders.

3. Conclusion

15. The taxicab industry continues to be highly regulated in the United States. Some of that regulation – particularly entry restraints – is not strictly necessary, particularly if maximum fare regulation is effectively implemented. Deregulation requires care, however, particularly with regard to handling airport and taxi stand market segments. The U.S. experience suggests that price competition does not appear to develop in those segments, and appropriate maximum fares are needed to protect the public and to induce the appropriate level of entry. One solution to specific cab stand issues, such as those at hotels and airports, is the use of contracts between cab firms and the hotels and airport authorities.
SELECTED BIBLIOGRAPHY OF POST-1984 LITERATURE


Ireland Competition Authority (April, 2002) “Submission on Qualitative Improvements in Taxi Services and Future Regulation of Those Services to the Department of the Environment and Local Government.”


## TAXICAB LICENSE VALUES IN VARIOUS CITIES

<table>
<thead>
<tr>
<th>City</th>
<th>License Value</th>
<th>Year</th>
<th>Source and Details</th>
</tr>
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<tbody>
<tr>
<td>Atlanta, GA</td>
<td>$30,000</td>
<td>2001</td>
<td>Janet Frankston, &quot;Atlanta's taxis / King of the cabs: A driving force, but for what?&quot; The Atlanta Journal-Constitution, December 17, 2001</td>
</tr>
<tr>
<td>Boston, MA</td>
<td>$227,000-260,000</td>
<td>2004</td>
<td>Chris Berdik, “Fare Game,” Boston Magazine, September 2004</td>
</tr>
<tr>
<td>Chicago, IL</td>
<td>$77,000</td>
<td>2007</td>
<td>Emma Graves Fitzsimmons, &quot;Chicago hails 2 driven cabbies; Award honors their service to riders with disabilities and those in neglected areas,&quot; Chicago Tribune, February 2007</td>
</tr>
<tr>
<td>Columbus, OH</td>
<td>Up to $25,000</td>
<td>1991-96</td>
<td>The Columbus Dispatch, editorial, November 11, 1996, p. 10A</td>
</tr>
<tr>
<td>Philadelphia, PA</td>
<td>$77,000</td>
<td>2005</td>
<td>&quot;Proposed Taxi Rate Increase&quot; Philadelphia Parking Authority Board</td>
</tr>
<tr>
<td>San Diego, CA</td>
<td>$126,000</td>
<td>2005</td>
<td>Jeff Ristine, &quot;Committee puts brakes on proposed $2 airport taxi fee,&quot; The San Diego Union-Tribune, April 2005</td>
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<tr>
<td>City</td>
<td>Year</td>
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<tr>
<td>Seattle, WA</td>
<td>2007</td>
<td>Scott Gutierrez, &quot;Longer wait times for taxis could mean city needs more cabs,&quot; Seattle Post-Intelligencer, April 2007</td>
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<td>Calgary, Canada</td>
<td>2007</td>
<td>&quot;The Taxi Cab; The door's always open, but the ride, it ain't free&quot; National Post, July 2006</td>
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<td>Ottawa</td>
<td>2007</td>
<td>“The Taxi Cab; The door's always open, but the ride, it ain't free&quot; National Post, July 2006</td>
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<tr>
<td>St. John's, Newfoundland (Canada)</td>
<td>2003</td>
<td>Craig Jackson “Taxi Charges Deferred”, St. John’s Telegram October 28, 2003</td>
<td></td>
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<tr>
<td>Toronto</td>
<td>2007</td>
<td>Curtis Rush, &quot;Cabs can't go green just yet, Moscoe says; Hybrids a decade away for taxi industry, he says, but critics charge councillor is behind the times,&quot; Toronto Star, May 23, 2007</td>
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<td>Vancouver</td>
<td>2007</td>
<td>Bruce Constantineau, &quot;Tourism officials hope new taxis will reduce waits; The province approved 111 more cabs, boosting the size of Vancouver's fleet by 23 per cent,&quot; Vancouver Sun, June 23, 2007</td>
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<tr>
<td>Adelaide, Australia</td>
<td>2006</td>
<td>&quot;2006 State and Territory Statistics&quot; Taxi Council Southern Australia</td>
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<tr>
<td>Hong Kong</td>
<td>HK$3,000,000</td>
<td>2007</td>
<td>Transport Advisory Committee chairwoman, South China Morning Post, April 2007</td>
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<td></td>
<td>(US$385,000)</td>
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<tr>
<td>Paris</td>
<td>125,000 euros</td>
<td>2005</td>
<td>“Private Taxis No-Go in France”, The Moscow News March 7, 2005</td>
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<td></td>
<td>(US$170,000)</td>
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Conversions to US dollars at exchange rates for August 29, 2007 and rounded to nearest thousand dollars. Australian$ = $0.82; Canadian$ = $0.94; Euro = $1.36; HK$ = $0.128.