REPORT ON THE SUPPLY OF GASOLINE IN JAMAICA

Fair Trading Commission

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Public Version

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EXECUTIVE SUMMARY

Pursuant to a Directive issued by the Minister of Commerce, Science and Technology an investigation was carried out into the practices within the petroleum industry, with particular focus on gasoline retailing. The Directive requires that the Fair Trading Commission (FTC) prepare and implement a Code of Conduct to govern the relationship between petroleum marketing companies and retailers. It is mandated by Cabinet that the focus of the Code be the protection of the Jamaican consumers. The investigation was therefore carried out to determine whether or not the industry is subject to anticompetitive activities, which undermine consumer welfare. In particular the investigation sought to determine if the activities of the participants within the industry are offensive under the provisions of the Fair Competition Act (FCA). The activities investigated are those related to pricing, i.e. predatory pricing, discriminatory pricing, price fixing and resale price maintenance. The exclusive dealing relationships between marketing companies and retailers were also investigated to determine if those arrangements negatively affect competition.

The participants in the industry are Petrojam Limited, which operates the island's only refinery; nine marketing companies - Petroleum Company of Jamaica Limited, Esso Standard Oil S.A. Limited, Shell Company (W.I) Limited, Texaco Caribbean Inc., Total Jamaica Limited, United Petroleum (Jamaica) Limited, Jampet Service Station, CoolOasis Limited and Epping Oil Company; and over two hundred retailers, which collectively operate 278 retail outlets. The relationships within the industry include vertically integrated firms and exclusive contractual arrangements. The four vertically integrated companies are the Petroleum Corporation of Jamaica, which through its subsidiaries operates at the refinery/importation, wholesale and retail levels of the market; and Shell, Total and Unipet which are involved at the wholesale and retail levels of the market. In relation to contractual agreements, all marketing companies enter into exclusive franchise arrangements, with the result that a retailer deals only with the marketing company to which it is contracted.

The investigation was carried out to address the issues set out in the Directive. In particular the Directive requires that in developing the Code the FTC should apply principles of fair and free competition, transparent and fair business practices, and will specifically:-

- conduct the necessary market studies and investigations in order to prescribe generally accepted accounting and costing principles to guide the calculation and review of rent, franchise fees, royalties, and product prices in order to ensure fairness, and to protect against discriminatory pricing, predatory pricing, price fixing, cartelization, tied selling, and other conduct in breach of the FCA;
- prescribe the terms on which Marketing Companies can own, operate, or otherwise control their own retail operations, insofar as such prescriptions are required to ensure that the terms on which Marketing Companies provide products and services to their operations, are the same terms and services offered to third party retailers of similar circumstances; and
- prescribe the terms on which contracting parties may enter into third party agreements for the provision of competing goods or service at the premises, which form the subject of the contract between the marketing companies and the dealers/retailers.

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These three aspects of the Directive were investigated in relation to the Sections 19-21 of the FCA which prohibit abuse of dominance if the activity of a dominant firm has exclusionary effects; Section 17 which prohibits agreements which lessen competition; Section 33 which prohibits exclusive dealing if such activity has exclusionary effects; Section 34 which prohibits price fixing; and Section 25 which prohibits resale price maintenance.

Allegations of predatory pricing are investigated under Sections 19-21 of the FCA. An activity will be offensive under these Sections only if the alleged offending party is dominant in a relevant market and its activities have been found to have had, are having or are likely to have the effect of lessening competition substantially. Practices relating to discriminatory pricing and exclusive dealing, which are investigated under Sections 17 and 33 of the FCA respectively are offensive only if the alleged offending party has market power and the net effect of its activities is the substantial lessening of competition. An activity while seemingly anti-competitive can have efficiency enhancing effects. Competition is therefore lessened only if the anti-competitive effects of an activity outweigh the efficiency enhancing effects of that activity. Offences under Sections 25 and 34 which address resale price maintenance and price fixing respectively are *per se* illegal – no assessment of the competitive effects is required.

The investigation in relation to predatory pricing is carried out under Sections 19-21 in accordance with the following four-step approach:

a) *Definition of the relevant market*— this is necessary in order to establish the market(s) which may be affected by the alleged abusive practices and the players therein in order to determine dominance of any player within the market.

b) *Assessment of dominance*—both market share and entry barriers are taken into consideration in assessing whether the firm in question is in fact dominant. The Staff generally considers a firm with a market share of at least 50 per cent of the relevant market to be dominant.

c) *Assessment of anti-competitive effects*—if dominance is established, the anti-competitive effects of the practices in question should be assessed. Specifically, in accordance with Section 20(1), it should be determined if the behaviour has impeded "the maintenance or development of effective competition in a market".

d) *Assessment of pro-competitive effects*—if it is found that the behaviour impedes the maintenance or development of effective competition in a market, an assessment in accordance with Section 20(2) is carried out to determine whether or not the practices were exclusively directed to improving the production or distribution of goods or to promoting technical or economic progress and consumers were allowed a fair share of the resulting benefit.

Petrojam, Shell, Esso and Texaco operate at the refinery/importation level of the market for automotive fuel. Petrojam produces, imports and supplies fuel to all the marketing companies. Shell, Esso and Texaco import fuel for distribution through their respective networks of retail outlets. While Petrojam was found to have a market share of over 50 per cent, the fact that Shell, Esso and Texaco have the ability to and do import a significant portion of their fuel requirement exposes Petrojam to competition from external refineries, thereby rendering it not dominant. Shell, Esso and Texaco are collectively the single largest customer of Petrojam.

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None of the nine marketing companies have been found to have market share of over 50 per cent. Shell was found to have the highest market share, i.e. [✂] per cent; and accounts for 20 per cent of the retail outlets. At the retail level, three marketing companies – Shell, Total and Unipet - were found to operate a significant proportion of their respective branded outlets. The number of company operated outlets is too small however for these companies to have a strong negative influence at the retail or the wholesale level of the market. Further no, below cost pricing was found at these retail outlets.

The practice of discriminatory pricing was investigated in relation to Section 17 of the FCA within the context of the following four-step approach:

a) *Definition of the relevant market*—this is necessary in order to establish the market(s) which may be affected by the arrangement and the players therein;

b) *Assessment of market power*—market share, entry barriers and general trading conditions are taken into consideration in assessing whether the firm in question has market power and therefore has the ability to effect an agreement that has an appreciable effect on competition. An agreement will generally have no appreciable effect on competition if the parties' combined market share of the relevant market is below 25 per cent.

c) *Assessment of effect on competition*—Section 17(1) prohibits provisions which have as their purpose or effect the substantial lessening of competition in a market. It is therefore necessary to establish first what the purpose of the provision is; and where that purpose is not clear on the face of the agreement it will be necessary to assess whether it might yet have that effect.

d) *Assessment of inapplicability*—if it is found that the purpose or effect is to substantially lessen competition in the relevant market, then the Commission will carry out an assessment in accordance with Section 17(4) to satisfy itself that the provision contributes to, or is exclusively directed to, improving the production or distribution of goods or to promoting technical or economic progress and consumers are allowed a fair share of the resulting benefit; is indispensable to the attainment of improved production or distribution; or does not afford an enterprise the possibility of eliminating competition in respect of a substantial part of the goods or services concerned. If the provision is found to satisfy Section 17(4) then it shall remain in force, despite its ex facie anti-competitive purpose or effect.

At the refinery/importation level of the market Petrojam which sells fuels to the nine marketing companies, was found to have market power which would allow it to discriminate between the importers – Shell, Texaco and Esso – and its subsidiary company, Petcom on one side and on the other side, the other wholesalers which are totally dependent on it for supplies. Petrojam however sells to all marketing companies at the same price, irrespective of volume of fuel purchased; it does not practise price discrimination.

Each of the nine marketing companies sells to its respective affiliated retail outlets at different prices. There is evidence to suggest that these marketing companies might be practising discriminatory pricing within their respective networks of retail outlets. In other words the differences in the prices charged to the retail outlets are not based on differences in the costs associated with supplying the outlets. Marketing companies indicated however that prices charged to retailers are influenced by the intensity of competition within trading areas, i.e. prices

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charged to a particular retail outlet are reflective of the level of the competition which that outlet faces.

In terms of discounts available to retail outlets, Shell is the only marketing company which indicated that it has a price support mechanism which is accessible to all retailers within its network. The differential pricing seems to be in response to the intensity of competition faced by particular retail outlets; and therefore is justified. It is recommended that in order to facilitate competition at this level of the market a pricing mechanism of uniformed pricing be established, which allows retailers to have equal access to discounts, if offered. This should rectify any unjustifiable differential pricing; and at the same time does not prevent marketing companies, through their retailers, from responding to competitive pressure within particular areas.

In relation to exclusive dealing it was found that each marketing company sells only to its network of retail outlets, i.e. no retailer gets its supply of fuel from more than one marketing company. Shell, Esso and Texaco are the only marketing companies to supply differentiated automotive fuels (unleaded 87 and unleaded 90) to their respective affiliated retail outlets. All marketing companies however can supply non-differentiated fuels. Exclusive dealing arrangements enhance the orderly delivery of fuel, facilitate planning and budgeting on the part of marketing companies and provide incentives for investments into product development, assets, promotion, training and technical support.

While these exclusive dealing arrangements appear to be exclusionary there is potential for entry of new marketing companies and expansion of existing ones. The wholesale level was found to have a Herfindhal-Hirshman Index of 2077.8 which indicates that the industry is highly concentrated. Currently of the 278 retail outlets at least 114 are not owned by any of the nine marketing companies thus the potential for switching between marketing companies is preserved. An increase in the number of marketing companies is unlikely to result in any significant changes at the refinery, since a positive change in the number of marketing companies need not produce any changes in the number of tankers being loaded at the distribution racks.

In order to facilitate such entry or expansion however the duration of contracts between marketing companies and retailers which operate their own retail outlets must be limited. As such, a 5-year limit on such contracts is recommended.

Price fixing and resale price maintenance are *per se* illegal. No evidence of price fixing or minimum resale price maintenance has been found in the industry. It is not illegal for marketing companies to recommend or suggest maximum resale prices.

The Jamaica Gasoline Retailers Association (JGRA) has been emphasising the need to prohibit marketing companies from operating as wholesalers and retailers. The Directive also requires that the FTC prescribe the terms on which marketing companies can own, operate or control their own retail outlets. This prohibition referred to as divorcement, ensures to an extent the security of retailers but could also result in an increase in retail prices to consumers. Fewer than 10 per cent of the retail outlets are integrated and the average retail prices of fuels sold at company operated outlets were found to be below the average prices at dealer operated outlets.

The proposed terms and conditions of the Code are reflective of the specific activities and the structure of the industry. While there are currently nine marketing companies the potential for additional marketing companies and more vigorous competition within the industry does exist.

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The Code therefore seeks to remove hindrances to such expansion and without too much disruption to the process.

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PART I: OVERVIEW

1. Introduction

1. This study and investigation of the petroleum industry, with particular focus on gasoline retailing, was carried out in response to a Ministerial Directive (Appendix A) issued by the Minister of Commerce, Science and Technology to the FTC pursuant to Sections 5(1)(b) and 9 of the FCA. The Directive required the FTC to conduct the necessary market research and investigation in order to prepare and later implement a Code of Conduct to govern the relationship between petroleum marketing companies and retailers. In particular, the Directive required the FTC to put in place a Code to regulate the vertical arrangements within the industry, consonant with the provisions of the FCA.

2. It was mandated by Cabinet that the focus of the Code be the protection of the Jamaican consumers. This was interpreted to mean that the ultimate outcome of the Code is to ensure the lowest possible gasoline prices and the widest possible choice of retail outlets for consumers. The objective of the Code therefore is to maximize consumer welfare subject to retailers' viability. In other words, the Code should provide for the viability of retailers while at the same time ensure the lowest possible prices and the widest choices for consumers, having regard to the provisions of the FCA.

3. The FCA does not regulate prices per se. Instead it seeks to ensure that the market conditions necessary for a competitive environment are in place. A competitive market will guarantee that the lowest possible prices and the widest choices are provided by the most efficient suppliers.

4. The study and investigation were carried out to address the issues raised in the Directive, which sets out in part, as follows:

   THE FAIR TRADING COMMISSION IS HEREBY DIRECTED as a matter of policy, as follows:

   I. To prepare and implement an Industry Code of Conduct by September 30th, 2004. This Code shall be based on international best practices, and appropriately sensitive to local operating conditions which will outline the minimum standards for the commercial arrangements between marketing companies and dealers/retailers in the industry; and have regard to the said Code in the exercise of their statutory functions.

   II. In developing the said Code, the Fair Trading Commission shall apply principles of fair and free competition, transparent and fair business practices and terms and conditions of contract, and will specifically:

      (a) prohibit the imposition of barriers to entry in the form of restrictions against the use of corporate entities as contracting parties, or as operators and managers under the contracts between Marketing Companies and dealers/retailers;

      (b) conduct the necessary market studies and investigations in order to prescribe generally accepted accounting and costing principles to guide the calculation and review of rent, franchise fees, royalties, and product prices in order to ensure

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fairness, and to protect against discriminatory pricing, predatory pricing, price fixing, cartelization, tied selling, and other conduct in breach of the Fair Competition Act;

(c) prohibit unilateral amendment or termination of the Contracts between Marketing Companies and dealers/retailers, save as provided for by the Contract itself, and prescribe an appropriate procedure for amendment, compensation for early termination, and termination generally;

(d) prescribe the terms on which Marketing Companies can own, operate, or otherwise control their own retail operations, insofar as such prescriptions are required to ensure that the same terms on which Marketing Companies provide products and services to their operations, are offered to third party retailers of similar circumstances;

(e) prescribe the terms on which contracting parties may enter into third party agreements for the provision of competing goods or service at the premises, which form the subject of the contract between the marketing companies and the dealers/retailers; and

(f) prescribe the terms, conditions, and procedures for notification of changes in the rent, franchise fees, royalties, and product prices.

5. The points are categorized according to whether an investigation under the FCA is required to inform the appropriate terms of the Code of Conduct. Points (a), (c) and (f) are classified as those which do not involve specific activities which are examinable under the Act. Points (b), (d) and (e) require that the appropriate investigations be carried out within the context of the Act.

6. Currently marketing companies enter into contracts only with individuals and not corporate entities. Point (a) therefore requires that the Code prohibit that restriction. Further, the marketing companies have agreed to the removal of such an imposition. Point (c) addresses the need for procedures for the notification of amendment of contracts and termination. It also addresses compensation for early termination, which the marketing companies have agreed to. Point (f) deals with the notification of changes in payment structure to be observed by retailers.

7. The investigation was carried out in relation to various sections of the FCA and addressed points (b), (d) and (e). Point (b) requires that the Code be prepared from a competition perspective and as such an assessment of the market must be carried out. This assessment provides the background for the appropriate recommendations and terms of the Code. The market research therefore focused on assessing whether the industry is subject to effective competition or is subject to market power. In keeping with certain provisions of the FCA, it is unlikely that a firm that does not have market power would be able to negatively affect competition within a market. Points (d) and (e) address vertical integration and exclusive dealing respectively, which can have efficiency enhancing effects as well as anticompetitive effects.

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8. The investigation was therefore carried out to determine the anti-competitive effects of the vertical arrangements in gasoline retailing. Specifically, it sought to determine the following:

   - The effects of marketing companies operating as both wholesaler and retailer;
   - The effects of exclusive arrangements in gasoline retailing; and
   - The presence and extent of any anti-competitive activities which may be taking place in the industry.

9. Industry information was sought from the nine marketing companies, the retailers (through the JGRA) and from Petrojam Limited, the local refinery. Responses, though incomplete, were received from eight of the nine marketing companies. One response was received from the JGRA, presumably on behalf of its membership. The marketing companies which responded to the FTC's request for information are Petcom, Epping, CoolOasis, Shell, Esso, Texaco, Total (National) and Unipet. Jampet did not submit a response. The information submitted and collected was used for analyzing and investigating the various practices involved in the retailing of gasoline.

10. This report is organized into three main Parts and comprises twelve Sections. Part I comprises 4 Sections. Section 1 introduces the report. Section 2 outlines the various allegations, the relevant provisions of the FCA and the methodology of investigating the allegations. Section 3 presents an analysis and assessment of the level of competitiveness within the market. A discussion on vertical integration generally, and in the context of the local industry is provided in Section 4.

11. The investigation into the various potentially anti-competitive practices and an overview of divorcement law are presented in Part II. Sections 5 through to 8 report the investigation into the allegations and practices of predatory pricing, discriminatory pricing, exclusive dealing, price fixing and resale price maintenance. Section 9 presents some of the issues relating to retail divorcement.

12. Part III contains a summary of the main findings of Part II; and that is set out in Section 10. The proposed terms of the Code of Conduct are set out in Section 11. The report includes four appendixes. Appendix A contains the Ministerial Directive. Appendix B contains views from the JGRA and the Consumer Affairs Commission on the competitiveness of the industry. The results of a consumer survey conducted by the FTC are presented in Appendix C; and an overview of vertical restraints is presented in Appendix D.

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2. Allegations and the relevant sections of the FCA

13. This section is concerned primarily with the alleged practices within the gasoline industry and their legitimacy under the FCA. The issue of differential pricing in the industry has been of great concern especially among retailers. It must be noted that the FCA does not regulate prices per se. Companies and individuals are generally free to set the prices of their products. The FCA addresses pricing issues only in circumstances in which a company's pricing strategy has the potential to adversely affect the competitive process.

14. The FCA seeks therefore to regulate the process of competition by prohibiting conduct which has or is likely to have anti-competitive effects. As such the practices which are examinable under the FCA are those which have the potential to adversely affect competition within a market. Some of these practices are exclusive dealing, predatory pricing, price fixing and minimum resale price maintenance.

15. In this section the allegations and the methods of investigating them are examined within the context of the FCA.

Alleged anti-competitive practices

16. The JGRA has for some time now been complaining about the practices of the marketing companies. A representative of the Association has stated that "service station operation in Jamaica has become increasingly difficult for many traditional dealers, especially since the deregulation of the industry in 1991. Gasoline retailers have for many years complained about the inequities in the trade that were forcing them into bankruptcy." A submission by the Association to the FTC states, among other things, that "up to the 1960s the industry was deregulated but the excesses committed by the marketing companies caused the Government to impose a regulatory framework which ended in 1991. Since then the marketing companies have significantly assume (sic) the role of regulator and have advanced their profitability at the expense of the retailer." The submission further states that "prior to deregulation in 1991 the mark-up on petrol from the refinery was shared proportionally 1/3 marketing companies and 2/3 retailers.[1] Immediately following deregulation the split in margins was reversed by the marketing companies. This led to rapid turnover of retailers - a situation which still continues but only on an accelerated basis."

17. The issues complained of and which could be deemed offensive under the FCA relate to the following:

- unfair termination of retailers' contracts;
- contracts of short duration and with onerous obligations;
- discriminatory pricing;
- vertical integration (wholesalers operating also as retailers);
- low retail pricing strategy by marketing companies; and
- the inability of retailers to set the prices of their products.

[1] Prior to the liberalization of the gasoline trade in 1991, retail prices were set by the Government.

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18. These issues along with those mentioned in the Directive can be grouped into five main categories of potentially anti-competitive practices for purposes of the application of the FCA. These categories are discriminatory pricing, predatory pricing, exclusive dealing, price fixing and resale price maintenance.

Application of the FCA

19. The provisions of the FCA apply to entities and individuals carrying on business in Jamaica. The local refinery, all the marketing companies and their respective retailers and all other entities involved in the supply of gasoline in Jamaica are considered to be doing business in Jamaica; and are therefore bound by the provisions of the FCA.

20. The five potentially offensive practices are examinable under Sections 17, 19-21, 25, 33 and 34 of the FCA. Each practice is discussed below in the context of relevant provisions of the Act.

21. *Discriminatory pricing*—this practice is addressed under Section 17. The Section deals with agreements which contain provisions which have as their purpose or effect the substantial lessening of competition in a market. Subsection 17(2) (e) states that the Section applies to provisions which "apply dissimilar conditions to equivalent transactions with other trading parties thereby placing them at a competitive disadvantage". Accordingly, it may be an offence for a supplier to discriminate, directly or directly, between purchasers who are in competition with one another and who purchase like quantities of the same products.

22. *Predatory pricing*—this practice is addressed under Sections 19-21 of the FCA, which prohibit the abuse of dominance, where such abuse has been found to lessen competition or found to have the potential to do so. Section 20 (d) states that a company abuses its dominant position if it "directly or indirectly imposes unfair purchases or selling prices or other uncompetitive practices". The Staff of the FTC interprets Section 20 (d) to include predatory pricing, which can be defined as "unreasonably low" pricing.

23. *Exclusive dealing*—this is a form of vertical restraint which is dealt with under Section 33. Exclusive dealing is the practice whereby a supplier seeks to prevent a dealer from buying goods from other suppliers. This action leads to restrictions in inter-brand competition.

24. *Price fixing*—Section 34 prohibits attempts by firms or individuals to influence upward, or discourage the reduction of the prices at which goods or services are sold or are advertised for sale; to unjustifiable discriminate against a person engaged in business; or to discriminate against a person engaged in business because of that person's low pricing policy.

25. *Minimum resale price maintenance*—this practice is prohibited under Section 25 of the Act, which makes it illegal for suppliers to force dealers to resell goods at pre-arranged minimum prices.

26. Some activities although anti-competitive may also have welfare enhancing (pro-competitive) effects. Those activities will not constitute an offence under the FCA if it can be demonstrated that they contribute to the improvement of production and distribution of goods and services. Such activities are unlikely to have the effect of

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substantial lessening of competition if they are carried out by a firm that does not have market power. Other conducts are viewed to be so detrimental to the competitive process that they are banned outright.

27. Prohibitions under the FCA therefore fall into two main categories. These are 'rule of reason' prohibitions and *per se* prohibitions. Rule of reason prohibitions require that the net competitive effect of a conduct be demonstrated, while *per se* prohibitions do not require any proof of their effects on competition. Practices which fall under the latter category are considered to be unlikely to have any pro-competitive effects and are therefore banned outright.

28. Investigations conducted under Sections 17, 19-21 and 33 are carried out, using the rule of reason approach. Under each of the Sections the Commission is required to determine whether a conduct has a substantial anti-competitive effect and, if so, whether that effect is outweighed by any procompetitive efficiencies resulting from the conduct. Where the procompetitive effects of a conduct are found to outweigh the anti-competitive effects then that conduct will not be treated as an offence. Predatory pricing, discriminatory pricing and exclusive dealing are therefore examinable under the rule of reason approach; and are prohibited only in the event that their overall effect is found to negatively affect competition. Price fixing and minimum resale price maintenance are addressed under Sections 25 and 34 and are illegal per se.

29. Parts of the relevant Sections are outlined below.

Rule of reason offences

30. **Section 17**—this section proscribes agreements which "have as their purpose the substantial lessening of competition, or have or are likely to have the effect of substantially lessening competition in a market". Subject to Section 17(4) all such provisions are unenforceable. Under Section 17(4), the prohibition may not apply to an agreement which the Commission is satisfied "(a) contributes to the improvement of production or distribution of goods and services; or the promotion of technical or economic progress while allowing consumers a fair share of the resulting benefit; (b) imposes on the enterprises concerned only such restrictions as are indispensable to the attainment of the objectives mentioned in paragraph (a); or (c) does not afford such enterprises the possibility of eliminating competition in respect of a substantial part of the goods or services concerned".

31. In conducting investigations under Section 17, the Staff of the FTC examines the terms and conditions of the agreement/arrangement which is the subject of the investigation within the context of the following four-step approach:

    a) *Definition of the relevant market*—this is necessary in order to establish the market(s) which may be affected by the arrangement and the players therein;

    b) *Assessment of market power*—market share, entry barriers and general trading conditions are taken into consideration in assessing whether the firm in question has market power and therefore have the ability to effect an agreement that have an appreciable effect on competition. In most jurisdictions, an agreement will generally be treated as having no appreciable effect on competition if the parties' combined market share of the relevant market does not exceed 25 per cent. There

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are circumstances however in which agreements can have an appreciable effect on a market even where the combined market share falls below the 25 per cent threshold. For example agreements between firms which directly or indirectly fixes prices or share markets; or is one of a network of similar agreements which have a cumulative effect on the market in question.

c) *Assessment of effect on competition*—Section 17(1) prohibits provisions which have as their purpose or effect the substantial lessening of competition in a market. It is therefore necessary to first establish what the purpose of the provision is. If it is not clear that the purpose is to lessen competition then it would be necessary to consider whether it might have that effect.

d) *Assessment of inapplicability*—if it is found that the purpose or effect is to substantially lessen competition in the relevant market, then the Commission will carry out an assessment in accordance with Section 17(4) to satisfy itself that the provision contributes to, or is exclusively directed to, improving the production or distribution of goods or to promoting technical or economic progress and consumers are allowed a fair share of the resulting benefit; is indispensable to the attainment of improved production or distribution; or does not afford an enterprise the possibility of eliminating competition in respect of a substantial part of the goods or services concerned. If the provision is found to satisfy Section 17(4) then it shall remain in force, despite its ex facie anti-competitive purpose or effect.

32. **Sections 19-21**—these Sections address the abuse of a dominant position. Section 19 identifies an enterprise as occupying a dominant position if: -

> "By itself or together with an interconnected company, it occupies such a position of economic strength as will enable it to operate in the market without effective constraints from its competitors or potential competitors."

33. Section 20, which contains a non-exhaustive list of abusive activities, provides that an enterprise abuses a dominant provision if it impedes the maintenance or development of effective competition in a market. Some activities which are considered to be abusive are: the restriction of the entry of any person into a market; the elimination of any person from a market; and the imposition of unfair purchase or selling prices or other uncompetitive practices;

34. An enterprise shall not be treated as abusing a dominant position however if it is shown that its behaviour was exclusively directed to improving the production or distribution of goods or to promoting technical or economic progress and consumers were allowed a fair share of the resulting benefit; or by reason only that the enterprise enforces or seeks to enforce any right under or existing by virtue of any copyright, patent, registered design or trade mark.

