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**LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM - Session II: Market
Definition in the Gas Sector**

- Contribution from Colombia -

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The attached document from Colombia is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session II at its forthcoming meeting to be held on 27-28 September 2022 to be held in Rio de Janeiro, Brazil.

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Session II: Market Definition in the Gas Sector

- Contribution from Colombia -*

1. Introduction

1. According to the National Administrative Statistics Department, the consumption of liquid fuels is a relevant component of Colombian family expenses¹. For the Colombian Oil and Gas Association –ACP acronym in Spanish–, liquid fuels account for 96% of final energy consumption in the transportation sector. The expectation for 2050 is that these will remain the main energy carriers that sustain the country's mobility².

2. The demand y pricing for liquid fuels in 2021, according to the ACP, continued to recover to levels achieved before the hit of the Covid-19 pandemic, with an increase in demand in the borderline regions. Total demand for liquid fuels (gasoline, diesel, and jet) averaged 302 thousand barrels per day (KBD), similar to 2019 consumption (299 KBD), with a growth of 27%, compared to 2020. The increase in gas was driven by the country's economic recovery, higher consumption of motorcycles and private vehicles, and increased demand in border areas³.

3. The ACP conducted interviews with market agents, who agreed that in the next five years, the sector will be particularly characterized by growing demand for liquid fuels; new opportunities for agents in the development of new lines of business (other activities and supply of other energy products or fuels with different specifications); expansion of import capacity, transportation by pipelines and storage, and the adaptation of supply plants and service stations in accordance with the new technical regulations. Another relevant aspect that was pointed out by the agents, was that the development of the sector will depend greatly on the progress of the country's energy transition, which will evolve in line with the market reality and with preponderant participation of liquid fuels and their blends with biofuels. In particular, the distributors see the diversification and differentiation of energy products as an alternative to competing, growing in the market, and increasing the value offered to consumers.

* Written submission from Colombia – Superintendencia de Industria y Comercio.

¹ See: <https://www.dane.gov.co/index.php/estadisticas-por-tema/precios-y-costos/indice-de-precios-al-consumidor-ipc/ipc-actualizacion-metodologica-2019/ipc-ponderadores>

² See: <https://acp.com.co/web2017/es/publicaciones-e-informes/economicos/842-informe-economico-evolucion-2021-y-perspectivas-2022-2030-del-mercado-de-combustibles-liquidos-en-colombia/file>

³ See: <https://acp.com.co/web2017/es/publicaciones-e-informes/economicos/842-informe-economico-evolucion-2021-y-perspectivas-2022-2030-del-mercado-de-combustibles-liquidos-en-colombia/file>

1.1. Regulatory and institutional frameworks

4. The distribution of petroleum-derived liquid fuels is a public service. This means that in the formation of national policy the Ministry of Mines and Energy formulates sector policy and regulates the economic agents that participate in the distribution chain⁴.

5. There are three entities that play an active role in the formation of the price of liquid fuels in Colombia. First, the Energy and Gas Regulatory Commission (hereinafter, CREG), determines "the parameters and methodology for calculating the price of fuels, taking into account the marketing margin, the percentage of evaporation, loss or any other concept that affects the volume of fuels". Second, the Ministry of Mines and Energy (hereinafter, MME), which defines the "prices and tariffs of gasoline, diesel (ACPM), biofuels and blends thereof", is the entity that determines the basic prices of liquid fuels. Finally, the Ministry of Finance and Public Credit (hereinafter, Minhacienda) sets the taxes on liquid fuels. Lastly, the Superintendence of Industry and Commerce has control and surveillance functions in relation to consumer protection, legal metrology, and free competition of the agents participating in the market.

6. The liquid fuels value chain, specifically gasoline and ACPM can be analyzed in three main segments: upstream, midstream, and downstream. As anticipated, this contribution will center on describing the market dynamics in the downstream segment. It is important to note that the contribution builds significantly on the insights from the market study conducted by the SIC in 2020, referenced above.

