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COMPETITION AND COMMODITY PRICE VOLATILITY

Contribution from Lithuania

-- Session I --

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COMPETITION AND COMMODITY PRICE VOLATILITY

-- Lithuania --

1. Background

1.1 *In recent years has there been significant volatility in the prices of commodities that are important to the general population in your country? Please briefly provide details (e.g., among others, on the product(s), market(s) and adjacent market(s) concerned and the magnitude and duration of this volatility, be it prices going up or down).*

1. There has indeed been some volatility in the prices of commodities in Lithuania. The Competition Council of the Republic of Lithuania (the “CC” or the “Competition Council”) has been primarily concerned with the volatility of prices in the groceries (mainly milk and other dairy products, flour, etc.) and fuel sectors (both wholesale and retail level). These two sectors have also been the major concern of the government and the general population.

2. With regard to the fuel sector there have been significant retail price fluctuations (increases) during a period before the end of 2009 until 2010, which led to Competition Council opening an investigation as to the possible anti-competitive agreements between the market players.

3. After having observed substantive price increases in August – September 2010 in the groceries sector the Competition Council, after having done some preliminary market overview, has opened an investigation into the possible anti-competitive behaviour in the groceries sector.

1.2 *Are the price volatility in these commodities, and the causes of that volatility, global, regional or domestic?*

4. The Competition Council has not conducted any specific investigation as to the “territorial” nature of the causes for price volatility, however, the formal investigations and market studies into the issue have indicated that there might be both global and domestic causes for the observed fluctuations. In the fuel sector the global tendencies mainly include fluctuations in crude oil prices (Platts index) while the domestic reasons are primarily related to the regulatory conditions. For instance, the regulatory limitation on the oil stock reserves and quality requirements (which are addressed in more detail in the answer to the question No 2.1. below) significantly limit the competitive pressure on the local market players and therefore allow for a slower or no pass-through of the reduced prices for input products to the final domestic consumers.

5. With regard to groceries, the Competition Council has in 2010 completed a study concerning price volatility across a wide range of groceries. The purpose of the investigation was to identify the causes of the recent changes in prices for groceries.

6. The information collected in the course of the investigation led to a conclusion that the price increase trend had been observed both in Lithuania and in other neighbouring markets and the causes for price volatility had not been limited to the national territory. The investigation has also revealed the price

fluctuations are also dependent on the number of intermediaries operating in the food product chain, the competitive structure of the elements of the chain and the differences in the bargaining power of the parties.

1.3 Does your agency have any ongoing / pre-emptive monitoring activities in relation to these sensitive commodities? For example, do you routinely monitor prices, quantities or behaviours in these markets (both domestic and foreign markets)?

7. Competition Council is currently conducting monitoring activities both in relation to the groceries and the retail fuel sector.

1.3.1 The fuel sector price monitoring

8. The monitoring of fuel prices has been initiated 1 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. The analysis of the collected data includes assessment of the changes in prices compared to the previous day, impact of crude oil prices on wholesale and retail prices and possible causes of price changes. In addition, Competition Council prepares weekly internal monitoring report on fuel prices in all EU member states and monthly analysis of changes in excise duties and value added tax for fuel.

1.3.2 Groceries price monitoring system

- Cooperation with other state agencies

Since 2010 and with a view to inform the public about food product prices in retail chains, the CC has contracted the State enterprise “Agricultural Information and Rural Business Centre” for the collection and management of information from retail chains. Such information is later published on a specifically established website www.produktukainos.lt.

The website contains weekly data on weighted average retail prices and margins at each level of production and distribution of the 10 most popular food products (milk, butter, curd, ham, sausages, eggs, flour, potatoes, white and dark bread) and price changes of these products over the last period (week, year). In addition to the above, the website also contains more detailed information on weighted average retail price of each item in 5 food groups (meat and meat products, poultry and eggs, cheese and dairy products, grain foods and cereals, potatoes, fruit and vegetables) – 45 products in total with indications of price changes of these over the previous period. The weekly information on average prices of the same food products is provided by each of the 4 major Lithuanian retail chains.

Together with the data on retail prices, the website also contains data on the most important changes in wholesale or production prices of some of the monitored food products in Lithuania and the EU member states as well as average price comparisons among the EU member states and the main reasons of these price differences.

Additionally, the CC has also entered into a cooperation agreement with the Lithuanian Institute of Agrarian Economics in order to carry out an analysis of the price structure of the retail sales of groceries marketed in Lithuania, the elements of the price structure of those products (VAT, processing, retail) and other related aspects.

