

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

ROUNDTABLE ON COMPETITION IN ROAD FUEL

-- Note by Chile --

This note is submitted by Chile 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. Overview of Road Fuel Industry in Chile and Regulation

1.1 *Extraction and refining*

1. The first stage of the value chain in the fuel industry is the extraction and refining of flammable liquids, particularly petroleum-based derivatives. In Chile, according to a provision in the Constitution of the Republic, the State has absolute, exclusive, inalienable and imprescriptible domain over all coal and hydrocarbon deposits and the other fossil substances. In addition, liquid or gaseous hydrocarbons cannot be the subject of exploration or production concessions.¹

2. Extraction and refining activities in Chile are performed exclusively by a state-owned company, ENAP.² ENAP owns refining facilities in the southernmost region of the country (Magallanes), the middle south (Concepción) and near the capital, Santiago (Concón). Unlike the case with extraction activities, the law does not restrict refining activities to the State. However, the fact that ENAP is the only supplier of refining services may suggest that there may not be sufficient profits to attract entry in this segment of the market in Chile, given sunk costs, scale economies and regulatory risks associated with an area in which the sole incumbent is a State Owned Enterprise (SOE).^{3 4}

3. Besides petroleum products extracted and refined in Chile, domestic demand of flammable liquids is also met through imports. ENAP supplies about 60% of flammable liquids demand domestically,

¹ Article 19 No. 24 Constitution of the Republic of Chile.

² ENAP is the acronym of Empresa Nacional del Petróleo. The company, which was created by law in 1950, is engaged in the exploration, production, refining, and marketing of hydrocarbons and their derivatives. It was initially responsible for prospecting and exploiting oil in the southern locations of Tierra del Fuego and the Straits of Magellan, where deposits were discovered between 1945 and 1950. Its subsidiary, ENAP Refinerías, operates three refineries. Through another subsidiary, ENAP Sipetrol (International Petroleum Company), founded in 1990, it has operations abroad. International production, primarily from neighboring countries, is responsible for most of ENAP's crude oil supply.

³ SOE is the acronym for state-owned enterprise.

⁴ The FNE reported in 2011, in Copec/Terpel merger case, that refining services needed a minimum efficient scale to reach equilibrium in production, due to economies of scale and high sunk costs. In addition, the size of Chilean economy would act as a natural barrier limiting the entry of new competitors in this segment. However, since there are volumes of imports—even though most of them by the major private distributor, Copec—the Competition Tribunal (“TDLC”) concluded that ENAP's capacity for abusing whatever market power it may have was thereby limited. The FNE's report is available here: <http://www.tdlc.cl/DocumentosMultiples/INFORME%20FNE%20NC%20380-10.pdf>; the TDLC's decision is available here: http://www.fne.gob.cl/wp-content/uploads/2011/05/reso_34_2011.pdf

while the remaining 40% is supplied by imports.⁵ Major companies involved in importing flammable liquids are ENAP and Copec. Among private distributors, Copec accounts for 95% of imports, while Enx/Shell and Petrobras import significantly lower quantities.

1.2 Transportation and storage

4. Flammable liquids must be transported to storage facilities. Transportation is done by means of pipelines, ships, and/or trucks. Pipeline transportation is provided by SONACOL, a private company co-owned by Copec, ENAP, Enx, Petrobras and Abastible.⁶ SONACOL's main pipeline unites refining facilities in Concón with storage facilities in Maipú (a southern department in the Santiago Metropolitan Region), and accounts for almost 95% of Santiago's flammable liquid demands. Due to the fast and safe transportation that pipelines provide for refined flammable liquids, ships and trucks are only imperfect substitutes.

5. Both ENAP-refined products, as well as imports, are stored in land and maritime storage facilities. ENAP and the major distributors (Copec, Enx, Petrobras and Terpel) participate in this segment of the value chain by means of storage facilities that are individually-owned, owned in common by subsidiaries, or owned by major industrial customers, such as major mining and power companies, and companies participating in spot transactions.⁷

6. Transportation from storage facilities to areas of consumption (e.g., industrial customers and retail gas stations) is mainly done through tanker trucks. This transportation service is generally outsourced by distributors. In some particular cases, transportation from storage facilities is done by ship.