35. In other words, an enterprise will not be treated as abusing a dominant position:

- if it can be shown that its behaviour is exclusively directed to improving the production or distribution of goods or to the promotion of technical or economic progress; and consumers are allowed a fair share of the resulting benefits.
- by reason only that the enterprise enforces or seeks to enforce any right under or existing by virtue of any copyright, patent, registered design or trade market.

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36. Section 21, which addresses the action to be taken by the Commission in respect to a finding of abuse of dominance, states that where the Commission finds that an enterprise has abused or is abusing a dominant position and that such abuse has had, is having or is likely to have the effect of lessening competition substantially in a market, the Commission shall notify the enterprise of its finding; and *direct the enterprise to take such steps as are necessary and reasonable to overcome the effects of abuse* in the market concerned. In its determination of whether a practice has had, is having or is likely to have the effect of lessening competition substantially in a market, the Commission shall consider whether the practice is a result of superior competitive performance.

37. Investigations under Sections 19-21 share some similarity with those carried out under Section 17. In particular investigations into allegations of abuse of dominance are carried out in accordance with the following four-step approach:

   a) *Definition of the relevant market*— this is necessary in order to establish the market(s) which may be affected by the alleged abusive practices and the players therein in order to determine dominance of any player within the market.

   b) *Assessment of dominance*—both market share and entry barriers are taken into consideration in assessing whether the firm in question is in fact dominant. In most jurisdictions an enterprise with a market share of at least 50% of the relevant market is generally considered to be dominant.[2] The Staff relies on the same percentage in its cases under Section 20 of the Act; this however does not preclude it from using a lower market share figure. Other factors such as the presence of obligatory trading partners and the general behaviour of a firm may also be taken into consideration in assessing dominance.

   c) *Assessment of anti-competitive effects*—if dominance is established, the anti-competitive effects of the practices in question should be assessed. Specifically, in accordance with Section 20(1), it should be determined if the behaviour has impeded "the maintenance or development of effective competition in a market".

   d) *Assessment of pro-competitive effects*—if it is found that the behaviour impedes the maintenance or development of effective competition in a market, an assessment in accordance with Section 20(2) is carried out to determine whether or not the practices were exclusively directed to improving the production or distribution of goods or to promoting technical or economic progress and consumers were allowed a fair share of the resulting benefit.

38. Whether a practice is found to be an offence would depend on whether the anti-competitive effects outweigh the pro-competitive effects. To be considered an offence under Sections 19-21 of the FCA, the overall effect of the practice must be the substantial lessening of competition or the potential substantial lessening of competition.

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[2] The European Court, for example, has stated that dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50%.[2] The OFT in the UK considers it unlikely that an undertaking will be individually dominant if its market share is below 40% (see OFT (1999), *The Competition Act 1998: The Chapter II Prohibition*, March). The Competition Bureau of Canada applies a guideline threshold of 35% market share in its assessment of dominance (see Competition Bureau (2001), *Enforcement Guidelines on the Abuse of Dominance Provisions,* July).

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39. **Section 33**—this Section, which addresses exclusive dealing defines the practice as " (a) any practice whereby a supplier of goods, as a condition of supplying the goods to a customer, requires that customer to either deal only or primarily in goods supplied by or designated by the supplier or his nominee; or refrain from dealing in a specified class or kind of goods except as supplied by the supplier or his nominee; and (b) any practice whereby a supplier of goods induces a customer to meet a condition referred to in sub-paragraph (a) by offering to supply the goods to the customer on more favorable terms or conditions if the customer agrees to meet that condition.

40. Section 33 (3) says that:

"Where on investigation the Commission finds that exclusive dealing … because it is engaged in by a major supplier of goods in a market or because it is widespread in a market, is likely to—

a) impede entry into or expansion of an enterprise in the market;

b) impede introduction of goods into or expansion of sales in the market; or

c) have any other exclusionary effect in the market,

with the result that competition is or is likely to be lessened substantially, the Commission may prohibit that supplier from continuing to engage in market restriction or exclusive dealing and to take such other action as, in the Commission's opinion, is necessary *to restore or stimulate competition in relation to the goods."*

41. Any practice which is examinable under Section 33 may also be examined under Section 17 and/or Sections 19-21 of the FCA. The procedure for investigating exclusive dealing is therefore the same as that used in investigations under either Section 17 or Sections 19-21. In particular, Section 33 relies on the test of "substantial lessening of competition". In line with the practice in other jurisdictions, a 25% market share threshold would be applied in this test. The abuse of dominance in Section 20, however, applies a higher market share threshold of 50%. In other words, there would be no exclusive dealing practice that would be considered a breach of Section 20 and/or Section 17 but not of Section 33. The reverse is true, i.e., an exclusive dealing practice that is not in breach of Section 33 will not be found to be in breach of Section 17 and/or Section 20 of the Act.

Per se illegal offences

42. **Section 25**—this Section prohibits minimum resale price maintenance. In particular it states that any term or condition of an agreement for the sale of goods by a supplier to a dealer is void to the extent that it purports to establish or provide for the establishment of minimum prices to be charged on the resale of the goods. The Section however does not preclude a supplier from notifying to dealers or otherwise publishing prices **recommended** as appropriate for the resale of goods supplied or to be supplied by the supplier.

43. **Section 34**—this Section makes it illegal for individuals or firms to, directly or indirectly, by agreement, threat, promise or by any other means influence upward or discourage the reduction of the price at which any other person supplies or offers to supply or advertises goods. It also outlaws unjustifiable discrimination or discrimination against persons engaged in business because of the low pricing strategy of those persons. Interconnected

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companies and principal-agent relationships are exempted from this Section. Recommended or suggested prices are generally illegal unless it can be shown that the person making the suggestion in doing so, also made it clear to the person to whom it was made, that he was under no obligation to accept it and would in no way suffer in his business relations with the person making the suggestion if he failed to accept the suggestion.

Methodology of investigation

44. In accordance with Sections 17, 19-21 and 33 of the FCA, the industry under investigation must be examined to determine if there are any activities which have, are having or are likely have the effect of restricting or hindering the maintenance or development of effective competition in a market. Given the nature of gasoline retailing, the investigation focuses on the types of contractual arrangement and practices that exist in the industry; and the effects, current and potential, of these arrangements and practices.

45. The contractual arrangements and practices are therefore investigated in reference to:

    a) their anti-competitive effect, i.e., if they are restricting or hindering or preventing the maintenance or development of effective competition in the market; and

    b) their pro-competitive benefits, i.e., if the arrangements and practices are exclusively directed to improving the production or distribution of goods with consumers being allowed a fair share of the resulting benefit.

46. In sum, the arrangements and practices which govern gasoline retailing in Jamaica are assessed in accordance with the following four-step approach:

    a) *Definition of the relevant market*—this is necessary in order to identify the relevant players and their relative market positions;

    b) *Assessment of market power or dominance*—both market share and entry barriers are taken into consideration in assessing whether the firm in question has market power or is dominant.

    c) *Assessment of anti-competitive effects*—if dominance or market power is established, the anti-competitive impact of the agreements or practices in question should be assessed. Specifically, in accordance with Section 17(1) it should be determined whether the object or effect of a provision in an agreement is the substantial lessening of competition; and in accordance with Section 20(1), if the behaviour has impeded "the maintenance or development of effective competition in a market".

    d) *Assessment of pro-competitive effects*—if it is found that the object or effect of a provision is the substantial lessening of competition or that the behaviour impedes the maintenance or development of effective competition in a market, then an assessment must be carried out to determine the efficiency enhancing effects of the provision or the behaviour in question.

47. As indicated above, for an offence to be established under Section 17, 19-21 and 33 of the Act the anti-competitive effect of a conduct must outweigh the efficiency enhancing

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effects. Further it is unlikely for a conduct by a firm to have an appreciable negative effect on competition if that firm does not have market power.

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3. Market analysis

48. The purpose of a market analysis is to evaluate the degree of competition in a market so as to determine whether that market is subject to effective competition or is subject to the exercise of market power. As indicated above, competition analysis under certain sections of the FCA requires that consideration be given to whether the activities of a firm have had, are having or are likely to have the effect of lessening competition substantially in a market. The activities of a firm are unlikely to have the effect of restricting or hindering competition if that firm does not have market power.

49. Assessing the degree of competition in any given industry is not a straightforward task. Because of the difficulties involved in defining the appropriate competitive price, determining whether market behavior results from the exercise of market power is difficult. While direct measures of market power are difficult, inferences can be drawn from the various characteristics of competition in the particular industry under investigation. These characteristics provide an indication of the nature of interactions between firms and can be used to assess the likelihood that market outcomes do or do not represent the outcome of effective competition. These characteristics include the availability of substitutes and product differentiation; number of competing firms supplying similar products; their market shares and market concentration; the nature of interaction between competing firms; and the existence of barriers to entry and market contestability.

50. A market analysis therefore entails defining the relevant market(s); identifying the various participants in each market; establishing the market share of each participant in order to evaluate market concentration; and assessing the degree of contestability of the relevant market.

Market definition

51. The definition of the relevant market is a tool used to aid the competitive assessment of an industry by identifying and delineating the boundaries of competition between firms. The main purpose of market definition is to identify the competitive constraints that the firms involved in an investigation face. The relevant market contains all those substitute products and areas which provide a significant competitive constraint on the products and areas of interest. Thus market definition enables the identification of competitors and calculation of their respective market shares. The relevant market has two dimensions: the product market and the geographic market. The objective of defining the market along these two dimensions is to identify actual competitors who are capable of constraining the behavior of or preventing a firm which may attempt to restrict competition within a market.

52. The ideal definition of a market must take into account substitution possibilities in both consumption and production. While the ability of consumers to switch to alternative products constitutes the most immediate and effective disciplinary force on firms who may wish to increase prices above competitive levels ("demand substitution") prices can also be constrained by the potential behavior of suppliers of other products ("supply substitution"). Firms that are not currently supplying a particular product might switch

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some of their existing facilities to supplying that product (or close substitutes) if relative prices should increase significantly.

The product market

53. The product market is taken to comprise all those goods and services which are regarded by the consumer as reasonable substitutes, by reason of the products' characteristics, their prices and intended use. The boundaries of the market are determined by taking the products relevant to the investigation and looking at the closest substitute products, i.e. those products to which consumers would switch if prices of the relevant products rose. These substitute products are included in the market if substitution by consumers would prevent prices of the relevant products from rising above competitive levels. The alternative products do not need to be perfect substitutes, but alternatives that would fill a role similar to that of the goods in question, and to which consumers would switch in the event of a price increase. Essentially, any similar goods that would prevent prices being set above competitive levels should be included in the definition of the relevant product market.

The geographic market

54. The geographic market comprises the area within which the firms concerned are involved in the supply of the relevant product; and includes all those areas where the conditions of competition are sufficiently homogeneous. The approach to defining the geographic market depends on whether the level of supply is retailing, wholesaling or manufacturing. Demand-side substitution is more relevant to the retailing level of a market, while supply-side substitution is more relevant for the wholesaling and manufacturing dimension of the market.

55. Chains of substitution can be an important factor in geographic markets, particularly retail markets. Consumers in any one location might not be willing to travel more than, say one or two miles to purchase from a particular retailer. If, however, there are sufficient consumers – marginal consumers – who are willing to seek out other retailers in other locations then all those areas would be considered to be part of a single geographic market. A chain of substitution may therefore be created linking various locations creating one relevant market as opposed to localized markets.

The relevant product in the gasoline industry

56. The test for demand-side substitutability seeks to identify the set of products that are sufficiently similar to be regarded by consumers as reasonable substitutes for each other.[3] In other words, the test seeks to identify the set of products which are considered substitutes for one another in the eyes of the buyer. The relevant product market is identified by giving consideration to the physical characteristics of the products, consumer's taste and perception and product prices.

[3] This concept of demand-side substitutability is identical to the concept of cross-price elasticity of demand between two products. Cross-price elasticity measures the degree of responsiveness of the quantity demand for one good to a given change in the price of some other good. The degree of substitutability between products is reflected in the magnitude of the cross-elasticity measure. If a small increase in the price of good X results in a large rise in the quantity demanded in of good Y, then good X and Y are close substitutes.

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Physical characteristics of products

57. All marketing companies purchase gasoline from Petrojam, which produces unleaded 87, unleaded 90 and diesel fuels. In addition to purchasing from Petrojam, Shell, Esso and Texaco import a portion of the automotive fuel they sell. Based on information submitted to the FTC these three companies add special additives to the gasoline they purchase from Petrojam. While the companies did not state specifically whether additives are added to all three types of fuels, our information which was gathered from Petrojam, is that a special additive (detergent) is added to both grades of unleaded gasoline at the loading rack when each of the three companies purchases gasoline from Petrojam. Petrojam on the other hand adds its own type of additive (detergent) to the unleaded gasoline which it sells to all the other marketing companies. This means that while grades of the unleaded gasoline sold by the marketing companies are differentiated by virtue of the different types of additives, the diesel fuel sold by Petrojam to all nine marketing companies is equivalent in quality, at least at the point when it is delivered into tankers for transport to either retail outlets or storage facilities.

58. In its submission to the FTC Shell referred to its differentiated unleaded 90 gasoline as V-Power. Reference to V-Power is also made at the Shell branded retail outlets both on the price boards and on the pumps. In their submissions neither Esso nor Texaco calls their differentiated gasoline by a specific name. Esso however refers to unleaded 87 as 5000 and unleaded 90 as 8000, while Texaco refers to unleaded 90 as Power-plus at their respective branded retail outlets. Both Shell and Texaco refer to unleaded 87 as 'regular'. While marketing companies seek to differentiate their products, all unleaded gasoline sold at the various retail outlets are either 87-octane or 90-octane. The 2000 amendments to the Petroleum (Quality Control) Act require that pumps be appropriately labeled to indicate the type of fuel they expel, i.e. whether the fuel is 87-octane, 90-octane or diesel fuel.

Consumer consumption and preferences

59. The results from a consumer survey commissioned by the FTC were used to assist in the assessment of product substitutability among the different types of gasoline.[4] The survey sought to, among other things, assess consumers' perception as to the difference in the quality of gasoline sold under the different brands. The survey also sought to uncover consumers' consumption patterns in terms of substitution between the unleaded 87 and unleaded 90 grades of gasoline. There are no substitutes for diesel. Motor vehicles designed to use diesel cannot use unleaded gasoline.

60. The results revealed that consumers do perceive a difference in the quality of gasoline sold under the different brands. In fact over 72.8 per cent of the respondents expressed this belief. Of this number, 48.2 per cent indicated that they purchase only one brand; 24.6 per cent indicated that they purchase only two brands and 27.1 per cent indicated that they purchase three or more brands. The survey revealed also that of the 584 respondents 301 or over 51 per cent substitute between the fuels sold under the different brands. For persons who indicated that they purchase only one brand, 23.6 per cent purchase only the Shell brand; approximately 11 per cent purchase only the Texaco

[4] The consumer survey was conducted over a three-week period; and 584 persons participated in the process.

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brand; and 7.8 per cent purchase only the Esso brand. This means that there is a segment of consumers who have strong brand loyalty.

61. In relation to interchangeability between the two grades of unleaded gasoline, 15.4 per cent of the respondents indicated that they use both grades. Further a number of respondents use unleaded 90 even though their vehicles are designed to use the lower octane gasoline.

Retail prices

62. The prices of products can help to determine whether they are in the same relevant market. Two products may not be considered reasonable substitutes, even if they share the same functionality, if they have substantially different prices. The pricing pattern by retailers of similar products can provide insights into the degree of substitutability between products. Retailers who believe that other products are substitutes for their products will price them accordingly. These prices do not have to be identical.

63. Automotive fuel retail prices are directly set or indirectly influenced by marketing companies or are set by individual retailers.[5] A survey of retail prices at over 80 retail outlets reveals that prices vary from station to station, with the degree of variation generally lower in areas where outlets are more closely located, for example under a quarter of a mile. The results of the survey of retail outlets located in the same general trading areas are set out in Table 1. General trading areas include locations where there are neighboring retail outlets or where retail outlets are within view of each other. The table records observations, conducted over a five-week period, of the prices of the three brands of differentiated unleaded 90 gasolines sold at various outlets. These prices tend to be marginally different for the most part. There are instances however in which the prices of the products are exactly the same. The price differentials appear to be less in instances where prices are displayed on price boards. The column labeled 'price visibility' indicates whether prices are displayed (D) or not displayed (ND).

64. The same pricing pattern is discerned when the prices of non-differentiated unleaded 90 are compared with those of the differentiated gasoline. Where retail outlets are located in proximity to one another the price differences tend to be very low. Again this is more evident in cases where prices are displayed.

65. It should be noted that firms can obtain market power from consumers' imperfect information on prices. If consumers have full information about prices, they would be able to respond immediately to any attempt by a supplier to raise its price above those of a competitor, thereby impeding such an attempt to increase price. However, when only a relatively small proportion of consumers are aware of competing offers, this can give a supplier the opportunity to raise its prices. The likelihood of such a price raise would depend on the proportion of informed consumers and the margin that the operator would lose on the lost sales. The higher the proportion of informed consumers to uninformed consumers, the more likely it is that prices will be competitive.

Table 1

[5] Retail prices at company-operated retail outlets are directly set by the marketer and are influenced in situations where price support is granted to the retailer.

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Prices of differentiated and unleaded 90 gasolines for retail outlets within the same areas

Differentiated products	*Price visibility*	*Observation 1*	*Observation 2*	*Observation 3*	*Observation 4*	*Observation 5*
Area A						
Power-plus	D	36.49	36.99	38.30	38.40	38.05
Power-plus	D	36.49	37.19	38.39	38.39	38.05
V-Power	D	36.59	37.19	38.40	38.85	38.05
V-Power	D	36.59	37.19	38.39	38.85	38.05
8000	D	37.35	38.73	39.93	38.39	38.05
8000	ND	38.41	39.05	40.34	40.34	39.86
Area B						
Power-plus	D	36.90	37.50	38.75	38.75	38.10
8000	D	37.30	38.43	39.63	39.63	38.83
V-Power	D	36.95	37.55	38.75	38.95	38.15
Area C						
V-Power	D	36.60	37.30	38.50	38.50	37.80
8000	D	36.25	37.20	38.50	38.50	37.80
Area D						
Power-plus	ND	37.25	37.55	38.75	38.75	38.75
8000	ND	38.41	39.05	40.34	40.34	39.86

Table 2
Maximum price difference of unleaded 90 gasoline within the same brand

Differentiated products	*Observation 1*	*Observation 2*	*Observation 3*	*Observation 4*	*Observation 5*
Power-plus	2.50	2.00	1.37	1.28	2.24
V-power	2.31	2.28	2.38	2.38	2.31
8000	5.41	5.21	5.33	5.33	6.13

66. It was also observed that price differences between the different brands within the same areas are generally less than the maximum price differences between same brands in the urban areas of Kingston and St. Andrew. Table 2 which sets out the maximum intra-brand price differences of unleaded 90 shows that price differentials can be as high as $6.13 per liter. The maximum inter-brand difference between the differentiated unleaded 90 gasoline as presented in Table 1 is $1.81 per liter, suggesting that prices are close enough for the products to be considered substitutes.

67. Figure 1 summarizes the extent of demand-side substitutability among the three types of automotive fuels sold by Petrojam based on their physical characteristics, the results of the consumer survey and price trends in the retail trade. Based on the results there are two distinct types of automotive fuels – unleaded and diesel. From the demand side, there is no substitution between unleaded and diesel fuels, as motor vehicles are designed to use either unleaded gasoline or diesel fuel. There is however some amount of substitutability between unleaded 87 and unleaded 90, as vehicles designed to use unleaded 87 can also use unleaded 90. Some vehicles however are designed to use unleaded 90 only, and in those instances there is no substitution in terms of octane level. There is however a substantial degree of substitution across brands. Approximately 48 per cent of respondents who perceive a difference in the quality of gasoline sold under the various brands buy gasoline from only one brand of retail outlets. This suggests that

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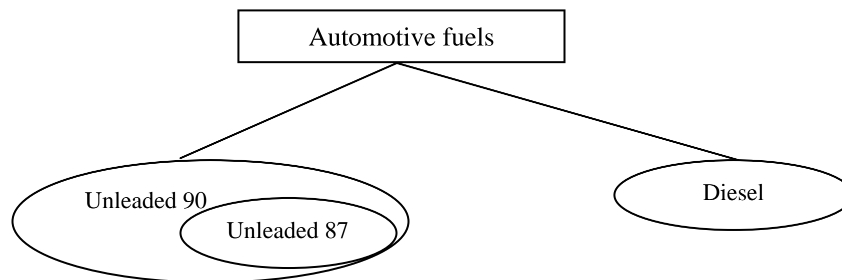
there is significant brand loyalty; however, the proportion of consumers who prefer one brand over all other brands to consumers who believe that gasoline is homogenous across branded sites is not large enough to be reflected in prices. In other words, the prices of differentiated gasoline are not significantly different from those of undifferentiated gasoline.

68. The pricing patterns of retailers, especially in the same trading areas and in cases where prices are displayed suggest that both differentiated and non-differentiated unleaded 90 are substitutable by consumers. These price differences were found to be marginal; and in some cases prices are identical.

69. It may therefore be concluded that while a portion of consumers believe that there is a difference in the quality of gasoline, a substantial number of them believe that the quality across brands is similar enough to be considered substitutes. The pattern of retail pricing also refutes the idea of separate markets for differentiated products. In other words, the pricing strategies of the marketers and retailers support a single market for unleaded 90; and substitution by consumer supports a single market for unleaded gasoline.

Figure 1
Relevant product market for automotive fuels



Supply-side substitutability

70. In addition to demand-side substitution, supply-side substitution is also examined in the process of defining the relevant product market. Based on the above there are nine types of automotive fuels supplied by the nine marketing companies. These can be broken down into two main groups. The first may be categorized as differentiated fuels and the other non-differentiated fuels. The unleaded 90, unleaded 87 and diesel fuels which contain Petrojam's additives are classified as undifferentiated, while the fuels supplied by Esso, Shell and Texaco are classified as differentiated fuels by virtue of the proprietary additives which are included in the fuels they distribute. The particular differentiated fuels are therefore supplied and can be supplied only by the relevant suppliers – Shell, Esso and Texaco. For example, Esso-5000 can be supplied only by Esso. These three marketing companies, while not currently supplying the non-differentiated unleaded gasolines can at any time supply these products without incurring any significant costs. This means that all marketing companies can supply the non-differentiated fuels supplied by Petrojam. V-power and Shell's unleaded 87, however, can be supplied by Shell only;

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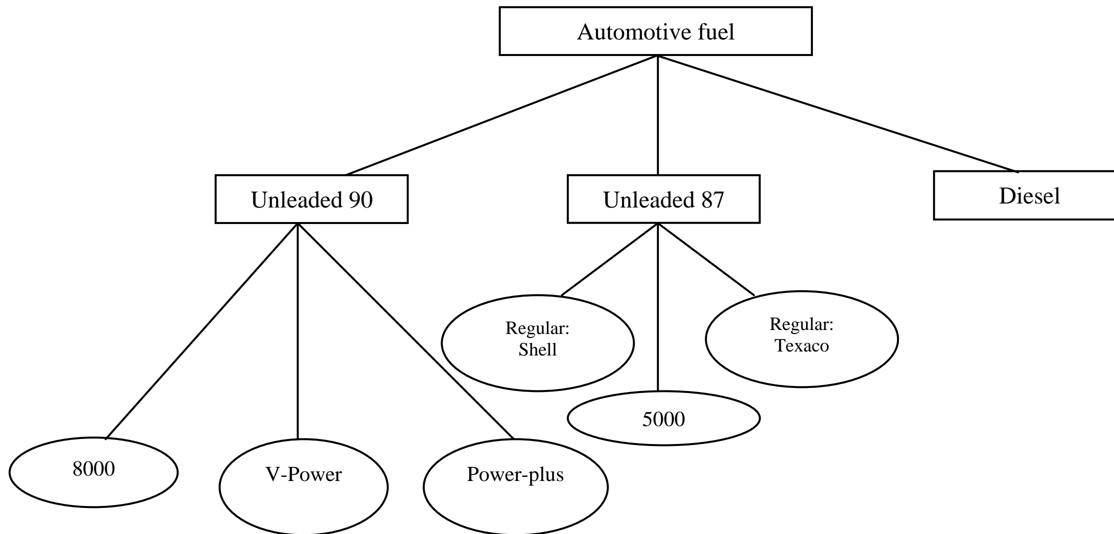
5000 and 8000 by Esso only; and Power-plus and Texaco's brand of unleaded 87 by Texaco only. Figure 2 shows the potential relevant market based on the products supplied by the marketing companies.

Figure 2
Types of automotive fuels



71. To the extent that all marketing companies can supply the three main types of automotive fuels supplied by Petrojam, then non-differentiated unleaded gasoline and diesel would be considered to be in the same market. This is irrespective of the fact the consumers cannot easily and costlessly switch between the two types of fuels. The ability of marketing companies, however, to alter their relative supplies of the products in response to any change in demand requires that the products form one relevant market. In terms of the differentiated products only the relevant marketing company can supply those products. Those products however may form separate markets only in the event that there are no substitutes for them.

72. A combination of the results of demand-side and supply-side substitution however leads to the conclusion that there is one relevant product market for automotive fuels. That is, the pricing behavior of a supplier of any of the different types of automotive fuels can be constrained by the other suppliers.

