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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

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ROUNDTABLE ON COMPETITION IN ROAD FUEL

-- Note by Lithuania --

This note is submitted by Lithuania to the Competition Committee FOR DISCUSSION under Item IX at its forthcoming meeting to be held on 19-20 June 2013.

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ROUNDTABLE ON COMPETITION IN ROAD FUEL

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1. BACKGROUND

1. In recent years the Competition Council of the Republic of Lithuania (hereafter – the "CC" or the "Competition Council") has been concerned with the volatility of prices in road fuel market. This sector has also been one of the major concerns of the government and general population and it is therefore very important in priority setting by the CC.

2. ENFORCEMENT ACTIVITIES

2.1 Anticompetitive agreements

2. In 2001 the CC issued a decision following an investigation regarding possible anticompetitive conduct agreed upon between AB "Orlen Lietuva" (Lithuanian local petrol refinery and the largest wholesaler) and the following fuel retailers: UAB "Lukoil Baltija", UAB "Lukoil Baltija" servisas, UAB "Lietuva Statoil", UAB "Pakrijas", UAB "Uotas" and UAB "Vaizga". The investigation started in 2000, resulting from the initiative of the CC. The main concern was that the mentioned contracts included obligations from the retailers (buyers of AB "Orlen Lietuva") not to import fuel and not to buy fuel from other importers. The concern of the CC was that such contractual provisions would breach Article 5 of the Law on Competition, prohibiting all anticompetitive agreements.

3. After conducting a thorough investigation, the CC concluded that AB "Orlen Lietuva" and the fuel retailers did engage in anticompetitive conduct and imposed the following fines: AB "Orlen Lietuva" – LTL 100.000 (EUR 28.962), UAB "Lukoil Baltija" – LTL 86.000 (EUR 24.907,32), UAB "Lietuva Statoil" – LTL 60.000 (EUR 17.377,20), UAB "Uotas" – LTL 39.000 (EUR 11.295,18), UAB "Pakrijas" – LTL 32.000 (EUR 9.267,84), and UAB "Vaizga" – LTL 29.000 (EUR 8.398,98). The decision of the CC was appealed by UAB „Lietuva Statoil", UAB "Lukoil Baltija", UAB "Uotas", UAB "Pakrijas", UAB "Vaizga" and AB "Orlen Lietuva" which eventually resulted in court reducing the fines imposed by the CC to all undertakings under investigation except for AB "Orlen Lietuva", the fine for which was removed altogether. The Court based the latter decision on the fact that the CC had already fined AB "Orlen Lietuva" for this exact breach in 2000, when the decision, imposing a fine of LTL 100.000 (EUR 28.962) on AB "Orlen Lietuva", had been issued.

2.2 Parallel pricing behaviour

4. There have been two cases opened by the CC after having identified instances of parallel pricing behaviour in road fuel market.

- In 2003 observed parallel behaviour by fuel retailers has fostered the CC to start an investigation into a possible breach of Article 5 of the Law on Competition (national equivalent of Article 101 of the Treaty of the Functioning of the European Union (TFEU), prohibiting anticompetitive agreements). The CC carried out a number of dawn raids in road fuel retail companies as well as in the Lithuanian oil products trade association.

It has been established in the course of investigation that during the period of 2002-2003, fuel prices set by these companies had been the same or very similar, looking at different cities and Lithuanian regions. It was also found that price changes occurred almost simultaneously. As to automotive gas market, the situation here was such that gas prices set by the aforementioned companies were practically the same and changed very rarely. Such gas price tendency could be observed throughout Lithuania.

The investigation depicted a leader-follower model of setting prices, however, there was no evidence found of companies consulting each other about prices in order to fix them at certain level or restrict competition in any other way.

The investigation confirmed that the factor influencing road fuel price similarity in Lithuania is the fact that Lithuanian retailers buy fuel from the sole producer – AB "Orlen Lietuva", whereas import was quite restricted (mostly by legal barriers) at the time of the investigation.

