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**ROUNDTABLE ON COMPETITION IN ROAD FUEL**

**-- Note by Turkey --**

*This note is submitted by Turkey 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 MARKET

### Note by Turkey

1. Turkey has recorded continuous economic growth in recent years. As a critical input used in various sectors in the economy, the demand for oil products has raised proportionately. Having very limited domestic reserves and meeting 90% of its crude oil need by imports, increase in consumption of oil products triggered a surge in oil imports.

2. In 2012, the total sales of gasoline, diesel and auto gas LPG increased by 4% year-on-year and reached 20 million tons. A decrease in gasoline sales by 7% was offset by the rise in sales of diesel and auto gas LPG, which rose by 6% and 2% respectively. As Turkey's oil production capacity is limited compared to overall demand, last increase in demand caused Turkey's crude oil import to rise to 20 million tons, an 8% increase compared to 2011. In addition to crude oil, Turkey imports other oil products such as diesel and small volumes of LPG. In 2012, the import of diesel rose by 3% to 8.5 million tons, while LPG import was down 1% to 3 million tons.

3. There are 6 refinery license owners<sup>1</sup>, 70 liquid fuel distributor license owners and 12.919 retailers (liquid fuel), 69 auto gas distributor license owners and 9913 retailers (auto gas) in Turkey<sup>2</sup>.

4. In the refinery market, Türkiye Petrol Rafinerileri A.Ş. (TÜPRAŞ, or Turkish Petroleum Refineries Inc.), holds 4 licenses and is the incumbent refinery company in Turkey with almost 90% and 50% market shares in terms of gasoline and diesel, respectively.

5. The liquid fuel distribution market has five major players and this has remained unchanged for a considerably long period of time. Although the total market share of the five largest liquid fuel distributors is sliding (from 77% in 2010 to 70% in 2012<sup>3</sup>), the market is still in an oligopolistic structure.

6. The auto gas LPG market displays a different outlook, with an even less concentrated structure on the distribution side. There is a market leader with 22% market share and the total market share of the first five distributors, which has also a downward tendency, was 47% in 2012<sup>4</sup>.

### 1. Regulation in the Turkish Road Fuel Market

7. The road fuel sector in Turkey is governed under the Petroleum Market Law, No. 5015 (Petroleum Market Law) and the Liquefied Petroleum Gases (LPG) Market Law and Amending Law to Electricity Market Law, No. 5307 (LPG Market Law)<sup>5</sup> under the supervision of a sectoral regulator,

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<sup>1</sup> 2 license owners are in the building phase and not active.

<sup>2</sup> Energy Market Regulatory Authority (The last access date 14.05.2013).

<sup>3</sup> The total market share of the first five liquid fuel distributor was 73% in 2011.

<sup>4</sup> For LPG distribution sector, this ratio was 59% in 2010 and 58% in 2011.

<sup>5</sup> Law No 5015, December 20, 2003, Law No 5307, March 13, 2005.

Energy Market Regulatory Authority (EMRA), aiming to ensure a transparent, non-discriminatory and reliable market activities in a cost-effective manner within a competitive environment.

8. For instance, even though The Petroleum Market Law allows refiners to enter into distribution activities via distributors<sup>6</sup>, it requires them to offer, on a non-discriminatory basis, the same conditions to those demanding fuel from itself as it does to its own distributor<sup>7</sup>. The Petroleum Market Law also restricts maximum market share of any distributor with 45% of the domestic market<sup>8</sup>. Furthermore, the Law restricts sales by fuel stations operated by distributors to a maximum 15% of the distributor's total domestic market share. Therefore, while there are no legal barriers against vertical integration up to the retail level, the Petroleum Market Law aims to prevent emergence of vertically integrated players with considerable market power in both distribution and retail.

9. Although the Petroleum Market Law brings a 15% threshold as cited above, it should be noted that, historically distribution firms have not displayed a tendency to vertically integrate to retail level even before the enactment of Law, due to high costs. Instead, an alternative vertical integration model has been instituted through rights such as 'lease' and 'usufruct'.

10. The Petroleum Market Law also requires fuel retailers to sign exclusive purchasing contracts with distributors<sup>9</sup>. Therefore, distributors in general have signed both exclusive purchasing contracts and usufruct contracts with the fuel stations. Moreover, according to the Petroleum Market Law, the distributors are prohibited from selling fuel to retailers that are supplied by other distributors<sup>10</sup>. Therefore, the Law does not allow operation of independent fuel stations<sup>11</sup> (so-called white flagged stations) which existed before the Petroleum Market Law and enhanced price competition.