1.3 Wholesale distribution

7. The wholesale distribution segment involves the purchase of ENAP's products and/or imported products, the transportation of these products to storage facilities, their storage, and finally, their transportation to the wholesale customers. Major participants in wholesale distribution are Copec, Enx(Shell), Terpel and Petrobras, along with other small providers (none of which have more than 5% market share). While wholesale distribution involves two kinds of customers, industrial customers and gas stations, the latter are the most relevant segment for the purposes of this contribution.

1.4 Retail distribution (gas stations)

8. There are around 1,500 gas stations throughout Chile. This distribution channel accounts for around 43% of refined flammables (i.e., gasoline, petrodiesel, kerosene) consumed in the country. Measured by the number of gas stations owned by each chain, Copec is the largest market participant, with

⁵ Petrodiesel is the main import, entering the country through Quintero, a maritime port nearby Santiago.

⁶ Abastible is a liquid petroleum company

⁷ For instance, in the case of the Metropolitan Region of Santiago, main storage facilities are located in Maipú, a southern department. One of these storage facilities belongs jointly to Copec and Enx; another one belongs to JLC, and independent distributor; another one belongs to the ex-Emalco (a formerly ENAP's subsidiary, today under ENAP's division of storage and pipelines). The major storage facility belongs to ENAP, which has a storage capacity for the 50% demand of the region. The second largest actor in terms of storage capacity is Copec which has facilities that it owns independently, and other storage facilities owned jointly with Enx(Shell).

665 gas stations, followed by Shell (376), Petrobras (246), Terpel (171), and other independent distributors (44).⁸

9. Different kinds of contractual arrangements govern the relationships between wholesalers and retailers. According to the most common forms in practice, some retailers use the branding of the specific wholesaler that provides the flammables, and resell the products at prices determined at the retail level. Other retailers follow an agency business model in which the retail price is fixed by the wholesaler, which also owns the flammables; the retailer is remunerated with some percentage of retail sales revenues.

10. Measured by the amount of sales, this segment has been identified by the competition authorities in Chile as a highly concentrated market, led by Copec with a market share of almost 60%.⁹

11. In the case of fuels distributed by retail gas stations, competition authorities in Chile have defined relevant geographic markets on the basis of small or local areas, since consumers would consider as actual substitutes only those gas stations located at a relatively short distance one from the others.¹⁰

1.5 Tax issues and regulations

12. Taxes on flammables are an important component of the retail price. Sales of flammables are subject to a specific tax representing around 10% of the retail price in the case of diesel, and around 30% in the case of gasoline.¹¹ The tax was introduced for the first time after a 1985 earthquake and was aimed at repairing the roads that had been destroyed.

13. Since the Gulf War (1990-1991), international oil prices generally have been increasing, leading the government to put in place different stabilization mechanisms to compensate for Chile's excessive vulnerability to international price increases.¹² The first mechanisms designed and implemented were

⁸ As expressed by TDLC, May 26th, 2011, Res. 34/2011, Copec/Terpel merger case, section 8.4, p. 22.

⁹ Ibidem

¹⁰ TDLC, April 26th, 2012, Res. 39/2012, Shell/Terpel merger case, section 8.5, p. 34: “[C]onsumers decide taking into account the alternatives they have for substituting consumption in a specific gas station. Thus, even though consumers could eventually travel for a hundred kilometers searching for an alternative gas station, high search costs make reasonable to think in a geographic market locally limited in case of distribution through gas stations”. In the FNE's report for this case, it expresses: “Two gas stations should be considered in the same geographic market if consumers of the products displace towards one or the other due to their proximity, accessing to better prices. Thus, the geographic relevant market should be determined according to the area of influence of the gas station defined on the basis of the time consumers are willing to displace in search of a better price” (free translation from the original in Spanish). Due to the overlap of areas of influence a ‘domino’ or ‘chain reaction’ effect, may make include within the geographic market some gas stations rather far. On the basis of the considerations above, and due to the lack of sufficient information, the FNE determined the geographic relevant markets as each of the administrative departments having gas stations from the two companies of the transaction under review, with the exception of the metropolitan area of Santiago, which justified to consider several departments jointly, due to longer distances commonly traveled by consumers. FNE's report, December 20, 2011, available here: http://www.fne.gob.cl/wp-content/uploads/2011/12/inf_tdlc_010_2011.pdf

¹¹ <http://sie.minenergia.cl/sieJSFServer/pages/reporte.xhtml?i=80>. Some transportation companies may recover what they have borne due to this tax.

