

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Working Party No. 2 on Competition and Regulation

**ROUNDTABLE ON COMPETITION POLICY FOR VERTICAL RELATIONS IN GASOLINE
RETAILING**

-- Turkey --

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The attached document is submitted to Working Party No. 2 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 20 October 2008.

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1. The Turkish Competition Authority (TCA) prepared a **Report on Fuel Market** dated 2.6.2008 with a view to assessing the market from the perspective of competition law. Following the findings of the Fuel Market Report, and the news in the media and complaints alleging that the Act no 4054 on the Protection of Competition (Competition Act) might have been violated, a preliminary inquiry has been initiated against Turkish Petroleum Refineries Corporation and the five largest distributors namely Petrol Ofisi A.Ş., Shell&Turcas Petrol A.Ş., BP Petrolleri A.Ş., Opet Petrolcülük A.Ş., Total Oil Türkiye A.Ş.

2. Following the preliminary inquiry, the Competition Board decided that the Competition Act was not violated and there was no need for an investigation when only the information and documents regarding pricing were taken into account.¹ However, when the findings of the Fuel Market Report were also considered, it was concluded that there were serious structural barriers against competition in the fuel market and the sector did not display a competitive outlook. The findings of the Fuel Market Report as well as the preliminary inquiry have been adopted as a formal Opinion of the Competition Board and sent to the Energy Market Regulatory Authority (EMRA) on 11.8.2008.

3. This contribution is based on findings of the Fuel Market Report.

1. Fuel Market in Turkey

4. Petroleum industry in Turkey has had a vertically integrated structure historically and the assessments regarding the structure drew attention to operational advantages caused by the structure such as ensuring security of supply. The petroleum producers faced no obstacle in building refineries or entering wholesale and retail sale chains in the past. The *de facto* situation existed in the past was confirmed legally by the Petroleum Market Law no 5015² (Petroleum Market Law) allowing the refiners to enter into distribution activities.³

5. However, the Petroleum Market Law restricted sales by fuel stations operated by distributors with a maximum 15% of the distributor's total domestic market share.⁴ Therefore, it can be said that while there exists no legal obstacle against vertical integration up to retail level, the Petroleum Market Law aims to prevent emergence of a vertically integrated structure between distribution and retail sale.

6. Although the Petroleum Market Law brings 15% threshold cited above, it should be said that, similar to current situation, the distribution firms have not had a tendency to vertically integrate at retail level even before the enactment of Petroleum Market Law due to high costs. However, instead of vertical integration via building fuel retailers or acquiring current fuel retailers, a sort of alternative vertical integration model has been instituted through rights such as 'lease' and 'usufruct'. Therefore, in practice more than 95% of fuel stations signed usufruct contracts with the distributors.

7. In fact, the Petroleum Market Law requires fuel retailers to sign exclusive purchasing contracts with distributors.⁵ Therefore, the distributors generally have signed both exclusive purchasing contracts and usufruct contracts with the fuel stations. Moreover, according to the Petroleum Market Law, the

¹ Decision is dated 24.7.2008 and numbered 08-47/653-250.

² Petroleum market activities are carried out by Petroleum Market Law, while production and searching activities are dealt with by Petroleum Law no 6326

³ Law No 5015, published in the official gazette on December 20, 2003.

⁴ See Article 7(5). Same article also provides that domestic market share of the distributor shall not exceed 45% of the total domestic market.

⁵ See Article 8(1).

distributors are prohibited from selling to fuel retailers that are supplied by other distributors.⁶ Therefore, the Petroleum Market Law did not allow operation of independent fuel stations (so-called white flagged stations) which existed before the Petroleum Market Law and brought price competition. Before the enactment of the Petroleum Market Law, such stations obtained their supplies at cheaper prices via border trade. The main reason for termination of their operation was the allegations that they involved in illegal fuel trafficking. However, it should be said that illegal fuel trafficking has nearly ended after entry into force of legislation regarding national marker (additive to be added to the fuel at the refinery exit point or at customs entry point) and its enforcement.

2. Provisions Prohibiting Discrimination

8. According to Petroleum Market Law, refineries can perform fuel distribution activities via its distributors.⁷ However, it should offer, on a category basis, the same conditions to those demanding fuel from itself as it does to its own distributor.⁸ According to another clause in the Petroleum Market Law, distributors can not grant subsidies to stations that they operate or treat them differently from other stations that they supply.⁹ Moreover, the provisions in the Act no 4054 on the Protection of Competition (Competition Act) prohibiting discriminatory agreements, concerted practices, decisions and abuse of dominant position are also applicable in energy markets.

