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HOW ENFORCEMENT AGAINST PRIVATE ANTICOMPETITIVE CONDUCT HAS CONTRIBUTED TO ECONOMIC DEVELOPMENT

Contribution of Chinese Taipei

-- Session IV --

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1. Introduction

1. In the past two decades, Chinese Taipei has gone through a series of reforms to bring its economy closer to a market-oriented one where competition rather than the state dictates the rules. This process of economic liberalisation has several dimensions which coincide with elements of competition policy, including trade liberalisation, de-regulation, privatisation, and competition law.

2. In the early phase of economic liberalisation, the primary objectives of competition policy, *i.e.* efficient allocation of resources and better choices for consumers, can be effectively pursued by trade liberalisation, de-regulation, and supplemented by privatisation. Trade liberalisation and de-regulation tend to be very effective to restructure those sectors which are overly concentrated.

3. However, when a specific sector has been sufficiently liberalised by way of introducing new competitors into the market, competition law and its enforcement would play a primary role in maintaining the market order as well as avoiding distortion caused by private anti-competitive practices.

4. In this paper we present Chinese Taipei's experience in restructuring the market for house-use liquefied petroleum gas (LPG) with the implementation of competition policy. This example could illustrate how vigorous enforcement of competition law may work alongside trade liberalisation and de-regulation to facilitate the healthy function of a newly liberalised market, as well as to contribute to economic development.

2. LPG Market and its Liberalisation

5. Chinese Taipei started to produce and consume LPG in 1958. Soon LPG was deemed to be a household necessity. In 1971, the total consumption volume (including industrial usage and household usage) of LPG was 176,200 tons. Thirty years later, the total consumption volume of LPG was 1.6 million tons, and the turnover of the sector was well above NT\$ 40 billion. In 2001, there were around 3.5 million households, over half of the total number of households in Chinese Taipei, using LPG as their primary fuel.

6. In the past, the state-owned enterprise Chinese Petroleum Corporation (the CPC) was the only body charged with exploring, producing, importing, refining, and marketing petroleum and natural gas. Consequently, the CPC had been the only supplier of LPG until the market was liberalised in 1999.

2.1 Distribution Market

7. After 1961, the CPC began to grant sole dealership to other companies. In 1978, in order to provide more employment opportunities for veterans, the Government set up the Liquefied Petroleum Gas Supply Division (the LPGSD) under the Veterans Affairs Commission (the VAC), and requested the CPC to designate the LPGSD as its sole dealer of LPG.

8. The economic policy adopted by the Government at that time did not favour market rules in public utilities, including the LPG market. Since 1973, the sole dealers of the CPC, including the LPGSD, took the following measures to discourage competition in downstream distribution markets:

- restrict new entrants into the bottling and transport markets;

- stopped issuing new retail license;
- the prohibition of existing retailers moving their business location or changing their its business area;
- setting a purchase quota for each retailer; and
- setting the retail price.

9. The freezing of new entrants into the bottling, transport and retail markets kept the ratio between bottling companies to retailers steady at 1 to 30 from 1973 to 1993. Meanwhile, the demand for LPG increasing four times in twenty years made the distribution businesses acquire an unduly high profit without devoting much effort. Limiting the numbers of retail licenses also meant the licenses themselves could be sold at a very high price.

10. Nevertheless, the retailers and their trade associations jointly contributed to establish the LPG Retail Businesses Research and Development Fund in 1990 to further monopolise the distribution market and prevent any competition. The Fund subsidised retailers that had difficulties in running businesses to survive, or helped them to retreat from the retail market, so as to prevent them from engaging in price or services competition with other retailers.

2.2 *The Fair Trade Act and the Distribution Market*

11. After nearly 10 years of policy debate, Chinese Taipei decided in 1991 to establish a legal framework to strengthen the implementation of its competition policy. The Fair Trade Act's broad coverage was a reflection of the legislators' perception of the pervasiveness of anticompetitive and unfair business practices in the economy.

12. In early February 1992, the Fair Trade Act was enacted and established the Fair Trade Commission (the FTC). The newly established competition authority soon received numerous complaints regarding the LPGSD's misuse of monopolistic power. After conducting comprehensive investigations, in February 1993, the FTC reached the following conclusions and informed the regulator of the CPC, the Ministry of Economic Affairs (the MOEA) and the VAC:

- the CPC and the LPGSD enjoyed monopolistic positions in the supply and distribution markets of LPG respectively;
- the exclusive dealing arrangement between them would otherwise breach the Fair Trade Act, considering the contract was signed long before the enactment of the Act;
- the CPC shall not renew such exclusive dealing arrangement with the LPGSD or grant sole dealership to any single company after expiry of the current contract with the LPGSD in February 1993; and
- the CPC shall, within a reasonable period of time, publish the supervisory regulations for its distributors which must contain feasible and reasonable distributor qualification requirements, in conformity with the Fair Trade Act.