¹² Chile's demand for petroleum derivatives is highly dependent on imports. And the import prices are a function of international prices, particularly WTI petroleum market in the case of Chile. A report issued by a British bank illustrated the consequences of this dependence, for instance, a 10% increase in the barrel of crude oil international prices would increase inflation in Chile in 1,14%, and would reduce the GDP in the range of 0,3 – 0,6%.

stabilization funds. The mechanism currently in force is a system that, instead of a fund, introduced a variable component in the calculation of the tax rate on flammables. The variable component of the rate is a function of differences between a median reference price and the import parity price, both determined weekly. The variable component is triggered when that difference exceeded a 12.5% upward and downward price band. In other words, the variable component of the tax rate is reduced when prices increase beyond the band, and is increased when prices decline below the band. The mechanism is aimed at avoiding transitory price increases and alleviating permanent increases, without turning into a subsidy. According to the legislation enacted in 2011, it is expected that this system will be replaced with an insurance mechanism supported by the use of financing derivatives, but the implementation of this next stage has proven to be very challenging and has been delayed.

14. The Chilean competition authorities have concluded that some regulatory requirements act as barriers to entry, particularly in the case of zoning and environmental regulations. These regulations may turn into a strong barrier to entry, particularly in some cities or areas where the building of new gas stations has been frozen by zoning authorities. In a recent merger case, for instance, the TDLC identified as legal barriers those regulations restraining the building of new gas stations in urban areas.¹³

2. Competition issues and Competition Law cases; remedies

2.1 *Price-fixing cases and complaints*

15. The first collusion case the TDLC confronted involved allegation of concerted practices among fuel retailers in the Valparaíso Region, which is located near Santiago. The case was initiated before the *Comisión Preventiva* of the Valparaíso Region, an administrative body predecessor of the TDLC.¹⁴ That entity held in April 2003 that the four defendant fuel retailers had been behaving in a concerted manner with the purpose of increasing, ensuring and maintaining their margins, and ordered them to cease the conduct. The main grounds for this decision were the significantly higher margins in the Valparaíso Region than in Santiago, in spite of the absence of the cost of transportation in Valparaíso from the refining facilities, a cost that must be borne for distribution in Santiago.

16. On the basis of this background, the FNE initiated an investigation in the road fuel markets in Valparaíso and Santiago. Afterwards, the FNE submitted a complaint before the TDLC against the major fuel distributors accusing them of collusion in the Metropolitan Area of Santiago, during the years 2001 and 2002, grounded on the increase in margins in a context of demand decline, asymmetric price adjustments ('rockets and feathers'), the similarity of level of prices and their evolution, and the downward of margins in an area where the defendants faced competition from an independent retailer.

17. In June 2005, the TDLC dismissed the FNE's complaint and overturned the prior decision of the *Comisión Preventiva*. The TDLC concluded that collusion could not be proven by an increase in margins, the asymmetry in price adjustments and/or the similarity of prices and their evolution in a homogeneous product market. According to the Competition Tribunal, these elements were not even sufficient to prove tacit collusion, since quantitative data was needed for discarding alternative explanations for margin increases. The TDLC also dismissed several allegations regarding the existence of barriers to entry in the upstream markets (namely transportation and storage). As to the entry barriers in the retail market, zoning regulations were identified, but their significance was not further analyzed. The extended practice of

¹³ TDLC, April 26th, 2012, Res. 39/2012, Shell/Terpel merger case, section 9.15, p. 51; available here: http://www.fne.gob.cl/wp-content/uploads/2012/08/reso_39_2012.pdf

¹⁴ Before the creation of the Competition Tribunal (TDLC), several *Comisiones Preventivas* in administrative regions and one in Santiago, were in charge of assessing conducts from a competition law approach but with no judicial punishing powers beyond issuing injunctions.

vertical integration between wholesale and retail distribution was considered as a potential facilitating practice for collusion.

