EN

Case No COMP/M.4348 - PKN / MAZEIKIU

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REGULATION (EC) No 139/2004
MERGER PROCEDURE

Article 6(1)(b) NON-OPPOSITION
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COMMISSION OF THE EUROPEAN COMMUNITIES

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PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying party

Dear Sir/Madam,

Subject : Case No COMP/M.4348 - PKN/ MAZEIKIU

1. On 29 September 2006, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 139/2004 (the "Merger Regulation") by which the undertaking Polski Koncern Naftowy Orlen S.A. ("PKN", Poland) acquires within the meaning of Article 3(1)(b) of the Council Regulation sole control of the undertaking AB Mažeikiu Nafta ("Mazeikiu". Lithuania), at present jointly controlled by the group Yukos International UK B.V. and The Republic of Lithuania, by way of purchase of shares.

I. THE PARTIES AND THE OPERATION

2. PKN is a Polish joint stock public company, active in the refining of crude oil and the wholesale and retail of petroleum products in Poland, Czech Republic, and Germany. Mazeikiu is a Lithuanian public company active in the refining of crude oil and the wholesale and retail of petroleum products in the Baltic States and Poland.

3. Currently Mazeikiu is owned by: Yukos International UK B.V. (53.7%), the Republic of Lithuania (40.7%), and free float (5.6%). The transaction will be effected in two stages. In the first stage PKN will acquire all the shares held by Yukos in Mazeikiu. In the second stage PKN would acquire […]% of Mazeikiu's shares from Lithuanian government which will retain a […]. After closing of the transaction PKN will own […]%, the Government of Lithuania […]%, and the public the remaining […]% of Mazeiku's shares[1]. The agreements for both stages of the transaction are conditional upon each other.

[1] Pursuant to the Lithuanian Securities Law, after closing of the transaction, PKN will have to launch a mandatory tender offer to purchase the remaining […] % free float shares of Mazeikiu.

4. The acquisition of majority of Mazeikiu's shares, will confer to PKN sole control over Mazeikiu. Therefore the transaction constitutes a concentration under the Merger Regulation.

II. COMMUNITY DIMENSION

5. The notified concentration meets the turnover thresholds of Article 1(2) of the Merger Regulation. The combined turnover of the undertakings concerned globally exceeds 5 billion euros (PKN 11,5 billion euros, Mazeikiu 3,2 billion euros), with the aggregated Community-wide turnover of each of the two parties being more than 250 million euros (PKN […] euros, Mazeikiu […] euros). None of the parties achieves more then two-thirds of its aggregated Community-wide turnover within one Member State. The transaction thus has a Community dimension.

III. RELEVANT MARKETS

6. The proposed transaction would give rise to horizontal overlaps (i) on the EEA-wide market for ex-refinery/cargo sales of diesel, gasoline and LPG, and (ii) on the Polish market for non-retail sales of diesel and gasoline. Vertically affected markets are: the Polish, Lithuanian, Czech, and Estonian non-retail markets for sales of diesel and gasoline and retail sales of motor fuels in Poland. Although both parties to the transaction are also active in a number of other markets, such as fuel oil[2], kerosene[3], bitumen[4], sulphur[5] these markets will not be further discussed as the parties operate in separate geographical markets, and hence the current transaction does not give rise to competition concerns on these markets.

<u>Relevant product markets</u>

7. The concerned sector is that of downstream oil activities, as described by the Commission in its *Exxon/Mobil* decision[6], as neither of the parties is active in upstream oil activities (*i.e.* the exploration, development, production, shipping and sale of crude oil process). Downstream oil activities include crude oil refining, as well as the marketing and distribution, at ex-refinery/cargo, non-retail and retail levels, of refined products to customers.