3. Pricing and Vertical Relations in Fuel Market

9. Although there exists no overt clause in the Petroleum Market Law regarding pricing by retailers, the secondary legislation concerning licences in petroleum market empowers the distributor to set maximum prices to be applied in the fuel retailers and notify it to EMRA.¹⁰ In practice, EMRA publishes the prices notified and therefore announces it to all undertakings in the market. Moreover, according to Petroleum Market Law, distributors should inform the fuel retailers of promotional campaigns to be carried out with their participation in a transparent and clear manner together with the documents regarding the costs of such campaigns.¹¹ However, the participation of the fuel retailers in the campaigns shall be optional.

10. The Petroleum Market Law aims to create a pricing structure that is in harmony with price changes in international market on one hand and to ensure that competitive advantages are reflected in the market through freedom to set price on the other. Within this framework, it is expected that retail prices rise as international prices rise whereas they fall as international prices fall. However, the Fuel Market Report mentions that although prices charged by refineries and retail prices rise when international prices rise, falls in international prices are not reflected in retail prices at identical rates. This indicates price rigidity at wholesale and retail level when international prices fall meaning that either changes in international prices are not taken into account in an adequate manner or competitive pricing does not occur despite liberalisation at whosale and retail level.

11. According to the Fuel Market Report, it is hard to create competition at retail level. As retail fuel products are homogenous to a great extent, severe price competition would put the fuel retailer who cuts

⁶ See Article 7(2).

⁷ See Article 5(1)(b).

⁸ See Article 5(1).

⁹ See Article 7(5).

¹⁰ See Article 34(1)(e) of the Implementing Regulation on Licences in the Petroleum Market.

¹¹ See Article 9(12).

the price at an advantageous position. However, the impact of the price competition will be harmful for all if other fuel retailers follow the price cut. Therefore, at retail level price competition is avoided and only trivial differences in price that can not be distinguished by consumers emerge. As a result, the retail fuel trade has been shaped as a market where price is taken as granted and fuel retailers refrain from price competition.

12. As prices are taken as granted, the consumers buy fuel at the closest fuel retailer that works with a well-known distributor without searching the prices at different fuel stations. Consumers prefer fuel retailers working with well-known distributors because of existence of illegal fuel trafficking in the past.

13. Since price competition is weak, the undertakings focus on amount of sale to increase their revenues. In order to reach a particular amount of sale, fuel retailers aim to sign a contract with one of the big distributors whereas the distributors try to sign long term contracts with fuel stations at busy spots. Therefore, the image of the distributor is combined with advantage of attractive sale outlets owned by fuel retailers and this leads to signing of usufruct contracts. As a result of such contracts, a particular amount of sale is guaranteed for both the distributor and the fuel retailer. This, in return, weakens the tendency of both the distributor and the fuel retailer to compete on price.

14. The usufruct contracts exclude distributors who have newly entered the market or whose image is not strong. As illegal fuel trafficking is no longer an important issue in the market, brand image of big distributors begins to lose its significance. This inevitably affects consumer preferences and fuel retailers located at busy spots lose incentive to sign contracts with big retailers. Small distributors who newly entered the market or willing to increase market share have begun to submit more attractive offers to fuel retailers. However, such distributors face usufruct contracts as impediments before concluding agreements with fuel retailers. Therefore, such contracts have become a factor that prevents competition between big and small retailers. From the point of big as well as small distributors, the most important factor that affects competition in the market is the location of the fuel stations and the duration of the contracts for retail fuel distribution.

15. It is hard to find a place to build fuel stations at busy spots in central residential areas and competition is not strong and usufruct costs are high. Therefore, fuel stations with high amount of sale in central residential areas are important to compete in the market. Moreover, the Petroleum Market Law and secondary legislation on licences in petroleum market require minimum amount of sale for distributors.¹² Therefore, it is very important for small distributors to operate fuel stations in central residential areas. Moreover, there are legal restrictions on land to build fuel stations such as distance limit.¹³ However, since it is very hard to find land to build new stations, developing horizontal competition among fuel stations beyond a certain point is difficult even in the absence of such legal restrictions. Even if the distance limit is abolished, it can not ensure competition among fuel retailers alone. As a result, the Fuel Market Report mentions that the realistic approach to make fuel stations compete is to create competition at distribution level. Furthermore, considering the difficulties to create competition at retail level, the Fuel Market Report states that distribution level is the most effective factor to create competition in the fuel market and a competitive structure should necessarily be instituted at this level. Therefore, restrictions derived from usufruct contracts should be removed to enable small distributors to conclude contracts with fuel stations in central residential areas at the end of the duration of their contracts.

¹² See Article 9(2) of the Petroleum Market Law and Article 17(2) of the Implementing Regulation on Licences in the Petroleum Market.