The relevant geographic market

73. At the refinery level the geographic market may extend beyond the borders of Jamaica, as three of the nine marketers, Esso, Shell and Texaco, import refined products into the island. The ability of companies other than the refinery to import and supply refined products means that the local refinery competes with other refineries outside of Jamaica. The extent or degree of such competition is constrained however by the capacity of storage facilities accessible by the importers. Esso, Shell and Texaco own storage

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facilities individually and jointly. In 2003 the three companies jointly imported approximately [✄] barrels of automotive fuels, an increase of nearly 10 per cent over the amount imported in 2002.

74. The distribution of automotive fuel is carried out island wide. Petrojam has two distribution points, one in Kingston and the other in Montego Bay, where fuel is loaded into tankers for delivery to retail outlets or storage facilities. Shell, Esso and Texaco are the only marketing companies with storage facilities. These facilities are located in Kingston and Montego Bay. The costs to transport automotive fuel from the distribution points can range between [✄] and [✄] per liter. With the exception of differences in transportation costs the terms and conditions of distribution across the island are similar.

75. While the distribution of automotive fuel is island wide, the extent of the relevant geographic market at the retail level may be localized or it may extend to the entire island. Because many people commute, it is difficult to tell which outlets compete with each other (outlets near one's work and those near the schools which one's children attend compete with outlets near one's house). The extent of the market depends primarily on the chain of substitution, i.e. the proximity of retailers and the distance consumers are willing to travel to obtain the relevant product, which in this case is a convenience good.[6] If there are sufficient consumers – marginal consumers – who are willing to seek out other retailers in other locations then all those areas would be considered to be part of a single geographic market.

76. From the consumer survey carried out by the FTC a number of the respondents indicated that the price of fuel is the most important factor in their choice of retail outlets. Convenience and proximity ranked next. The majority of respondents indicated that they pass a number of outlets on their regular routes; and over 38 per cent of the respondents indicated that they have driven out of a station to purchase at another having discovered the price of gasoline at the first station. This means that consumers have choices in retail outlets and are, to some extent, willing to seek better prices. A chain of substitution may therefore be created linking the various retail outlets across the island.

77. Chains of substitution however often break down in rural areas, resulting in a number of localized markets. These markets however do not create competition concerns if there are enough competitors within each area. Based on survey of retail prices outlets that are located more closely (e.g. neighboring outlets) appear to compete more intensively. Table 3 gives an overview of the distribution of retail outlets in Jamaica. At least four different brands of retail outlets are represented in each parish; and no single brand represents over 50 per cent of the outlets in any parish. Information on the actual distance between retail outlets was not collected.

[6] Convenience goods are items which are bought frequently with little shopping around because the costs of obtaining price comparisons outweigh the benefits.

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Table 3
Distribution of gasoline retail outlets

PARISHES	*Esso*	*Shell*	*Texaco*	*NFL*	*Petcom*	*Unipet*	*Cool*	*Epping*	*Jampet*	*TOTAL*
Kingston and St. Andrew	21	16	22	7	4	3	0	3	0	76
St. Catherine	3	7	8	2	5	1	0	0	2	28
St.Thomas	2	2	2	1	1	1	0	0	0	9
Portland	1	1	2	1	1	0	0	1	0	7
St. Mary	2	3	3	0	1	1	3	7	0	20
St. Ann	2	4	8	1	2	1	2	4	0	24
Trelawny	2	1	2	0	1	0	0	0	0	6
St. James	2	4	7	2	2	0	1	0	0	18
Hanover	1	3	2	0	2	0	0	0	0	8
Westmoreland	3	3	6	2	3	0	3	1	0	21
St. Elizabeth	3	4	5	1	3	1	1	1	0	19
Manchester	3	4	7	1	3	1	1	1	0	21
Clarendon	6	4	3	3	2	0	2	1	0	21
TOTAL # OF OUTLETS	**51**	**56**	**77**	**21**	**30**	**9**	**13**	**19**	**2**	**278**

78. The geographic extent of the market at the production level is global. The local refinery competes with other refineries for the sale of automotive fuels to Esso, Shell and Texaco. The extent of this competition depends primarily on storage capacity. At the distribution level, notwithstanding the differences in transportation costs, the market may be considered to be the entire island. The maximum transport cost for delivery of fuels was found to be [✂] per liter, which is less than, in some cases, the difference in retail prices at intra-brand retail outlets which are approximately the same distance away from the refinery.

79. At the retail level the geographic market may be localized or it may be the entire island. This will depend on the proximity of outlets and the areas covered by motorists. The more areas covered by a large number of motorist on a regular basis the less likely it is that markets will be localized.

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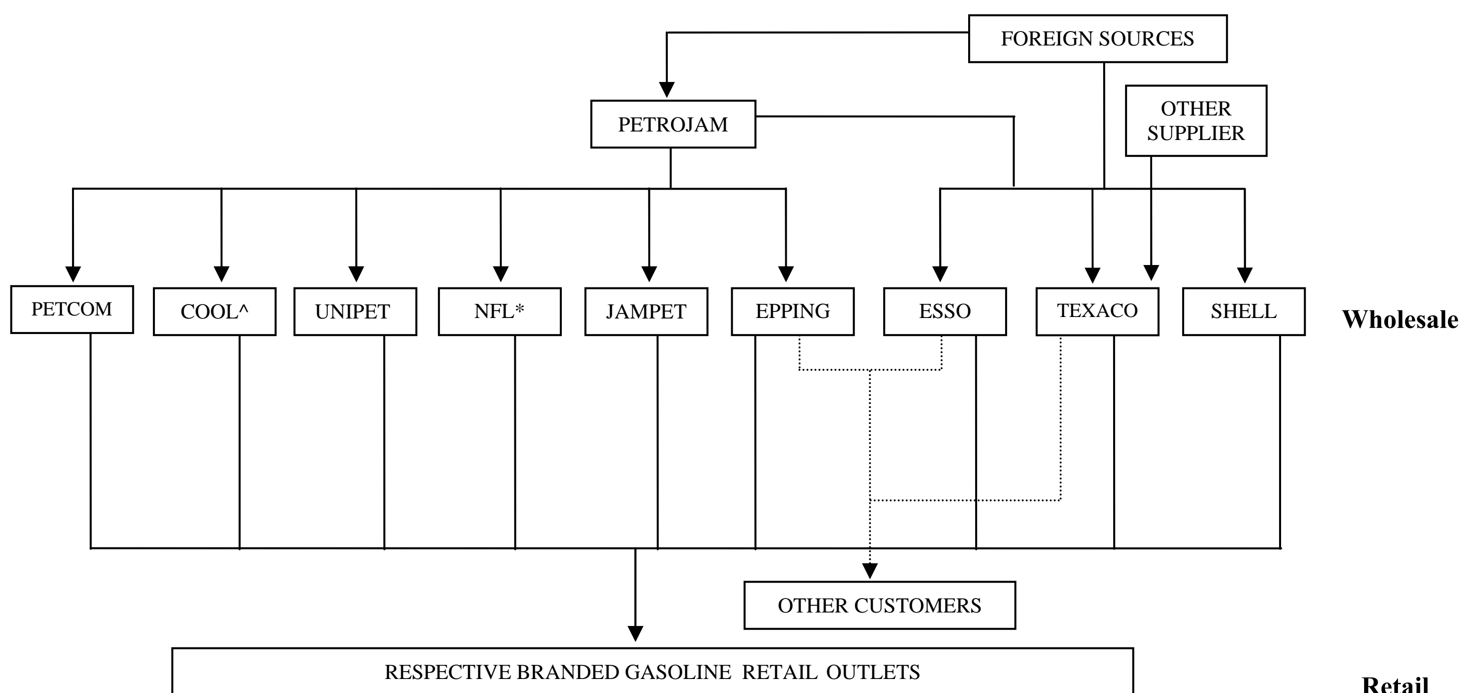
Industry Structure of Gasoline

80. There are three main levels of activity in the supply chain in the petroleum industry in Jamaica: refinery/production and importation; wholesaling and distributing; and retailing. The producing, importing, wholesaling/distributing and retailing of gasoline take place through a series of stages and involve a number of firms with some being involved in more than one stage of the process of getting gasoline to end users and final consumers (see Figure 3).

Figure 3
The gasoline industry



^ COOL - CoolOasis Limited
* NFL - National Fluids and Lubricants (service outlets are now operated by Total Jamaica Limited)

81. The main participants in the market for the supply of gasoline are Petrojam Limited; Petroleum Company of Jamaica Limited (Petcom)[7] ; Esso Standard Oil S.A. Limited; Shell Company (W.I) Limited; Texaco Caribbean Inc.; Total Jamaica Limited (operators of the National Branded outlets)[8]; United Petroleum (Jamaica) Limited (Unipet); Jampet Service Station; CoolOasis Limited; and Epping Oil Company and over two hundred retailers, some of which are members of the Gasoline Retailers Association. All these

[7] Both Petrojam Limited and Petcom are wholly-owned subsidiaries of Petroleum Corporation of Jamaica, which is a statutory body of the Government of Jamaica and falls under the Ministry of Commerce, Science and technology.
[8] Total Jamaica Limited bought the assets of National Fuels & Lubricants and started operating the outlets on April 1, 2004.

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participants together contribute to the supply of gasoline to end users and final consumers.

Production and importation

82. Petrojam Limited is the sole producer of gasoline in Jamaica. It operates the country's only refinery, which was acquired from Esso in 1982. It refines crude oil and sells a range of refined petroleum products to all marketing companies. In addition to crude oil, Petrojam also imports some of the refined petroleum products which it sells. Other importers of refined petroleum products, including automotive fuel, are Shell, Esso and Texaco.

83. In 2003, approximately [✂] barrels of automotive fuel were produced by Petrojam, [✂] barrels were exported and a total of [✂] barrels were imported collectively by the four importers. A total of [✂] barrels (an increase of 18 per cent) were therefore available for local consumption, compared to [✂] barrels in 2002. Table 4 presents a breakdown of total supply (production and import) by the local producer and importers. Of the total volume of fuel consumed in 2003, [✂] per cent was produced while [✂] per cent was imported. In 2002, [✂] per cent was produced while [✂] per cent was imported. The refinery was down for approximately 4 months in 2003. With the exception of [✂], all importers recorded an increase in the volume of automotive fuel imported in 2003.

Table 4

Relative contribution of supply of automotive fuel for the years 2002 and 2003

	Production (less exports)	*Imports*	*Local consumption*
2002	{ Information deleted. See note on cover page. }		
2003			

84. The total volume of automotive fuel (production and importation) supplied by Petrojam in 2003 increased over that which was supplied in 2002 by approximately 23 per cent; and the proportion it sold to the nine marketing companies relative to its other customers fell by about 11 per cent. This means that a greater proportion of Petrojam's supply of automotive fuel was sold to sources other than the marketing companies in 2003.

Wholesaling/Distributing

85. The wholesaling/distributing of automotive fuel involves nine marketing companies. These are Esso, Shell, Texaco, Petcom, Total (National), Unipet, Jampet, CoolOasis and Epping. Each marketing company distributes fuels to retail outlets bearing its respective brand. With the exception of Esso, Epping and Texaco all other marketing companies distribute their entire supply of automotive fuel through their respective branded retail outlets.[9] Esso, Epping and Texaco indicated in their submissions to the FTC that they sell gasoline, albeit a small fraction, to sources other than outlets bearing their brands.

86. The contractual arrangements governing the relationship between marketing companies and retailers make it obligatory for retailers to purchase their entire requirement of

[9] The FTC did not receive any response from Jampet.

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gasoline from the respective branded marketing companies. This means that each branded retail outlet is supplied only by its affiliate marketing company; and no branded outlet is supplied by more than one marketing company. For example, a Texaco branded retail outlet is prohibited from buying automotive fuel from any other source but Texaco.

Retailing

87. The retailing of automotive fuel is carried out by the marketing companies, operating their own retail outlets and by independent dealers, who have entered into contractual arrangement with a marketing company. There are two categories of arrangements between marketing companies and dealers. In the first type, the marketing company owns the retail outlet and leases/rents it to a dealer under the brand of the company; and the second type relates to a dealer-owned outlet. In the latter case the dealer owns the property and signs a contract with the marketing company to sell only its brand of automotive fuel. Retail outlets in Jamaica are generally linked to one of the nine marketing companies. There is, however, at least one retail outlet that does not bear the brand of any of the nine marketing companies.

88. There are 278 branded retail outlets across the island. Table 5 sets out the mode of operation of these outlets. Approximately 10 per cent of branded outlets are operated directly by marketing companies either through commission agents or employees. Unipet operates approximately 44 per cent of its branded outlets. Total (National) operates 38 per cent and Shell operates 23 per cent of their branded outlets respectively. Of the 30 Petcom branded outlets only 1 is operated directly by Petcom.

Table 5
Branded retail outlets and their mode of operation

Marketing Companies	*Retail sites*	*Company operated*	*Dealer operated*
Texaco	77	0	77
Shell	56	13	43
Esso	51	0	51
Petcom	30	1	29
Total (National)	21	8	13
Epping	19	0	19
CoolOasis	13	0	13
Unipet	9	4	5
Jampet	2	NI[10]	NI
TOTAL	**278**	**≤ 28**	**≥ 250**

89. The island's gasoline industry is served by one local refinery (Petrojam), four importers (Petrojam, Shell, Esso and Texaco), nine marketing companies and several retailers all affiliated with one of the nine marketing companies. The local refinery and Petcom, one of the marketing companies, which operates a retail outlet, are subsidiary of the Petroleum Corporation of Jamaica. Each marketing company sells only to their respective branded outlets, and therefore competes with each other at the retail level of

[10] No information provided.

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the market. Retail outlets, whether owned by the marketing companies or otherwise, are generally operated by independent dealers. Four marketing companies, Shell, National, Petcom and Unipet, operate directly a few of their retail outlets.

Market shares

90. Market share is calculated on the basis of total automotive fuels distributed by the nine marketing companies, whether sourced from Petrojam or imported. For the year 2003 the total supply was [✂] barrels, an increase of 19.5 per cent over the previous year's. All marketing companies recorded increased purchases. Each company's share of the market for 2002 and 2003 is set out in Table 6. In both years Shell comes out as the market leader with market share of over [✂] per cent.

91. Between 2002 and 2003 five marketers experienced increases in their market share while four experienced declines. There were however no significant changes in the ranking of the companies. Esso and Texaco have traded second and third positions, while CoolOasis and Unipet traded eighth and ninth positions. All other companies have retained their relative positions.

Table 6
Relative market share of the Marketing Companies (2002 and 2003)

Marketing Companies	*Relative market share 2002*	*Relative market share 2003*
Shell	{Information deleted. See note on cover page. }	
Esso		
Texaco		
Petcom		
National (Total)		
Epping		
Jampet		
CoolOasis		
Unipet		
TOTAL	**100**	**100**

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Assessment of competitiveness

Market concentration

92. Economic theory suggests that the vigor of competition in an industry is related positively to the number of firms in that industry. The degree of inequality between the firms also matters. The most commonly used proxy for the existence of market power or the level of competition in an industry is some measure of concentration which takes into account the extent of inequality among firms. This concept of competition has its roots in the Structure-Conduct-Performance (SCP) model of competition. The SCP model holds that the structure of the industry (e.g., number of sellers and buyers, product differentiation, vertical integration etc) determines the conduct of firms (e.g. pricing behaviour) and this in turn determines their performance (e.g. production and allocative efficiency). The model holds that the more concentrated the market structure or the greater the inequality between firms, the less competitive will be the market which in turn leads to both higher prices and higher profits. In other words, the more concentrated the market, the more likely it is that competition is not effective.

93. The two most used measures of market concentration are the concentration ratio and the Herfindhal-Hirshman Index. Concentration ratios record the percentage of a market's sales accounted for by a given number of the largest firms in that market. A number of concentration ratios for a given market can be calculated. The two firm concentration ratio (CR2), for example, is defined as the sum of the market shares of the leading two firms in the market. Similarly, the more commonly used four firm concentration ratio (CR4) is the sum of the market shares of the leading four firms in the market.

94. Concentration ratios have two significant deficiencies as proxies for the effectiveness of competition in an industry. Firstly, they do not take into account the relative sizes of the leading companies. For example, a market which has four firms each with a 20% market share will have the same concentration ratio as a market in which the leading four firms have respective market shares of 50%, 20%, 7% and 3%. Although in both instances the total market share of the four firms is 80%, it is probable that the competitiveness of the two markets will differ. Secondly, concentration ratios do not take into account the total number of firms in a market or the market shares of smaller companies.[11]

95. The Herfindhal-Hirshman Index (HHI), attempts to rectify some of the drawbacks of concentration ratios by taking into account the number and market shares of all firms in the market. The HHI is calculated by summing the squared market shares of all the firms in the market. Thus a market consisting of only four firms with market shares of 50%, 25%, 20% and 5% has an HHI of 3550.[12]

96. The index attains its maximum value of 10,000 when the industry is occupied by only one firm. The value declines with increases in the number of firms and increases with rising inequality among firms. The HHI therefore ranges between a maximum of 10,000

[11] In many industries, the ability of existing firms to expand capacity can provide a more important competitive constraint than the potential for entry. If smaller firms have the capacity to increase output in response to a price increase by leading firms in the market, then they can provide an effective competitive constraint on market behavior.

[12] $HHI = (50^2 + 25^2 + 20^2 + 5^2) = (2,500 + 625 + 400 + 25) = 3550$

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(where there is only one firm) and a minimum of 0 (where there is a large number of equally sized firms).[13] The range of market concentration as measured by the HHI can be classified as follows:[14]

- Unconcentrated (HHI below 1000)—this HHI threshold would, for example, have 10 equally-sized firms;
- Moderately concentrated (HHI between 1000 – 1800)—at HHI equal to 1800, there may be about 5 equally-sized firms; and
- Highly concentrated (HHI above 1800)

Barriers to entry and potential competition

97. Another indicator of the competitiveness of a market is barriers to entry. According to the "contestable markets theory", where there are low barriers to entry, competitive pressures could come from the threat of potential entry, in addition to or instead of from existing firms. Therefore, even a firm with a large market share may be subject to competitive pressure from outside of the market where barriers to entry are low.

98. There are various ways in which different types of entry barriers may be classified. The U.K. Office of Fair Trading (OFT) identifies three categories of sources:

- *Absolute advantages*—which arise when the incumbents own or have access to important assets or resources that are not accessible to the potential entrants;
- *Strategic advantages*—which arise when an undertaking gains an advantage from being in the market first. This is also known as a "first-mover advantage". Strategic advantages could arise, for example, due to high sunk costs, economies of scale and informational constraints, where an incumbent may have more information on the existing costs of production than an entrant does; and this, in conjunction with sunk costs, may constitute a barrier to entry. [15]
- *Exclusionary behaviour*—which may be carried out by the incumbent. Such behaviour includes vertical restraints, predation and refusal to supply.

99. It should be noted that cost advantages derived solely from the efficiency of the incumbents are not to be considered as a barrier to entry.

100. In summary, the competitiveness of the market may be assessed with reference to the concentration in the market and the barriers to entry. Market concentration is a function of the number of firms in the market, their respective market shares and the degree of inequality among them. The larger the number of firms and the lower the inequality among them in terms of their market shares, the less concentrated is the market. Conversely, the fewer the firms and the greater the level of inequality, the more

[13] The range of the HHI depends on how market share is expressed, for example 50% or 0.5. It could range between 0 and 10,000 or 0 and 1. One is merely a scale of the other.

[14] This classification is based on the Federal Trade Commission and Department of Justice (DOJ) guidelines.

[15] Sunk costs refers to the investments that have to be made to enable production of a good or service. These costs are incurred even before a single unit of good or service is produced. An example of sunk costs can be found in telecommunications where the cable network has to be put in place – at a high cost – before any voice or data transmission can be made.

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concentrated is the market. Economic theory suggests that the more concentrated the market, the less competitive it is likely to be.

101. Where markets are unconcentrated or there are low barriers to entry, competition is likely to exist and to be effective. Where markets are concentrated and high barriers to entry exist, competition may be low. Table 6 summarizes the competitiveness of a sector under various conditions.

Table 6
Indicators of competitiveness

Market concentration	*Low barriers to entry*	*High barriers to entry*
Unconcentrated	Competitive	Competitive
Concentrated	Likely to be competitive	Uncompetitive

Assessment of the competitiveness in the automotive fuel market

Market concentration

102. The market shares of the nine marketing companies and the relative distribution of branded retail outlets are presented in Table 7. While Shell has the largest market share ([✂]), its network of retail outlets is not the largest. Texaco, which has the third largest market share ([✂]), has the largest network of retail outlets. Assuming that all the supplies of each of the marketing companies are sold through their respective branded outlets, Jampet which supplies two outlets seems to be on average the most effective.[16] Shell and Petcom are ranked second and third. Here effectiveness refers to fuels sold per branded retail sites.

103. The difference between the market shares of the two largest distributors is [✂] percentage points, and the difference between the largest and the smallest distributor is [✂] percentage points. These figures were [✂] and [✂] percentage points respectively in 2002.

[16] The information on the number of outlets operated under the Jampet brand was taken from the telephone directory as that company did not respond to the information request made by the FTC. Based on information gathered by the FTC not all the gasoline purchased from Petrojam by all the marketing companies are distributed through their respective branded outlets.

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Table 7
Market share of the nine marketing companies and the distribution of branded outlets

Marketing Company	*Share of supply of fuels (2003)*	*Distribution of branded retail outlets (June 30, 2004)*
Shell		20.1
Esso		18.4
Texaco	{Information deleted. See note on cover page. }	27.7
Petcom		10.8
National (Total)		7.6
Epping		6.8
Jampet		0.7
Cooloasis		4.7
Unipet		3.2
TOTAL	**100**	**100**

104. The concentration indicators for the distribution level of the market are reported in Table 8. A four-firm concentration ratio (CR4) was calculated based on the market shares of the nine marketing companies for the year 2003. This ratio of 84.3 which represents a slight reduction over that which obtained in 2002, means that the 4 largest marketers jointly control almost 85 per cent of the distribution level of the market while the remaining 5 marketers jointly control a mere 15 per cent. The decreased ratio represents a marginal shift in market shares between the top four firms and the five smaller ones, in favour of the smaller distributors. This suggests a reduction in concentration and possibly an improvement in the degree of competition.

105. The HHI figure of 2077.8 however represents an increase in concentration in 2003. The index in 2002 was 2053.1. Given that there has not been any change in the number of firms, this increased concentration is as a direct result of an increase in the level of inequality among the firms.[17] In 2002 the difference between the top two distributors, then Shell and Texaco, was [✄] percentage points. The gap between the number one and number two firms, Shell and Esso, increased to [✄] percentage points in 2003. While the inequality has increased, the combined market share of the second and third largest firms, which recorded a decline in 2003, is greater than Shell's market share. The presence of Esso and Texaco should therefore serve as an effective competitive constraint for Shell.

Table 8
Concentration indicators for the wholesale market

Indicator	*Concentration level*	*Classification*
Number of firms	9	
Concentration Ratio-4	84.3	
HHI	2077.8	Highly concentrated

[17] An industry with nine equally sized firms has an HHI of 1,111.

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106. The total supply of automotive fuels by the nine marketing companies for 2003 was [✂] barrels. If this amount was equally distributed among the 278 retail outlets then each station would have sold about [✂] barrels of fuels for the year 2003. Table 9 reports the concentration indicators for the nine marketing companies on the assumption of equal sales by each retail outlet. A concentration ratio based on the top four firms was calculated. This ratio of [✂] means that, if fuels were equally distributed across retail outlets, then the top four distributors would account for about [✂] per cent of the market, making it less concentrated than the actual number reported.

107. The HHI, under the assumption of equal sales by each retail outlet is [✂], rendering the market less concentrated than it actually is. Notwithstanding the heterogeneity of the retail outlets, given their distribution across the nine marketing companies, there is potential for more intense competition among the distributors.

Table 9

Concentration indicators for the wholesale market based on equal distribution to retail outlets

Indicator	*Concentration level*	*Classification*
Number of firms	9	
Concentration Ratio-4	✂	
HHI	✂	Moderately concentrated

108. The 278 retail outlets are operated by approximately 252 retailers. Unipet, National, Shell and Petcom operate directly a few of the retail outlets under their respective brands. Shell and National are the largest retailers. Shell operates 13 sites in the Shell network while National operates 6 sites in the National network. No other retailer operates more than 6 retail outlets. A few retailers however operate 2 or 3 outlets.

109. Table 10 records the CR-9 and the HHI for the retail market.[18] These figures are calculated on the basis that the total fuel distributed by the marketing companies is done equally among the number of retail outlets within their respective networks. Here the market share of each distributor is retained. A CR-9 of 15.4 per cent and an HHI of 96.7 were recorded. Under the assumption of equality across all retail outlets, irrespective of brand, the CR-9 and HHI are [✂] per cent and [✂] respectively.

110. The retail market although unconcentrated, appears to have the potential to be even more competitive. Given however that retail outlets are differentiated, e.g. in terms of amenities, the potential of equality among retailers in terms of sales might not be achievable.

Table 10

Concentration indicators for the retail market

Indicator	*Concentration level*	*Classification*
Number of retailers	252	
Concentration Ratio-9	✂	
HHI	✂	Unconcentrated

[18] The top nine retailers were used because there are only nine retailers which operate more than one outlet.

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Barriers to entry

111. Given the nature of the supply of gasoline in Jamaica, there are two main levels of the supply chain at which a firm could enter. A firm could enter at the production and/or importation level to compete directly with Petrojam, or at wholesale/retail level to compete with the current marketing companies. Entry at the production level would require significant capital expenditure and the length of time from initiation to actual entry could be considerably long. Such an entrant would need to invest in a refinery and storage facilities and all the necessary equipment and facilities which are required to import crude and produce and distribute the final product. Entry at the level of importation should be much shorter than at the refinery level, but would also require substantial capital outlay.

112. A potential entrant, at the wholesale/retailing level, would be required to establish a distribution channel which includes road tankers and a number of retail outlets to supply. Currently there are approximately 114 retail outlets which are not owned by the existing marketing companies. Most of the tankers are owned by independent firms and are contracted to marketing companies.