Since there was no evidence of the breach of the Article 5 of the Law on Competition found, the investigation was closed in 2004.

- Another similar investigation was launched in 2010. The CC decided to investigate whether actions of the companies operating in fuel trade market and their association complied with the requirements of Article 5 of the Law on Competition.

  Several dawn raids had been carried out following the start of the investigation. However, after analysing all the data collected, the CC found no evidence that could confirm that retailers engaged in anticompetitive conduct thus breaching Article 5 of Law on Competition. It was therefore decided to close the investigation in 2012.

2.3 Abuse of dominance

5. The major abuse of dominance case was carried out in the market for oil and oil products. The case started in 2004, resulting from the initiative of the CC. The dominant undertaking (domestic oil refinery) AB "Orlen Lietuva" was found to have granted annual loyalty rebates and non-compete obligations as well as imposed restrictions upon parallel import and resale possibilities. The infringement included instances of discriminative discounting with a view of preventing import of oil products into the Lithuanian territory. This conduct was found to have infringed Article 102 TFEU and its national equivalent.

6. On 21 January 2013, the Supreme Administrative Court of Lithuania (the Supreme Court) issued a non-appealable ruling stating that the CC has legally imposed a fine of nearly EUR 2.300.000 upon AB "Orlen Lietuva" for abusing its dominant position with the aim to restrict the import of fuels to the territory of Lithuania.

7. Already in 2005, the Competition Council fined the Company for the abuse of its dominant position, however, the Supreme Court overturned this decision and obliged the CC to carry out a further investigation. After the detailed investigation, the CC found that AB "Orlen Lietuva" abused its dominant position in the market of fuel (petrol and diesel) sales in Lithuania. By applying a certain pricing policy and obligations to purchase a fixed amount of fuel from itself, AB "Orlen Lietuva" sought "to tie" its buyers thus restricting the import of petrol and diesel into the territory of Lithuania. The fuel market of

Lithuania was essentially closed for other producers, therefore, competition was significantly limited. This actually resulted in the loss of possibility for consumers to take advantage of the benefits of competition.

8. Having examined the case, the Supreme Court acknowledged that the arguments of CC qualifying the behaviour as an infringement of Article 102 TFEU and its national equivalent were well-founded. The Supreme Court also affirmed that the CC had adequately evaluated the infringement as serious when deciding on the amount of a fine as well as supported the acknowledgement of the fact that AB "Orlen Lietuva" committed the infringement repeatedly. The Court reduced the fine imposed by the CC by 5 percent, from EUR 2.383.862 to EUR 2.261.133, since, according to the Supreme Court, the CC failed to prove one of the elements of the infringement regarding price fixing for diesel sold only for ships as the CC did not thoroughly evaluate the applicable regulatory framework.

9. After the investigation performed by the CC the AB "Orlen Lietuva" was obliged to stop anti-competitive practices. To the knowledge of the CC, this obligation has been complied with.

2.4 Mergers and acquisitions

10. Assessment of the merger in the market for oil and oil products *PKN ORLEN S.A./AB Klaipėdos nafta* carried out by the Competition Council in 2009 resulted in the merger being abandoned following the findings that such merger could result in a dominant position in the market. The concerns about the merger between two oil wholesalers were primarily raised due to the fact that the company subject to the proposed acquisition – AB Klaipėdos nafta – was established with a view to organise an alternative supply of oil and (dark and light) oil products and having assessed its technical facilities and infrastructure could have potentially become a competitor of the purchaser – PKN ORLEN S.A. (domestic oil refinery and the largest wholesaler in Lithuania) – in supply of oil products to the Lithuanian market. Based on the parties to the merger being closest and strongest competitors, it was concluded that the intended concentration could have resulted in a restrictive effect upon efficient competition as it could have strengthened the dominant position of PKN ORLEN S.A. in the wholesale market of oil products.