7. The Single Regulatory Decree 1073 of 2015 compiled the norms that regulate the petroleum-derived liquid fuels market and defined seven main agents within the commercialization chain, namely: refiner, importer, storer, transporter, large consumer, wholesale distributor, and retailer. All competition variables in the market mechanism are intervened and regulated. The price determination mechanism includes some components that are rigid and others that have a certain degree of flexibility. As for the former, it is clear that they are the result of the institutional framework that regulates the fuel distribution market in Colombia. The latter are those arising from the interaction of economic agents in the wholesale and retail distribution markets. In order to delve deeper into these dynamics, a review of the market structure in terms of industrial organization is presented.

1.2. Enforcement experiences: merger control in the gas sector

8. We will present the competitive dynamics between refiners, wholesale distributors, and retail distributors as primary agents within the liquid fuels marketing chain, especially gasoline and diesel through some enforcement experiences.

9. The analysis of the gas and oil sectors made by SIC has changed over the years. Today, in cases where a wholesaler takes control of a retailer, we evaluate the wholesale fuel distribution market, the retail market, and the oil lubricants wholesale and retail markets. The definition of the market for fuel-related products has changed from an aggregate market, which included both gasoline (regular and extra) and diesel, to a segmented market. The latter, defined since 2015 (SIC Resolution No. 88848 of 2015, **TERPEL – G5** merger), by three types of fuels: (i) regular gasoline; (ii) extra gasoline; and (iii) diesel fuel. The segmentation of the market was decided through a review of the characteristics of each fuel and their substitutability. Diesel is not a substitute for gasoline

⁴ See: <https://www.sic.gov.co/sites/default/files/documentos/032021/ES-Mercado-de-combustibles-en-Colombia.pdf>

(regular or extra) since its operation and combustion technology are different. On the other hand, regarding the substitutability between regular and extra gasoline, although these two have certain characteristics and uses in common, it is important to highlight that regular gasoline can be substituted by extra gasoline, but extra gasoline cannot be replaced by regular gasoline. Thus, **SIC** has found that these two types of gasoline are not part of the same relevant market, but each one is part of its own market.

10. Regarding the relevant geographic market, **SIC** has identified some issues with the definition of the wholesale distribution of fuels. Before 2019 we analyzed the market with a national scope. However, in the analysis of the merger between **ORGANIZACIÓN TERPEL S.A. - TERPEL** and **DISTRIBUIDORA COLOMBIANA DE COMBUSTIBLES S.A.S. – DISCCO** (SIC Resolution No. 35210 of 2019), **SIC** identified that in the chain value of the market of wholesale distribution of fuels existed some geographic barriers of entry.

11. The basis for the analysis was that the wholesale distribution of fuels included the storage, handling, and wholesale dispatch of the fuels since it is **not likely** to perform wholesale distribution if the agents do not have the necessary infrastructure (either owned or leased) that allows them to store the fuel and, from there, supply it to their customers. In this regard, Article 2.2.2.1.1.2.2.2.3.95 of Decree 1073 of 2015 stated: "(...) **Commercial storage capacity**. The wholesale distributor must have at all times a minimum storage capacity corresponding to 30% of its monthly volume of dispatches from each supply plant it owns, (...)"

12. Therefore, wholesale distributors that do not have their own supply plants, will depend on the surplus capacity of their competitors that have the respective infrastructure, for the exercise of their functions in the wholesale distribution market of petroleum liquid fuels, within the regions established in paragraph 2 of the same article: north, east, central, central-west, south-west and central-south. **All of which may be regarded as a geographic entry barrier, limiting the geographic market vision of the activity of wholesale distribution of petroleum-derived liquid fuels that SIC decisions had considered as national in scope until then.**

13. To analyze a new scope of the geographic market, **SIC** defined thirteen different regions in Colombia to study this market. These zones were defined through a **hierarchical cluster study methodology** suggested in the study "Methodology for the definition of relevant markets in the activities of wholesale distribution and retail distribution of liquid fuels in Colombia", by the Energy and Gas Regulatory Commission - **CREG**. This methodology consists of calculating sets in a hierarchical manner, to ensure that each of the plants belongs to a single grouping, using the simple link as an approximation method. The above, from distances calculated, consider as inputs the following variables: **(i)** the coordinates (x, y) corresponding to the location of the plant; **(ii)** the weighted average prices of current gasoline per plant; and **(iii)** the weighted average prices of diesel; all of the above standardized. Thus, after the operation between **TERPEL** and **DISCCO** in all the integration operations involving wholesale and retail distribution markets of liquid fuels, the geographic market of wholesale distribution of fuels has been defined as regional, considering each of the geographic zones mentioned. The regions are:

- Antioquia, Boyacá, Caldas, Cauca, Choco, Cundinamarca, Meta, Nariño, Quindío, Risaralda, Santander, Tolima y Valle del Cauca. (Centro-Occidente)
- Cesar y Norte de Santander.
- Atlántico, Bolívar, Córdoba, Magdalena y Sucre.
- Guaviare y Vaupés.

- Caquetá y Huila.
- La Guajira.
- Vichada.
- Putumayo.
- Arauca.
- Casanare.
- Amazonas.
- San Andrés y Providencia.

Figure 1. Map of the markets of wholesale distribution of fuel



Source: SIC Resolution No. 35210 of 2019 (TERPEL – DISCCO merger).

14. In addition to the definition of the geographic market in the wholesale distribution of fuels, in the retail distribution of fuels, **SIC** has considered **an isochrones methodology** to define the relevant geographic market. Specifically, a radius of 4 kilometers around the gas station for urban areas, and 10 kilometers for rural areas. In some recent cases, we have wondered whether the dual highway could be a barrier in rural areas, as the consumers of fuels wouldn't consider opposite lane stations when deciding to buy gasoline as they would have to make a return that would affect their travel time heavily (but we have not yet considered it).

15. Finally, the other issue **SIC** has identified is that of a wholesaler's competitive control over its affiliates in the zone of influence of the retail market. In numerous instances, both service stations affiliated with its brand and the wholesaler's own stations coexist within the same isochrone. The analysis that we do case-by-case is to analyze the capacity of the competitors of the wholesaler (in the upstream market in the region affected by the operation) to stop any anticompetitive behavior by the latter. This analysis is made to draw conclusions about whether the wholesaler does or does not have the possibility of

exercising competitive control over its affiliated stations. In some cases, we have found that owners of the affiliated stations have (in the medium term) other wholesale distributors with whom they can flag their stations. Thus, in those cases, the affiliated stations are considered independent agents of the wholesaler. Moreover, in cases where **SIC** has identified that the wholesaler could have competitive control over the retail stations associated with its brand, all the stations associated with the brand are considered when calculating market shares.

16. On this point, **SIC** highlights that in the case of assuming that the affiliated stations were controlled by the wholesaler, the conclusion is not that the projected operation would produce a **null effect**. This is because the real effect of the operation is a change of control, specifically from **negative to positive control**, which in practical terms implies that the retailer that before could choose another wholesale distributor different from the wholesaler involved in the merger (in the medium term), after the integration operation is carried out will not be able to change wholesaler. For this reason, the purchase of a retailer by a wholesaler has an impact on the **vertically related market**.

1.3. Market study into the downstream sector/distribution chain: insights for further consideration

17. The market study analyzed the wholesale and retail distribution of liquid petroleum fuels (gasoline and ACPM) in the country. The purpose of the study was to design a signaling mechanism to classify the relevant fuel markets according to their level of risk in terms of possible infringements to free economic competition.

18. The main findings are as follows. The **SIC** found that the public service condition implies the existence of rigidities in the final price formation structure, which is why gasoline does not move at the pace of the international oil price. In addition, the infrastructure of the derivatives distribution network and the dynamics of price formation among wholesalers allow the characterization of wholesale supply markets with differentiated price behaviors. It was also determined that, although retail markets are atomized, they are strongly linked to wholesale dynamics. With these results and in order to periodically assess the risk of anticompetitive behavior in the retail market, a monitoring methodology was designed; the proposal will allow monitoring, at the same time, the geographic markets of regular gasoline (583 municipalities), ACPM (646 municipalities) and Extra gasoline (167 municipalities).