11. The Petroleum Market Law and secondary legislation on licenses require minimum amount of sale for distributors<sup>12</sup> (minimum 60,000 tons/year). Therefore, it is very important for small distributors to operate fuel stations in areas of central residence. Moreover, there are other legal restrictions such as building fuel stations outside a distance limit<sup>13</sup>. According to another clause in the Petroleum Market Law, distributors cannot grant subsidies to stations that they operate or treat them differently from other stations that they supply<sup>14</sup>.

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<sup>6</sup> Article 5(1)(b).

<sup>7</sup> Article 5(1).

<sup>8</sup> Article 7(5).

<sup>9</sup> Article 8(1).

<sup>10</sup> Article 7(2).

<sup>11</sup> 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 adopting legislation regarding national marker (additive to be added to the fuel at the refinery exit point or at customs entry point) and its enforcement.

<sup>12</sup> Article 9(2), the Petroleum Market Law and Article 17(2), the Implementing Regulation on Licenses in the Petroleum Market.

<sup>13</sup> 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 kilometers on highways and 1 kilometer within the city.

<sup>14</sup> Article 7(5).

12. Despite these structural regulations, the Petroleum and LPG Market Laws aim 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 the price on the other.

13. Although there is no overt clause in the Petroleum Market Law regarding pricing by retailers, the secondary legislation empowers the distributor to set maximum prices to be applied in the fuel retailers provided that they are notified to the regulator<sup>15</sup>. In practice, maximum prices at retail level set by distributors can be applied as resale price by fuel retailers and distributors may become decision maker in setting margins for retailers in a vertically integrated petroleum industry. Besides, respective margins for distributors and retailers, the taxes [special consumption tax (SCT) and ad valorem tax (AVT)] are also important components of resale prices. As a result of the legislation and vertically integrated structure of the sector, the breakdown of the average resale price can be demonstrated as follows: 35% refinery tax-free price, 30-45% SCT, 5% distributor share, 5-10% retailer share and %15 AVT.

14. Finally, the provisions in the Act No. 4054 on the Protection of Competition (Competition Act) prohibiting horizontal and vertical agreements distorting competition, and abuse of dominant position are also applicable in both the petroleum and LPG market.

15. Despite numerous laws and regulations, the fuel market is argued to be far from effective competition. In fact some of the clauses mentioned above have been the subject of Turkish Competition Authority's (TCA) "Liquid Fuel Sector Report", the conclusions of which were sent by the TCA as its opinion to the EMRA and the Ministry of Energy and Natural Resources with a view to promote effective competition in the market.

## **2. Turkish Competition Authority's Activities in the Road Fuel Market**

16. The TCA's practices in the road fuel sector can be categorized under three groups: enforcement activities, market studies, and advocacy. Actually, the fuel sector have been always seen as anticompetitive and there has been numerous complaints, examined within the framework of anticompetitive practices, including agreements and abuses of dominant position under articles 4<sup>16</sup> and 6<sup>17</sup> of the Competition Act. Moreover, all merger and acquisition activities in the market are subject to review by the TCA.

17. With respect to the past activities of the TCA in the fuel sector, numerous preliminary inquiries, exemption and clearance files, preliminary examinations on merger and acquisition activities have been concluded. Recently, there has been an investigation against TÜPRAŞ and its distributor Opet Petrolcülük A.Ş. (OPET). Moreover, a market study was carried out in 2008 and results and recommendations of the study were sent to the EMRA. Also, in 2013 the TCA's opinion for the Draft Petroleum Law was sent to the Ministry of Energy and Natural Resources.

18. Regarding the cases related with horizontal agreements and concerted practices, it can be observed that the subject of the majority of the preliminary inquiries is related to either parallel behavior between the pricing strategies of the national distribution companies or the horizontal agreements between retailers in local markets. A significant portion of those inquiries did not lead to investigation, as it was concluded that these behaviors could not be regarded as an infringement due to the existence of only circumstantial evidence, such as parallel pricing. Other cases were also cleared because of the prices of

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<sup>15</sup> Article 34(1)(e), the Implementing Regulation on Licenses in the Petroleum Market.

<sup>16</sup> Article 4 prohibits anti-competitive agreements, concerted practices and decisions.

<sup>17</sup> Article 6 prohibits abuse of dominant position.

retailers, claimed to take part in agreement of price fixing, were different from each other and lower than the other retailers' prices.

19. With regard to the decisions concerning abuse of dominant position; the cases can be said to be mainly about TÜPRAŞ, the dominant wholesaler, and none of them led to investigation due to lack of sufficient evidence. However, in July 2012, it was decided to initiate an investigation whether or not TÜPRAŞ abused its dominant position through exploitive and exclusionary behaviors. Moreover, in the same case the relation between TÜPRAŞ and OPET is examined to determine whether there is an infringement of competition through sharing market. The case is estimated to be finalized at the end of November.

