PRICING POLICY (MOTOR FUEL): COMMISSION MEMORANDUM

Subject: Pricing policy

Industry: Motor fuel

Source: Commission Statement MEMO/00/55, dated 20 September 2000

(Note. It is to the Commission's credit that, at a time when public opinion is seriously disturbed by the problem of excessive petrol and diesel prices, it should be examining the question whether anti-competitive practices in the motor fuel industry are making a substantial contribution to the high price levels. However, it is only too clear from the Commission's statement that, among the factors which make up the final price to consumers, oil company profits are relatively small. Both the crude oil price, dictated largely by OPEC, and - still more - the levels of national taxation, account for rises in price in the last year. As far as OPEC is concerned, the competition rules do not apply, since the prices are not set by undertakings but by sovereign states; and the Commission says that the states concerned are not motivated exclusively by economic considerations. As to tax levels, which are as high as 75% in the United Kingdom, these are not only outside the scope of the competition rules but also outside the jurisdiction of the European Community. The Commission statement accordingly concentrates on the ways in which it may be able to influence the price element by action against cartels and by imposing rigorous conditions on the conclusion of oil company mergers and acquisitions.)

EC competition policy and the motor fuel sector

The Commission meets the national competition authorities on 29 September to discuss competition policy issues in the motor fuel sector. The aim of this meeting, which has been organised since early July, is to exchange experiences and information with the national competition authorities concerning the respective enforcement activities in this sector. Mario Monti, commissioner in charge of competition, has stated that "we are well aware that competition rules alone cannot solve all, or even most, problems in this sector, but we intend to explore to what extent Community and national competition law can contribute to a more competitive motor fuel sector for the benefit of the European citizen."

The structure of motor fuel prices

The price of motor fuels can be divided into three main components: crude oil prices, taxes and costs for refining, marketing and distribution. Crude oil prices have dramatically increased (more than 180% on average) since December 1998. This is mostly, but not only, due to the limitation of output by important producing countries, essentially but not exclusively the OPEC countries. The world-wide economic growth has led to an increase in demand. Currency fluctuations and the depreciation of the Euro against the US dollar have firmly

contributed to the price increase for European refiners, since crude oil is generally quoted in US dollars on the international spot markets.

Member States impose special taxes on motor fuels, which, when added to the price of oil, constitute the base for the VAT. It should be noted that the tax factor is currently the highest of the three main factors affecting the price of motor fuel (from approximately 50% in Portugal, Greece and Luxembourg to 75% in the UK). The special taxes on motor fuels have as one of its main objectives to discourage the use of mineral oils as main source of energy so as to reduce the overall emissions of gases to the atmosphere. This level of taxes on mineral oils should also promote the use of alternative energy sources, including renewable energy, which are more respectful to the environment.

The costs for refining, marketing and distribution are, in relative terms, the lowest of the three price components. It is on this component that EC competition rules can have an impact. However, since the motor fuel price depends largely on the factors described above (crude oil prices, currency fluctuations and taxes), it follows that any anti-trust intervention could only have a limited impact on the price of motor fuel.

Competition enforcement in the upstream market: crude oil production

The production constraints agreed by some producing countries, such as the OPEC members, have restrictive effects similar to a cartel. However, it does not appear possible to apply EC competition law to such restrictive acts when they are adopted by sovereign states and not by undertakings within the meaning of Article 81 of the Treaty. Moreover, the activities of OPEC members relate not only to the conditions under which the natural resources of these states are marketed, but also to the management of those exhaustible resources. It is therefore difficult to conclude that OPEC conducts a purely economic activity. As a result, an action based on Articles 81 and 82 of the Treaty against OPEC does not appear feasible. Similar conclusions have been reached by antitrust authorities in the United States.

Action against possible exploitative parallel conduct of multinational oil firms on the upstream market could be envisaged. However, lessons from recent merger investigations carried out by the Commission, such as Exxon/Mobil and BPAmoco/Arco, show that is difficult to prove that oil companies enjoy single or collective dominant positions on these markets. Even if market power were to be established, any antitrust intervention on the upstream market against the private operators would have a limited impact if the oil producing countries, such as the OPEC members, had to be excluded from it.

Competition enforcement in the downstream markets: refining, marketing and distribution of motor fuels

The most obvious tool for applying competition rules in the down-stream markets would be to attack any illicit co-operation between the oil companies, whether at

refinery, marketing or distribution level. There is a general perception that prices of motor fuels are the object of co-ordination by major oil companies due to the similar or identical prices. However, the Commission must prove more than parallel pricing behaviour among the oil companies to establish the existence of a cartel, since there may be other economic explanations for such parallelism. Indeed, it can in many cases be explained by the economic conditions and the market structure and not as a result of co-ordination; that is to say, few suppliers sell a homogenous product in a transparent market with inelastic demand. Under such conditions, companies are able to raise their prices to match the price of their competitors without having to reach an agreement or any other form of co-operation. The fact that the markets in most, if not all, Member States are oligopolistic is thus not sufficient to establish the existence of a cartel.

Although prices are currently at a high level, this does not automatically imply an abusive pricing policy by the oil operators. To establish that, one would first need to demonstrate that the operators are dominant on the markets. Second, the pricing policy should constitute an abuse in the form of excessive or discriminatory pricing. In this context, it appears that the increase of the price for motor fuels, in average, largely reflects the increase of the price of crude oil (see annex). As regards the recently announced profits of several major vertically integrated oil companies, it appears that these profits have mainly been achieved at the level of production (up-stream), due to the high crude oil price, and not at the level of distribution (down-stream). It does not appear possible, under EC competition rules, to oblige vertically integrated companies to use their profits from their up-stream activities to lower prices for their down-stream products. Moreover, in a long-term perspective, compensating losses at the distribution level with up-stream profits may distort competition in the market as it could result in non-integrated independent operators being driven out of the distribution market.