18. Despite the dismissal of the FNE's complaint, the TDLC issued some recommendations regarding transparency in the operations of the company owning Chile's major pipeline, others aimed at facilitating the development of alternative pipelines, and ordered the FNE to monitor vertical relationships between the wholesale and retail segments.

19. It is worth recalling that, at the time the competition authorities dealt with this case, they did not have adequate powers for investigating cartel conduct (as leniency, dawn raids, wiretapping were not introduced until 2009). Thus, cartel cases were built mainly on the basis of circumstantial evidence.

20. Other cartel allegations have been raised, most frequently by local political representatives. These complaints usually concern a local area (such a city or a region), lack significant evidence for grounding an action and, since they are made publicly, any potential investigation is early deprived of surprise factor. Nevertheless, some have translated into actual and formal complaints before the FNE. And some of these have triggered the initiation of investigations still ongoing, while others have been dismissed.

2.2 *Merger cases*

21. A major cross-border transaction involving the Copec group (by far the major player in fuel distribution) and a Colombian parent company of Terpel Chile (a Copec rival in retail and wholesale distribution) provided an opportunity for undertaking an in-depth review of regulatory, structural and behavioral elements in this industry. The presentation that follows is divided into three different stages: (1) the TDLC's decision on the original transaction submitted for merger review; (2) the TDLC's refusal to approve the proposed purchaser of the assets that it ordered to be divested; and (3) the Supreme Court's ruling overturning the TDLC's decision regarding the disposition of the divested assets. The FNE's position in each of these stages will be detailed as well.

22. *TDLC's merger decision on the original transaction submitted for merger review.* In 2010, the Copec group initiated a consultation for approval before the TDLC regarding a pending transaction that would grant Copec control over Terpel Colombia, a holding company in Colombia that was the parent company of Terpel Chile, a rival of Copec in the Chilean markets of fuel distribution. In Copec's submission, the company proposed the following commitments: the divestiture of Terpel Chile within two years, along with several measures aimed at keeping the management and sensitive commercial information of Terpel Chile completely separate and independent from both Terpel Colombia and Copec until the divestiture was completed.

23. In May 2011, the TDLC concluded that wholesale and retail distribution were highly concentrated markets, worsened by significant levels of vertical integration, and by barriers to entry and expansion. With respect to refining and imports, the TDLC concluded that ENAP's capacity for incurring in market power abuse was limited by the availability of imports. As to transportation, even though it mentions the risk of exclusionary prices in access to a duopoly pipeline infrastructure integrated by ENAP and SONACOL, available capacity of SONACOL's pipelines would limit this risk. Maritime transport, even though dominated by ENAP, would be open to the entry of alternative carriers. As to storage, the TDLC concluded that companies not owning a storage facility could rent storage capacity from someone

else, as Terpel has done, under the condition of accessing to fair (non-exclusionary) prices for storage facilities.¹⁵

24. The major risks the TDLC identified were in wholesale distribution and in retail distribution through gas stations. The TDLC upheld the position of the FNE, holding that maritime terminals and storage facilities were essential facilities for the wholesale distribution at a national level, that the high sunk costs were an entry deterrent and that the time needed for planning new infrastructure and logistics projects for wholesale distribution made it very hard to have timely entry or new entry at all. The high and increasing market share of Copec in wholesale distribution and the stability of concentration indexes since 2007 (C4 over 90% and HHI over 4500), were additional factors in reaching the conclusion on the non-contestable character of the wholesale distribution segment. As to the retail distribution through gas stations, the levels of concentration (and to some extent, the corresponding market shares) in the wholesale segment were replicated by the retail segment due, in part, to vertical integrations strategies through direct ownership of gas stations or other contractual arrangements. Moreover, the TDLC agreed with the FNE's position that the homogeneous nature of the products, and the ease of monitoring due to vertical integration and the manner form of making prices public, increased the risks of coordinated effects. Hence, the TDLC concluded that the transaction under review would result in significant risks of harm to competition in the distribution of fuels through gas stations.¹⁶