113. A retailer wishing to enter the industry could either lease a service station or purchase one. That retailer however would need to enter into a supply arrangement with a distributor as he could not buy directly from the refinery.

114. Apart from set up costs, another barrier to entry is the regulation of the industry. The Ministry of Mining and Energy must grant approval for a company to enter the petroleum product market[19]. Applicants are required to provide the following documents:

- Certificate from the Registrar of Companies;
- National Environment & Planning Agency's approval certificate;
- Approval from the Ministry of Transport and Works;
- Approval from the Office of the Commissioner of Police;
- Approval from the Parish Council/Town Planning Department;
- TRN Card;
- Tax Compliance Certificate;
- Approval from Health Authorities;
- Fire Brigade Safety Certificate;
- License from Inland Revenue Department;
- Pump Calibration Certificate;
- NIS Compliance Certificate.

115. While the entry barriers may seem high, there is room for expansion in the industry. This is especially true given that over 40 per cent of current retail sites are owned by

[19] Petrojam response to survey form, dated May 14, 2001

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independent retailers. A market for unbranded and independent retailing could therefore develop.

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4. Vertical integration

116. The objective of the Code of Conduct is to ensure a competitive market for petroleum products and services. Such a market will deliver the lowest possible prices and the widest choices for the Jamaican consumers.

117. The Code will therefore regulate the various vertical relations within the gasoline industry, having regard to the provisions of the FCA. Vertical relations, and in particular vertical integrations, are not in themselves illegal. Firms are generally free to operate at any level of the supply chain they choose, but like that of any other firm the conduct of vertically integrated firms is examinable under the FCA. Vertically integrated firms are subjected to regulations only in the event that their conduct is found to be in breach of the provisions of the FCA, i.e. if such conduct is found to substantially lessen competition within a market.

118. This Section provides a general overview of vertical integration. It then identifies the vertical arrangements within the gasoline industry, paying particular attention to the features of gasoline retailing in Jamaica.

What is vertical integration?

119. A producer of goods wishing to sell its products must decide how best to do so. The producer may carry out all functions from the supply of raw material to sale to the ultimate consumer. A firm may therefore carry out a number of processes, each of which could be performed by a separate firm. For example, a food processing company may own a packaging company and a chain of supermarkets where it sells its products directly to final consumers, thereby operating at the production, packaging and retail levels of the supply chain.

120. A firm is said to be vertically integrated if it owns at least two successive stages in the supply of a good as opposed to operating at only one stage. A vertically integrated firm owns both an upstream and a downstream process.[20] A firm can integrate vertically in two different directions: forward or backward. Forward integration ('downstream') occurs when a firm undertakes further finishing or distribution of a product in the direction of the end-user or final consumer. For example, a manufacturing firm may set up retail outlets or establish a subsidiary company to which the task of retailing is entrusted. Backward integration ('upstream') occurs when a firm begins producing products that were previously supplied to it by another firm. For example, a retailer may undertake the production of goods it would otherwise buy from a separate firm. The concept of forward and backward vertical integration is illustrated in Figure 4. In the first chain the processes of production, wholesaling and retailing are carried out by separate firms. The second chain represents the wholesaler integrating forward into retailing; and the third chain represents the wholesaler integrating backward into production.

121. Vertical integration, whether forward or backward, may be achieved through internal growth, for example by the setting up of retail outlets; or through external growth by

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[20] A firm is upstream of another if it provides an input into the other. A firm is downstream of another if it uses an output of the other.

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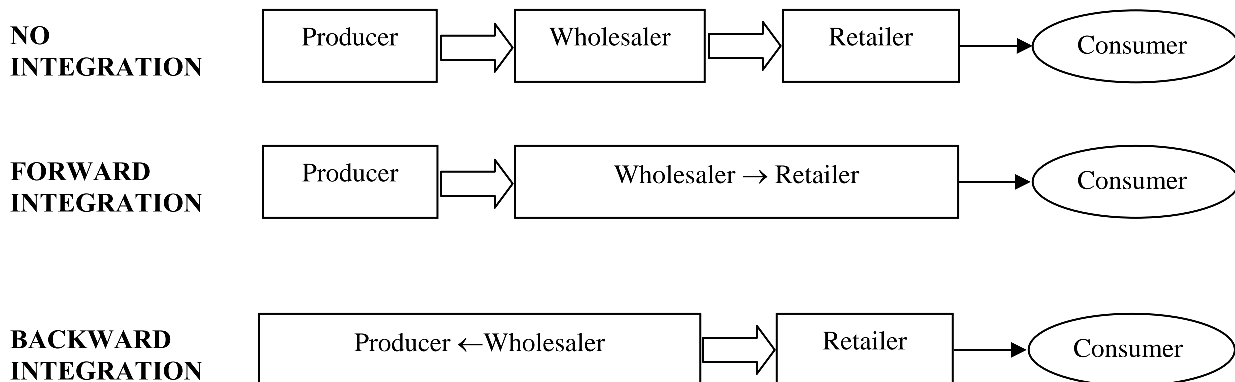
acquiring, for example, distribution networks downstream in the market. A vertically integrated firm therefore has total control over its operation at each stage of the supply chain at which it operates; and as such can make the necessary decisions to maximize its objective.

Figure 4
Forward and backward integration



122. In addition to vertical integration into a single firm, distinct processes can be vertically related by market transactions or contracts between separate firms. These contracts usually involve restrictive terms and conditions; and are used to mimic vertical integration. A firm may therefore form a vertical relation by entering into an exclusive and restrictive long-term contract with another firm. For example, the food processor may enter into an agreement with a packaging company and require that the company does not deal with any other food processors. Or if it sells its products to retail outlets it might determine the retail prices at which retailers should resell the products.

Why firms vertically integrate?

123. The chain from production to the delivery of final products can involve a number of processes, which if not carefully coordinated can result in a sub-optimal outcome due to inefficiencies.[21] Firms may therefore vertically integrate in order to avoid these inefficiencies which can arise from contracts or market transactions. The two issues which affect a firm's decision whether to integrate or not are cost and control. A profit maximizing firm will internalize a sequence of processes if the associated costs are lower than they would be if it were to carry out the same processes through the market or through contractual relations. In relation to control, a firm may need to have control over sources of inputs to prevent "hold-up", boycotts or poor coordination.

124. A firm may substitute ownership for contracts, if contracts are costly and inadequate. Contracts can be inadequate for the following reasons:

[21] The firm may produce fewer products than is possible.

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- *the goods or services cannot be well-specified*—it may be too expensive or impossible for a firm to completely define the exact products relevant to the contract, making it impossible for an arbitrator to decide whether or not a breach has occurred by virtue of delivery of the incorrect product.
- *obligations cannot be specified in all possible circumstances*—it can be extremely difficult to stipulate in a contract each party's obligations for every possible conceivable eventuality that could arise during a transaction. If an unanticipated event occurs and if the contract does not state each party's obligation in such an event, then the contract may be costly or impossible to enforce.
- *the legal system may not enforce them*—contracts may contain obligations which are illegal under competition law and therefore are unenforceable.

125. Firms may also integrate to avoid the problems associated with lack of control. In particular a firm may vertically integrate to avoid 'hold-up', boycotts or poor coordination. A seller, for example, might attempt to exploit a buyer who is dependent on the seller by claiming that production costs are higher and pressing for an increase in the negotiated price. Such opportunistic behaviour seeks to exploit or 'hold-up' one party to the benefit of the other party. Boycott can take various forms. A producer may for example withhold the supplies of goods from a distributor in order to force that distributor to resell those goods only on the terms and conditions specified by the producer. Poor coordination may be manifested through untimely delivery of much needed inputs when those inputs are supplied by a separate firm.

126. Firms therefore may vertically integrate to avoid the problems associated with market transactions and contractual relations and to be ultimately cost effective. These efficiencies include lower transaction costs, production costs and optimal distribution of products. In competitive markets these savings are passed on to consumers through lower prices and better services.

127. Despite the many problems which vertical integration can overcome and the efficiency gains which may accrue from it, in some instances it can have negative effects. Vertical integration can reduce competition if it results in vertical foreclosure to new or existing competitors or results in high entry barriers.

128. Where a firm already dominates one or more vertical stages, vertical integration may lead to various anti-competitive effects. While forward integration may be used to secure a market, it can simultaneously foreclose that market to competitors. For example, a funeral home may purchase a burial ground thereby foreclosing the market for burial spots to other funeral homes. Similarly, backward integration can guarantee supply sources, but it can also be used to prevent rivals gaining access to those sources.

129. Further, a vertically integrated firm which supplies a scarce raw material that is used by both itself and its competitors, can practice a price squeeze, i.e. to squeeze the profit margins of its competitors by charging them a higher price for the raw material than the price applied when that raw material is for its own use. At the same time it is setting relatively low final product prices. Such a practice affects existing competitors and sends a strong signal to potential competitors not to enter, thereby raising entry barriers. In this case a potential entrant would need to enter at more than one level of the market

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simultaneously. A true entry barrier is created only if the need for multi-level entry makes entry into the market more expensive than it would be otherwise.

130. A vertically integrated firm can facilitate price discrimination. For example a distributor prior to forward integration may charge one price to all retailers, but after undertaking the retail process might segment the market and charge different prices to customers.

Alternative to vertical integration

131. While a vertically integrated firm can produce cost savings, in some instances it can lead to higher costs associated with larger internal organizations if the necessary synergies are not created. Such a firm can vertically disintegrate from a high cost stage and enter into contractual relations with a separate firm for the products it normally produces in-house. Similarly, rather than vertically integrate in the first place, a firm might form vertical arrangements with independent firms and impose various vertical restrictions in an attempt to mimic vertical integration. Such arrangements or vertical restraints, like vertical integrations, can have efficiency enhancing effects as well as anti-competitive effects, depending on the market power of the firm imposing the restrictions.

132. A firm may enter into contractual relations with commercial agents, for the sale of its products. In these contracts property in the goods does not pass to the agent. The agent does not bear any risk itself; nor does it share in the profits or losses of the firm. The agent is usually paid a commission and its position is similar to that of an employee of the firm. Agency agreements are exempted from the provisions of competition law, as they are treated in the same way as interconnected companies are treated. Essentially, an agent and its principal are considered to be one entity.[22]

133. Vertical arrangements with separate firms for the distribution or sale of a product can take the form of franchise agreements. A franchise is a special type of vertical relation between two firms usually referred to as the franchisor and franchisee; and that is entered into, usually, for a specified period of time, whereby the franchisee pays a royalty to the franchisor for the assignment of the rights (exclusive or non-exclusive) to supply its products, using its trade marks, logos, designs, know-how and intellectual property rights. A franchise agreement enables a franchisee to operate as an independent business while using the name and know-how of the franchisor. The transfer of intellectual property rights from the franchisor to the franchisee is the feature of franchises that distinguishes them from other distribution arrangements. Such agreements allow for the development of the franchisor without it having to raise large amounts of capital. Individual franchisees are usually required to put up large capital, with the franchisor providing advertising and promotion, technical assistance, specialized equipment and training.

134. In order for a franchise system to function effectively it is essential that each franchisee conform to the uniform commercial methods specified by the franchisor. All franchisees must achieve the same standards for the system to work. The franchisor should therefore be able to impose common standards on all franchisees. Further, the use of the franchisor's intellectual property by the franchisee makes it legitimate for the franchisor to impose terms and conditions for the protection of those rights. The franchisor must

[22] An agency contract involves an agent and a principal, on whose behalf the agent acts.

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ensure that the franchisee does not act in a way that could create negative externalities for the entire franchise.[23]

135. The economic literature on franchising is concerned with incentive issues and how they are managed in these contracts. There are two main categories of incentive mechanisms relevant to franchise arrangements. These are residual claim and self enforcement. The first relates to the fact that the franchisees, the residual claimants, keep all the profit, net of fees and operating expenses, they earn from the operation.[24] They therefore have the incentive to maximize profits. The second type of incentive, which can be viewed as complementary to the first, relates to the ongoing rent that the franchisee would forgo if his contract were to be terminated by the franchisor.[25] If this rent is positive, and the possibility for the franchisor to terminate the contract exists, then the franchisee will have the incentive to perform according to the standards set by the franchisor. The presence of the residual claim and self enforcement incentives in effect imposes an incentive-compatibility constraint which aligns the incentives of the franchisee with that of the franchisor. If however the possibility of termination is removed then a franchisee might not operate as effectively as he would if the situation were otherwise.

Effects of vertical arrangements on competition

136. Vertical arrangements have a similar impact on competition as vertical integration does. Inherent in the notion of vertical integration is the substitution of ownership for contractual relations or market transactions. This can result in cost savings which can be passed on to the consumer. Contractual arrangements can have the same efficiency enhancing effects as vertical integration. These arrangements, which may or may not be exclusive generally place restrictions on the parties to the contract and are referred to as vertical restraints. (See Appendix D for a discussion on vertical restraints).

137. A vertical arrangement may require that a retailer carry only the products of one supplier and that those products must be sold at a particular price. While on the face of it this restraint appears anti-competitive, it can also be beneficial to the producer, dealer and consumers, i.e. it can be welfare enhancing. In a vertical relationship the two parties (producer and retailer) deal in complementary products. They are both involved at different stages in the process of getting the same product to the ultimate consumer. Given that the demand for a product increases as its price falls, both parties will want the other to reduce its price. This will result in lower prices for the consumer and increased sales for both parties. In this case a vertical restraint, possibly in the form of a maximum resale price, imposed by the producer on the retailer has a positive effect.

138. While vertical restraints can be used to reduce economic inefficiencies, they can also have anti-competitive effects. Vertical restraints can reduce inter-brand competition and intra-brand competition. Inter-brand competition deals with competition involving products of different brands, while intra-brand competition involves competition among firms selling products of the same brand.

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[23] Externalities are costs or benefits that are not captured by the firms creating them.

[24] This contrasts with agency arrangement whereby the agent does not share in the profit earned from the operation. He is paid either a commission or a fixed salary.

[25] Here rent refers to the difference between the gains earned as a result of being associated with the franchised chain and the returns he could earn from engaging in his next best alternative.

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Vertical relations within the gasoline industry

139. The local gasoline industry comprises one refinery, nine marketing companies, haulage contractors and over 250 retailers. In terms of vertical integration, a few participants operate at more than one level of the supply chain. These levels are refinery, importation, wholesaling, transportation and retailing.[26] Currently at least 4 marketing companies (Shell, National, Petcom and Unipet) operate as both wholesaler and retailer; three wholesalers (Shell, Esso and Texaco) operate also as importers; and only one wholesaler (Shell) operates as importer and retailer. The local refinery, Petrojam, and one of the marketing companies, Petcom, are wholly owned subsidiaries of Petroleum Corporation of Jamaica. Petcom also operates at the retail level of the market. This means that the Petroleum Corporation of Jamaica is a totally integrated company: there is common ownership at the importation, refinery, transportation, wholesale and retail levels of the supply of automotive fuels.

140. All other relationships within the industry are contractual and market exchange. The relationship between the refinery and the independent marketing companies is one of market exchange. The refinery advised that fuels are sold to all marketing companies, including Petcom, at the same price. The relationship between marketing companies and retailers not owned by them is contractual. In particular, the retailing level of the industry is based on franchising, whereby the retailers use the trade marks, logos, etc. of the marketing companies in return for fees. The marketing companies provide equipment, training, advertising and promotion. There is at least one retail outlet which has a non-franchise contractual arrangement with a marketing company. This retail outlet while it purchases its requirement of automotive fuel from the marketing company, it does not use the logo, trade mark, etc. of that or any other marketing company.

141. The level of investment in retail outlets provided by marketing companies and retailers varies across outlets. In some instances the marketing companies own the property, pumps, canopies and tanks. At some sites the property may be owned by the retailer with the marketing companies owning the tanks, pumps and canopies.

Retail outlets

Number of outlets

142. There are 278 branded gasoline retail outlets in Jamaica representing the nine marketing companies and accounting for the sale of approximately [✄] liters of motor fuels in 2003. This compares with sales of about [✄] liters in 2002. Changes in the number of outlets are set out in Table 11. In 2000 Shell, Esso, and Texaco collectively had 209 retail outlets. That number fell to 184 in 2004, representing a 12 per cent decrease. At the same time the number of outlets affiliated with the other marketing companies has increased. In particular, the number of outlets under the brands of Petcom, Epping and National collectively increased by over 42 per cent.

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[26] In Section 3, refinery and importation are treated as one level for the purposes of identifying competitive constraints. Transportation was not identified in the supply chain as a distinct process.

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Table 11
Number of branded retail outlets for the period 2000 – June 2004.

Marketing Companies	*2000*	*2001*	*2002*	*2003*	*June 2004*
Texaco	81	81	80	77	77
Shell	61	60	59	56	56
Esso	67	65	60	56	51
Petcom	21	25	29	30	30
Total (National)	15	16	18	19	21
Epping	13	13	15	18	19
Cooloasis	NI	NI	NI	NI	13
Unipet	9	9	10	9	9
Jampet	NI	NI	NI	NI	2
TOTAL	**> 267**	**> 269**	**> 271**	**> 265**	**278**

143. These 278 branded retail outlets fall into two main categories. The first category comprises outlets which are owned by the marketing companies which supply those outlets. This category can be further divided into:

- franchised outlets operated under a franchise arrangement by independent dealers; and
- directly managed/agency outlets operated by an employee of the marketing company which owns the outlet or by a self-employed agent receiving a commission.

144. The second category comprises outlets not owned by marketing companies. This group of outlets can be further divided into:

- outlets that are owned and operated by dealers who have entered into a franchise arrangement with a marketing company;
- outlets that are leased to and are operated directly by marketing companies; and
- outlets that are leased to marketing companies and operated by independent dealers under a franchise arrangement with the lessee marketing company.

145. The retail outlets in Jamaica are distributed as follows:

- Refinery-owned and operated – 1, (0.4%)
- Refinery-owned, dealer-operated – 2, (0.7%)
- Wholesaler-owned and operated – 21, (7.6%)
- Wholesaler-owned, dealer operated – 95, (34.2%)
- Independently owned – 114, (41%)
- Unclassified – 43, (15.5%)

Agreements between marketing companies and retailers

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146. The contractual arrangements which govern the relationship between the marketing companies and retailers fall into three main categories. These arrangements are underpinned by the ownership of the property on which the gasoline retail outlet is erected; and as such are classified generally as company operated, lessee dealers and open dealers. Company operated outlets are generally owned and operated directly by the marketing company, through commission agents or managers.[27] Lessee operated outlets are owned by the marketing company, who leases them to independent businesspersons to operate, under the brand of the marketing company. Open dealers own and operate their own retail outlets, and contract with a marketing company. The duration of an open dealer contract can be up to 8 years. Both lessee dealer outlets and open dealer outlets are operated under franchise arrangements.

147. Some of the conditions of the different retailing agreements relate to the following:

Post termination non-compete—This clause is found in the [✂]. It stipulates that during and for a period of one year after termination of the Agreement, the [✂] may not, without [✂] written consent purchase, possess, open, establish, operate or perform business in any [✂] within [✂] miles of [✂], unless it is exclusively supplied by [✂].

No competition—[✂] agreement requires that dealers do not engage directly in any business venture that is in competition with the venture which is the subject of the agreement.

Minimum sales—Dealers are required to attain the greatest volume of turnover for the business, consistent with good service to the public and to achieve the minimum monthly fuel and lubricant sales.

Exclusive dealing—All retail agreements require that dealers sell only the products of the relevant marketing company at the retail outlet which is the subject of the agreement.

Retail price—The contracts of at least two marketing companies stipulate that dealers should undertake to use their best endeavor to ensure that their products are competitively priced in relation to other products of similar quality and specification.

Features of retail outlets

148. Retail outlets differ in a number of dimensions. These include opening hours, size, layout, location, convenience stores, number and quality of pumps, service offerings and credit facilities. While some outlets open on a 24-hour basis every day, some open between the hours of 6 am and 9 pm and may or may not open on Sundays and on public holidays. All outlets have a convenience store which carries a variety of products – both petroleum and non-petroleum.

149. The number of pumps is generally positively related to the size and layout of the outlet. In terms of the quality of pumps, the Bureau of Standards which has responsibility for the administration of the Weights and Measures Act carries out periodic checks of pumps to ensure that they are properly calibrated. Pumps which have been passed by the Bureau

[27] There are cases where the marketers do not own the outlets they operate.

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are marked accordingly and can be identified by a yellow sticker marked ‘Passed’.[28] Pumps are checked on a six-monthly basis.

150. All pumps are capable of displaying the price per liter of gasoline, the quantity purchased and to an extent the total dollar value of the gasoline purchased. For some pumps the window which displays the dollar value of purchase can accommodate only five digits. This means that for purchases of gasoline valuing one thousand dollars ($1,000.00) or more the pump will start over after reaching an amount of $999.99. Some of these limiting pumps however stop at values below $999.99, thereby requiring the attendants and motorists to calculate the total purchases in instances in which the value of the gasoline bought is more than that which can be accommodated on the pumps.[29]

Gasoline pricing

151. Jamaica is a net importer of crude oil and petroleum products and therefore is totally dependent on imports for its petroleum need. Movements in the price of crude oil in the global market are reflected in the prices consumers pay for gasoline at the pumps. Given that Jamaica is a price taker, the price of crude oil is exogenous and as such outside the control of the players in the local industry. Retail prices of gasoline sold in Jamaica depend on the costs of crude oil, which can be extremely volatile; costs of production; storage costs; transportation costs; taxes; wholesale prices and demand conditions.[30]

Wholesale pricing

152. Wholesale prices are the prices at which marketing companies sell gasoline to retailers. All marketing companies purchase gasoline directly from Petrojam, which publishes the ex-refinery price of unleaded 87, unleaded 90 and diesel fuels each week. Shell, Esso and Texaco import a portion of the fuel they distribute.

153. Motor fuels purchased from Petrojam or imported by the three marketing companies are transported to retail outlets from either of two distribution points controlled by the refinery or from storage facilities owned by the importing marketing companies. The wholesale prices therefore reflect the ex-refinery prices or importation costs, local transportation costs, processing costs for differentiated gasoline, the wholesaler margin and other extraneous factors. Wholesale prices vary across marketing companies and are not published. Each marketing company sells only to its affiliated retail outlets and each retailer is obliged to purchase exclusively from its related marketing company; therefore even if one company is selling at a lower price than another the retailers of the higher priced company are prohibited from purchasing from the low priced company.

154. Each company enters into haulage contracts for the transportation of fuels from the refinery or storage facilities to its network of outlets.[31] Transportation costs vary between [✄] and [✄] per liter of gasoline; and are based on zoning, i.e. the rates charged by a contractor to distribute fuels to the various outlets within a particular area are identical.

[28] The results of the consumer survey revealed that whether a pump is passed or not influences consumers’ choice of retail outlets.
[29] The results of the consumer survey revealed that 52 per cent of the respondents generally spend over $1,000.00 each time they purchase gas.
[30] In a perfectly competitive market prices are determined solely by cost conditions.
[31] At least two marketing companies own tankers.

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The wholesale prices of each marketing company to its affiliate retailers within the same zone are not necessarily identical. Intra-brand wholesale prices differ based on the level of investment made by the marketing company in the particular retail outlet to which it is selling. The differences in wholesale prices may also be associated with the level of price support offered by the marketing company at the request of the retailer and the intensity of the competition within the general area.

Retail pricing

155. Retail prices are set by the marketing companies at the retail outlets which they operate. Most marketing companies indicated that they are not directly involved in the determination of retail prices at dealer operated outlets. In particular marketing companies indicated that dealers are generally free to set their own retail prices. One marketing company indicated that it suggests but does not dictate the retail prices while another indicated that its involvement depends on whether price support is given to a retailer.

156. The contract of one of the marketing companies which indicated that it has no involvement in the determination of retail prices seem to indicate otherwise. The contract states that "…The parties agree that [marketing company][32], subject to fully complying with all applicable laws related thereto, may advise as to pricing and other marketing strategies for Products based on price zone surveys and other tools conducted by [marketing company] from time to time."

157. Table 12 shows information on average retail prices relating to six of the nine brands.[33] The brands included are those which are represented by at least three retail sites in the urban regions of Kingston and St. Andrew. The survey covered 62 retail outlets and prices were collected on a weekly basis. The average prices were calculated separately for all three types of fuel – unleaded 87, unleaded 90 and diesel – for each of the six brands covered. As the data show, the average retail prices for unleaded 87 and 90 at the Esso branded outlets, were above the average prices related to the other five brands for the four-week period covered. The Petcom, Unipet and National brands all shared the spots for lowest average prices. Some of the sites included are company operated outlets. The average retail prices at these outlets were found to be, in most instances, marginally below the average prices at dealer operated outlets of the same brand. The average prices at company operated outlets were also found to be below average retail prices for unleaded 87 and 90 gasoline at dealer operated Esso and Texaco branded outlets.

[32] Identity of company withheld for reasons of confidentiality.
[33] The averages are calculated under the assumption that each retail outlet sold equal quantity.