Needless to say, if the Commission were to find any evidence of a price cartel or any other anti-competitive behaviour in the motor fuel sector, it would take immediate action. It is the Commission's experience that cartels in the motor fuel sector are usually organised at national level. As a general rule, cases that are purely national in scope are usually not dealt with by the Commission, but by the national competition authorities. A number of national authorities have recently prosecuted cartels and other infringements of competition law within their national territories.

As an example, the Swedish competition authority has recently found a cartel between 90% of the oil suppliers in Sweden who had agreed on the level of rebates and prices to wholesale customers. The Italian competition authority has recently imposed a high fine on oil companies for co-ordinating resale price maintenance at retail level. A third example is the German Federal Cartel Office which has recently adopted a decision ordering vertically integrated companies not to charge different prices to independent resellers from those they charge to their own resellers. Other competition authorities, such as in Denmark, Germany, France and Spain have recently launched investigations in the motor

fuel sector. The above competition authorities will all share their experiences at the meeting of 29 September.

As regards horizontal cooperation at refining level, the cases recently investigated by the Commission have not shown the existence of restrictions of competition. For the moment, these forms of cooperation seem to be driven by the need to reduce the existing refining over-capacity in Europe.

The downstream markets for motor fuel retailing are, in most Member States, mature markets with stagnant or shrinking volume as a general tendency. They are characterised by exclusivity arrangements linking petrol retailers to refiners (so-called vertical restraints). This may lead to market foreclosure, making it difficult for existing operators to increase their market shares through gaining additional retailers and for new entrants to enter the market. In this respect, the Commission adopted in December 1999 a new policy on vertical restraints that will lead to changes in the oil sector. The new Regulation has came into force in June 2000 with a transitional period until the end of 2001 for existing contracts to be adapted to the new policy. The most important change is the shortening of the maximum duration of exclusive service station agreements from 10 years to 5 years. All being well, this will have the beneficial effect of enabling petrol retailers to change supplier more often after the expiry of the 5-year contract. The Commission will monitor to which extent the new policy will promote competition in the market.

Market integration issues

The existing price differences (before taxes) at retail level among the different Member States are somewhat surprising given that oil and refined products are commodities, which are quoted internationally. This may reflect the different cost and market structures across Europe, but it may also be a sign of imperfect market integration within the single market. Indeed, it appears that trade of motor fuel does not, in general, take place on a cross-border basis, but rather on a local basis.

This lack of cross-border trade may result either from co-ordinated business practices (market sharing) or from State measures amounting to barriers to trade. In this latter respect, for example, measures imposing security reserves at national level for every import are often said by market operators to constitute barriers to market penetration and thus not being in line with the principles of the Internal Market and EC Directive 98/93 on security reserves.

Structural measures to improve competitive conditions

It is true that there is a concentrated structure in the motor fuel sector, with oligopolistic dominance in some European markets and possibly single dominance in others. While adopting structural measures to make the markets less concentrated could effectively help in improving the competitive environment, the Commission does not, unlike the US authorities, enjoy such powers under Articles 81 and 82 of the EC Treaty.

On the contrary, structural remedies are applied in the context of EC merger control proceedings. In these cases, merging companies may offer structural undertakings to the Commission in order to remove the Commission's competition concerns. The Commission has recently examined several mergers in the motor fuel sector and intervened when necessary to ensure that the concentrations would not lead to a creation or strengthening of a dominant position. Thus, for instance, in the Exxon/Mobil merger, to eliminate the concerns of the Commission, the parties undertook to divest Mobil's share in Aral, a motor fuel retailing company present in Germany and Austria. The parties also undertook to dissolve the fuel part of the BP/Mobil joint venture which was present across Europe. Subject to these undertakings, the Commission authorised this merger.

Similar undertakings were offered in the TotalFina/Elf merger, notably to sell 70 motorway service stations in France to competitors. TotalFina also undertook to divest a large proportion of its transport and storage logistics. The Commission is currently monitoring that divestiture of motorway service stations is done in a way that promotes competition. In this context, the Commission has provisionally rejected the proposed buyers presented by TotalFinaElf since the buyers are unlikely to exercise competitive pressure on TotalFinaElf.

In some cases, Member States may have the power to take structural measures under national legislation. Examples of structural measures include: limiting the growth of existing companies in the motor fuel sector; compulsory divestiture of assets (including divestiture of logistic facilities); facilitation of establishment of new competitors at retail level (such as supermarkets); allocation of new retail outlets on the basis of competition criteria (for example concessions on motorways or concession of public land in town centres) and so on.

Competition rules alone cannot remedy all the problems

The Commission will continue monitoring the competitive conditions in this sector and take action if it has evidence pointing to anti-competitive behaviour within its sphere of competence. It will also co-operate with national competition authorities in the implementation of national competition rules to this sector. While the application of competition rules is a tool to ensure that competition in the motor fuel market is not distorted, these rules alone cannot of course provide a full answer to all the problems caused by the increase of the oil price on the European economy in the absence of other supplementary measures. Such measures could intend to relieve the pressure exerted by supply and demand of crude oil with a view to achieving a reasonable and stable price level, for instance fostering the use of alternative energy sources in order to reduce the long-term demand for motor fuel. ■

We regret that the August, 2000, issue of the newsletter was wrongly shown as Volume 23, Issue 9. It should have been shown as Issue 8. The present issue is Issue 9. There has been no arbitrary jump from 7 to 9; and no issues are missing.