25. The TDLC imposed remedies beyond the commitments proposed by the merging parties conditioning the divestiture package as follows (1) all the assets must be sold in only one package, to one purchaser only; (2) the aim of the divestiture should be to allow the development of an entity competitively viable and totally independent both from Copec and from Terpel Colombia in order to effectively compete with Copec; and (3) the divestiture should be performed within 18 months since the effective takeover of Terpel Colombia. Other remedies were aimed at ensuring effective monitoring of and compliance with the divestiture process. In particular, the TDLC imposed a mandatory notification prior to the divestiture in case the purchaser was an incumbent.¹⁷

26. *TDLC's refusal of the proposed purchaser.* The purchaser interested in acquiring the divestiture package was Shell, the second largest actor in fuel distribution market. In a divided 3-to-2 decision issued in April 2012, the TDLC rejected the proposed acquisition of Terpel Chile's divested assets by Shell. The main grounds for TDLC's decision involved entry barriers and coordinated effects, and the dismissal of each of the efficiencies advanced by the merging parties. Thus, the TDLC concluded that there were not any remedies available that could mitigate the competitive risks of an acquisition by Shell, and that the purchase by Shell would not fulfill the purpose of the divestiture of developing an effective viable and independent market participant.¹⁸

27. The differences between the TDLC's majority and minority focused mainly on efficiencies. Contrary to the majority, the dissenting judges did not agree with blocking Shell's purchase. The minority considered that some efficiencies—such as the increase in the number of customers, which would thereby

¹⁵ Blue Oil, a fuel distributor oriented towards industrial customers claimed in this proceeding that such exclusionary prices have been imposed by ENAP, affecting its competitiveness, an allegation Blue Oil had raised before in another proceeding against ENAP.

¹⁶ These conclusions did not extend to industrial customers due to the higher bargaining power of customers and the relatively higher number of suppliers in this channel.

¹⁷ Records of this case, known as the Copec/Terpel merger case, and the corresponding TDLC's decision are available here: <http://www.tdlc.cl/Portal.Base/Web/VerContenido.aspx?ID=2738&GUID=>

¹⁸ Records of this case, known as the Shell/Terpel case, and the corresponding TDLC's decision are available here: <http://www.tdlc.cl/Portal.Base/Web/VerContenido.aspx?ID=2921>

allow the merged entity to reach sufficient scale to make direct imports, and the savings on storage costs—were efficiencies sufficiently verifiable, feasible and directly attributable to the transaction and that they would likely benefit consumers.

28. The FNE's report, took an intermediate position, agreeing with some of the efficiencies raised by the merging parties but identifying high coordinated effects in some specific areas, justifying the imposition of divestiture remedies with respect to those areas, ensuring that the purchaser would be an independent company.¹⁹

29. *Supreme Court's ruling overturning TDLC's decision.* In January 2013, the Supreme Court overturned the TDLC's decision that had blocked the purchase by Shell. The Court held that prohibiting the transaction was not proportionate in the case and, following the view of the FNE, approved the purchase by Shell subjected to divestiture of at least one gas station in all the markets in which the yield of concentration post-transaction would exceed those determined by the FNE in its internal guideline for horizontal mergers as threshold for preliminary competitive concern.²⁰

2.3 *Dominance cases*

30. There is only one exclusionary abuse case that the TDLC has dealt with to date in this industry. In that case, the plaintiff was an independent wholesale distributor that wanted to buy fuel from ENAP but did not comply with ENAP's requirements. The plaintiff claimed a refusal to deal and an exclusionary abuse, an accusation that the TDLC dismissed on the basis that the requirements were reasonable.²¹

31. In another exclusionary abuse allegation, in 2009, Blue Oil Company, an international fuel trader, sought to initiate a proceeding requesting pre-complaint disclosures by ENAP, claiming that ENAP was abusing its market power in order to exclude Blue Oil from the market for distribution to industrial customers. The TDLC dismissed the petition, holding that the requested disclosure was not needed in order to submit a formal complaint and initiate a regular adversarial proceeding against ENAP. Finally, Blue Oil did not submit a complaint.²²