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Table 12

Weekly average retail prices for automotive fuels for the month of July, 2004

July 3-4, 2004

Brand	*87*	*Brand*	*90*	*Brand*	*Diesel*
Esso	35.01	Esso	37.70	Texaco	30.07
Texaco	34.76	Texaco	37.31	Esso	30.02
Shell	33.73	Shell	36.73	Petcom	29.75
Petcom	33.37	NFL	36.03	Unipet	28.56
Unipet	33.27	Unipet	35.05	Shell	28.44
NFL	33.16	Petcom	34.84	NFL	27.97

July 10-11, 2004

Brand	*87*	*Brand*	*90*	*Brand*	*Diesel*
Esso	35.55	Esso	38.41	Esso	30.89
Texaco	35.18	Texaco	37.84	Texaco	30.82
Shell	34.34	Shell	37.33	Petcom	30.38
NFL	33.96	NFL	36.70	Unipet	29.42
Unipet	33.93	Unipet	35.72	Shell	29.29
Petcom	33.79	Petcom	35.27	NFL	29.09

July 17-18, 2004

Brand	*87*	*Brand*	*90*	*Brand*	*Diesel*
Esso	36.85	Esso	39.71	Esso	31.33
Texaco	36.26	Texaco	38.97	Texaco	31.26
Shell	35.54	Shell	38.57	Petcom	30.58
Petcom	35.23	NFL	37.99	Unipet	29.82
Unipet	35.14	Petcom	36.96	Shell	29.68
NFL	34.68	Unipet	36.92	NFL	29.32

July 24-25, 2004

Brand	*87*	*Brand*	*90*	*Brand*	*Diesel*
Esso	36.75	Esso	39.66	Texaco	31.60
Texaco	36.36	Texaco	38.98	Esso	31.38
Shell	35.82	Shell	38.76	Petcom	30.69
Petcom	35.23	NFL	37.99	Shell	30.08
Unipet	35.14	Petcom	37.11	NFL	29.97
NFL	35.03	Unipet	36.92	Unipet	29.91

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158. Table 13, which complements Table 12, shows the highest and lowest absolute prices of the three types of fuels in relation to the 62 retail outlets surveyed during the month of July. One particular Esso branded station accounted for the highest prices for unleaded 87 and unleaded 90 and shares the spot for highest diesel price with a Texaco station for the month of July. The differences in prices at the highest priced outlets, across the six brands, were found to be as much as $3.77 per liter; while the difference in prices between the highest and lowest prices were found to be as much as $6.36 per liter for 90-unleaded, $5.64 per liter for 87-unleaded and $4.84 per liter for diesel. The lowest price for unleaded 90 at a Texaco branded station was found to be higher than the highest priced gasoline of the same grade at Petcom and Unipet outlets.

159. Retail prices seem to be higher in instances in which the prices are not displayed on the display board than when they are displayed. In general there is a positive correlation between higher prices and non-display of prices. Of the 62 outlets surveyed over the one-month period 28 consistently failed to display their prices. Of the remaining 34 outlets, only 27 consistently displayed the prices of all three fuels.

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Table 13

Absolute highest and lowest retail automotive fuel prices (Jamaican dollars per liter)

July 3-4, 2004

		Esso	*Texaco*	*Shell*	*Petcom*	*NFL*	*Unipet*
Unleaded 87	Highest	37.89	36.79	34.68	34.71	34.57	34.40
	Lowest	32.54	33.29	32.54	32.46	32.25	32.46
Unleaded 90	Highest	39.70	38.99	37.96	36.30	37.97	36.26
	Lowest	34.29	36.49	35.65	33.98	34.64	33.91
Diesel	Highest	31.79	32.16	29.68	31.50	28.60	29.30
	Lowest	27.89	27.94	27.65	27.87	27.78	28.08

July10-11, 2004

		Esso	*Texaco*	*Shell*	*Petcom*	*NFL*	*Unipet*
Unleaded 87	Highest	38.30	36.79	35.33	35.37	34.60	35.20
	Lowest	33.49	33.91	33.14	32.94	33.28	33.06
Unleaded 90	Highest	40.60	38.99	38.61	36.95	37.89	37.06
	Lowest	35.39	36.99	36.33	34.24	35.99	34.51
Diesel	Highest	33.14	33.06	30.58	31.50	29.99	30.30
	Lowest	28.78	28.79	28.57	28.99	28.38	28.98

July 17-18, 2004

		Esso	*Texaco*	*Shell*	*Petcom*	*NFL*	*Unipet*
Unleaded 87	Highest	39.57	37.49	36.62	36.69	35.80	36.40
	Lowest	34.69	34.99	34.34	34.26	33.40	34.26
Unleaded 90	Highest	41.92	39.67	39.91	38.26	39.09	38.26
	Lowest	36.59	38.30	37.53	35.98	36.43	35.71
Diesel	Highest	33.49	33.46	30.86	31.50	30.39	30.70
	Lowest	29.19	29.10	28.97	29.17	28.65	29.38

July 24-25, 2004

		Esso	*Texaco*	*Shell*	*Petcom*	*NFL*	*Unipet*
Unleaded 87	Highest	39.57	38.45	36.75	36.69	35.80	36.40
	Lowest	34.69	35.11	34.34	34.26	34.05	34.26
Unleaded 90	Highest	41.92	39.67	39.91	38.26	39.09	38.26
	Lowest	36.59	38.39	37.53	36.43	36.43	35.71
Diesel	Highest	33.46	33.71	31.14	31.50	30.83	30.70
	Lowest	29.44	29.69	29.49	29.23	29.23	29.38

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Summary

160. This Section presented an overview of vertical relations and their effects on competition. In general vertical integration and vertical restraints can have both efficiency enhancing effects as well as anti-competitive effects. Vertical relations are more likely to have significant anti-competitive effects - foreclosure of markets or restriction of expansion - in situations in which the parties involved have significant market power.

161. The Section presented also an overview of the vertical relations in the local gasoline industry and some of the main features of gasoline retailing. In particular fewer than 10 per cent of the retail outlets are integrated and therefore operated by marketing companies. There are at least 114 retail outlets which are not owned by any of the marketing companies, thus the potential for switching between marketing companies is preserved. The average retail prices of fuels sold at company operated outlets were found to be below the average prices at dealer operated outlets. There are instances however in which the prices at dealer operated outlets were lower than those at company operated outlets.

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PART II: INVESTIGATION INTO ALLEGATIONS

5. Predatory pricing

162. One of the benefits of competition is the downward pressure it imposes on a firm's pricing strategy. In a competitive market a firm is constrained by its competitors from increasing its price above competitive levels. Competition therefore leads to relatively low prices. There is a view, however, that in some instances prices may be too low and as such can be detrimental to competition. This type of low pricing strategy is considered to be predatory pricing.

163. Predatory pricing, a subset of predatory behavior, is an exclusionary conduct. It is normally thought of as an action taken by a dominant firm against a competitor for the purpose of eliminating that competitor as a competitive constraint. It is a strategy whereby a dominant firm reduces its prices below cost when faced with competition from an existing competitor or potential competition from a firm wishing to enter the market, with the aim of driving the existing competitor out of the market or deterring entry of the potential entrant. An alternative view is that the predating firm prices its products below the average costs employed by its competitors. The competitors must then lower their prices below average cost, thereby losing money; and if they fail to cut prices, they will still lose money by virtue of having higher prices. In the end the competitors become non-viable and exit the market and the predatory firm then increases its prices above that which obtained before predation, having gotten rid of its competitors.

164. This alternative view of predatory pricing however seems to run contrary to rivalry among firms and the competitive process, as it seems to penalize the more effective firm for its superior efficiency which has allowed it to price its product at such low cost. Predatory pricing is therefore considered to be behavior calculated to eliminate from the market an equally or more efficient competitor, since by pricing below its own costs the alleged predator would also be pricing below the cost of its competitors. Below cost pricing raises anti-competitive concerns only in the event that a dominant firm prices below its own costs.

165. Distinguishing predatory pricing or "unfair competition" from legitimate vigorous competition is not simple. Low prices are normally seen as a benefit from, and the successful result of the process of competition. Since one of the main objectives of competition policy is to create conditions in which consumers benefit from effective competition, the distinction must be drawn between low prices that result from predatory pricing, and low prices that result from legitimate competitive behavior.

166. There are three key elements to predatory pricing:

    Intent—Predation does not happen 'by coincidence'. There must be an intention to predate. Intent however, is a subjective concept and difficult to determine. Sometimes intent is inferred if an incumbent reduces price upon entry of a new competitor, therefore forcing the new competitor to exit; and subsequently raises its price back to its original level. Such behaviour, however, may also obtain under competitive circumstances since new entry raises overall market output and forces the incumbent to

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decrease its price or else concede market share. Such a price reduction is often not predatory but is instead a natural response to the increased competition.

Feasibility—certain structural conditions of the market must exist for predation to be feasible. Specifically, successful predation requires that the alleged predator be dominant during the predation period. This is because the predator must expand output in order to depress the overall market price and put pressure on its competitors. To have a significant impact on the market, the predating firm would need a sufficiently high market share from the start. Otherwise the predating firm itself will not be able to survive through the predation period. Moreover, if market demand is price elastic[34], apart from the extra sales that the predator has to take over from its victims, it must also take on extra sales at a loss, to satisfy the new demand that is created at the lower price. This makes predatory pricing in fact more costly – at least in the short term – for the predator than for its victims. Accordingly, predatory pricing always comes under the category of abuse of dominance.

Furthermore, predation is about the predator deliberately incurring losses in the short run, with the intention of making supernormal profits in the long run. In the short run, it incurs losses in order to eliminate competitors or deter entry. In the long run, it will expect to recoup the losses by charging higher prices. Predation works only if the firm will be able to recoup its short run losses by charging higher prices in the future – which will be possible only if the competition which it faces in the future is not able to constrain its behaviour.

While *future* market power is distinct from *current* market power, a currently dominant firm can be expected to retain future dominance and to recoup losses following predatory action. In other words, the market structure is likely to be retained.

Execution—finally for predatory pricing to take place the alleged predator must implement a pricing strategy that is in some way below cost and which is consistent with the intention to predate.

Application of the FCA to predatory pricing

167. Sections 19-21 of the FCA prohibit the abuse of dominance, if such abuse has had, is having or is likely to have the effect of lessening competition substantially. Under Section 20(1), an enterprise would be considered to be abusing its dominant position if it impedes the maintenance or development of effective competition in a market. For the purposes of the Act an enterprise holds a dominant position in a market if by itself or together with an interconnected company, it occupies such a position of economic strength as will enable it to operate in the market *without effective constraints from its competitors or potential competitors.*

168. Section 20(1)(d) states that an enterprise abuses its dominant position if it "directly or indirectly imposes unfair purchase or selling prices or other uncompetitive practices". The Staff of the FTC interprets section 20(1)(d) to include below cost pricing or predatory pricing.

[34] Demand is said to be elastic if the proportional change in quantity demanded, as a result of the change in price, is greater than the proportional change in price. This means that a price change will cause an even greater change in quantity demanded.

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169. In accordance with Section 20(2)(a) an enterprise will not be treated as abusing a dominant position:

- if it can be shown that its behaviour was exclusively directed to improving the production or distribution of goods or to the promotion of technical or economic progress; and
- consumers are allowed a fair share of the resulting benefits.

170. In determining whether a conduct by a dominant firm has had, is having or is likely to have the effect of lessening competition substantially in a market the Commission considers whether the conduct is as a result of superior competitive performance.

171. Where the Commission finds that a dominant firm has engaged in below cost pricing and such pricing strategy has had, is having or is likely to have the effect of hindering or preventing competition in a market, the Commission in accordance with Section 21(1)(a) is authorized to "*direct the enterprise to take such actions as are necessary and reasonable to overcome the effects of the abuse in the market*."

Predatory pricing: investigation guidelines

172. Many competition authorities apply a two-step method in investigating predatory pricing.[35] The first step is to determine the feasibility of the market structure for predation. If the structural conditions are considered not to be feasible for successful predation, then the conclusion drawn is that any below cost pricing employed by a firm is unlikely to have a substantial adverse effect on the market; and thus the investigation is terminated.

173. If the structural conditions suggest that predation is feasible, then the second step is to carry out a price-cost comparison to determine if below cost pricing has been implemented in a manner that could be considered predatory. The second step also includes an analysis of the circumstances and context in which the below-cost pricing has taken place; the length of time of the low pricing strategy; and the likely economic benefits of the pricing strategy to the alleged predator.

Step 1: Analysis of market structure

174. As discussed above, a pre-condition for successful predation is a market structure in which the alleged predator has a sufficiently large market share and therefore may be dominant. The first step in the investigation is therefore, to determine if the alleged predator is dominant in the *relevant* market. The following must be considered in such a determination:-

Market shares—a market share of 50 per cent is generally used as a guideline threshold for dominance. The Staff of the FTC in its investigations under Sections 19-21 of the FCA however does not rule out dominance in cases in which the largest firm has a market share of less than 50 per cent.

Barriers to entry—the ability of a firm to dominate a market is constrained to the extent that new entrants may easily enter the market. Where barriers to entry are low, any

[35] For example, the United Kingdom and Canada.

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action by the firm to increase prices and therefore profits, would attract new entrants, who would put competitive pressure on the allegedly dominant firm, forcing it to reduce prices again. In this case, the firm cannot be considered to be dominant. If, however, barriers to entry are high, entry will be unlikely even if the market is highly profitable. In this case, the firm will more likely be able to sustain high prices and profitability and may therefore be considered dominant.

Existing competitors—the reaction of existing competitors can constrain the behaviour of a large firm. If existing competitors can respond quickly, substantially and inexpensively to the actions of a large firm, then that firm is unlikely to be considered dominant. The market shares of existing competitors vis-à-vis that of the alleged dominant firm are therefore considered.

Obligatory trading partner—the extent to which a firm depends on another firm for the supply of goods is also used in the evaluation of dominance. Where customers are totally dependent on a particular supplier then that supplier may be considered dominant.

175. A market may therefore be feasible for predation if the alleged predator has a market share of approximately 50 per cent; there are high entry barriers; existing competitors are ineffective; and other firms are totally dependent on the alleged predator..

Step 2: Analysis of prices and costs

176. If a firm is found to be dominant, the next step is to assess the price-cost relationship so as to ascertain if a pricing strategy which is consistent with predation has taken or is taking place. A determination must therefore be made whether prices are unreasonably low. This assessment is done by comparing the alleged predator's costs with its prices. The following guidelines are used in the determination of unreasonably low prices:

- Price below average variable costs — predation can be assumed.
- Price between average total costs and average variable costs ("grey zone") — evidence on such pricing may indicate predation.
- Price above average total cost — no evidence of predation.

177. The duration and extent of the below-cost pricing must also be taken into account. Specifically, below-cost pricing must be in effect for 'long enough' so as to be sufficient to inflict material harm upon competitors, otherwise it cannot be considered predatory. What is considered to be 'long enough' a time period differs from market to market. Similarly, below cost pricing on only a small fraction of a product line is unlikely to drive competitors out of a competitively meaningful market consisting of an entire product line of multiple products. Such 'limited' action, therefore, would not constitute predation.

Analysis of alleged predatory pricing in the gasoline industry

178. This section analyses whether predatory pricing is taking place in the gasoline industry using the principles outlined above. The first step is to assess dominance at the various levels within the industry. This involves the evaluation of the market shares of each participant in the relevant market; entry barriers and existing competitors; and the nature of the relationships within the industry at the importation/refinery, wholesale and retail

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levels. If dominance is found at any of these levels of the market then a pricing assessment is carried out to determine whether or not a pricing strategy of below cost has been employed.

Assessment of dominance at the refinery/importation level

179. From Section 3, it was determined that the relevant product is automotive fuel (unleaded 90, unleaded 87 and diesel fuel); and that the four companies involved in its supply at the refinery/importation level of the industry are Petrojam (local refinery), Shell, Esso and Texaco. Table 14 sets out the respective market shares of these four companies for the years 2002 and 2003.

180. The total supply (importation and production) of automotive fuel for the years 2002 and 2003 amounted to [✂] and [✂] barrels respectively, with Petrojam accounting for the largest market share in both years. It controlled about [✂] per cent of supplies in 2002 and [✂] per cent in 2003. Shell, Esso and Texaco collectively accounted for only [✂] per cent of total supplies in 2003. That amount represents approximately [✂] per cent of total sales to their respective networks of retail outlets.

Table 14
Relative contribution of supply of automotive fuel for the years 2002 and 2003

		Petrojam	*Esso*	*Shell*	*Texaco*	*Total quantity*
Quantity (barrels)	*2002*	{ Information deleted. See note on cover page. }				
	2003					
Market share	*2002*					
	2003					

181. The height of entry barriers at this level of the market is directly related to the ability of companies to import and store fuels.[36] All importation of automotive fuel attracts duties. Fuel imported from countries within the region (Caricom) attracts duties of 10 per cent while imports from countries outside the region attract duty of 15 per cent. In 2003 total imports amounted to [✂] barrels, with Shell, Esso and Texaco accounting for [✂] per cent.

182. Currently Shell, Esso and Texaco collectively have storage capacity of over [✂] barrels and they imported approximately [✂] barrels of automotive fuels in 2003. That amount is approximately [✂] times their storage capacity. While these companies have individual storage facilities, they also have a shared facility under a joint venture arrangement. No other marketing company owns or has access to storage facilities. The three marketing companies therefore, through their abilities to import a substantial amount of their requirements have exposed Petrojam to competition from overseas. In effect their importation capabilities have lowered entry barriers.

[36] An entrant could also enter the market by setting up a refinery. This is however a long-term project and would therefore not have an immediate impact on a firm's conduct.

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183. Petrojam sells automotive fuel to a number of companies including the nine marketing companies. In 2003, [✂] per cent of its supplies was to the nine marketing companies, with Shell, Esso and Texaco accounting for [✂] per cent and the other six marketing companies accounting for [✂] per cent. These six companies (CoolOasis, Jampet, Epping, Total, Petcom and Unipet) are totally dependent on Petrojam for their requirement of fuels, as the other three marketing companies distribute primarily through their own networks of retail outlets and to a few industrial customers. Shell, Esso and Texaco do not sell to these companies.

184. At this level of the market, Petrojam has a commanding market share of over 50 per cent and six of the nine marketing companies are totally dependent on it for their supplies. Shell, Esso and Texaco, Petrojam's largest customers, import a substantial amount of their fuel requirement. Petrojam therefore competes directly with other refineries and as such its behaviour is constrained, i.e. it cannot act independently of its competitors or potential competitors. It can therefore be concluded that Petrojam is not dominant.

Assessment of dominance at the wholesale level

185. Petrojam distributes the relevant product, automotive fuel, to the nine marketing companies which in turn wholesale to retailers. The nine companies therefore operate at the wholesale level of the market and the total amount of fuel supplied by them in 2003 was [✂] barrels. Their respective market shares are represented in Table 15.

Table 15
Relative market share of the Marketing Companies (2003)

Shell	*Esso*	*Texaco*	*Petcom*	*Total*	*Epping*	*Jampet*	*CoolOasis*	*Unipet*
{ Information deleted. See note on cover page. }								

186. From the table no company has a market share of over 50 per cent. Shell has the highest market share of [✂] per cent in 2003 up from [✂] per cent in 2002. Its closest rivals are Esso with [✂] per cent and Texaco with [✂] per cent.

187. All marketing companies distribute their supply of automotive fuel through their respective networks of retail outlets under supply contracts and franchise arrangements. Esso, Texaco and Epping also distribute to sources other than their affiliated retail outlets. These wholesalers compete at this level of the market for supply contracts. Fuel supplied under these contracts may be done through retail outlets or directly to the relevant customers. Marketing companies also compete for contracts to supply retail outlets which are not owned by them.

188. Entry barriers at this level of the market are fairly low. There is no need for marketing companies to own storage facilities. Fuels are distributed directly from the refinery's distribution racks to retail outlets. An entrant to this level of the market need only establish a network of retail outlets and gain access to transportation. Tankers are not generally owned by marketing companies. Marketing companies contract with tanker owners for the transportation of fuel to the relevant destinations. There are over 100 retail outlets which are not owned by any of the nine marketing companies and there are a

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few which are owned by marketing companies, that are up for sale. Unipet has the least number of affiliated retail outlets - 9. In 1980 there were only three marketing companies (Esso, Shell and Texaco) compared to nine today. Table 16 sets out the ownership structure of retail outlets.

Table 16
Ownership structure of branded retail outlets

Marketing Companies	*Number of outlets owned by affiliated marketing company*	*Number of outlets not owned by affiliated company*
Texaco	51	26
Shell	NI	NI
Esso	38	13
Petcom	3	27
Total (National)	10	11
Epping	2	17
CoolOasis	0	13
Unipet	2	7
Jampet	NI	NI
TOTAL	**106**	**114**

Note: Fifty-eight (58) of the outlets are not classified, due to insufficient information.

189. Given that no firm has a market share of over 50 per cent, entry barriers are relatively low and from the relative positions of the top four firms it can be concluded that no firm is dominant at this level of the market. Each company competes with the other primarily at the retail level through its respective affiliated retail outlets.

Assessment of dominance at the retail level

190. The retail level of the market for automotive fuel comprises over 250 retailers representing the nine marketing companies. Given that companies compete with each other through these retailers, Table 17 sets out the market shares of each of the nine marketing companies on the assumption of equal sales across retail outlets within each network. The data presented is based also on the assumption that the geographic extent of the market is individual parishes.

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Table 17

Relative market shares (%) of the Marketing Companies at the retail level with respect to their affiliated retail outlets (2003)

		Esso	*Shell*	*Texaco*	*NFL*	*Petcom*	*Unipet*	*Cool*	*Epping*	*Jampet*
PARISHES	Kingston and St. Andrew									
	St. Catherine									
	St.Thomas									
	Portland									
	St. Mary	Information deleted. See note on cover page.								
	S. Ann									
	Trelawny									
	St. James									
	Hanover									
	Westmoreland									
	St. Elizabeth									
	Manchester									
	Clarendon									

191. On the assumption that each parish is a relevant geographic market, there is one instance in which a company has a market share of over 50 per cent. The market share for Shell was found to be [✂] per cent in the parish of Hanover. Based on the assumption of equal sales across retail outlets within the Shell network it would appear that Shell may be dominant in the gasoline retail market in the parish of Hanover.

192. In that parish there are 3 Shell, 2 Petcom, 2 Texaco and 1 Esso branded retail outlets. The presence of these other companies should be able to constrain Shell's behaviour given that it controls only 37.5 per cent of the outlets. The fact that 67.5 per cent of the retail outlets are controlled by competitors suggests that the other companies do have the capacity to constrain Shell's behaviour. In other words, it is unlikely that Shell can act independently of its competitors. Also, given the general pattern of market shares across the island and the distribution of outlets, it appears that Shell is more effective than some of its competitors.

193. In terms of individual retailers, there are at least 9 retailers that operate two or more retail outlets across the island. Of the marketing companies involved directly in retailing, Shell operates 13 out of the 56 Shell branded retail outlets; National operates 8 out of the 21 Total (National) branded outlets; and Unipet operates 4 out of the 9 branded retail outlets. Petcom operates only one retail outlet. Tables 18 – 20 present a breakdown of the outlets operated directly by Shell, Total (National) and Unipet in terms of location. While these three marketing companies directly control a large proportion of their respective branded outlets, the proportion of direct-operated outlets to the total number of outlets within each of the parishes in which they operate is miniscule. For example, in Kingston and St. Andrew Shell directly operates 43 per cent of the Shell branded outlets; this however represents only 9 per cent of the total number of outlets in Kingston and St. Andrew. The situation for Total (National) is similar. While it operates directly 85 per cent of its

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branded outlets, it controls only a mere 7.9 per cent of the number of outlets in Kingston and St. Andrew.

Table 18
Proportion of retail outlets operated directly by Shell

	Kingston and St. Andrew	*St. Catherine*	*St. James*	*St. Ann*	*Total*
Number of outlets operated directly by Shell	7	3	2	1	13
Number of outlets under the Shell brand	16	7	4	4	56
% of Shell branded outlets operated directly by Shell	**(43.8%)**	**(42.8%)**	**(50%)**	**(25%)**	**(23.2%)**
Total number of outlets	76	28	18	24	278
% operated directly by Shell	**(9.2%)**	**(10.7%)**	**(11.1%)**	**(4.2%)**	**(4.7%)**

Table 19
Proportion of retail outlets operated directly by Total (TJL)

	Kingston and St. Andrew	*St. Catherine*	*Clarendon*	*Total*
Number of outlets operated directly by TJL	6	1	1	8
Number of outlets under the TJL brand	7	2	3	21
% of TJL branded outlets operated directly by TJL	**(85.7%)**	**(50%)**	**(33.3%)**	**(38.1%)**
Total number of outlets	76	28	18	278
% operated directly by TJL	**(7.9%)**	**(3.6%)**	**(5.5%)**	**(2.9%)**

Table 20
Proportion of retail outlets operated directly by Unipet

	Kingston and St. Andrew	*St. Catherine*	*St. Elizabeth*	*Total*
Number of outlets operated directly by Unipet	2	1	1	4
Number of outlets under the Unipet brand	3	1	1	9
% of Unipet branded outlets operated directly by Unipet	**(66.7%)**	**(100%)**	**(100%)**	**(44.4%)**
Total number of outlets	76	28	19	278
% operated directly by Unipet	**(2.6%)**	**(3.6%)**	**(5.3%)**	**(1.4%)**

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194. Given that these companies have large market shares in relation to their branded outlets, the question to be answered is: are these companies practising below cost pricing? In other words, are these companies retailing automotive fuel at prices below cost and therefore pricing their own affiliated retailers out of the market?

195. Below is an examination of the pricing behaviour of these three companies at the retail level.

Cost-price analysis at the retail level of the market

196. The three companies purchase automotive fuel from Petrojam at the same prices, irrespective of volume purchased; and these prices are published every week in the Thursday edition of the Daily Gleaner. Shell imports a portion of the fuel which it sells. As indicated above a company's pricing practices come up for scrutiny for possible predatory pricing if prices are set below average variable cost or between average variable cost and average total cost. At the retailing level of the market, pricing practices could amount to predatory pricing if retailers sell gasoline at prices below their costs, which include the prices at which Petrojam sells and transportation cost (average variable cost). Retail prices set below the total costs of fuel, transportation and operation may also be considered predatory when practised by a dominant retailer.