11. When assessing the competitive effect the CC has also taken into consideration the anticipated changes in supply of raw material after the decommissioning of the Ignalina Nuclear Power Plant, which would result in an increased demand for fuel oil received from Mažeikiai (home base of PKN ORLEN S.A.), as well as through AB Klaipėdos nafta (which is a less costly and more efficient supply method than the railway transportation of oil from other countries). The CC concluded that the acquisition by PKN ORLEN S.A. directly or through AB "Orlen Lietuva" (Lithuanian branch of PKN ORLEN S.A.) of AB Klaipėdos nafta would further strengthen dominance of PKN ORLEN S.A. in the Lithuanian energy sector, additionally affecting the power generation sector.

12. AB Klaipėdos nafta itself had the necessary capacity to supply fuel to both small and large fuel retail networks. By importing fuels through AB Klaipėdos nafta major retail gas trading networks could create an efficient competition to PKN ORLEN., affect prices set by PKN ORLEN and such price reduction could eventually be passed through to consumers. The acquisition of AB Klaipėdos nafta by PKN ORLEN would significantly reduce alternative possibilities for other networks trading in oil products to purchase all kinds of oil products. After the analysis of the possible effect of the transaction, the CC filed to the Economics Committee of the Lithuanian Parliament (Seimas) that such concentration could not be authorised.

2.5 Non-notified mergers

13. The CC is currently undertaking several investigations into potential non-notified mergers in the road fuel sector. Law on Competition states that concentrations must be notified to the Competition

Council when the turnover of the merging parties meets the set thresholds. Law on Competition states that a concentration shall be notified to the Competition Council prior to the implementation of the concentration.

14. The investigation opened in 2012 was concerned with the actions of UAB "Lukoil Baltija" (one of the largest fuel retailers in Lithuania, which is also engaged in wholesale trade). It has been established that an unlimited duration joint venture agreement has been signed between UAB "Lukoil Baltija" and UAB "Okseta", by which the undertakings agreed to organise retail trade in fuel and other goods and services by cooperating their property, workforce and know-how. Pursuant to this agreement petrol stations owned by UAB "Okseta" were transferred for a full operation by UAB "Lukoil Baltija". The investigation concluded that that UAB "Lukoil Baltija" may have gained control of a number of petrol stations essentially implementing mergers without notifying the CC and without obtaining the merger clearance by the authority. Breach has been identified regarding this agreement, resulting in the CC imposing a LTL 1.177.600 (EUR 341.056,53) fine upon UAB "Lukoil Baltija".

15. There are two more investigations of a similar nature currently ongoing – one, where control of petrol stations was allegedly gained by UAB "Lukoil Baltija", and another – by UAB "Baltic Petroleum".

3. MARKET STUDIES

3.1 Please describe whether your agency has conducted market studies to analyse the road fuel sector and which were the main objectives of these studies, the main issues under research and the main results of these studies.

16. The CC has recently launched a market study to analyse the road fuel sector. There have been several small scale market analyses undertaken by the CC previously as well, the findings of which were made public. The start of the recent market study was fostered by the fact that fuel prices before duties and taxes in Lithuania are among the highest in the region (Lithuania, Latvia, Estonia and Poland)[1]. Lithuanian fuel market is unique due to the fact that there is one sole petrol refinery operating in the country, which is also the largest wholesaler in the market (AB "Orlen Lietuva"), which makes this sector potentially problematic in terms of competition policy.

17. The main objective of the market study is to fully understand the functioning of the road fuel market on every level of the supply chain, evaluate the current situation in the market and indicate whether there are any barriers (natural, legal or artificial) preventing efficient competition from emerging in this market. The main focus of the study is on the wholesale level of the supply chain though, as the CC is aiming to understand the reason behind relatively low fuel import levels in Lithuania, indicate possible barriers, if any, and come up with ways to remove those. The study is still on-going.

