MFECC issues recommendations to foster competition in gasoline and diesel market

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Introduction

The constitutional energy amendment published in the *Official Gazette* on December 20 2013 transformed the Mexican energy market into a competitive market that enables private investment. As a result, gasoline and diesel prices will be liberalised after December 31 2017, as established by the new Hydrocarbon Law. In addition, the Hydrocarbon Law has enabled parties outside the Mexican Petroleum (Pemex) franchise model to sell gasoline and diesel since January 2015.

In light of this, the Mexican Federal Economic Competition Commission (MFECC) has issued a series of recommendations to foster competition in the gasoline and diesel market, taking into account legislative concerns and the market's performance.

Concerns

The MFECC's main concerns were as follows:

- In order to transit into a liberalised market, there has been a maximum price limit on public sales of gasoline and diesel since January 1 2015, which will be lifted on December 31 2017.(1) The maximum price is determined monthly by the Ministry of Treasury and Public Credit in accordance with a price band (with minimum and maximum values) that it determines annually. This band primarily takes into account product prices, taxes and guaranteed margins for retailers. However, it has generated the following concerns in regards to competition:
  - If product prices are reduced, the applicable taxes will be increased accordingly and it would therefore be impossible to transfer savings to end users. Ultimately, the tax component of the gasoline price band distorts the incentives for competitors to enter the market.
  - The formula for determining the maximum value does not reflect regional logistical costs of each economic agent, which can reduce competition and free concurrence.
- The Hydrocarbon Law granted the Energy Regulating Commission (CRE) the power to continue regulating first-hand sales of oil products and petrochemicals until there is more market competition.(2) As part of such regulation, a maximum price for first-hand sales is established using a formula. However, the formula:
  - does not reflect the cost of transportation from the reference market to the first-hand point of sale (given the fact that it considers outdated Pemex information), which can reduce competition and free concurrence;
  - is updated monthly and includes average prices. This can provoke strategic behaviour among acquirers and marketers that buy from Pemex only if its price is lower than the reference market, and vice versa (this behaviour may lead to Pemex implementing measures to avoid price arbitrage); and

    - uses only the Houston market as a reference, despite the fact that other US cities bordering with Mexico have different price dynamics and infrastructures and could be considered as reference markets for first-hand sales (given the fact that they compete with bordering Mexican cities).
- The lack of transportation and storage infrastructure can constitute a competition barrier for new competitors due to increased costs for the transportation and storage of their products.
- The CRE has not defined the specific mechanisms that Pemex must follow in the event of excess demand for the efficient allocation of storage and transportation capacity in accordance with the open-access principle.
- Restrictions relating to foreign investment and market participation can limit free concurrence in transportation activities.
- Few franchise and provision agreements between Pemex and gas stations have been amended to conform with the present competitive rules and principles, which limits competition.
- The grouping of gas stations can give substantial power to certain economic agents, which can prevent competitors entering the market and facilitate non-competitive practices.
- The Gasoline Associations' interest in buying large volumes of gasoline to improve fuel buying conditions may facilitate non-competitive practices.
- The local requirements pertaining to the location of gas stations (including the minimum permitted distance between stations) favour established economic agents and limit a competitor's right to choose the most efficient gas station configuration in accordance with objective market conditions.

Recommendations

Taking into account the above concerns, the MFECC issued the following recommendations.

- It was recommended that the Ministry of Treasury and Public Credit and the federal congress:
    - expand the minimum and maximum limits of the price band;
    - establish different regional public sale prices in order to reflect the differences in logistical costs and foster concurrence; and
    - consider up-to-date Pemex information, as approved by the CRE, to reflect the actual logistical costs of each region.
- It was recommended that the CRE:
    - make Pemex's actual transportation costs for each first-hand sale point transparent;
    - update the reference market prices considered in the first-hand sale maximum price formula on a weekly basis in order to avoid price arbitrage and consider other international markets in the formula;
    - guarantee the establishment of competitive, clear and transparent mechanisms to ensure the most efficient allocation of Pemex's transportation and storage capacity;
    - amend Pemex's franchise agreements and enable such agreements to be terminated by prior notice;
    - require that the MFECC be notified in advance of any transaction that consolidates several gas stations or enables several economic agents to acquire large volumes of gasoline;
    - require marketing permit applicants to provide certain information that can be used to identify economic groups at a regional level; and
    - require permit holders to publish their prices in a visible place and on the Internet.
- It was recommended that the federal congress amend the Foreign Investment Law to allow foreign investment participation.
- It was recommended that the Industrial Security and Environment Protection National Agency and local congresses and councils eliminate restrictions pertaining to the location of gas stations (including the minimum permitted distance between stations) that are not justified by security reasons.
- It was recommended that the Secretariat of Energy create an integrated pipelines and storage transportation system administered by an independent manager.

Comment

The MFECC's recommendations were intended to restrict the actions of various players in the gasoline and diesel market *ex ante* to avoid future competition concerns. In this regard, the relevant authorities should take the MFECC's recommendations seriously. Given that the gasoline and diesel market is transitioning to a liberalised market, the MFECC's intervention will be necessary only when there is a lack of effective competition conditions and free concurrence. However, it is important to establish a mechanism by which the CRE can:

- obtain useful and up-to-date information on the performance of the gasoline and diesel market; and
- share this information with the MFECC.

This will ensure that the MFECC has good knowledge of the market and enable it to exercise its powers effectively, including:

- investigating anti-competitive practices;
- determining whether there is a lack of competitive conditions;
- determining the existence of essential inputs; and
- determining the existence of competition barriers or illegal mergers that might affect competition.

Despite the MFECC's recommendations, the following concerns still exist:

- The transitory maximum public sale prices scheme may prevent new competitors from entering the market due to a lack of profitability in comparison to Pemex's price structure (which is used as a factor in the maximum price formula).
- It is unclear how the MFECC will review collaborations between competitors relating to the acquisition of large volumes of gasoline. In this regard, the MFECC should consider issuing specific guidelines for competitor collaboration (either general or market specific) that explain how collaborations must be carried out and when the MFECC should be notified.
- As suggested by the MFECC, local requirements pertaining to the minimum distance between gas stations may provoke artificial market segmentation between competitors, which requires an immediate solution.
- The creation of an integrated transportation system for pipelines and storage administered by an independent manager – intended to guarantee open access to pipeline transportation and storage infrastructure – may generate excessive costs in the market that could be transferred to end users. Therefore, as an alternative to this system, the MFECC should establish guidelines that guarantee open access to Pemex's infrastructure and promote compliance with these guidelines.

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Endnotes

(1) The price of gasoline and diesel will be liberalised after this date.

(2) A 'first-hand sale' is the first sale in Mexico by Pemex or its subsidiary bodies or divisions, or any other state-owned or governed company, to a third party or other first-hand sales body. This must be carried out at processing plants, oil refineries, imported product injection points or production camp hydrocarbons injection points.