COFECE-029-2018

COFECE issues recommendations to increase competition in the market for LP Gas

- *The Commission published the document **Transition Towards Competitive Energy Markets: LP Gas,** which provides an analysis of different links in the productive chain and recommendations to improve competition in this market.*

- *Few companies participate throughout the LPG market value chain -import, storage, distribution and retail. Vertical integration may be beneficial because of the efficiencies generated in these companies' operation, but it is also a condition that inhibits entry of new competitors that may be able to provide LPG under more favorable conditions, in terms of quality and price.*

- *The Energy Regulatory Commission (CRE) must ensure full compliance with the Hydrocarbon Law so that existing companies publish their transportation and storage capacities, as well as share their installed infrastructure to enable the participation of new agents in the market.*

- *According to COFECE's estimates, an increase in the number of competitors will significantly reduce LPG's average final price; for example, when a region increases the number of distributors from one to two, prices may diminish in 6.5%.*

Mexico City, June 18, 2018.- Diverse activities of the Mexican Liquid Petroleum Gas (LPG) industry -import, transportation, storage, distribution and retail-, have areas of opportunity to introduce greater competition, increase the number of competitors and improve LPG retail prices, as this fuel is used by 76% of households in Mexico. Increases in LPG retail prices have significant regressive effects in the poorest of Mexican households, which allocate more than three and a half times their budget on the purchase of LPG than families with greater financial resources.

The impact on the Mexicans' pockets motivated the Federal Economic Competition Commission (COFECE or Commission) to issue recommendations to the Energy Regulatory Commission (CRE) and other public agencies to ensure greater competition, via the document: *Transition Towards Competitive Energy Markets: LP Gas*. According to COFECE's estimates, an increase in the number of competitors results in significant reductions in LPG retail prices; for example, when a region sees an increase from one to two distributors, the price may diminish as much as 6.5%.

In January 2017 the retail price of LPG was released from control after 11 years of being subject to maximum prices. During this period, the Ministry of Economy determined prices through a calculation not linked to the LPG Spot Price.[1] Today, license holders freely set prices, considering international market prices, as well as the cost of each of the activities required to transport this fuel from its place of production to the areas of consumption: production or import, commercialization, transportation, storage and distribution, plus a sales margin.

However, over the past year, LPG prices increased, on average 8% in different regions of the country. Regardless of COFECE's Investigative Authority's investigation for possible anticompetitive conducts in the market for the distribution and commercialization of this fuel, the aforementioned document assesses public policy alternatives for existing companies to face increased competition, which would structurally reduce prices.

As for the import of this fuel, the document shows a 30% increase of imports from 2000-2015 in terms of total consumption; in the face of a fall in national production and the entry of private firms to the sector (which had been reserved to the State until the opening of the market), imports increased 60% by the end of 2017. Noteworthy is the absence of public information on import prices, that is the prices at which companies, private and Pemex, buy fuel abroad and import, given this level of imports. This makes impossible the analysis of importing and retailing firm's commercialization margins.

The document also shows the existence of a reduced number of groups that simultaneously participate in all activities along the production chain, from LPG import to retail. Vertical integration may present benefits in terms of efficiencies generated by companies in their operation, it is also a condition that could block entry of new competitors. For example, the opening of the market in 2016 to imports generated greater concentration, which is

[1] In Mexico's legislation, this refers to *precio de referencia internacional de la molécula*

probably due to the low number of economic groups capable of importing and storing the product before commercialization.

The evidence gathered for this report shows there may be unused capacity of LPG transportation and storage under Pemex and private firms. This is infrastructure not fully exploited and not available to other players, which hinders market entry or increases production costs. Thus, recommendations for CRE were issued so Pemex and private companies in the sector adhere to the *Hydrocarbon Law* as soon as possible and share their infrastructure, as a way of fostering the entry of new competitors, especially considering: 1) the underutilization of pipeline transportation and LPG storage; 2) the legal obligation to publish their capacity and operation infrastructure, which has not been complied with; and 3) the obligation to hold open seasons in the assignment of unutilized infrastructure, as per regulatory framework.

Notwithstanding the opening of the market, in the final stage of the chain, distribution and sale to the final consumer, there has not been an increase of market participants. In 2015, 48% of the domestic market was concentrated in five economic groups, in 2016 this level was maintained, and 2017 saw a 53% increase. These market concentrations deepen regionally in the distribution of this fuel; the states of Yucatan, Baja California Sur and the pacific region stand out.

Transition Towards Competitive Energy Markets: LP Gas specifically recommends the following to CRE:

- **Imports:** gather and publish data on price movements based on data collected at the point of entry into Mexico, with the objective of having reliable information on LPG companies' sales margins.

- **Commercialization**: suspend or deny licenses to vertically integrated agents (cross-shareholding) that do not request COFECE's favorable opinion as per article 83 of the *Hydrocarbon Law*.

- **Transportation and storage**:

    - Guarantee any company free access to pipelines and storage terminals, property of Pemex and private companies.

- Pemex and private companies must comply with their obligation to publish information on the effectively utilized capacity in each pipeline system and storage terminal to identify underutilization problems and/or artificial restrictions. Failure in compliance should result in the enforcement of the appropriate sanctions.

- Review the cases in which Open Seasons should be held for the assignment of unutilized capacity.

- Impose regulation on private LPG storage companies, and harmonize open access to storage terminals at which there is pipeline transportation.

- **Distribution**: impose on distributors that hire or have commercial ties with commission agents the obligation of reporting prices and quantities sold through these economic agents.

In terms of retail, COFECE also recommends:

- DICONSA should evaluate the possibility of using all stores as a point of sale of LPG through public tenders with a regional scope in order to select the supplier with the best conditions in terms of price and service at those stores.

- Competent authorities, governments and local legislatures should eliminate barriers to the establishment of LPG retailers included in local legislations.

As shown in the document, a successful transition to open markets and competition requires detailed and reliable information on import, commercialization, transportation, storage and retail of LPG activities, as well as the strict enforcement of the regulation set forth in the *Hydrocarbon Law*.

It is only through fostering the entry of more players (such as new and existing firms) in diverse regions of the country, fully exploiting the installed pipeline infrastructure and storage, and the strict enforcement of existing legislation in all links of the chain, may Mexicans be guaranteed conditions that will lead to the best possible prices in the market.

See full document in Spanish: Transition Towards Competitive Energy Markets: LP Gas

– 000 –

A BETTER MEXICO IS EVERYONE'S BUSINESS

The Federal Economic Competition Commission is entrusted with safeguarding competition and free market access. Through this, it contributes to consumer welfare and the efficient functioning of markets. Through its work, COFECE seeks better conditions for consumers, greater output, better services and a "level playing field" for businesses