1 It should be mentioned, that the prices compared here are the nominal ones, displayed outside petrol stations. However, almost every retailer has discount cards in place, which consumers can buy and use in order to get a fixed discount for fuel (*e.g.* LTL 0,1 from each litre of fuel bought). Therefore, since the discount cards are extremely popular in Lithuania, and a vast majority of customers use them, the actual price they pay for fuel is lower than the officially displayed one. There is hence a possibility, that, considering actual fuel prices as opposed to officially displayed ones, Lithuania would not be the one with the highest fuel prices in the region. However, this issue was outside the scope of this market study and therefore was not looked at in detail.

3.2 Only a relatively small proportion of road fuel prices are generally subject to national or local competition – the gross margins for refining, wholesaling and retailing road fuel. Please discuss, if this issue was addressed by your studies, the contribution of margins by refiners, wholesalers and retailers to changes in pump prices.

18. Our most recent market study is not addressing the issue of gross margins on every level of fuel supply chain, since it is not the main focus of the study. However, as was presented to the Lithuanian Parliament (Seimas) by the CC in April 2012, gross margins by fuel retailers were approximately 3-15% in 2010, 6-14% in 2011 and 6-12% in 2012 for diesel, whereas for petrol retailers' gross margins were 4-12% in 2010 and 2011, and 3-8% in 2012.

3.3 Please describe how relevant are taxes and duties in pump price formation in your country.

19. Taxes and duties are very relevant in pump price formation in Lithuania. In fact, VAT (21%) and excise duty account for nearly 50% of the retail petrol and approximately 40% of the retail diesel price. It is therefore a very significant part of the final fuel price.

3.4 Please describe whether you have identified regulatory constraints in the road fuel sector which may have a possible impact on the level or flexibility of road fuel prices (e.g. constraints which may hamper access to logistics infrastructures – such as ports, pipelines or storage depots –, issues relating to licensing or to the granting of concessions to operate relevant infrastructure or service stations, regulation which may affect competitive conditions in highways).

20. To the knowledge of the CC, there are currently no major constraints which could hamper access to logistics infrastructure, such as ports, pipelines or storage depots.

21. However, there are some potential regulatory constraints currently in place which may have a somewhat restrictive effect on competition in fuel market. These are mandatory fuel reserve requirements. Lithuania has certain thresholds in place that establish maximum amount of fuel that is allowed to be imported without an obligation to store any reserves (up to 1.000 litres of petrol and up to 2.500 litres of diesel). Some, mostly small retailers consider this particular requirement as the main deterrent from importing more fuel. Another potential problem, related to reserve storage is the requirement to store at least 70% of all mandatory reserves in the territory of Lithuania. Even though the latter requirement was softened in 2008 by reducing the threshold from the former 90% following the investigation by the CC, it is still difficult to assess whether such a change has brought any tangible benefits for importers and made imports a more attractive option. However, it is worth noting that State enterprise Lithuanian oil products agency provides oil reserves' accumulation and management services to undertakings. In other words, firms that are required to store fuel reserves can transfer their duty of finding storage facilities and reserve maintenance to Lithuanian oil products agency, which should make keeping mandatory fuel reserves easier for importers. The latter enterprise will gain full responsibility for centralised fuel reserves' accumulation and management in 2015, whereas fuel importers will still be able to store their reserves independently or via the Lithuanian oil products agency.

22. Talking about other potential regulatory constraints which may have a possible impact on the level of fuel prices, the requirement to mix fuel with certain bio supplements could be one of those. Even though all EU countries will gradually have to increase the amount of such supplements and eventually reach the thresholds set by the relevant EU Directive, Lithuania has already adopted the maximum requirements. This makes fuel more expensive than it could be at the moment.

3.5 Please describe if you have found evidence of "asymmetric price adjustments", also known as "rockets and feathers", and what you have found to explain such asymmetries in the length or pattern of price adjustments.

23. The issue of "rockets and feathers" is outside the scope of our market study due to limited resources at the moment.

3.6 Please describe whether your market research has discussed differences in pricing policy by oil companies, independent retailers and supermarket retailers (please describe the relevance of economies of scale, economies of scope, discounts, and vertical issues – e.g. vertical integration, wholesale supply terms – in this context). Please also discuss whether you have analysed price differences in different geographical areas and its relation to local market conditions.