1.3.3 Monitoring pursuant to the Law on the Prohibition of Unfair Practices of Retailers

9. Another means for supervising behaviour at the retail level, in particular the retail groceries sector, has been vested in the Competition Council through the adoption of the Law on the Prohibition of

Unfair Practices of Retailers (the Law) in April 2010¹. The main purpose of the Law is to ensure the balance between the interests of suppliers and retailers having a significant market power.

10. Acting in accordance with the provision of the Law which vests in the CC the power to carry out monitoring and to report annually to the Government on the achievements of objectives sought by this Law, the CC initiated an inquiry into the retail chains. The first report was submitted 1 March 2011. This report concluded that all clauses prohibited by the Law were removed from the contracts with suppliers. However, the analysis revealed that some contracts contained additional clauses regarding fixed discounts that did not depend either on the amount of supplier's goods sold, or on reasonable transportation or advertising costs, etc. Another important finding was that some contracts contained a provision regarding the application of a basic price for all retailers. On the basis of these findings, amendments to the Law are currently under consideration in the Government.

2. Competition law enforcement & formal investigations

2.1 *Please provide a brief overview of significant competition law enforcement matters that your agency has undertaken in relation to commodities: Please explain how the matter came to the attention of the agency, the substance of the allegation, the analysis undertaken and the remedies imposed (if any).*

2.1.1 Merger assessments

11. The Competition Council has been assessing a number of notified mergers in relation to commodities. The markets assessed included, among others, retail and wholesale trade of pesticides, seed, grain, production of flour, distribution and retail sale of oil. There have, however, been no merger prohibitions in relation to commodities and one instance, where the merger was abandoned following the preliminary findings of the CC.

12. One of the merger cases, namely, the *AmberTrust/Litagros chemija (2005)*, between undertakings directly or indirectly active of the markets for the purchase, storage of grain cultures and sale of flour meant for bread and bakery products was cleared, in particular relying on the fact that upon Lithuania's entry into the EU, the duties upon import of grain and flour have significantly decreased, and duties on imports from the EU Member States have been eliminated and so were the customs barriers. The Competition Council concluded that even taking into account significant share of the market that would have been covered by the merged entities following the merger, there would be no unilateral decisive influence arising as a result of the transaction due to a strong countervailing buyer power from the retail chains and other players of the bread and bakery market.

13. Assessment of the merger in the market for oil and oil products *PKN Orlen/Klaipėdos nafta (2009)* 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 on the market. The concerns were primarily raised due to the fact that AB Klaipėdos nafta was established with a view to organise an alternative supply of oil and oil products (dark and light). One of the major segments of the operations of the company is storage of oil and oil products and loading services. The assessment of the infrastructure operated by AB Klaipėdos nafta, and its technical facilities led to a conclusion that the company could have potentially become a competitor of PKN ORLEN in supply of oil products to the Lithuanian market. Therefore, 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 AB Mažeikių nafta in the wholesale market of oil products.

¹ Law of the on the Prohibition of Unfair Practices of Retailers, 22 December 2009 – No XI-626 http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc_l?p_id=406491

14. 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, 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 States). The CC concluded that the acquisition by PKN Orlen S.A. directly or through AB Mažeikių nafta (ORLEN Lietuva) of AB Klaipėdos nafta would further strengthen the dominance of AB Mažeikių nafta in the Lithuanian energy sector by also affecting the power generation sector.

15. AB Klaipėdos nafta itself had the necessary capacity to supply fuels both to small and the large retail trade networks trading in fuel. By importing fuels through AB Klaipėdos nafta major retail gas trading networks could create an efficient competition to PKN ORLEN, affect the prices of PKN ORLEN and such price reduction could eventually be passed through to consumers. The acquisition by PKN Orlen S.A. of the control of AB Klaipėdos nafta would significantly reduce the alternative possibilities for other networks engaged in 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.

2.1.2 *Cartels and horizontal agreements*

16. In 2007 Competition Council has finalised two investigations on anti-competitive agreements relating to commodities, both concerned groceries. Additional two investigations are still ongoing.

- The Dairies case – exchange of commercially sensitive information

The first investigation concerned an exchange of commercially sensitive information among milk processing companies (*Dairies II*). The investigation has been triggered by the increase in prices of food products in the middle of the year and the interim findings of the analysis of the price increase conducted by the experts of the Competition Council.