197. Table 21 reports the profit margins of nine retail outlets. The first three retail outlets are company operated outlets, while the other six are dealer operated outlets. The outlets which are included are those with the lowest retail prices. The profit margins are calculated by taking the difference between retail prices of fuels and the refinery prices. Included also is transportation cost, which is estimated at $0.50 per liter. The retail prices used are those which obtain on the weekend following the publication of Petrojam prices. From the table it is evident that no company-operated outlets recorded a loss per liter of fuel, suggesting that these companies are not pricing below product costs and transportation cost, i.e. they are not pricing below average variable costs.

198. Whether these outlets are retailing below their operational costs is inferred from the profit margins at the dealer operated outlets. The margins at an Esso and a Petcom dealer operated outlet are consistently below those at some Shell company operated outlets. The margins at these dealer operated outlets are presumably shared between the respective marketing companies and the dealers, which means that the two outlets operated under the Esso and Petcom brands are operating on lower margins than those Shell outlets are. This means that if Shell is selling below operational cost at these outlets, then the particular Esso and Petcom branded outlets are also selling below cost.

199. Further, the profit margins (difference between retail price and wholesale price) at dealer operated outlets were found to be below those at the company operated outlets, suggesting that company operated outlets are not operating below their cost. A comparison between the retail prices at the six Shell operated outlets in Kingston and St. Andrew and the wholesale price at one Shell dealer operated outlet revealed that the wholesale prices charged are below those retail prices. Further the profit margin of this particular dealer operated outlet is comparable with that of other retailers, suggesting that it is not operating below cost.

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200. An examination of retail prices at the Shell branded outlets revealed that the prices at dealer operated outlets are comparable with those at company operated outlets; and that prices at company operated outlets are on average lower ($0.25 per liter) than those at the dealer operated outlets. The same trend was discovered for Unipet and National branded outlets.

201. The retail prices at some of the outlets operated by Unipet, National and Shell were found to be below the wholesale prices charged by Esso and Texaco at some of their respective affiliated outlets. This however is not considered predatory pricing. As indicated above predatory pricing relates to a company selling below its own costs.

Table21

Percentage margin of lowest retail price outlets over Petrojam prices

	Observation 1			**Observation 2**			**Observation 3**		
	Unleaded 87	***Unleaded 90***	***Diesel***	***Unleaded 87***	***Unleaded 90***	***Diesel***	***Unleaded 87***	***Unleaded 90***	***Diesel***
National*	6.6%	9.2%	7.1%	6.2%	8.8%	6.4%	8.7%	6.4%	5%
Unipet*	7.3%	7%	8.3%	6.9%	6.6%	7.9%	7%	5%	7%
Shell*	10.7%	15.4%	7.8%	10.1%	14.6%	7.4%	11.9%	13.6%	7.9%
National	12.4%	14.4%	10.3%	11.7%	13.6%	9.4%	14.5%	13.6%	9.2%
Unipet	8.9%	10.4%	9.1%	8.4%	9.8%	7.9%	8.6%	7.4%	7.8%
Shell	7.5%	12.5%	8.5%	7.1%	12%	7.4%	7.3%	9.6%	7.2%
Petcom	7.3%	7.2%	7.5%	6.9%	7.4%	7.1%	7%	5%	7%
Esso	7%	8.2%	7.6%	8.2%	9.2%	7.2%	8.4%	6.8%	7%
Texaco	10%	15%	7.8%	9.1%	14.3%	6.9%	11.9%	14.6%	7.9%

Note: * Company operated retail outlets

202. Given the preceding analysis on predatory pricing the following may be concluded:

- Predatory pricing at the refinery/importation level is not feasible since Petrojam, while having a large market share, is not considered dominant. The fact that Shell, Esso and Texaco are its largest customers and these companies are capable of importing a significant proportion of their fuel requirements means that Petrojam is exposed to competition from refineries overseas. Petrojam therefore operates in the global market.
- Petrojam sells to all marketing companies at the same price, i.e. it does not discriminate between marketing companies. If it should set prices below its cost then consumers would benefit while at the same time no company would be negatively affected.
- At the wholesale level of the market, Shell had the largest market shares in 2002 and 2003. The market shares however are too low for Shell to be considered dominant. A predatory pricing strategy would therefore not be feasible. Any attempt at predation would be too costly.

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- Shell, Unipet and National are the only marketing companies that operate as retailers. While the proportion of outlets operated by these companies is large in relation to their respective affiliated branded outlets, it is insignificant in relation to the total number of retail outlets.
- The pricing practices at company operated outlets are not consistent with below cost pricing. The retail prices at some of these outlets were found to be below the wholesale prices charged by other marketing companies, but this is not considered predatory.

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6. Discriminatory pricing

203. Price discrimination can be defined as the sale of different units of a good or service at price differentials which do not directly correspond to differences in supply cost. This definition includes the sale of identical products to different consumers at varying prices; the sale of the same product at different prices to the same consumer; and the charging of the same price for transactions entailing different costs. Price discrimination therefore entails a firm obtaining different rates of return on different sales of identical transactions or a firm obtaining the same rate of return on the sale of identical products, which reflects different transaction costs. For a firm to practice price discrimination profitably three conditions must be satisfied. Firstly, the firm must have significant control over price. Secondly, the firm must be able to divide its customers into groups with different price elasticities of demand.[37] Thirdly, opportunities for arbitrage – the resale of goods by low-price customers to high-price customers – must be restricted.

204. There are three main classes of price discrimination: perfect or first-degree, second degree and third degree price discrimination. With first degree price discrimination a firm sets a different price for every customer based on each customer's willingness to pay. In other words each customer is charged his reservation price and the supplier appropriates the entire consumer surplus in the form of revenue. In order for a supplier to practice first degree price discrimination it must acquire extensive information about each customer. In other words, it must know the maximum price the buyer is willing to pay for its products. Second-degree price discrimination or non-linear pricing occurs when prices differ depending on the number of units of the product bought. An example is the supply of electricity where different rates are charge for different blocks of kilowatt hours used. Third-degree price discrimination occurs when a firm does not have sufficient information to practice first degree price discrimination but it can segment its market and price each segment differently, for example when adults are charged a different fare from children are.

205. There are numerous examples in which the same good is sold at different prices to different consumers, in the absence of any significant cost differential. Price discrimination, a very common practice, can be both beneficial and detrimental. It can be used to enhance efficiency and therefore increase consumer welfare as well as it can be used solely as a means to exclude a firm from a market.

206. There are five key elements of the offence of discriminatory pricing:

- The goods sold must be of like or similar quality and quantity, i.e. sales of goods to two or more buyers must be comparable.
- The sale must be made within the same time period.
- There must be pricing strategy where discounts, price concessions or other advantages are granted to one buyer but are not being made available to another.

[37] Price-elasticity of demand is a measure of the degree of responsiveness of demand to a given change in price. If a change in price results in a more than proportionate change in quantity demanded, then demand is price-elastic, i.e. the buyer is very price sensitive. If a change in price produces a less than proportionate change in the quantity demanded, then demand is price inelastic, i.e. buyers are not very price sensitive.

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- The discrimination must be between buyers who are in competition with one another.

Application of the FCA to discriminatory pricing

207. Discriminatory pricing is addressed under Section 17 of the FCA. This Section applies to agreements which have as their purpose or effect the substantial lessening of competition in a market. In particular, Subsection 17(2) (e) states that the Section applies to provisions which "apply dissimilar conditions to equivalent transactions with other trading parties thereby placing them at a competitive disadvantage". Accordingly, it may be an offence for a supplier to discriminate, directly or directly, between buyers who are in competition with one another and who purchase like quantities of the same products.

208. In other words, it may be an offence if a firm charges different prices to different customers, or categories of customers, for the same product where the differences in prices do not reflect any differences in relative cost, quantity, quality or any other characteristics of the products supplied. Although recognized as price discrimination, it is not an offence under the FCA for a firm to charge different customers, or categories of customers, the same price for a product even though the costs of supplying the product are in fact different. A policy of uniform delivered prices throughout the island, for example, is not considered discriminatory under the FCA.

209. Under Section 17(4) even if a provision has as its purpose the substantial lessening of competition or has or is likely to have the effect of substantially lessening competition an offence may not be established if the Commission is satisfied that the agreement –

   - contributes to improving the production or distribution of goods or to promoting technical or economic progress and consumers are allowed a fair share of the resulting benefit;
   - is not more restrictive than it needs to be for the attainment of those benefits; or
   - does not have the potential to eliminate competition in respect of a substantial part of the products concerned.

210. Any provision which has as its purpose of effect the substantial lessening of competition and which does not satisfied any of the above conditions is void pursuant to Section 17(3). Price discrimination raises competition concerns since it can be used to exclude competitors from a market or to reduce the degree of competition between competitors.

Discriminatory pricing: investigation guidelines

211. As in the case of investigations relating to predatory pricing, investigations into allegations of discriminatory pricing involve a two-step approach. The first step is to assess the feasibility of the market conditions for discriminatory pricing. If the conditions are considered not to be feasible for a firm to successfully price discriminate, then the conclusion drawn is that price discrimination is unlikely and thus the investigation terminates.

212. If it is determined that the market conditions are feasible for discrimination, then the second step is to carry out an analysis to determine whether differential pricing is being

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practised; and if it is, whether the pricing strategy is discriminatory.[38] The second step also includes an analysis of the circumstances and the context in which discriminatory pricing is practiced and the likely economic benefits of such a pricing strategy. The main justification for selling identical products to different customers at different prices involves the strategy of meeting-the-competition. In other words it may be permissible for a supplier to sell to competing firms at discriminatory prices in an effort to meet the low prices of another supplier. Price discrimination is generally allowed if there is no injury to competition and if it is practised in order to meet a low price set by a competitor.

Step 1: Analysis of market condition

213. A pre-condition for successful price discrimination, is a market structure in which the supplier has significant control over prices; is able to divide its buyers into different groups according to their abilities and willingness to pay; and has the power to prevent arbitrage. The first step in the investigation therefore is to determine if the alleged discriminating firm has sufficient market power in the *relevant* market to successfully practise price discrimination. The following must be considered in such a determination:-

Market share—an arrangement will generally have an appreciable effect on competition if the combined market share of the parties to the arrangement, e.g. supplier and retailer, is at least 25 per cent. Further an arrangement can substantially lessen competition among competitors at the same level of the market if those competitors collectively have a market share of at least 25 per cent. An agreement can also have an appreciable effect on a market even where the combined market share of the players falls below the 25 per cent threshold if it is one of a network of similar agreements.

Barriers to entry—the ability of a firm to exercise market power is constrained to the extent that new entrants may easily enter the market. Where barriers to entry are low, any action by the firm to price discriminate would attract new entrants who would attempt to sell to the buyers who are being discriminated against, thereby restraining the conduct of the would-be discriminating firm. In this case, the firm cannot be considered to have market power. If, however, barriers to entry are high due to, for example contractual relations, entry will be unlikely even if the market is highly profitable. In this case, the firm will be more likely to have market power and therefore may have the ability to practise price discrimination profitably.

Obligatory trading partner—the extent to which one firm depends on another firm for the supply of goods is also used in the evaluation of market power. Where customers are totally dependent on a particular supplier for the supply of goods then that supplier may be considered to have market power.

214. A firm may therefore be capable of practising price discrimination in such a way as to substantially lessen competition if the combined market share of that firm and the other

[38] Differential pricing refers to the situation in which prices vary between customers and/or between services provided to the same customers. There are two broad categories of differential pricing: one that has the purpose or object to negatively affect competition, and the other that is a normal outcome of markets and is due to market conditions such as cost factors.

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parties to an arrangement to practise discriminatory pricing is at least 25 per cent; or if the arrangement to discriminate is part a network of such arrangements; entry barriers are high; and other firms are totally dependent on it for their supplies.

Step 2: Analysis of prices and costs

215. If a firm is found to have market power and therefore the ability to successfully discriminate, then the next step is to assess its pricing practices to determine if it is engaging in discriminatory pricing. In particular its prices to various buyers, who are in competition which one another, are assessed to determine if these differentials are as a result of significant differences in costs; or if the differentials are as a result of discounts; and whether those discounts are available to all buyers. The following guidelines are used in the determination of discriminatory pricing:

- Different prices are charged to two buyers who purchase similar quantities of the same product and there are no significant differences in the cost of supplying them - *price discrimination can be assumed*.
- Different prices are charged to two buyers who purchase similar quantities of the same product and the price differences are commensurate with the differences in the cost of supplying them – *no evidence of price discrimination*.

Analysis of alleged discriminatory pricing in gasoline industry

216. This section analyses whether discriminatory pricing is taking place in the gasoline industry, using the principles outlined above. The first step is to assess market power at the various levels within the industry. This involves an evaluation of the market share of each participant, entry barriers and the nature of the relationships within the industry at the importation/refinery, wholesale and retail levels of the industry. If market power is found at any of these levels of the market then a pricing assessment is carried out to determine whether or not the relevant firm is practising price discrimination. For a supplier to successfully price discriminate it must have a certain level of control over its buyers and the structure of the market must be such that the buyers are unable to resell to each other. Whether price discrimination amounts to an offence will depend on whether it has the effect of eliminating competition.

Assessment of market power at the refinery/importation level

217. The four companies operating at this level of the market are Petrojam, Shell, Esso and Texaco. In 2003 Petrojam had a market share of [✄] per cent while Shell, Esso and Texaco collectively accounted for [✄] per cent of total supplies (production plus importation). These three companies while importing a significant proportion of their fuel requirements also source some of their supplies from Petrojam. There are however no exclusive supply arrangements between Petrojam and these companies; they can therefore choose their suppliers.

218. In addition to supplying Shell, Esso and Texaco, Petrojam also supplies Petcom its affiliate and the other five marketing companies. These five independent marketing companies, which account for [✄] per cent of Petrojam's total supply, rely solely on Petrojam for their entire fuel requirement. Currently these marketing companies do not have the capability to import and as such have only one source of supply.

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219. Petrojam therefore has market power at this level of the market; and therefore has the potential to segment its customers according to their elasticities of demand. Essentially, it can divide its customers into two groups: the first comprising companies with multiple supply sources (including Petcom) and the other comprising companies with only one source. In other words, it has the potential to sell to Shell, Esso, Texaco and Petcom at a lower price than it sells to the other five marketing companies.

220. Given that Shell, Esso, Texaco and Petcom collectively have a market share of [✂] per cent and control approximately 77 per cent of retail outlets, then discrimination by Petrojam in this way is highly likely to eliminate the other five marketing companies from the market.

221. Being a part of a vertically integrated firm Petrojam can also sell to Petcom at lower prices than it sells to the other marketing companies even though those prices are not reflective of differences in cost. The extent to which Petrojam can carry out this practice however is constrained by the ability of Shell, Esso and Texaco to import at lower prices than those charged by Petrojam.

222. Whether price discrimination by Petrojam is permissible in favour of Shell, Esso, Texaco and Petcom depends on the extent to which competition is likely to be affected. Shell, Esso and Texaco collectively account for [✂] per cent of Petrojam's supplies to marking companies and control over [✂] per cent of retail outlets. Petcom along with the other five marketing companies account for only [✂] per cent of Petrojam's sales. If Petrojam does not try to meet the competition from foreign suppliers it could lose its three largest customers; and if it discriminates against the marketing companies for which it is the only source of supply it could eliminate these companies from the market. The competitive effect of Petrojam's losing the business of its largest customers would need to be balanced against its retaining the business of the five smaller customers.

Assessment of differential pricing

223. Petrojam sells to all marketing companies, including Petcom, at the same price, i.e. it does not engage in discriminatory pricing. The ex-refinery prices of unleaded 87, unleaded 90 and diesel fuels are published each week in the Daily Gleaner.

Assessment of market power at the wholesale level

224. There are nine marketing companies operating at the wholesale level of the market. Each has entered into exclusive dealing arrangements with retailers to supply particular retail outlets. This means that once an arrangement has been entered into between a marketing company and a retailer, then that retailer cannot purchase its requirement of fuel from any supplier other than that marketing company.

225. There are two dimensions of competition at this level of the market. There is competition *for* the market and competition *in* the market. Competition *for* the market occurs when marketing companies compete for supply contracts to supply retail outlets not owned by them. Competition in the market occurs when marketing companies, through their affiliated retailers, compete to sell fuels to end users and consumers. All marketing companies indicated that it consider other marketing companies to be their competitors.

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226. The fact that a retailer is required to purchase its requirement of fuel from only one marketing company appears to give each company a degree of control over the wholesale prices it charges to each retailer within its respective network of retail outlets. This degree of control therefore means that companies are likely to have the potential to price discriminate among retail outlets.

Assessment of differential pricing

227. The wholesale prices at which the marketing companies distribute fuel to retailers are determined by Petrojam’s ex-refinery prices, import costs (in the case of Shell, Esso and Texaco) and transportation costs. Petrojam charges the same prices to all marketing companies. The transportation costs for delivering fuel from the Kingston or Montego Bay distribution racks to retail outlets vary across marketing companies. Each marketing company has its own defined geographic regions within which the transportation price to deliver fuel to each outlet is identical.

228. Table 21 reflects the wholesale prices charged by Texaco and Esso to a sample of four of their respective affiliated retail outlets. All outlets are located in the urban areas of Kingston and St. Andrew. From the information presented in the table it can be seen that Texaco practices uniform pricing in the sale of unleaded 90 and diesel fuel. Apparently, however, it charges discriminatory prices in the sale of unleaded 87 gasoline.

229. Esso charges different prices to each of the four retailers concerned in relation to all three types of fuel. In its submission to the FTC, it indicated that it has 29 different price zones and 9 different transportation costs. The maximum difference between transportation costs was reported to be [✂] per liter of fuel delivered. The differences between the wholesale prices charged to these four Esso retailers differ for all three fuels based on the nine observations recorded in Table 21. These price differentials suggest that the wholesale prices charged by Esso are discriminatory. Further a survey of retail outlets in Kingston and St. Andrew revealed that the retail prices of fuels at one Esso branded outlet were lower than the wholesale prices charged by Esso to other retailers. This suggests that either the low price outlet is selling below cost or that its wholesale prices are significantly lower than what is charged to other Esso retailers.

230. An examination of the wholesale prices charged by Shell to two of its retailers, which are located in Kingston, revealed that the prices may not be reflective of differences in the costs of supplying those two outlets. In particular, it was found that the differences in wholesale prices for unleaded 87 charged to those two outlets over a two-month period ranged between [✂] and [✂]. Over that period the lower prices were not consistently applied; between the two outlets there are instances in which one outlet gets the lower price and other instances in which that same outlet gets the higher price.

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Table 21

Wholesale price to individual retail outlets

	Type of gasoline								
Marketing company	***Unleaded 87***	***Unleaded 90***	***Diesel***	***Unleaded 87***	***Unleaded 90***	***Diesel***	***Unleaded 87***	***Unleaded 90***	***Diesel***
Texaco	{ Information deleted. See note on cover page. }								
Esso									

231. Based on the foregoing the status of the gasoline industry in relation to discriminatory pricing may be summarized as follows:-

- Petrojam has the ability to divide its customers according to the number of supply sources available to them. That is, it has the ability to sell to Shell, Esso, Texaco and Petcom at lower prices than those at which it sells to the other five marketing companies.
- Petrojam, which publishes its ex-refinery prices each week, sells to all marketing companies at the same prices per liter for unleaded 90, unleaded 87 and diesel fuels.
- Each marketing company sells fuels to its network of retail outlets through exclusive supply arrangements. During a contract period a retailer has only one source of supply.
- Marketing companies sell to their respective retail outlets at wholesale price differentials which do not necessarily reflect differences in the costs of supplying these outlets.
- According to marketing companies wholesale prices are based on costs (costs of product and transportation) and the level of competition faced by retail outlets.

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7. Exclusive dealing

232. Point 2(e) of the directive requires that the FTC, in developing the Code of Conduct shall apply principles of fair and free competition, transparent and fair business practices and terms and conditions of contract, and will specifically "prescribe the terms on which contracting parties may enter into third party agreements for the provision of competing goods or service at the premises, which form the subject of the contract between the marketing companies and the dealers/retailers."

233. This point is considered to raise the issue of open supply and as such the Code of Conduct must therefore address the conditions under which retailers can purchase supplies from sources other than their affiliated marketing company. Currently each retailer is under contractual obligation to purchase its entire requirement from the contracting marketing company. In other words, exclusivity features prominently in the contractual arrangements relating to gasoline retailing.

234. An exclusive dealing agreement is a type of vertical restraint whereby a supplier prohibits any retailer carrying its product from selling competing products. It therefore restricts the downstream firm, who agrees not to deal with any other firm that competes with the upstream firm's activities. The effect of exclusive dealing is the reduction of different brands of products within a single retail outlet.

235. Exclusive dealing agreements have both anti-competitive effects as well as efficiency enhancing effects. These agreements can reduce interbrand competition by foreclosing the market to potential entrants or by preventing the expansion of competitors within a market. The extent to which exclusive dealing limits competition depends on the market share of the firm imposing the restraint. Long-term exclusive dealing contracts by an upstream enterprise with a large market share can raise entry costs of a potential upstream competitor. For instance, if a cement plant signs long term supply contracts with all building contractors then if another company wishes to enter the market and supply contractors it would have no customers to serve.

236. An exclusive dealing agreement can have positive effects. It can reduce free-riding in the upstream market especially in the case where the upstream firm provides non-appropriable know-how or services to retailers. Those retailers can then use the know-how and services provided by one firm to sell the goods supplied by others. An exclusive dealing agreement can prevent this behaviour, thereby providing more incentive for the upstream firms to invest in and provide such services. The ability of firms to free-ride on another's investment leads to a reduction of total investments and therefore a reduction in consumer welfare.

Application of the FCA to exclusive dealing

237. Section 33 of the FCA addresses exclusive dealing. The Section states the following:

"exclusive dealing" means—

(a) any practice whereby a supplier of goods, as a condition of supplying the goods to a customer, requires that customer to—

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(i) deal only or primarily in goods supplied by or designated by the supplier or his nominee; or

(ii) refrain from dealing in a specified class or kind of goods except as supplied by the supplier or his nominee; and

(b) any practice whereby a supplier of goods induces a customer to meet a condition referred to in sub-paragraph (a) by offering to supply the goods to the customer on more favorable terms or conditions if the customer agrees to meet that condition.

238. Recognizing that exclusive dealing can have efficiency enhancing effects, Section 33 (3) requires that such conduct be examined for its pro-competitive effects. Thus the Section states:-

"Where on investigation the Commission finds that exclusive dealing … because it is engaged in by a major supplier of goods in a market or because it is widespread in a market, is likely to—

(a) impede entry into or expansion of an enterprise in the market;

(b) impede introduction of goods into or expansion of sales in the market; or

(c) have any other exclusionary effect in the market,

with the effect that competition is or is likely to be lessened substantially, the Commission may prohibit the supplier from continuing to engage in … exclusive dealing and to take such other action as, … is necessary to restore or stimulate competition in relation to the goods.

239. While exclusive dealing agreements reduce competition among different brands within a single outlet, the degree of the effect of such agreements depends on the number of retail outlets selling competing brands. Whether an exclusive dealing agreement amounts to an offence under the FCA depends on whether the anti-competitive effects outweigh the efficiency enhancing effects.

Exclusive dealing: investigation guidelines

240. Given that exclusive dealing agreements can have both anti-competitive effects as well as efficiency enhancing effects investigations into such practices require that consideration be given to market shares of the parties involved, structure and dynamics of the market, and the nature of the product involved. Whether an exclusive dealing agreement lessens competition substantially and should therefore be prohibited; or enhances efficiency and should therefore be permitted requires an assessment of the following:

- *Market shares*—an exclusive dealing agreement is unlikely to harm competition if the parties have small market shares. In particular, if the combined market share of the parties to the agreement is below 25 per cent then such agreement is unlikely to substantially lessen competition.
- *Structure and dynamics of market*—exclusive dealing agreements are unlikely to harm competition if markets are not concentrated. If entry is relatively easy then such agreements may be used to support dynamic change rather than to suppress competition.

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- *Length of agreement*—the longer the duration of an agreement the more is the potential for it to foreclose markets to entrants and to prevent expansion of existing competitors.
- *Nature of products and services*—if the services associated with the products are non-appropriable then an exclusive dealing agreement could reduce free-riding. Where there are no such services then an exclusive dealing agreement is more likely used to reduce competition.

Assessment of exclusive dealing in the gasoline industry

241. At the refinery/importation level of the market there are no exclusive dealing agreements. Currently Petrojam supplies the nine marketing companies. With the exception of Shell, Esso and Texaco all the other marketing companies (Petcom, Epping, Total, Jampet, CoolOasis and Unipet) source their entire requirement of fuel from Petrojam. They have no other choice of supplier. Shell, Esso and Texaco which import a portion of their fuel requirement do not sell to the other marketing companies.

242. The nine marketing companies supply retail outlets through supply contracts of varying durations. No retail outlet is supplied by more than one marketing company at a time; and no marketing company supplies outlets not bearing its logo. All contracts between marketing companies and retailers specify that retailers must purchase their entire fuel requirement only from the contracting marketing company.

243. Table 22 sets out the relative shares of fuel supplied by the nine marketing companies along with the number of outlets under each brand. These outlets are divided into two groups - those owned by marketing companies and those not owned by marketing companies.

Table 22

Relative market share and ownership structure of retail outlets

	Shell	Esso	Texaco	Petcom	National	Epping	Jampet	Cool	Unipet
Market share in 2003									
Number of outlets	56	51	77	30	21	19	2	13	9
Number of outlets owned by marketing company	NI	38	51	3	10	2	NI	0	2
Number of outlets not owned by marketing company	NI	13	26	27	11	17	NI	13	7

Note: NI – no information provided.

244. Shell recorded the largest market share and second largest number of retail outlets in 2003. Texaco recorded the third largest market share and the largest number of retail outlets, while Esso recorded the second largest market share and the third largest number of retail outlets. These three companies were found to have the largest market shares and the largest numbers of retail outlets. Their aggregate market shares amount to [✄] per cent and they control a total of 184 retail outlets or 66 per cent.