20. In terms of mergers and acquisitions, and exemption and negative clearance files, the Competition Board approved all of the merger and acquisition applications<sup>18</sup> but did not grant exemption for one file since the joint venture agreement, subject of the file, was regarded as restricting competition and not fulfilling the conditions for the exemption<sup>19</sup>.

21. When analyzing the activities of TCA, the "Liquid Fuel Sector Report" and the preliminary inquiry carried out after sector report should be analyzed in more detail together with the TCA's recommendation sent to the EMRA. In essence, findings and evaluations in these studies about structural and operational features of the fuel sector and discussions about amendments in the Petroleum Law are still valid for the Turkish fuel market's conditions.

22. One key finding of these studies is that due to product standardization in the liquid fuel sector, price should be the most important factor for competition between distribution companies who are also decisive in retail pricing to a great extent in practice. However, it has been observed that in the market, distributors have formed a pricing strategy based on generating ad-hoc profits by following either the TÜPRAŞ's price or international prices and avoiding to engage price competition. As a result, it is observed that price reductions were not reflected to market with the same sensitivity as price increases (rockets and feathers). This downward price stickiness has caused high resale prices in Turkey, even in terms of non-tax prices as well, compared to the neighboring markets. In the Report, it is also mentioned that this pricing strategy, directed by large distribution companies, could be claimed to be a "concerted practice" and enforcement may be an option, but probably not an appropriate option for creating lasting competition. This is because there are serious structural barriers effecting distribution companies' pricing strategies and these barriers should be eliminated.

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<sup>18</sup> In its meeting on 21.10.2005, the Competition Board authorized that TÜPRAŞ be transferred to KOÇ-SHELL Joint Venture Group which was the highest bidder in the privatization tender. When handling the acquisition transaction, the Board evaluated that the existing dominant position of TÜPRAŞ would be strengthened with the acquisition of TÜPRAŞ by KOÇ, operating with OPET, having the second largest storage capacity in Turkey, in the liquid fuel distribution market and with AYGAZ A.Ş. (AYGAZ Inc.), the leading LPG distribution company and the largest LPG importer, in the LPG market. Although the Board reached the conviction that the acquisition transaction would not result in a significant decrease of competition in the relevant markets in respect of the liquid fuel supply, it only authorized the acquisition transaction conditionally as regards the LPG market. Since the position of TÜPRAŞ did not change in the LPG import directed at the Aegean Region in particular as a result of logistic problems which had emerged in the LPG supply in the past and that the integration of TÜPRAŞ and AYGAZ would result in a significant decrease of competition in the LPG supply as regards this region in case no measures were taken, the Board decided that the facilities for the LPG import, which took place in TÜPRAŞ İzmir Refinery (in Aegean Region), be opened to use such that they also enabled distribution companies to make direct import during 3 years following the transfer transaction was imposed as a condition for KOÇ-SHELL partnership to acquire TÜPRAŞ.

<sup>19</sup> Decision dated 04.07.2012 and numbered 12-36/1041-329.

23. In this respect, vertical integration to resale level is considered as the most important factor effecting competition. In Turkey, a different vertical integration model has existed instead of standard vertical integration strategies including set up or acquisition of fuel retailer arms. Actually, it is observed that the existence of this “alternative integration model” is directly related to the lack of price competition. Since the price competition is avoided at retail level (only trivial differences in price which cannot be distinguished by consumers remain), the retail fuel trade has been shaped as a market where price is taken as granted. As prices are taken as granted, the consumers tend to choose the fuel retailer based on physical proximity and brand name<sup>20</sup>.

24. Due to lack of price competition, retailers’ focus has shifted to boosting sales to maximize their revenues. To this end, fuel retailers tend to approach distributors with established brand names for long-term contracts, whereas the opposite may be the case for with fuel stations at busy spots. Therefore, the brand image of the distributor is tried to be combined with advantage of attractive sale outlets owned by fuel retailers and this leads to contracts, i.e. usufruct and rental 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.

25. The Fuel Market Report mentions that the realistic approach to make fuel stations to compete is to create competition at distribution level. Therefore, restrictions on contracts durations should be softened to enable small distributors to conclude contracts with fuel stations in areas of central residence. Moreover, contracts with long durations may easily violate the five year limit granted to “non-compete” provisions by the Block Exemption Communiqué on Vertical Agreements No. 2002/2. The Report, hence recommends that non-compete provisions which exceed five years through such contracts (usufruct and rental contracts) and similar means, or contracts that bring about this result, should not be permitted.

26. Furthermore, independent fuel retailers (so-called white flagged retailers) are considered as an important factor for ensuring a competitive market in the Fuel Market Report. Therefore, removal of restrictions on retailers through the provision of “exclusive distribution/exclusive purchasing” in the Petroleum Law is recommended. The Report claims that without independent dealerships, a structure where distribution companies were compelled to price competitively is not a viable outcome under current fast-changing market conditions.