This investigation involved analysis of the different levels of dairy products supply chain – purchasing of raw milk and marketing of various dairy products. As a result of the investigation, the Competition Council concluded that having regularly exchanged sensitive information which provided milk producers with data on prices on the procurement of raw milk, as well as quantity data, the undertakings active on the milk and dairy processing market were able to precisely monitor the activities and strategic decisions of their competitors and align their behaviour accordingly.

- Meat processing market

In 2007 Competition Council also closed an investigation into possible anticompetitive agreements between meat producers and their association. There was a trend of price increases on the market for processed meat products and a preliminary market analysis suggested that undertakings engaged in the meat processing activities as well as their association could have coordinated their actions related to setting the price and also could have exchanged confidential information. However, the Competition Council did not gather substantial evidence that would have allowed it to conclude that a price-fixing agreement has been concluded between the undertakings active in the meat processing market.

- Investigation into the pricing practices in the milk, milk products, flour and bakery products markets

After having observed substantive price increases in August – September 2010 in the groceries sector and having received additional information from the Ministry of Agriculture, the Competition Council has conducted an assessment of the change in the key input prices as well as the wholesale and retail price for dairy and grain products. Such analysis showed that the change in the input price alone did not fully account for the extent of the increase in the retail prices for dairy and grain products in the country. The CC's analysis revealed that the prices for groceries had not increased exclusively for objective economic reasons and that the fluctuations could have emerged due to a weakening of competition. Based on these findings, the CC initiated investigations under the national Competition Law. The investigation, which is still ongoing, is aimed at assessing whether a number of undertakings engaged in the production and/or marketing of food products (milk and milk products, flour, bakery goods, i.e. processed goods) have participated in anti-competitive agreements or concerted practices that could have possibly led to the increase in retail prices of mentioned products.

- Investigation into the horizontal agreement in the fuel sector

Following a substantial increase of retail fuel prices the Competition Council has started an investigation into the possible anti-competitive price-fixing agreements in the market for retail sales of fuel through the gas stations. The investigation did not reveal price-fixing practices between the majority of the gas stations and therefore was terminated with regard to most of the gas station owners. The investigation with regard to a few remaining undertakings is still ongoing.

2.1.3 *Abuse of dominance actions*

17. The major abuse of dominance case concerning commodities was carried out in the market for oil and oil products. The dominant undertaking (domestic oil refinery undertaking) 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. The final decision is currently under appeal.

2.1.4 *Any price control or other actions to regulate prices.*

18. Pursuant to the Article 4 of the Law on Competition, the Competition Council is entitled to examine whether certain provisions of the laws or other decisions adopted by public authorities are in compliance with the Law on Competition. Article 4 of the Law on Competition prohibits adoption of laws or other decisions that grant privileges or discriminate against any undertakings which may bring about differences in competitive conditions for competitors in the relevant market.

19. In 2010, the Competition Council carried out an investigation concerning the actions of the Ministry of Energy (the "Ministry") that refused to issue an authorisation to UAB "Lukoil Baltija" to accumulate and store the oil products reserve in the Republic of Latvia. The investigation led to a conclusion that such actions of the Ministry infringed Article 4 of the Law on Competition.

20. The CC noted that by unreasonably refusing the authorisation to UAB "Lukoil Baltija" to store part of its fuel reserve in another country and by not providing any reasonable grounds for such a refusal, the Ministry has not only restricted the possibilities of the company to procure the storage service outside Lithuania, but has also prevented the it from acquiring the storage service at a lower cost. Since at that

particular time there were no vacant storage facilities in Lithuania, the company was prevented from acquiring the service outside the country. As a result of such actions by the Ministry import of fuels into Lithuania was artificially restricted and competition conditions in the wholesale fuel market were adversely affected, as Lithuanian consumers were forced to purchase fuels from a single producer only. Furthermore, it produced a negative effect upon the undertakings operating in the retail fuel markets, since they were prevented from price competition.

2.2 *Has your agency undertaken a market study into any commodity or commodities? Please explain what triggered the market study, the substance of the allegation, the analysis undertaken and the remedies imposed (if any).*

21. There have been two market analyses assessing the fuel sector. Both of them were primarily concerned with the regulatory environment and its implication for the competitive structure on the fuel markets.