13. In September 1993, the CPC promulgated the qualification requirements for its LPG distributors and formally opened up the LPG distribution markets, including: dealership, bottling, transport, and retail.

By the end of April 1994, new entrants including 1 bottling company, 7 transport companies and 39 retailers were allowed to enter into this market. Further, by the end of 1994, there were already 4 dealers contracted to the CPC. Since then, along with the liberalisation of the whole petroleum products markets, new investments have been continuously devoted to this market.

2.3 *Liberalisation of the Supply Market*

14. In June 1996, the Government decided to permit the establishment of privately owned and operated petroleum refinery enterprises. This move gave these new firms with self-owned and operated refineries the right to produce, import, export, and market petroleum products, including LPG. The LPG import market was further opened in January 1999 to companies that did not own or operate petroleum refineries. Since then, the LPG market has been fully liberalised.

15. By the end of 2001, the number of LPG suppliers, including producers and importers, had increased to four, and the number of dealers had increased to ten. However, at this time there are still nearly 100 bottling and transport companies and slightly more than 3,000 retailers, while the ratio between bottling and transport companies and retailers is not much different than before the liberalisation of the LPG market.

3. *Economic Implication of the Liberalisation of LPG Market*

16. Before the house-use LPG distribution markets were de-regulated, the price of LPG and the gross profit of distributors at each level were decided by the Government. The sole dealer LPGSD earned NT\$0.9 from the CPC for every kilo of LPG it sold to downstream businesses at the price posted by the CPC. The retailers also sold bottled LPG to end-customers at the retail prices set by the Government. The retail prices varied between regions according to transportation costs, rent costs, labour costs and the reasonable level of profit taken into account by the Government.

3.1 *Competition in the Dealer Markets*

17. The CPC's storage tanks for locally-produced and imported LPG are located in the north (in Taoyuan and Keelung) and in the south (in Kaohsiung) respectively. Before the supply market was liberalised, the CPC required the existing ten dealers to draw LPG from the storage tank closest to their business location. This requirement grouped the dealers within two geographic markets, with three of them located in the north and the other seven in the south. In addition to the CPC's requirement, the difference in transportation costs between south and north, NT\$1.0 per kilo, which was higher than the gross profit the dealer received, also made the barrier between northern and southern dealer markets unbreakable.

18. The situation in the two dealer markets was quite different, however. In the south, the seven dealers competed with each other intensively. High rebate was offered by dealers to attract bottling and transport companies and caused the gross profit of dealers to decrease to only NT\$0.2 or NT\$0.3 per kilo of LPG. However, in the north, the three dealers did not really compete with each other, before the supply market was liberalised in mid-1999. Consequently the gross profit could still remain at NT\$0.9 or even increase to NT\$1.2 per kilo. Apparently, competition in the southern dealer market benefited the downstream bottling and transport companies. However, the dealer market did not work well in the north, possibly because of local oligopoly.

3.2 *Competition in the Supply Market*

19. In May 1999, new LPG importers began to enter into the supply market. To compete with the incumbent CPC, new suppliers paid a high rebate to dealers and made a gross profit of up to NT\$1.7 per

kilo for dealers that traded with them, much higher than the CPC's offer of NT\$0.9 per kilo. Price competition started to change the once solid market structure.

20. Meanwhile, due to new entrants into the transport market, transportation costs between south and north decreased from NT\$1.0 to NT\$0.8 or NT\$0.7 per kilo which was lower than the dealers' new gross profit of NT\$1.7 per kilo. Dealers in the south can then sell their LPG to the north market and still make profit. The boundary between the two dealer markets therefore gradually disappeared. The merging of the two dealer markets transformed the oligopoly in the north into a state of intensive competition. Since July 1999, the three dealers in the north began to raise their rebate to the bottling companies and decrease their own profit. In the long term, gross profit of all dealers is expected to stay at a competitive level, probably around NT\$0.2 or NT\$0.3 per kilo of LPG.

21. On the other hand, to ease storage pressures in the southern market caused by new competitors, from July 2000 the CPC started to subsidise its dealers in the north to draw LPG from storage tanks in the south. In October 2000, due to another new supplier entering into the supply market in the central region, the CPC decided to largely increase its rebate after March 2001. Thereafter, the bottling companies began to receive the rebate up to NT\$1.0 per kilo from the CPC.

3.3 *Competition in the Bottling and Retail Markets*

22. De-regulation and trade liberalisation introduced new entrants into the supply market and the dealer market and changed their structures and concentration ratio. The benefit enjoyed by the dealers and the bottling and transport companies was expected to pass on to the retailers and eventually to the consumers. However, the FTC found out that was not the case.