¹³ Article 8(4) of the Petroleum Market Law provides an explicit restriction on trade regarding fuel and LPG stations and requires that distances between fuel and LPG stations on the same direction shall be no less than 10 kilometres on highways and 1 kilometre within the city.

16. The Fuel Market Report cites those issues regarding retail market and the contracts as reasons preventing price competition in the fuel market despite price liberalization since January 2005. Therefore, among other measures regarding prices, the Fuel Market Report urges that legal regulation is needed to prevent de facto abolition of five-year non-competition restrictions in contracts with fuel retailers via use of usufruct contracts and contracts for lease.

4. Competition Advocacy

17. Apart from those cited above, the Fuel Market Report provides some other suggestions to bring competition in the fuel market some of which are in the following.

18. The findings of the Fuel Market Report provide that the 15% threshold creates a model that restricts vertical integration although the distributors do not have a tendency to set up fuel stations operated by them. However, this model is not necessarily the preferable model in terms of price competition as vertical integration, when its financial advantages are taken into account, results in separation of profits obtained by the distributor and the fuel retailer. Therefore, the Fuel Market Report recommends that the 15% threshold be removed from the Petroleum Market Law. Parallel to removal of the threshold, the Fuel Market Report suggests that the prohibition of discrimination by distributors in favour of fuel stations operated by them should only be applicable to the dominant distributor in order to enable other distributors to enter the market in a more competitive way by charging competitive prices to the fuel retailers operated by themselves by means of financial integration.¹⁴

19. Moreover, the Fuel Market Report suggests that in order to have competitive effects from separation between distributors and retail outlets nearly all of the latter of which are outside the vertically integrated structure, non-competition clauses should be removed at retail level and the separation is transformed into commercial independence in its real sense for the fuel retailers. The main reason is that such clauses exclude vertical competition as fuel retailers bound by non-competition obligation are not different than fuel retailers operated by distributors. Thus, the Fuel Market Report suggests taking usufructs and leases as agreements having non-competition clauses, changing the Block Exemption Communiqué on Vertical Agreements¹⁵ issued by the TCA to remove exceptions to rights such as usufructs¹⁶ and prohibiting non-competition clauses if the duration exceeds five years or prohibiting

¹⁴ The TCA is aware that there has been no tendency to vertically integrate in the fuel market in the past, and therefore these measures can only produce effects in mid or long term.

¹⁵ Communiqué No 2002/2, published in the Official Gazette dated 14.7.2002 and numbered 24815.

¹⁶ Article 5 of the Block Exemption Communiqué on Vertical Agreements is as follows:

“The exemption granted by this Communiqué shall not be applicable to obligations in the agreement which are mentioned below.

a) Non-compete obligation imposed on the purchaser, which is for an indefinite period or whose duration exceeds five years.

In case of agreeing that the non-compete obligation may be implicitly renewed in a way to exceed the duration mentioned above, the non-compete obligation shall be deemed for an indefinite period.

Should the ownership of the facility to be used by the purchaser while continuing its activities based on the agreement belongs to the provider together with the land or under a right to build over, which has been secured from third persons not connected with the purchaser, or should the purchaser shall continue this activity of it in a facility which is the subject of a real or personal right of use obtained by the provider from third persons not connected with the purchaser, the non-compete obligation imposed on the purchaser may be tied to the duration of use of the said facility by the purchaser; it is to such an extent that the non-compete obligation merely encompasses the activity of the purchaser to be conducted by it in the said facility, in terms of the part of this duration exceeding five years.”

agreements producing the same result. However, the Fuel Market Report favours distributors with a market share below 5% and suggests permitting them to conclude agreements with non-competition clauses longer than five years.

20. Moreover, the Fuel Market Report considers independent fuel retailers (so-called white flagged) as the most competitive model and recommends removal of restrictions on such retailers as illegal fuel trafficking observed in the past has been prevented to a great extent via national marker and inspections. By enabling existence of independent fuel retailers and fuel retailers who are imposed non-competition obligation with only limited duration, competition will be created among distributors, and fuel retailers would be permitted to purchase fuel from small distributors thereby increasing competition in upstream market of distribution.

21. The Fuel Market Report also recommends that the prohibition of discrimination by refineries vis-à-vis distributors should only be applicable to the dominant distributor in order to enable new refineries to build their distribution channels and price competitively.

22. As maximum prices at retail level set by distributors are taken and applied as resale price by fuel retailers and distributors are decisive in setting margins valid for fuel retailers, margins valid for distributors and fuel retailers rise relatively when prices fall indicating that there is not sufficient price competition at wholesale and retail level, effective measures should be taken regarding pricing together with reassessment of publication of prices by EMRA, a practice which could facilitate concerted practices.