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245. The combined market shares among Shell, Esso and Texaco and their respective affiliated retail outlets were found to be above 25 per cent. These exclusive dealing agreements therefore are likely to have a substantial effect on the market. The combined market shares of each of the other six marketing companies and their respective affiliated retail outlets were all found to be below 25 per cent.

246. Based on the market shares of the nine companies the HHI was found to be 2077.8 rendering the wholesale level of the market highly concentrated (See Section 3). Given the current number of retail outlets and the total supply of fuel in 2003, if the sale of fuel were equal across each network of outlets then the HHI would be [✄], rendering the market moderately concentrated. Currently there are at least 114 or 41 per cent of the retail outlets not owned by any of the marketing companies.[39] Given this large number of independent retail outlets entry at the wholesale level of the market is relatively easy; and as such the potential exists for the market to be less concentrated. The duration of supply contracts has been found to be as long as 8 years.

247. The contracts between retailers and marketing companies are franchise contracts. These types of contracts therefore require that each retail outlet conform to the service standard specified by the marketing companies. Each marketing company provides varying levels of support to and investment in retail outlets. This support and investment is specifically provided in order to facilitate the sale of fuel supplied by the marketing company providing the support and investment. Table 23 outlines the level of support made by marketing companies to their affiliated retail outlets.

Table 23

Level of support and investment made by marketing company

Marketing company	Support	Investment
Texaco		
Shell		
Esso		
Epping	Information deleted. See note on cover page.	
Petcom		
Unipet		
National (Total)		
CoolOasis		
Jampet		

248. The types and levels of support differ from company to company and vary across retail outlets with each network. The support offered by marketing companies includes training, marketing support and price support. The training provided by some marketing companies to retailers and their staff is geared specifically to marketing and promoting

[39] The total number was not ascertained as Shell did not provide the information requested in this regard; and Jampet provided no information at all.

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the product of that marketing company and to guaranteeing a certain standard of operation across all retail outlets within a particular network.

249. Advertising and promotion of the network of outlets are generally carried out by the respective marketing companies. With the exception of Shell's, these promotions do not focus on the type of fuel sold at the retail outlets. In addition to promotion and advertising carried out by the marketing companies, a few retailers advertise the type of services they provide at the retail outlet they manage.

250. The level of price support offered by marketing companies in some instances varies with the level of investment made by the marketing company. The investment provided is in relation to dealer owned retail outlets; and the level varies across outlets. For example, a marketing company may provide equipment only or it may provide pumps, tanks, canopy and equipment. There are a few outlets in which the contracting marketing company has no investment.

251. As is typical of exclusive dealing agreements, there is some amount of investment and support given to retailers which agree to carry the product of the contracting supplier. In relation to the gasoline industry the level of investment and staff training seems to justify the need for exclusivity. It is unlikely that a marketing company would provide significant investment in terms of assets and retailer training if other marketing companies could free-ride on its investment.

252. There are two groups of fuel supplied by the nine marketing companies – homogeneous or non-differentiated fuel and heterogeneous or differentiated fuel. Non-differentiated unleaded 87 and unleaded 90 are supplied by Petcom, Epping, Total, Jampet, CoolOasis and Unipet while differentiated unleaded 87 and unleaded 90 are supplied by Shell, Esso and Texaco. Diesel fuels supplied by all nine marketing companies are homogenous. The differentiated fuels supplied by the three marketing companies are blended using their respective proprietary additives; and therefore these fuels cannot be supplied by any other marketing company. For example the type of unleaded 90 (V-Power) supplied by Shell to its branded retail outlets cannot be supplied by any other marketing companies. Non-differentiated fuel can be supplied by any of the nine marketing companies.

253. Based on the foregoing the status of the gasoline industry in relation to exclusive dealing agreements may be summarized as follows:-

- There are no exclusive dealing agreements at the refinery/importation level of the market. Six of the nine marketing companies source their entire requirement of automotive fuel from Petrojam not on the basis of exclusive dealing agreements but because of lack of choice. These companies do not have the facilities to import the supplies.

- All marketing companies enter into some form of contractual arrangement with retailers for the supply of fuel. This level of the market may be classified as highly concentrated. The combined market shares of Shell and its affiliated retailers; Esso and its affiliated retailers; and Texaco and its affiliated retailers are above the 25 per cent threshold raising the possibility of substantial lessening of competition.

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- There are over 114 retail outlets that are not owned by marketing companies. The potential for changes in the distribution of retail outlets therefore exists. This makes it possible for entry at the wholesale level of the market.
- Currently Petrojam deals only with the nine marketing companies and not with individual retailers. This acts as a barrier to entry into the retail end of the market therefore preventing retailer-owned outlets from being independent of marketing companies. An increase in the number of marketing companies or independent retailers is unlikely to result in any significant changes in Petrojam's distribution operations. A change in the ownership or affiliation of retail outlets will not affect the number of tankers accessing the distribution racks.
- All marketing companies provide some amount of support and investment to retail outlets with which they have exclusive supply arrangements. Given the type of investments made by marketing companies, it is unlikely that they would continue to make such investments if there were no exclusive dealing agreements in place.
- Differentiated fuels provided by Shell, Esso and Texaco cannot be supplied by any other wholesaler without infringement of the property rights of these companies. Non-differentiated fuels can however be supplied by the nine marketing companies.
- Any effort to have non-differentiated fuels (unleaded 87 or unleaded 90) supplied to and sold at Shell, Esso or Texaco branded retail outlets would negatively affect the companies which have invested in developing these products. This could also amount to misrepresentation or passing-off if the type of fuel being sold at a particular outlet is not as represented, resulting in a loss of integrity of the companies' products and a disincentive to invest in product innovation. Ultimately there would be less choice for the consumer.

254. In sum, given the structure of the market, entry at the wholesale level is relatively easy. The potential is therefore there for entry of new marketing companies and the expansion of existing companies. Exclusive dealing agreements of relatively short duration do not unduly prevent entry into or expansion of companies in the market.

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8. Resale price maintenance and price fixing

255. One of the issues complained of by the retailers is their inability to set prices. This matter raises issues of resale price maintenance and price fixing, which are per se offences under the FCA - Sections 25 and 34 respectively, breaches of which attract a fine of up to five million dollars ($5,000,000.00).

Resale price maintenance

256. This offence is addressed in Section 25 of the FCA. The Section prohibits minimum resale price maintenance. It reads:-

> 25. "(1) Any term or condition of an agreement for the sale of goods by a supplier to a dealer is void to the extent that it purports to establish or provide for the establishment of minimum prices to be charged on the resale of the goods in Jamaica.
>
> (2) Subject to subsections (3) and (4), it is unlawful for a supplier of goods (including an association or person acting on behalf of such supplier) to—
>
> a) include in an agreement for the sale of goods, a term or condition with is void by virtue of this section;
>
> b) require as a condition of supplying goods to a dealer, the inclusion in the agreement of any term or condition, or the giving of any undertaking to the effect;
>
> c) notify to dealers, or otherwise publish on or in relation to any goods, a price stated or calculated to be understood as the minimum price which may be charged on the resale of the goods in Jamaica.
>
> (3) Paragraph (a) of subsection (2) does not affect the enforceability of an agreement except in respect of the term or condition which is void by virtue of this section.
>
> (4) Nothing in paragraph (c) of subsection (2) shall be construed as precluding a supplier (or an association or person acting on behalf of a supplier) from notifying to dealers or otherwise publishing prices recommended as appropriate for the resale of goods supplied or to be supplied by the supplier."

257. For an offence to occur the following elements must be satisfied:

- The supplier must indicate to the dealer the price at which the retailer must resell the relevant products;
- The supplier must condition the supply of goods to a dealer on the dealer's agreement to sell at the specified price; and
- The price set must be a minimum resale price, i.e. the supplier must set a price floor for the products it supplies.

258. The section does not make it illegal for a supplier to set maximum resale prices. Maximum resale price maintenance prevents a retailer from setting its prices too high and therefore benefits consumers.

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Resale price maintenance in gasoline retailing

259. Retailers may be constrained in their ability to set their own retail prices as a result of their own operational costs, wholesale prices and the local competitive conditions. An additional constraint may be the setting of retail prices by marketing companies. The nine marketing companies were asked to indicate their involvement in determining the retail prices of fuel sold at their respective branded retail outlets. Table 24 sets out the responses.

Table 24

Involvement of marketing company in the setting of retail prices

Marketing companies	Involvement of setting retail prices
Texaco	Information deleted. See note on cover page.
Shell	
Esso	
Epping	
Petcom	
Unipet	
National (Total)	
CoolOasis	
Jampet	

260. While all marketing companies deny that they set retail prices, no retailer has ever complained to the FTC that it was directly prevented from selling below a price suggested or recommended by a marketing company. The marketing company and the retailer are involved in a vertical relationship and as such each wants the other to reduce its price. The lower the retail price of fuels the greater the demand should be for those products. It therefore does not benefit the marketing company to impose minimum resale restrictions; and it is not an offence under the FCA for a marketing company to suggest or recommend a maximum resale price as long as the company does not prohibit a retailer from selling below that suggested or recommended price.

Price fixing

261. Price fixing is addressed in Section 34 of the FCA. The section states the following:

> 34. (1) A person who is engaged in the business of producing or supplying goods shall not, directly or indirectly—
>
> *(a)* by agreement, threat, promise or any like means, attempt to influence upward or discourage the reduction of, the price at which any other person supplies or offers to supply or advertises goods;
>
> *(b)* refuse to supply goods to or otherwise discriminate against any other person engaged in business;
>
> *(c)* refuse to supply goods to or otherwise discriminate against any other person engaged in business because of the low pricing policy of that other person.

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(2) Subsection (1) does not apply where the person attempting to influence the conduct of another person and that other person are—

(a) interconnected companies; or

(b) principal and agent.

(3) For the purposes of this section, a suggestion by a producer or supplier of goods of a resale price or minimum resale price in respect thereof, however arrived at, is proof of an attempt to influence the person to whom the suggestion is made, unless it is proved that the person making the suggestion, in so doing, also made it clear to the person to whom it was made that he was under no obligation to accept it and would in no way suffer in his business relations with the person making the suggestion or with any other person if he failed to accept the suggestion.

(4) For the purposes of this section, the publication by a supplier of goods other than a retailer, of an advertisement that mentions a resale price for the goods is an attempt to influence upward the selling price of any person into whose hands the goods come for resale unless the price is so expressed as to make it clear to any person who becomes aware of the advertisement that the goods may be sold at a lower price.

262. For an offence to occur the following elements, as set out in the Section must be satisfied:

- A supplier must by agreement, threat, promise or intimidation attempt to influence upward or discourage the reduction of, the price at which a dealer supplies or offers to supply or advertises goods;
- A supplier must refuse to supply or otherwise discriminate against any other person engaged in business;
- A supplier must refuse to supply goods to or otherwise discriminate against a dealer because of the low pricing policy of that dealer.

263. The FCA therefore makes it illegal for a supplier to influence upward, or discourage the reduction of the prices at which a retailer resells products; to discriminate against persons engaged in business; or to otherwise discriminate against a dealer because of the pricing policy of that dealer. This provision does not prevent a dealer from setting a maximum resale price. Retailers operating under a maximum resale price regime are not prohibited from reducing their prices and as such are not influenced to keep prices high.

264. Relationships involving interconnected companies or principal and agent are exempted from the Section. This means that a principal is allowed to set the prices at which its agent resells products. Likewise a company is not prohibited from setting the prices at which its subsidiary resells products.

Price fixing in gasoline retailing

265. All marketing companies have indicated that they do not set the retail prices at retail outlets which are operated by dealers. They indicate that retailers are responsible and do set the prices at which they retail fuels. The levels of wholesale prices cannot be taken as an indication of a dealer influencing prices as in any vertical relationship between a supplier and a retailer the price at which the retailer resells must be influenced by the wholesale prices.

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266. Investigation under Section 17 of the FCA has produced evidence of marketing companies charging retailers differential wholesale prices which are not reflective of differences in supply costs. Some of these price differentials appear to be based on the level of competition faced by particular retailers.

267. As with price fixing, it is not an offence for suppliers to recommend or suggest maximum resale prices. The setting of maximum resale prices does not prevent retailers from engaging in price competition. The difference between wholesale prices and the suggested prices may however be too small to allow for the recovery of operational expenses, thereby hindering a retailer's ability to compete.

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9. Divorcement

268. Provision 2(d) of the Ministerial Directive requires that the FTC in developing the Code "prescribe the terms on which Marketing Companies can own, operate, or otherwise control their own retail operations, insofar as such prescriptions are required to ensure that the same terms on which Marketing Companies provide products and services to their operations, are offered to third party retailers of similar circumstances." This provision requires that the FTC set out the conditions under which a marketing company can operate at the retail level of the market, raising the issue of divorcement.

269. The terms "divorcement" and "retail divorcement" are used to refer to the prohibition of integrated oil companies from operating their own retail outlets. Divorcement legislations are currently in place in a number of states in the United States of America. In effect, those laws require that outlets owned by oil companies be divested to and/or operated by a dealer. On the one hand, the main arguments frequently advanced in favour of divorcement legislation include the following:-

- It allows independents to survive—divorcement is necessary to ensure the economic survival of independent service stations and enhance their ability to compete as small businesses.
- Increases competition—oil companies are attempting to control, monopolize, and unduly influence the retail gasoline market. Divorcement will therefore increase competition in the market.
- Gives retailers greater control over their operations—oil companies control a large portion of dealers' operating costs, including station rent, wholesale price costs, and branding charges through contractual arrangements. Dealers have been forced out of business due to artificial increases in these costs and other unreasonable clauses in renewal leases. Elimination of these controls will allow dealers to make business decisions to more effectively compete in the market; and
- Eliminates predatory pricing made possible by vertical integration—vertical integration has allowed oil companies to engage in predatory pricing by permitting them to subsidize the gasoline supplied to company operated outlets through profits earned at other levels of operation. These prices which are below cost and below the wholesale prices charged to lessee dealers are intended to drive lessee-dealers out of the retail gasoline market so that the outlets can become company-operated.

270. Opponents of divorcement legislation, on the other hand, have argued that divorcement will result in the following:-

- Less efficiency—oil companies vertically integrate downstream to enable them to more efficiently market their products, not to engage in predatory pricing. Studies have shown that gasoline marketing is highly competitive and that there is no evidence of predatory pricing. The United States Department of Justice and the Federal Trade Commission have found no evidence of predatory pricing in the industry.

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- Reduced competition—divorcement would sharply reduce competition, thereby limiting consumers' freedom of choice. Consumers would not have as wide a range of gasoline brands, services, prices, and hours of operations if refiners are excluded from the market;
- Higher gasoline prices and reduced hours of operation—restricted competition will result in higher gasoline prices for consumers. Studies of the effects of Maryland's divorcement statute indicated that divorcement raised gasoline prices and reduced the average hours of operation of stations which were divested;
- Reduced tank safety and less market innovation—the safety of underground storage tanks, which has been enhanced by refiner investments in new and safer tanks, would be reduced.

271. The main reasons for such a law are to address the issue of predatory pricing, 'unfair' competition at the retailing level of the market and allegations that refiners are attempting to force their own affiliated dealers out of the market. Divorcement legislation was therefore put in place to regulate vertically integrated firms, which operate specifically at both the refinery and retail levels of the market.

The local industry and implications of divorcement

272. The local gasoline industry has four vertically integrated companies. These are Petroleum Corporation of Jamaica, which operates at the refinery/importation, wholesale and retail levels of the market; and Shell, Total (National), and Unipet which operate at the wholesale and retail levels of the market. No evidence of predatory pricing on the part of these company-operated outlets was found. The profit margins on fuel at company-operated retail outlets were found to be positive. Further, while the average retail prices of fuels at company operated outlets were found to be marginally lower than those at dealer operated outlets, there are instances in which the retail prices at dealer operated outlets were found to be lower than those at company-operated outlets.

273. A survey of the retail prices at Shell and Total (National) company-operated retail outlets revealed that those prices are significantly lower than retail prices at dealer operated outlets (of different brands) within the same area. This suggests that prohibiting companies from operating their own retail outlets is likely to result in higher retail prices to the consumers. Further, any requirement by marketing companies to divest retail outlets is likely to result in dealers purchasing only the most attractive or lucrative outlets. The least lucrative outlets would not be attractive to a single-outlet operator or a marketing company. It is therefore likely that these outlets would be closed, which would result in a reduction of the number of outlets and an increase in retail prices.

274. The sale of company-owned retail outlets will no doubt increase the number of outlets being owned by retailers and therefore increase the potential for these retailers to switch between marketing companies. There are at least 114 outlets which are not owned by any of the nine marketing companies. The ability of retailers to switch marketing companies or to form their own companies does exist. In other words, there is significant potential for increased competition at the retail level of the market. This increased competition will lead to lower prices, more amenities and more choices for the consumers.

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275. While divorcement can result in a change in the ownership structure or the method of operation of retail outlets, it is unlikely to be beneficial to the consumers. Opportunities currently exist for a less concentrated market. Imposing restrictions on marketing companies, especially in instances where there is no evidence of anticompetitive behaviour, is likely to result in inefficiencies, which ultimately will be passed on to consumers through higher prices and increased disamenities.

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PART III: CONCLUSIONS AND RECOMMENDATIONS

10. Summary

276. The following summarizes the findings of the allegations of predatory pricing, discriminatory pricing, exclusive dealing, price fixing and resale price maintenance within the petroleum industry:

Predatory pricing

- Predatory pricing involves below cost pricing by a dominant firm with the view to exclude a competitor from the market or foreclose a market. This practice was investigated under Sections 19-21 of the FCA in relation to the three distinct stages in the supply of automotive fuels – refinery/importation, wholesale and retail.
- There are four companies operating at the refinery/importation level of the market. These are Petrojam, which refines and imports petroleum products and Shell, Texaco and Esso which import only.
- Of the total supply (production and importation) of automotive fuels Petrojam accounted for approximately [✂] per cent in 2003 up from [✂] per cent in 2002.
- Shell, Esso and Texaco, which are collectively Petrojam's largest customer, by importing approximately [✂] per cent of their fuel requirement, expose Petrojam to competition from external refineries. This means that Petrojam is operating at the global level; and is therefore unlikely to be dominant.
- Below cost pricing by a non-dominant firm is not a feasible strategy and would not amount to a breach of any provision of the FCA.
- At the wholesale level of the market each marketing company sells only to its network of retail outlets. No marketing company was found to have a market share of over 50 per cent; and no marketing company owns over 20 per cent of the number of retail outlets.
- Based on the market shares of the marketing companies and the nature of the contractual relations it can be concluded that no marketing company holds a dominant position at the wholesale level of the market.
- In terms of retailing, Shell, Total (National), Unipet and Petcom operate directly a fraction of their respective retail outlets. Shell directly operates 23 per cent of the Shell branded retail outlets; Total (National) operates 38 per cent of the Total (National) branded retail outlets; Unipet operates 44 per cent of the Unipet branded retail outlets; and Petcom operates a mere 3 per cent of the Petcom branded outlets.
- The total number of company operated outlets (26) however is too small to have any significant negative impact on the market. The retail prices at these outlets were not found to be below cost. The retail prices of fuels at one Total (National) operated outlet were found to be below the wholesale price charged by one marketing company to a retailer. This however is not predatory pricing.

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Discriminatory pricing

- Discriminatory pricing is the charging of different prices to different customers for the same product where the differences in prices do not reflect any differences in relative cost. This practice is offensive under Section 17 of the FCA if its net effect is the substantial lessening of competition among competitors.
- No evidence of discriminatory pricing was found at the refinery/importation level of the market. Petrojam sells to the nine marketing companies at the same prices.
- Each marketing company sells to retailers within its respective network at different prices which in some cases do not reflect any differences in cost. These price differentials are not explained by a system of discounts which are available to all retailers. The main explanation for differences in prices is a response to competition within particular areas.
- There is therefore some evidence of discriminatory pricing.

Exclusive dealing

- An exclusive dealing agreement is one in which a supplier prohibits retailer carrying its products from carrying competing products. Exclusive arrangements are considered anti-competitive if they foreclose a substantial part of the market from competitors.
- There are no exclusive dealing contracts at the refinery/importation level of the market. Shell, Esso and Texaco source their supply of fuel from both Petrojam and direct import. The other marketing companies source their supply of fuel from Petrojam, which is their only supplier.
- The marketing companies enter into exclusive dealing contracts with retailers for the supply for fuel. The distribution of retail outlets across marketing companies ranges between 9 and 77.
- This level of the market was found to be highly concentrated, with Shell, Texaco and Esso having an aggregate market share of [✂] per cent and controlling a total of 66 per cent of the retail outlets.
- There are approximately 114 out of 278 retail outlets which are not owned by any of the nine marketing companies. The potential therefore exists for entry or expansion at the wholesale level of the market.

Price fixing and resale price maintenance

- While marketing companies set retail prices at company operated outlets, there is no evidence of minimum resale price maintenance.
- Shell indicates that it suggests the retail prices at which retailers should resell fuels only in the situation in which retailers have benefited from price support.

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11. Proposed terms of Code of Conduct

277. The following are the proposed terms of the Code of Conduct

Viability of business

1. A Wholesaler shall not, directly or indirectly or through any officer, agent or employee in respect of the sale and distribution of petroleum products:-

    a. fail to act in good faith in performing or complying with any term or provision of, or collateral to, a contract with a retailer;

    b. impose on a retailer any contractual provisions including a provision respecting an increase in the rental for a gasoline retail outlet, that are likely to be impossible or unreasonably onerous to perform at the time it is demanded to be performed; or

    c. cancel, terminate or fail to renew a contract with a retailer for a cause not contemplated in the relevant contract.

2. A wholesaler shall not recommend or suggest to a retailer retail prices of fuels which would make it impossible for the retailer to cover the operational cost of the outlet.

3. A wholesaler must give notice of no less than one (1) month of any changes in the applicable rents and fees. Increases in such rents and fees shall not be made payable retroactively.

4. A wholesaler shall not refuse to sign a contract with a dealer on the ground that the dealer is a limited liability company.

5. A contract between a wholesaler and a retailer shall contain in clear and unambiguous terms the criteria upon which the wholesaler offers or grants discounts or price support to its retailers.

Duration of contract

6. No contract between a wholesaler and a retailer shall be for less than three (3) years, in respect of a company-owned retail outlet, PROVIDED THAT the retailer is not serving a probationary period which must not be more than one (1) year.

7. No contract between a wholesaler and a retailer shall be for more than five (5) years, in respect of a dealer-owned retail outlet.

8. An existing contract between a wholesaler and a retailer, in respect of a company-owned retail outlet, excluding a probationary period, which is for a

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period less than three (3) years shall be pro-rated so as to comply with Provision (6) herein.

9. An existing contract between a wholesaler and a retailer, in respect of a dealer-owned retail outlet and which is in excess of five (5) years shall be pro-rated so as to comply with Provision (7) herein.

10. All contracts must have a specified duration.

Disposal of property

11. Where a wholesaler is desirous of selling property housing a gasoline retail outlet, the retailer who has been operating that outlet for a period of ten or more years shall be given the first option to purchase the said property.

12. No agreement for the sale by a wholesaler of property housing a gasoline retail outlet shall contain a provision prohibiting the buyer from operating a gasoline retail outlet or any other business at that location, PROVIDED THAT said business is in accordance with the relevant Town and Country or any other zoning laws for the time being in force in Jamaica.

Compensation for termination

13. Where a wholesaler terminates a contract with a retailer for any cause not contained and recognized in the said contract the wholesaler shall compensate the retailer for the unexpired proportion of the contract.

14. Where a retailer terminates a contract with a wholesaler for any cause not contained and recognized in the said contract the retailer shall compensate the wholesaler for the unexpired part of the contract, PROVIDED THAT the contract is in relation to a dealer-owned retail outlet.

15. The method for calculating the compensation shall be set out in the contract between the parties.

Notice of termination or non-renewal

16. A minimum of three (3) months notice shall be given by any party who wishes to end a contract before its expiration date.

17. Notice of renewal or non-renewal of a contract shall be given to either party three (3) months prior to the end of the contract and the parties shall communicate to each other any new terms and conditions within the said time frame.

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18. Prior to the commencement of a contract, a wholesaler shall advise retailers of the grounds for termination or non-renewal of that contract.

19. For the purpose of this Code, notice means notice in writing.

20. Any notice or demand to be served or made on any party shall be deemed to be sufficiently served or made if served personally or sent by pre-paid registered post addressed to the relevant party's address and shall be deemed to have been received seven (7) days after date of posting in any post office in Jamaica. This method is not exclusive and shall be in addition to any other available procedure, inclusive of such Notice being served on the Attorney representing a party to the contract, which shall be deemed Notice to such party.

Display of pump prices

21. Gasoline retail outlets shall prominently display the prices of gasoline on both sides of a double-sided display board.

22. Prices on pumps shall be visible; and no price shall be displayed on pumps that are not operational.

23. Prices displayed on pumps shall be identical to the prices displayed on the display board.

24. The layout of the display board shall be two columns by three rows. The first column shall list the type of gasoline in the order of unleaded 87, unleaded 90 and diesel; and the second shall display the corresponding prices.

Price discrimination

25. A Wholesaler who operates a retail outlet directly or indirectly through an agent or employee shall not retail gasoline at that outlet at prices at or below the prices at which it supplies outlets operated by independent retailers, within the same transportation zone.

26. Where a wholesaler grants discounts those discounts shall be made available to all retailers within its network of retail outlets, who meet the criteria under which discounts or price support are/is granted.

27. A wholesaler shall sell to all retailers within the same trading area at the same price, except in situations in which discounts or price support are/is given to a dealer at the request of that dealer. A trading area is the area in which the transportation cost to deliver fuel to retail outlets is identical.