24. There are no supermarket retailers in Lithuania. The retailers can be roughly split into two groups – oil companies – large retailers with strong brand name, having established large petrol station networks throughout the whole country, medium-sized retailers, not so well-known, but operating a medium sized petrol station networks in the country, and small, usually local retailers, operating only several petrol stations in a particular local area. However, since the main focus of the market study is fuel wholesale market, the question regarding differences in pricing policy by retailers is currently left outside the scope of the study.

3.7 Please describe the resources needed to conduct such kind of market studies. In this context, describe the human resources involved in the research developed by your agency (economists, lawyers, financial analysts, paralegals, research analysts, personnel with specialized expertise in the petroleum industry, external consultants).

25. The market study was essentially started by two people – independent consultants that worked within the CC for a 4 months period with the support of an economist and a lawyer from the Anti-Competitive Agreements division. Due to limited human resources, the scope of the market study had to be kept relatively narrow, especially having in mind limited timeframe.

3.8 Please describe any particular difficulties which you might have faced while conducting market studies in road fuel markets, such as in gathering the necessary data, how important was cooperation with other agencies in your jurisdiction and if international cooperation was also relevant in carrying out such market studies.

26. Perhaps the main difficulty that was encountered in the course of the market study (apart from the already mentioned limited human resources and tight timeframe) was a relative difficulty to collect information from the market participants. The CC team has also cooperated with the team from the OFT that undertook the recent Call for Information into the UK road fuel market in order to define he scope of the market study. The CC therefore considers international cooperation extremely important as it enables competition authorities of different countries to share valuable experience and know-how with each other.

3.9 Please discuss how important are international comparisons in the elaboration of market studies in the road fuel sector and whether comparisons with economies of similar size are eventually of more importance.

27. The CC considers international comparisons in the elaboration of market studies in the road fuel sector as very important. Such market studies, undertaken by different countries, may not, and probably will not be directly comparable with each other, because each country's road fuel market is somewhat unique, with different features and specifics. Therefore, comparisons with economies of similar size are

more likely to be beneficial. Nevertheless, comparisons with economies that are completely different can also prove to be useful, since those can still provide good insights into the tools and methods used in conducting the analysis.

3.10 Please describe whether the market studies conducted by your agency are used or not as a first screen to detect anticompetitive behaviour.

28. Due to lack of resources, market studies have so far not been extensively used to detect anticompetitive behaviour. However, there is a tendency to start using them as a first screen, usually together with some additional supporting evidence.

4. MARKET MONITORING

29. Competition Council is constantly conducting monitoring activities in relation to the retail fuel sector. The market monitoring is done internally and has been initiated on 1st December 2009 following an increase in the retail price of fuel. The Competition Council collects daily information on global crude oil prices, the wholesale and retail prices of A-95 gasoline and diesel in certain gas stations.

30. Talking about Lithuanian fuel retail market, the Competition Council regularly collects data on the retail Euro-super 95 and Automotive gas oil prices from the major petrol station networks operating in Lithuania. The data is collected every Monday, and is used to calculate average price for each of those stations in certain cities. Weekly wholesale prices, set by the crude oil refinery AB “Orlen Lietuva”, are also monitored on a weekly basis. Majority of the data is confidential and can only be used for internal monitoring purposes.

31. In addition to the data mentioned above, the Competition Council collects crude oil prices (in USD/barrel), as well as consumer prices of petroleum products in Lithuania and other European countries, separating those into prices net of duties and taxes and prices inclusive duties and taxes. Finally, information on relevant sector specific taxes and duties in different European countries is also collected.

32. The analysis of the collected data includes assessment of the changes in both fuel retail and wholesale prices, taking into account the impact of crude oil prices, any changes in relevant taxes and/or duties, and evaluating any other possible causes of price changes.

5. ADVOCACY

33. The CC has not issued any sector specific recommendations to improve competition and competitive conditions in the road fuel sector.