23. To comply with the regulations in the fire code concerning LPG businesses, the retailers need to obtain high-pressure gas storage permits as a prerequisite for operation. But to raise the necessary capital to acquire storage yards was quite difficult for such small sized businesses. Retailers depend on the larger scaled bottling companies to provide them with the necessary capital or with storage permits. This market practice generated a long-standing asymmetry of market power between the bottling companies and the retailers. The LPG bottling companies could thereby use their advantageous position to engage in anti-competitive practices to fix or raise prices.

4. Enforcement against Cartels in LPG Distribution Market

24. In August 2000, a retailer filed a complaint with the FTC alleging possible cartel monopolisation of a retail market, preventing it from entering into the northern market. This retailer was newly established in August 1999 and failed to find any of the LPG bottling companies willing to trade with it. Instead this retailer sought to obtain supply from other retailers. However soon other retailers were under pressure from bottling companies to prevent them from offering LPG to the new retailer.

25. After conducting comprehensive investigations in March 2003, the FTC concluded that 30 LPG bottling and transport companies in five neighbouring cities and counties in the north, some of whom were vertically integrated with upstream dealers, formed two regional cartels to monopolise the bottling and retail markets and thus violated the Fair Trade Act.

26. In April 1999, the FTC discovered that 16 LPG bottling companies in Keelung city, Taipei city and Taipei county and 14 in Taoyuan and Hsinchu counties formed two separate cartels, known as the Taipei Management Committee and the Taoyuan Management Committee respectively. Both of them used very similar tactics to monopolise the regional markets.

27. The cartels' members held meetings on an irregular basis to decide issues relating to the control of their respective market. Agreements they reached during the period of cartels included the following:

- preventing bottling companies from conducting price competition within their own business regions, or conducting cross-region competition;
- requesting retailers to trade with certain bottling companies and prohibiting them from switching trading counterparts freely;
- fixing or raising the price of the bottled LPG sold to the retailers, and demanding that retailers maintain or raise the resale prices;
- contributing to so-called market stabilisation funds and establishing joint bank accounts to manage the funds; and
- using market stabilisation funds to support a team to constantly monitor the practices of concerned bottling companies and retailers.

28. The FTC also found out, measures taken by the cartels to implement their decisions and to punish retailers not following the demands included:

- using market stabilisation funds to subsidise bottling companies which had difficulties in running their businesses, so as to prevent them conducting price competition;
- dispatching personnel to resolve disputes between retailers regarding competition for customers;
- deploying predatory pricing against any retailer who switched to another bottling company or reduced retail prices to compete for customers. The Committees would use their own employees and transport vehicles to sell LPG in this retailer's business area at an even lower price to force it to follow the cartel members' decisions; and
- threatening the suspension of supply if retailers refused to raise the retail price.

29. The two cartels covered more than 90% of LPG bottling and retail markets in the north. The market mechanism in the north for LPG was severely impaired and the rights and interests of millions of consumers infringed. The FTC believed the national economy, the consumer welfare and LPG market had been adversely affected in the following ways:

- national economy: once the cartels raised NT\$1.0 per kilo for bottling and transport fees or retail price, they could make NT\$1.05 million for every 700 tons of LPG. Considering that monthly trading volume of LPG in the said areas were over 20,000 tons, and the duration the cartels were in existence was more than 33 months, the undue profit received by cartel members was estimated to be in excess of NT\$1 billion;
- consumer welfare: the cartels forced retail prices to be raised to and maintained at an unreasonable high level and restricted the consumers' ability to choose a more desirable bottled LPG supplier, thus harming the consumers' interests directly;
- new investment in the distribution market: the cartels preventing any new entrants into the

distribution sector discouraged new investment in this sector and impaired the benefits produced by the liberalisation of the LPG market; and

- unfair competition in distribution market: some vertically integrated distribution enterprises could use undue profit received to engage in cross-subsidy to conduct or deepen unfair competition in the dealer market and further to harm market function in the whole distribution market.

30. In its decision, the FTC issued a cease-and-desist order to all cartel members, and imposed administrative fines on each member in accordance with their business scale, undue profit received, and co-operative attitude during the investigations. However, the ceiling of administrative fines stipulated in the Fair Trade Act on each violator per offence is NT\$25 million; therefore the total amount of the fine was only NT\$343.75 million. Still, once those members form a cartel again, each one of them will have to face the risk of criminal sanctions, including both criminal fines up to NT\$50 million and imprisonment up to three years.

5. Conclusion

31. In this paper, we have detailed how certain elements of competition policy, including de-regulation and trade liberalisation, have changed the structure of the household LPG market in Chinese Taipei. However, we have also illustrated how hard core cartels, the most egregious violations of competition law, according to the OECD Council's Recommendation, have distorted the function of a newly liberalised market, thus decreasing the benefits brought by economic liberalisation and harming consumers.

32. We have seen in this case that solely relying on market liberalisation was not enough to guarantee a healthy market function and the benefits produced thereby. It is the vigorous enforcement of another indispensable element of competition policy, competition law, which can halt anticompetitive practices, restore market function and contribute to economic development.