8. With respect to the sales of refined oil products PKN and Mazeikiu are active at three levels of distribution encompassing (i) ex-refinery/cargo sales, (ii) non-retail sales and (iii) retail sales. According to the parties, these three levels of sales should be

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2 According to the previous practice, heavy fuel oil and light fuel oil constitute separate relevant product markets and these markets are at largest national. See: M.3110 Southern German Package 11/06/2003, M.574, Saudi Amraco / Moh., 23/05/1995. The parties to the current transaction are not active on the same national markets.

3 In line with the Commission's past practice, aviation fuel forms a separate single market which is geographically limited to a single airport. See: M.1383 Exxon / Mobil, 29/09/1999, M.1628, TotalFina/Elf, 09/02/2000. Both parties to the Transaction conduct business on this product market, but on completely distinct geographic areas, so that their activities do not overlap.

4 Based on the Commission's past practice, bitumen constitutes a separate product market which is national in scope. See: M.3543 PKN Orlen / Unipetrol, 20/04/2005. There are no geographic overlaps between the activities of the parties.

5 In line with the Commission's past practice sulphur forms a separate product market. The Commission has in the past retained the geographic market for sulphur to be at least European-wide. See: M.1628, TotalFina/Elf, 09/02/2000. The parties submit that the aggregate market share of the parties to the Transaction is well below 15 %, with a very marginal aggregation of market shares.

6 M.1383 Exxon/Mobil, 29/09/1999, para.7.

distinguished as they address different characteristics of demand and entail different distribution logistics. However, in the Commission's previous decisions[7], although the distinction between primary and secondary stage of non-retail distribution (e.g ex-refinery/cargo sales and non-retail sales) was mentioned, the competition assessment was mainly based on combined non-retail sales of fuels which included both distribution levels. The Commission found in previous cases, that both at the ex-refinery and non-retail levels it is not possible to aggregate the different types of fuels into one category. Therefore sales at these two levels are further subdivided into sales of gasoline, diesel, fuel oil and LPG ("the fuels")[8].

Ex-refinery cargo sales / non-retail sales

9. Ex-refinery/cargo sales constitute a primary level of distribution and according to the parties, should be distinguished from smaller non-retail sales of the fuels (secondary level of distribution)[9]. The ex-refinery/cargo sales consist of large volume sales[10] by refiners directly at the refinery gate, or delivered by primary transport (*i.e.* generally by rail, pipeline, ship or barge) to clients' terminals (storage facilities) inland or abroad. The customers are wholesalers, traders or internal wholesale arm of the refiners which usually own or rent large storage facilities. In most cases the burden of VAT and other excise taxes falls on the customer.

10. The non-retail sales consist of smaller volumes,[11] usually directly from the suppliers' inland storage facilities, which are delivered by secondary transport (generally by truck) to the clients' premises. The typical customers include (i) branded and unbranded service stations; (ii) independent small resellers; (iii) industrial and commercial consumers (i.e. transportation companies) as well as public institutions (i.e. hospitals, the army); and to a marginal extent (iv) individual consumers. The non-retail sales are usually made on FOT basis, *i.e.* excise taxes and VAT are paid by the seller.

11. The respondents (customers or competitors identified by the parties as active at cargo level) to the market investigation have largely agreed with the parties' proposal to distinguish between the ex refinery/cargo sales and non-retail sales of fuels. According to the majority of the parties' competitors such a distinction is common in the industry. Ex refinery sales typically consist of sales made in large lots and on a spot basis by refiners to other oil companies, traders, large industrial customers. They are distinct from non-retail sales which involve value added services such as: smaller delivery' sizes (truck size), multiple delivery locations, infrastructure of storage and terminals, and often payment term flexibility.

12. A number of customers mentioned that at cargo level they do not pay excise duties at the moment of delivery. Moreover the importers in Poland are obliged to keep mandatory fuel reserves and hence they must face higher costs than those incurred by the wholesalers active only on the national level. However, according to some of the parties' competitors, although cargo/ex refinery sales and non-retail sales constitute different commercial-distribution channels, they do not necessary constitute separate

[7] M.1383 Exxon/Mobil, 29/09/1999, para 430; M. 727 BP/Mobil, paragraph 28

[8] M.1383 Exxon/Mobil paragraph: 438,439; M.3516 Repsol YPF/Shell Portugal 13/09/2004, paragraph 11.