28. Within fourteen (14) days of the implementation of this Code all wholesalers shall supply to [the body implementing this Code] an up-to-date list of the

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established trading areas and indicating all the outlets which fall within each area and shall provide an updated list within seven (7) days of such update for the life of this Code.

29. Where a wholesaler recommends or suggests the price at which gasoline should be retailed at a dealer operated outlet that price shall not be below the price, discounted or otherwise, at which it supplies another retail outlet within the same trading area.

Predatory pricing

30. A Wholesaler shall not sell gasoline to independent retailers at prices below the cost of the gasoline together with and the cost of supplying it.

31. A wholesaler who operates a retail outlet directly or indirectly through an officer, agent or employee shall not retail gasoline at prices that do not allow for the recovery of the operational expenses of retailing the gasoline.

32. Where a wholesaler grants discounts to dealers those discount prices shall not be below the cost of the gasoline together with the cost of supplying it.

33. Where a wholesaler recommends or suggests the price at which gasoline should be retailed at a dealer operated outlet that price shall not be below the cost of the gasoline together with the cost of supplying it.

Obligation of wholesaler

34. A retailer who owns the property housing a retail outlet and who has entered into a contract with a wholesaler shall not be in any way prevented from switching to another wholesaler at the end the contract.

35. At the end of a contract by effluxion of time, or where any party wishes to discontinue the contract, in respect of retailer-owned property, the wholesaler must remove its signage, logo etc within one (1) week of the end of the contract.

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Appendix A: Directive issued by the Minister

278. The Directive which was issued pursuant to Section 9 of the FCA sets out as follows:

Whereas various members of the Petroleum Industry have made representations to the Minister, and have called on the Government of Jamaica to provide a legislative and regulatory framework for the effective regulation of the Industry; and

Whereas it is necessary in the interest of the Industry and the public as a whole that the Fair Trading Commission be directed to prepare and implement an Industry Code of Conduct that will facilitate the achievement of the following policy objectives:

(a) The expeditious and conclusive resolution of commercial issues through discussion, and self regulation.

(b) The promotion and maintenance of a competitive environment with specific regard to the curtailment and elimination of conduct which constitutes an abuse of dominance, pursuant to and consistent with the provisions of the Fair Competition Act.

(c) To ensure as far as possible that parties are on an equal footing and are not prejudiced by their financial position in the negotiation and adjudication of matters in dispute, or matters of commercial significance.

(d) To assist the regulators and policy makers in their administration and protection of competition within the industry.

THE FAIR TRADING COMMISSION IS HEREBY DIRECTED as a matter of policy, as follows:

1. To prepare and implement an Industry Code of Conduct by September 30th, 2004. This Code shall be based on international best practices, and appropriately sensitive to local operating conditions which will outline the minimum standards for the commercial arrangements between marketing companies and dealers/retailers in the industry; and have regard to the said Code in the exercise of their statutory functions.

2. In developing the said Code, the Fair Trading Commission shall apply principles of fair and free competition, transparent and fair business practices and terms and conditions of contract, and will specifically:

    2.1 prohibit the imposition of barriers to entry in the form of restrictions against the use of corporate entities as contracting parties, or as operators and managers under the contracts between Marketing Companies and dealers/retailers;

    2.2. conduct the necessary market studies and investigations in order to prescribe generally accepted accounting and costing principles to guide the calculation and review of rent, franchise fees, royalties, and product prices in order to ensure fairness, and to protect against discriminatory pricing, predatory

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pricing, price fixing, cartelization, tied selling, and other conduct in breach of the Fair Competition Act;

2.3 prohibit unilateral amendment or termination of the Contracts between Marketing Companies and dealers/retailers, save as provided for by the Contract itself, and prescribe an appropriate procedure for amendment, compensation for early termination, and termination generally;

2.4 prescribe the terms on which Marketing Companies can own, operate, or otherwise control their own retail operations, insofar as such prescriptions are required to ensure that the same terms on which Marketing Companies provide products and services to their operations, are offered to third party retailers of similar circumstances;

2.5 prescribe the terms on which contracting parties may enter into third party agreements for the provision of competing goods or service at the premises, which form the subject of the contract between the marketing companies and the dealers/retailers; and

2.6 prescribe the terms, conditions, and procedures for notification of changes in the rent, franchise fees, royalties, and product prices.

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APPENDIX B: Views on the competitiveness of gasoline retailing

279. The FTC sought the views of the general public and selected agencies and groups on the competitiveness of gasoline retailing in Jamaica. Responses were received from the Consumer Affairs Commission (CAC) and JGRA. Both respondents view the market as not being competitive. The JGRA argues that retail prices are influenced by the marketing companies, resulting in the market not being competitive. It believes also that differential pricing works counter to the competitive process. The mode of operation on the part of marketing companies is seen as a hindrance to competition. Overall the JGRA's view on whether the market is competitive relates to the relationship between marketing companies and their respective dealers.

280. The CAC indicated that it has been monitoring the industry for some time. In particular it monitors retail prices of over 70 retail outlets on a monthly basis. The CAC believes that lack of relevant information on the industry negatively affects competition.

Views from JGRA

Question 1: What are your views of the competitiveness of gasoline retailing in Jamaica?

Response:

- Competitiveness in its true sense does not exist in the market. When marketers dictate margins to retailers then competition does not exist.
- Marketing Companies sell products to retailers in the same trade area at varying prices without there being any established attendant costs attached, thus rendering the retailers uncompetitive.

Question 2: What are the factors which hinder competition within the gasoline retailing market?

Response:

- Marketing Companies act as both wholesalers and retailers thereby competing unfairly with their own retailers.
- Contract terms for retailers vary and are weighted heavily in favour of the marketing companies thus making it difficult for effective competition.
- Retailers are charged commercial rental for sites by the marketing companies who at the same time restrict retailers on what merchandise they can sell thereby making it difficult for them to compete.
- Marketing Companies' margins are significantly higher than retailers' margins which is not consistent with normal trading practices.

Question 3: What specific actions can be taken to remove any hindrance to competition within the industry?

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Response:

- Marketing Companies should not be wholesalers and retailers.
- Marketing Companies should sell to their respective retailers in the same trade area at the same price and the retailers should be free to set their own prices based on market forces just as Petrojam sells all Marketing Companies under the same terms, conditions and price.

Question 4: What are the effects of the different retailing agreements on gasoline marketing in Jamaica?

Response:

- There are three (3) types of retailing agreements currently in Jamaica. These are; (1) Company operated stations (2) Agencies – commissioned managers paid by the marketing company and (3) Dealerships. Company and Agent operated sites compete unfairly with Dealer operated sites.
- Restrictive conditions of trade are prohibitive to business growth and entrepreneurial development.
- Dealers are not operating under the same trading conditions.
- There is a high attrition of Dealers due to the above conditions.

Question 5: What can be done to reduce wholesale and retail prices of gasoline?

Response:

- Improvement of operational efficiencies by all stakeholders in the industry.
- Sourcing of cheaper supply of product by the refinery.
- Public displays of prices by all parties to allow transparency in the petroleum industry. The refinery and retailers already do so. It is now time for the Marketing Companies to do so.
- Implementation of self service.
- Reduction of Government tax.
- The temperature adjustment cost factor which is given to the Marketing Companies by Petrojam must be passed on to the Retailer as this will result in lower prices to the consumer.

Question 6: What can be done to reduce the operating cost of service stations?

Response:

- Implementation of self service.
- Conduct manpower and operational audit at service stations to determine cost reductions

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- Tanker Wagons should be calibrated regularly to minimize significant losses to the retailers and ultimately the consumer.

Views for CAC

Question 1: What are your views of the competitiveness of gasoline retailing in Jamaica?

Response: There is a general perception that the competitiveness of gasoline retailing in Jamaica is high. The average consumer determines the level of competition to be a function of the number of service stations within any one locality or in close proximity to each other. There is also a consideration given to secondary services at the Petrol Stations that impact their perception of competition or competitiveness.

It is therefore important that the actual behaviour and mechanisms that are at play within the sub-sector are not counter to the true spirit of competition. If the complaint from the JGRA is true, then the real competitiveness of gasoline retailing in Jamaica is below the perception and interpretation of the Consumer.

More importantly, the consuming public would have been denied the benefit of competitive pricing arrangements outside of coordinated decisions that are independent of market forces. Such as would be the case in a cartel.

Question 2: What are the factors which hinder competition within the gasoline retailing market?

Response: Based on our information, the factors that hinder competition within the gasoline retailing market are presented in ranked order below:

1. The absence of transparency regarding the pricing structure at all levels, refinery, marketing companies, retailers and price at the pump is a primary hindrance to competition. The inability to collect and collate related information such as volume sold per petrol station per week, or the price at which it has been purchased by the retailer or entity that would allow independent and empirical information regarding real consumption, fluctuation in consumption specific to any one station as a function of retail price at that station and therefore consumer responsiveness to price movements to be available for analysis and policy development. The value and benefit of such information will be utilizable for industry players and policy makers alike.

2. The inability of individual retailers to arrive at prices (without interference from marketing companies) based on administrative and other costs that would be case specific. Such practices, if proven to be at play, are equivalent to price fixing and are counter to true market competition.

3. The apparent "price pegging" that has often been picked up between proximate Petrol Stations wherein a difference of J$O.OI -J$0.03 is all that exists between the petrol products surveyed. In the qualitative component of our surveys, respondents have indicated that they will "top up" their prices to

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"match" the price of a neighbouring station since they can "get away" with a "little extra" profit per litre.

4. The full and clear display of prices on display boards is not mandated under law; therefore there are no sanctions for not providing this service. If the prices are not displayed, the Consumer's Right to Information is affected. Notwithstanding that the prices are displayed at the pumps, the additional layer of information and customer service provided by the use of display boards is premium.

Question 3: What specific actions can be taken to remove any hindrance to competition within the industry?

Response: The suggestions for the removal of 'hindrances' to competition within the industry are set out below in corresponding order to the points from above: -

1. Reporting procedures and mechanisms must be developed and included in any Code of Conduct. This information will provide higher order analysis and evaluation and would assist in resolving the issue raised in Question 5 of the document originating from the FTC and meet the objectives as set out in the initiating document from the Minister of Commerce, Science and technology (with Energy).

2. Provide a measured and clearly articulated framework that regulates and guides the pricing and retailing arrangements between the marketing companies and the Petrol Stations. This should be aimed at removing any ambiguity guiding the conduct of Marketing Companies, so that 'allegation' that is now popular from the JGRA and other stakeholders may be thoroughly accommodated.

3. Workshops, Seminars and other Capacity Building interventions are provided, perhaps in conjunction with the Fair Trading Commission and the Consumer Affairs Commission on the benefits of Competition to the Business as well as to the Consumer. Such enhanced capacity will provide the requisite confidence for retailers to not rely on slim pickings as gained through "price pegging" but to benefit more wholesomely from customer service and true market competition.

4. The Display of Prices on Billboards as well as at the pumps should be mandated. Further, this requirement must be mindful of the evolutions within gasoline retailing in Jamaica. One such being the offer of full service as well as self-service within any one Petrol Station. Therefore, the billboards should be formatted to reflect the differences in prices in a clear manner to the Consumer. Linked to this would be the appropriate public education and marketing of this development through say a Consumer Affairs Commission in regards to the public education and by individual petrol stations with respect to the marketing.

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Question 4: **What are the effects of the different retailing agreements on gasoline marketing in Jamaica?**

Response: The inability to collect and collate information regarding what can be agreed as a "fair" price reflective of market forces is heightened in any process when there is a multiplicity of retailing agreements. The situation is further made difficult if these agreements are ambiguous and there is unwillingness for disclosure and an aversion to discussions on the matter.

The ambiguity and multiplicity as reported leads to a fissure in the minds of the consuming public as to whether retailers (business persons) are engaging in "price gouging" or other unfair practises, or whether the prices being paid for petroleum products reflect the real costs of purchasing these products.

Combined, these situations do not auger well for public education or for the development of policies and programmes linked to the supply, use and conservation of petroleum products.

Question 5: **What can be done to reduce wholesale and retail prices of gasoline?**

Response: To respond to this question may require greater industry knowledge than is posited at present within the Consumer Affairs Commission. On this matter therefore the Commission defers to sister agencies such as the Petroleum Corporation of Jamaica and the Fair Trading Commission as well as other stakeholders.

Having said this, it is generally the case in supply chain dynamics of any product that when a procurement mechanism is put in place that is informed by: -

i. Consumption Patterns and Trends
ii. Implications on Demands based on seasonality or increase in motor vehicle usage or industrial expansion (both of which are current in Jamaica)
iii. Cost of inputs along the entire production cycle
iv. Improvements in conversion efficiency
v. Improvements in distribution and service
vi. The benefits of fair and competitive pricing

... then usually the final cost of products to the consumer is positively affected (lower than would have been the case if an appropriate procurement and production mechanism is not in place).

Question 6: **What can be done to reduce the operating cost of service stations?**

Response: Service stations need to further diversify the menu of service products that are available and the manner in which these services are priced and provided. The

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remittances to operating costs and actual profit made in such situations functions so as to subsidise the cost of anyone service product. Making the businessperson less dependent on profit from anyone service product, and usually such a business benefits from increase business volume from which to accrue profits. Whereas there may be stipulations from the Marketing companies that will restrict or guide the scope of products offered, these stipulations may need to be removed/reassessed to allow greater scope for creativity by the petrol retailer.

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Appendix C: Results of consumer survey

281. The FTC as part of its investigation into the petroleum industry has conducted a consumer survey to gather information pertaining to consumers' opinions and spending patterns as they relate to gasoline consumption. Specifically, the questions asked were geared towards discerning consumer's vigilance, sensitivity to prices, brand loyalty and general conduct regarding gasoline consumption. The survey was conducted over a three-week period; and a total of five hundred and eighty-four (584) persons participated. Of this number, 47.6 % indicated that they are female, 40.1 % male, while 12.3 % of the respondents did not indicate their gender. The responses from the survey provided valuable information which has been used in analyzing the level and dimension of competition in gasoline retailing. The following are the main results of the survey:

Type of gasoline used

282. The survey sought information on the type of fuel used. Over 51 per cent of the respondents indicated that they use only unleaded 90, 30.3 per cent indicated that they use unleaded 87 while 15.4 per cent indicated that they use both unleaded 87 and 90. The fact that persons interchange between unleaded 87 and unleaded 90 suggests that persons may be using a higher octane gasoline than is necessary; and are therefore spending more on gasoline than they need to. Based on price surveys conducted by the FTC, intra-brand price differences between unleaded 90 and 87 have been found to be as high as $5.33/liter; and price differences across different brands were found to be as high as $8.50/liter.

283. The results revealed also that for some persons who have indicated that they use only unleaded 90 may be using a higher octane gasoline than is necessary. Petrojam has issued a flyer indicating the grade of gasoline which is suitable for particular types of vehicles. For example, the flyer indicated that unleaded 87 gasoline is suitable for Toyota Starlet and Corolla with cc ratings of 1.6 liter or less; Honda CRV with cc rating of 1.9 liter; all Hyundai make vehicles; and all Kia make vehicles.

Brand loyalty

284. In response to perceived difference in the quality of gasoline sold under the various brands 425 or 72.8 per cent of the respondents indicated that they believe that there is difference in quality. Of that number, 48.2 per cent indicated that they purchase only one brand; 24.6 per cent indicated that they purchase only two brands and 27.1 per cent indicated that they purchase three or more brands. For persons who indicated that they purchase only one brand, 23.6 per cent purchase only the Shell brand; approximately 11 per cent purchase only the Texaco brand; and 7.8 per cent purchase only the Esso brand.

Price Sensitivity

285. The survey sought also, to establish consumer conduct in relation to sensitivity towards prices. Of the 584 respondents, 51.7 per cent indicated that they find out the price of the gasoline prior to purchasing. Overall 70 per cent of the respondents indicated that they do not buy gasoline at retail outlets that do not display prices. Further, approximately 49 per cent of the respondents indicated that they have driven out of a gasoline retail outlet to purchase gasoline at another having found out the price at the first outlet.

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Spending Patterns

286. The results of the survey revealed 202 of the respondents spend between $1000 and $1500 while 101 respondents spend over $1500 on gasoline. Of those 303 persons who spend over $1000, approximately 60 per cent generally purchase gasoline on a weekly basis.

287. Approximately 85 per cent of the respondents indicated that their gasoline bills are entirely personal. Eleven per cent indicated that their gasoline bills are shared between themselves and their companies, while only 2.9 per cent indicated that their gasoline expenses are entirely company paid.

Conservation Measures

288. Persons were asked to indicate some of the measures they use to help reduce their gasoline bills. It is interesting to note that of the 584 respondents 524 indicated that they do something to reduce their gas bills but over 44 per cent of these persons do not check the price of gas before purchase. Over 24.3 per cent of respondents admitted to making fewer trips; 21.7 per cent indicated that they use the air conditioner less; and 5.8 per cent indicated that they drive slower.

289. Some of the other methods used by consumers to reduce their gasoline bills are car pooling, regular servicing of motor vehicles, purchasing gasoline when the temperature is cool, and avoiding heavy traffic.

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Appendix D: Vertical restraints and competition policy

290. Vertical restraints are provisions contained in agreements made between undertakings operating at different levels in the economic process, restricting the commercial freedom of one or more parties. The agreement containing such provisions might, for example, be between a manufacturer and a retailer, a manufacturer and a wholesaler, a wholesaler and a retailer, a retailer and a customer, or even between two wholesalers which, for the purposes of the agreement, operate at different stages in the supply chain. In this report, reference is made to agreements between a supplier and a retailer, but the same principles apply to agreements between any other two parties which, for the purposes of the agreement, operate at different stages in the supply chain.

291. Vertical agreements impose many conditions and restraints on contracting parties. Most of these would be considered to be common and acceptable contractual arrangements. Clear contractual arrangements are necessary to facilitate the smooth functioning of businesses and, by virtue of this, vertical restraints often allow firms to improve the efficiencies of their operations through creating transaction cost efficiencies.

292. While they are generally beneficial some vertical restraints may restrict competition. The types of restraints that may restrict competition, include, but are not limited to the following:

- *Resale price maintenance*—this practice occurs when the supplier specifies the resale price of the product. Commonly, the supplier will specify only a minimum or a maximum price.
- *Selective distribution*—this practice occurs when a distributor supplies to only a limited number of retailers who are restricted in their ability to re-sell the products.
- *Exclusive distribution*—this is a particular form of selective distribution whereby a manufacturer supplies to only one distributor in a particular territory or allows only one distributor to supply a particular class of customers, for example, businesses or consumers.
- *Exclusive dealing*—is the practice whereby a supplier agrees to supply goods to a retailer on the condition that the retailer does not sell the goods of competing suppliers;
- *Tie-in sale*—refers to the situation in which a supplier makes the purchase of one product (the “tying” product) conditional on the purchase of a second product (the “tied” product).
- *Full-line forcing*—is an extreme form of tie-in sale whereby the distributor must deal in the full range of the supplier’s product range.
- *Quantity forcing*—this practice occurs when the retailer is required to purchase a minimum quantity of a certain product.
- *Fidelity discounts*—is the practice whereby the retailer receives discounts based on the proportion of its sales that come from the supplier.

293. Any assessment of vertical restraints requires that consideration be given to both their potential anti-competitive effects and any countervailing benefits they produce.

294. The task is, therefore, to determine whether the net effect of a particular vertical restraint is anti-competitive or pro-competitive. In order to do so, it is useful to understand the

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conditions under which a vertical restraint is anti-competitive, compared to conditions under which it would be pro-competitive. The following discusses both the potential anti-competitive and pro-competitive effects of vertical restraints.

Anti-competitive effects of vertical restraints

295. The main negative effects on the market that may result from vertical restraints, and which competition law aims at preventing are the following:

- Foreclosure of other suppliers or other buyers through raising barriers to entry;
- Reduction in inter-brand competition between the companies operating at the same level of the market; and
- Reduction of intra-brand competition between distributors of the same brand.

296. The anti-competitive effects depend on various factors including the market share of the supplier(s) involved in the restraint, the proportion of the market covered by the restraint, the specific nature of the market and the exact nature of the restraint.

297. For most vertical restraints, competition concerns generally arise only if there is insufficient inter-brand competition, i.e., if market power exists at the level of the supplier or the buyer or both. Conceptually, market power is the power to raise price above the competitive level and, at least in the short term, to obtain supernormal profits. Where there are many firms competing in an unconcentrated market, it can be assumed that most vertical restraints will not have appreciable negative effects. A market is considered to be unconcentrated when its Hirschman-Herfindahl Index (HHI) is below 1,000.

298. There are, however, some restraints that are considered to be anti-competitive regardless of the market power of the player. The restraints that fall into this category are typically price restraints, for example, minimum resale price maintenance. Since minimum resale price maintenance directly restricts price competition, it is considered to significantly lessen competition regardless of the market shares of the firms.

Pro-competitive effects of vertical restraints

299. It is important to recognize that vertical restraints can also have positive effects by, in particular, promoting non-price competition and improved quality of services. When a company has no market power, it can try to increase its profits only by optimizing its manufacturing or distribution processes. In a number of situations, vertical restraints may be helpful since the usual arm's length dealings between a supplier and a buyer can lead to a sub-optimal level of investment and sales. To be considered pro-competitive, however, conditions must be such that there are higher levels of investment and sales (output) with the imposition of the restraints than without. The following describes some of the reasons that may justify the impositions of certain vertical restraints:

a) *To 'solve a "free-rider" problem'*—one distributor may free-ride on the investments and promotion efforts of another distributor. This type of problem is most common at the wholesale and retail levels. Exclusive distribution or similar restrictions may be helpful in avoiding such free-riding. Free riding can also occur between suppliers, for instance where one invests in promotion at the buyer's premises, in

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general at the retail level that may also attract customers for its competitors. Non-compete type restraints can help to overcome free-riding in this situation.

b) For there to be a problem, there needs to be a real free-rider issue. Free-riding between buyers can occur only on pre-sales services and not on after-sales services. The product will usually need to be relatively new or technically complex as the customer may otherwise very well know what he or she wants, based on past purchases. And the product must be of a reasonably high value as it is otherwise not attractive for a customer to go to one shop for information and to another to buy. Lastly, it must not be practical for the supplier to impose on all buyers, by contract, effective service requirements concerning pre-sales services.

c) Free-riding between suppliers is also restricted to specific situations, namely in cases where the promotion takes place at the buyer's premises and is generic, not brand specific.

d) *To 'open up or enter new markets'*—where a manufacturer wants to enter a new geographic market, for instance by exporting to another country for the first time this may involve special 'first time investments' by the distributor to establish the brand in the market. In order to persuade a local distributor to make these investments it may be necessary to provide territorial protection to the distributor so that he can recoup these investments by temporarily charging a higher price. Distributors based in other markets should then be restrained for a limited period from selling in the new market. This is a special case of the free-rider problem described under point (a).

e) *The 'certification free-rider issue'*—in some sectors, certain retailers have a reputation for stocking only 'quality' products. In such a case, selling through these retailers may be vital for the introduction of a new product. If the manufacturer cannot initially limit his sales to the premium stores, he runs the risk of being de-listed and the product introduction may fail. This means that there may be a reason for allowing for a limited duration a restriction such as exclusive distribution or selective distribution. It must be enough to guarantee introduction of the new product but not so long as to hinder large-scale dissemination. Such benefits are more likely with 'experience' goods or complex goods that represent a relatively large purchase for the final consumer.

f) *Transfer of knowledge*—the 'specific hold-up problem that may arise in the case of transfer of substantial know-how'. The know-how, once provided, cannot be taken back and the provider of the know-how may not want it to be used for or by his competitors. In as far as the know-how was not readily available to the buyer, is substantial and indispensable for the operation of the agreement, such a transfer may justify a non-compete type of restriction.

g) *'Capital market imperfections'*—the usual providers of capital (banks, equity markets) may provide capital sub-optimally when they have imperfect information on the quality of the borrower or there is an inadequate basis on which to secure the loan. The buyer or supplier may have better information and be able, through an exclusive relationship, to obtain extra security for his investment. Where the supplier provides the loan to the buyer this may lead to non-compete or quantity forcing on

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the buyer. Where the buyer provides the loan to the supplier this may be the reason for imposing exclusivity in supply or quantity forcing on the supplier.

h) *'Uniformity and quality standardization'*—a vertical restraint may help to increase sales by creating a brand image and thereby increasing the attractiveness of a product to the final consumer by imposing a certain measure of uniformity and quality standardization on the distributors. This can be found for instance in selective distribution and franchising.

300. The eight situations mentioned above make it clear that under certain conditions vertical agreements are likely to help realize efficiencies and the development of new markets and may offset possible negative effects. In general the case is strongest for vertical restraints of a limited duration, which help the introduction of new complex products or protect relationship-specific investments. A vertical restraint is sometimes necessary for as long as the supplier sells his product to the buyer (see in particular the situations described in points (a), (f) and (h)).

301. Finally, in circumstances where a vertical restraint is implemented due to its pro-competitive benefits, efforts must be made to ensure that the following two conditions hold:

- *The restraint is not more limiting than it should be*—in this regard, it should be noted that there is a large measure of substitutability between the different vertical restraints. This means that the same inefficiency problem can be solved by different vertical restraints. For instance, economies of scale in distribution may possibly be achieved by using exclusive distribution, selective distribution, quantity forcing or exclusive purchasing. This is important as the negative effects on competition may differ between the various vertical restraints. This plays a role when indispensability of the restraint is discussed.
- *The "switching costs" of resellers to move between suppliers is not unduly high*—that is, it is not excessively difficult for resellers to switch to a different supplier. To this end, contracts with anti-competitive vertical restraints must not be for long duration and, in general, there should be no post-non-compete obligations imposed on resellers. The only circumstances in which this would not apply would be when there are trade secrets or customer goodwill in the business that the undertaking can reasonably be expected to exploit.

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