27. Another recommendation is the elimination of the minimum sales limit of 60.000 tons imposed for the renewal of distribution licenses, which is regarded as an entry barrier.

28. In addition to these, the Fuel Market Report also recommends removal of the arrangements about the required physical distance between the liquid fuel stations, the 45% restriction concerning the market shares of distribution companies and the prohibition of discrimination by refineries vis-à-vis distributors except the dominant distributor in order to enable new refineries to build their distribution channels and price competitively.

29. Following the findings of the Fuel Market Report, and the news in the media and complaints alleging that the Competition Act might have been violated, a preliminary inquiry was initiated against TÜPRAŞ and the five largest liquid fuel distributors. In the end, the Competition Board decided that the Competition Act was not violated and there was no need for an investigation. Considering findings of the Fuel Market Report, it was concluded that there were serious structural barriers against competition in the fuel market and the sector did not display a competitive outlook. Therefore, regulatory powers entrusted to the EMRA may be called for action until a competitive structure is ensured, and the findings of the Fuel

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<sup>20</sup> In Turkey, consumers prefer fuel retailers working with well-known distributors because of existence of illegal fuel trafficking in the past.

Market Report and the preliminary inquiry combined as a formal Opinion of the Competition Board and sent to the EMRA in 2008, as an advocacy measure.

30. At the end of June 2009, the EMRA, based upon its mandate about price regulation<sup>21</sup>, regarded the findings of the TCA about the fuel sector enough to intervene to prices and decided to apply price ceiling and impose restrictions on margins of the distributor and retailers.

31. However, this intervention has not provided a lasting competition in the sector since the structural barriers and competitive restraints mentioned in the Fuel Sector Report so far have not been removed. In fact, the sector still does not display a competitive outlook and complaints claiming parallel pricing between distributors and retailers have continued.

32. In 2012, upon several complaints concerning the restriction of competition, the Competition Board decided to initiate a preliminary inquiry to detect whether the undertakings in fuel sector violate the Competition Act. Although a tendency for parallel pricing by following the refinery price was found between the distribution companies, it was decided not to initiate an investigation with regards to distributors due to lack of evidence.

33. However, as mentioned above, the Competition Board initiated an investigation against the incumbent refinery company, TÜPRAŞ, to find out whether TÜPRAŞ abused its dominant position through exploitive and exclusionary practices. In this investigation any possible violation of competition law by TÜPRAŞ and OPET is also investigated in the form of market partitioning or sharing. Moreover, following the same inquiry, an examination was started on whether the exemption granted to Turkish Oil Industry Association's activities to collect market statistics<sup>22</sup> should be withdrawn due to the possibility of restrictive effect on competition.

34. Recently, the TCA sent its opinion on the draft law about the amendments in Petroleum Law. Some suggestions about the issues that can create a restrictive effect on competition are made. Actually, the stance of the TCA does not fall far from its stance in the Liquid Fuel Sector Report and the previous TCA's opinion. The issues about minimum sale amount, restriction concerning the market shares of distribution companies and exclusive purchasing agreements are mentioned once again. The obligation of minimum sale amount on retailers, introduced with the draft law, is criticized and some recommendations are made for determining the amount as well. Regarding the exclusive purchasing contracts between distributors and retailers, in addition to allowing the operation of independent fuel oil stations, it is suggested to arrange the duration of contracts such as usufructs and rental contracts not to exceed 5 years. Moreover, the TCA recommends introducing an arrangement about legal separation of refinery and distribution operations. Another suggestion is canceling the obligation of operating in LPG cylinder sector on LPG distribution companies, to operate in auto gas distribution.

35. Lastly, the TCA discussed the current arrangement about pricing mechanism and proposed (i) making the refinery price subject to approval of regulatory authority (ii) removing the implementation of ceiling price on retail price determined by distribution companies as it is thought to have anticompetitive effects in market by making parallel pricing in both distribution and resale level easier.

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<sup>21</sup> Article 10 (13) of the Petroleum Law is as follows:

*“However, in the case that the risks arising from agreements and activities aimed at or may result in hindering, disrupting or restricting the competitive environment and delivery in the petroleum market, the Authority shall be authorized to determine base and/or ceiling price(s) and take necessary measures to apply on regional or national basis in all phases of activities not exceeding two months in each time.”*

<sup>22</sup> The decision dated 20.09.2007 and numbered 07-76/907-345.

36. Although the TCA has been one of the authorities that have direct influence on the market both through the enforcement of Competition Act and through its advocacy activities, as seen above, the TCA's activities only are not sufficient to ensure a lasting competition in fuel market. It could be said that it is of great importance to remove the structural problems in the sector and make required legislative changes in order to create a competitive market structure.