[9] M.1383 Exxon/Mobil paragraph 431, M. 727 BP/Mobil, paragraph 28, M.3291 Preem / Skandinaviska Raffinaderi 1/12/2003, para 11.

[10] Train loads of 2.5-3 ktons; barge volumes of 2-5 ktons; pipeline volumes of 4-12 ktons; or up to 80 ktons by ship.

[11] Around 20-30 tons at one time.

relevant product markets, since the main factor is the competition between the refineries. It was also pointed out by one of PKN's customers that PKN activities on Polish market are concentrated on secondary distribution (from storage facilities) rather then from primary distribution level, and hence, it is difficult to separate these two markets.[12]

13. Moreover, the market arrangements proved not to be as straightforward as submitted by the parties: although the delivery sizes at primary level of distribution tend to be bigger then at secondary level of distribution[13], fuels are bought both from refineries and storage facilities[14]. Also, although products for cargo customers are delivered by rail, pipeline, ship or barge, truck deliveries are made at both levels of distribution.[15] Furthermore, depending on contract arrangements transport costs are paid by either suppliers or customers.[16]

14. Most of the competitors and customers operating at non-retail level who responded to market investigation also confirmed that the distinction between ex-refinery sales and non-retail sales is appropriate at least from the operational point of view[17]. This distinction is further reflected in practice by the fact that most of the non-retail customers buy the bulk of their supply from storage facilities located around the country and within a distance of less than 150kms from their premises[18]. However, this distinction becomes blurred in case of companies located within 150kms from the refinery site. Although the customers located within this range buy directly at refineries, their purchase patterns suggest that the refinery acts more like a wholesaler at secondary level of distribution, due to small delivery size, deliveries usually by truck, and the fact that all the duties and taxes are paid by the supplier.

15. In any case the exact product market definition can be left open, as the competition assessment would not be significantly different if the transaction is assessed on the basis of separate product markets for non-retail sales and ex-refinery cargo sales or on combined market for non-retail sales (including both levels of distribution).

Retail sales

16. Retail sales involve sales of fuels to motorists through service stations. In line with the Commission's past practice, the notifying party submits that the relevant product market is constituted by the retail sales of motor fuels with no need for a further segmentation between gasoline, diesel and LPG[19]. Although from the demand side there is no substitutability between those products, as motorists must use the type of fuel suitable for their vehicle, from the supply side however there is substitutability as the distribution of these different types of fuels is made at the same point of sales in order to serve the maximum number of automotive customers.

17. In the present case there is no need to decide whether ex refinery/cargo sales, non-retail sales and retail sales, constitute separate relevant product markets since,

[12] See questionnaires to cargo competitors and cargo customers, question 4.
[13] See questionnaires to cargo competitors and cargo customers, question 6.
[14] See questionnaires to cargo competitors and cargo customers, question 5.
[15] See questionnaires to cargo competitors and cargo customers, question 8.
[16] See questionnaires to cargo competitors and cargo customers, question 7.
[17] See questionnaires to non-retail competitors and non-retail customers, questions 4 and 5.
[18] See questionnaires to non-retail competitors and non-retail customers, questions 6 and 11
[19] M.1383 Exxon/Mobil; M.3516 Repsol YPF / Shell Portugal; M.3291 Preem / Skandinaviska Raffinaderi 1/12/2003.

whichever definitions are used, the transaction will not give rise to competition concerns.