32. Beyond the TDLC activities, the FNE has received and analyzed complaints for both exclusionary and exploitative conduct. Regarding exclusionary abuses, for instance, a complaint accusing Copec of sham litigation was submitted before the FNE by Hotelera Neuquén in 2010. The FNE decided to close the investigation without further action on the basis that Copec's actions were aimed at enforcing an award granted in an arbitration proceeding and thus the alleged facts did not satisfy the TDLC's case-law on sham litigation, which require an exclusionary purpose as the motivation for the conduct.

33. As to complaints claiming exploitative market power, for instance, in 2010, two congressmen submitted a complaint before the FNE against ENAP, accusing the company of price discrimination, since ENAP was charging lower prices in Santiago than in the rest of the regions. The FNE dismissed the

¹⁹ The FNE's report for the Shell/Terpel proceeding is available here: http://www.fne.gob.cl/wp-content/uploads/2011/12/inf_tdlc_010_2011.pdf

²⁰ Records of this case, known as the Shell/Terpel case, including the corresponding decisions, are available here: <http://www.tdlc.cl/Portal.Base/Web/VerContenido.aspx?ID=3083&GUID=>

²¹ TDLC, April 18, 2008, Ruling 64/2008, MICOM S.A. vs. ENAP case, available, here: http://www.fne.gob.cl/wp-content/uploads/2011/03/sent_0064_2008.pdf

²² Records of this summary proceeding initiated by Blue Oil against ENAP, and the TDLC's decision are available here: <http://www.tdlc.cl/Portal.Base/Web/VerContenido.aspx?ID=2367&GUID=>

complaint on the grounds that there were objective and economic foundations for the differentiations in prices ENAP charged.

34. Some others dominance allegations are mixed with vertical relationships and vertical contractual disputes. We will deal with them separately in the next section.

2.4 Vertical Restraints

35. There are several cases involving vertical relationships between an independent distributor - usually a SME²³- and a principal actor in fuel distribution. Commonly, the SME distributor has a contractual arrangement upstream with conditions that, according to the complainant, progressively became excessively onerous, and thus constitute an ‘abuse of dominance’ in the contractual relationship, or a ‘covert vertical integration’ that has harmed the plaintiff. All the cases under this category have been dismissed on the basis that an actual or potential harm to competition was not shown. There is one exception, in which the TDLC ruled in favor of the plaintiff, but on the basis of the infringement of older decisions on vertical restraints in fuel distribution that had been issued by the competition law bodies that preceded the TDLC. That condemnation, however, was overruled by the Supreme Court.²⁴

3. Competition Advocacy in Fuel markets

36. Competition advocacy actions in this industry have been rare. There are no standalone competition advocacy activities to mention. However, in some of the aforementioned enforcement cases, the TDLC has performed a sort of competition advocacy beyond traditional remedies. For instance, in the dismissed price fixing case described above, the TDLC issued some recommendations regarding transparency in the operations of the company owning the major pipeline, sought to facilitate the development of alternative pipelines (none of which were actually implemented afterwards), and ordered the FNE to monitor vertical relationships between the wholesale and retail segments.

4. Monitoring Fuel prices

37. The FNE has not undertaken an active role in monitoring fuel prices. Due to the nature of the product, changes in prices are monitored by a high number of stakeholders better positioned than the FNE for monitoring price increases (moreover with an instant on-line information now available due to the initiative of the CNE, a public body in charge of energy regulations²⁵). In the last few years, the FNE has acquired expertise performing price screening. This proactive detection strategy could be useful to identify potential patterns in the road fuel industry.

²³ Small and medium enterprises.

²⁴ TDLC, June 6th, 2007, Ruling 53/2007, Labbe Haupt y Cía. Ltda. vs. Shell case, records available here: <http://www.tdlc.cl/Portal.Base/Web/VerContenido.aspx?ID=790&GUID=>

²⁵ <http://www.bencinaenlinea.cl> This information platform was launched by the Comisión Nacional de Energía (CNE) in 2012.