22. First, simultaneously with the investigation of the decision of the Ministry of Energy refusing to grant UAB "Lukoil Lietuva" an authorisation to store part of its required oil reserves in Latvia, the CC in 2010 carried out an investigation concerning the compliance of the Rules on the formation, management, accumulation and control of State oil and oil products reserve (the "Rules"), adopted by the Lithuanian Government in 2002, with the requirements of Article 4 of the LC. The decision of the CC concluded that the rule under which only 10 percent of the State oil and oil products reserve could be stored outside of the Lithuanian territory was not sufficient in order not to restrict the oil products import and ensure a smooth functioning of the Lithuanian market, as well as an efficient competition in the wholesale market of trade in oil products. Furthermore, the CC also concluded that the regulation was ambiguous and did not clearly define the basis for calculation of the State reserve allowed to be stored in other States.

23. The CC concluded that the analysed provision of the Rules infringed Article 4(1) of the LC and, with a view to ensuring enhanced transparency of the decision-making process, recommended the Government to establish a clear and unambiguous procedure for the recognition of oil and oil products as part of State reserve as well as a procedure for the issuance of authorisations to store oil and oil product reserves in other Member States.

24. During the period of the investigation, the Government has amended the Rules according to which the percent of the State reserve to be stored in other countries was increased from 10 to 30.

25. At the time of this submission, the Government has also already made a reform allowing 100 percent of the State reserve to be stored in other States from the 1 January 2012.

26. Second, the Competition Council has also undertaken a market study into the fuel market in the years 2010 and 2011. The trigger for the study was the increase in fuel prices that led to openly expressed concerns by Government and the general public. Competition Council analysed the fuel prices in the retail market in the Republic of Lithuania and in neighbouring countries as well as the tax burden applicable to the retail fuel sector.

27. The study assessed fuel prices in Lithuania, Latvia, Estonia and Poland during a short period between March 2011 and May 2011 and concluded that the rising price trend was common to all of the assessed countries, while the order of countries according to the level of price varied from month to month. The study also included the assessment of the regulatory burden that revealed legal provisions that might have direct effect on the level of competition in the oil market in Lithuania.

28. One of the provisions related to the already mentioned limitations as to the amount of oil reserves that could be kept outside of the territory of Lithuania. Second provision, identified by the market study

revealed that substantial quality requirements for the oil products that can be imported to Lithuania could be a reason for higher level of oil price in Lithuania. The study also took account of the fact that there is only one gasoline producer in the country.

2.3 *Has your agency received requests from governments or other parts of society to formally investigate commodities markets or requests for the competition authority to put downward pressure on prices where there has not been information or evidence suggesting anticompetitive behaviour? What was the nature and circumstances of the request and how did your agency respond?*

29. The Competition Council occasionally receives applications from representatives of the Government, members of the Parliament or active members of the society reporting about possible competition infringements. These requests are often triggered by the announcements in the media regarding price increases for certain products. As previously described, Competition Council has prepared several reports on monitoring activities regarding prices of food products and fuel in order to clarify the situation. The main problem of these requests is lack of actual evidence of anti-competitive conduct.

30. Formal investigations opened based on the requests or information from the government or other parts of society are described in more detail in the answer to the question No. 2.1. above.

3. Advocacy opportunities and challenges

3.1 *Has your agency been confronted by a government proposal to address pressing concerns about commodity prices that did impede competition (or would have impeded competition if it had been introduced)? What was the nature of the problem that the government was seeking to address? What was the timing and political constraints upon your opportunity to provide advocacy? What advice did the agency provide and what was the result?*

31. Due to the increases in food prices in autumn 2010, a group of members of the Lithuanian Parliament (Seimas) proposed amendments to the Law on Prices of the Republic of Lithuania that concerned imposing a limit on the retail price mark-up. The proposal caused heated debate in the society and divergent views within the legislative system. However, after discussions the proposed amendments have not been adopted. One of the arguments put through by the CC and some other groups was that mark-up regulation might have a negative impact on competition in the retail trade sector and be a cause for additional future price increase. Additionally, the mark-up limitation was thought to also have the ability to drive certain commodities out of the market.

3.2 *Please describe any pre-emptive steps available to your agency to: i) Reduce the risk that commodity price volatility becoming a problem in your country? ii) Reduce the risk that governments or public societies seek policy responses to problematic commodity price volatility that would impede competition?*

32. The main tool that the Competition Council possesses and that could be used to as a pre-emptive step to reduce the risk of commodity price volatility and prevent any premature responses to this problem mainly includes advocacy. Competition Council plays an important role in the legislative process and is often being consulted by public authorities when new legislation is being adopted.

33. The CC is currently preparing Guidelines for the Regulatory Impact Assessment that are expected to be passed by the Competition Council in the early 2012. The purpose of these guidelines is to ensure that public authorities active in the legislative process take into account potential competition concerns that could be created as a result of the proposed legislation.