Relevant geographical markets

Gasoline/diesel

Ex refinery/cargo sales

18. In BP/Mobil[20], the Commission found that the relevant geographical market for ex-refinery sales appeared to be the EU or Western Europe wide. However in another decision Preem/Skandinaviska[21,] while assessing a transaction in Sweden, the Commission concluded that, given the significant imports and exports between the Scandinavian countries and the high level of overall imports, the relevant geographic market is at least Scandinavian (meaning here Finland, Norway, Sweden and Denmark).

19. In the current transaction, the parties submit that the markets for ex-refinery/cargo sales of diesel and gasoline are at least EU-wide, including new member states. Ex-refinery diesel and gasoline are traded commodities bought and sold internationally, and moving easily across international borders. In most European countries import and export rates are high. The transportation costs are relatively low and only marginally impact the total product price[22]. The ex-refinery prices in the EEA track each other closely. These prices are reported by independent, commercial price reporting agencies, such as Platts and Argus.

20. The results of the market investigation were not conclusive. Some of the respondents considered cargo sales of gasoline and diesel as being EEA-wide or even wider (possibly including CIS countries). This is because transport costs tend to be low when compared with product prices. Cargo market prices around the world track each other closely and in case of price differences export from different regions (CIS, Middle East and the US) is possible. However, some other players considered these markets to be regional, consisting of the CEE countries[23] and often Austria and Germany. Also some competitors and customers active mainly at national level, proposed national markets.[24]

21. There are certain elements pointing towards the EEA-wide dimension of the markets in question. In particular, the market respondents largely confirmed that transport costs are rather small with the average transport cost representing between 1% and 4% of the total price for both gasoline/diesel.[25] Also import volumes from outside the CEE region as a percentage of the total sales/purchases in the same region tends to be significant, also pointing towards wider geographic dimension of these markets.[26]

20 M. 727 BP/Mobil, paragraph 34.

21 M.3291 Preem/Skandinaviska Raffinaderi, paragraph 14.

22 Transportation costs are estimated to be in a range from 1 to 5 % of total product price.

23 Central and Eastern Europe, including: Poland, Czech Republic, Slovakia, Hungary and Baltic States: Lithuania, Latvia, Estonia

24 See questionnaires to cargo competitors, question 8 and questionnaires to cargo customers, question 9.

25 See questionnaires to cargo competitors, question 12 and questionnaires to cargo customers, question 16.

26 See questionnaires to cargo competitors, question 14 and questionnaires to cargo customers, question 12.

Finally, the market investigation confirmed that the prices are linked to the PLATTS quotations.[27]

22. On the other hand, some competitors and customers mentioned that price differences between different countries in the EEA occur due to demand fluctuations and different indexing.[28] These price differences are more evident when compared with the CIS countries.[29] A majority of the respondents mentioned that fuel quality requirements of the European Union prevent substantial imports from Russia and other CIS countries and it will take time for the CIS refineries to adjust their production in order to meet these requirements.[30] Accordingly, at this stage of market development, it appears that geographic dimension of cargo sales of gasoline and diesel are not wider then the EEA.

23. The other question is whether ex-refinery markets should be narrowed to the CEE region. Almost all competitors and customers confirmed that they sell/buy gasoline/diesel within 500 km range[31] and their cargo customers or suppliers are based in this region.[32] However, when asked about alternative suppliers, cargo customers from the CEE usually point towards suppliers from neighbouring countries of this region, Germany and Austria and in the case of customers from Baltic States, also Scandinavia and the CIS countries.[33] It might mean that the catchment areas of 500 km overlap to certain extent to lead towards wider geographic market then current distances.

24. However, for the purpose of this decision it is not necessary to conclude whether ex-refinery sales of gasoline and diesel in Poland and Lithuania are part of an EEA-wide market or part of a narrower regional market including the CEE countries and Baltic States, as irrespective of the exact geographic market definition, the current transaction does not give rise to competition concerns.

Non-retail sales

25. In a previous decision concerning the Polish and Czech non-retail sales of gasoline and diesel the Commission found that the relevant markets appeared to be national, leaving the exact market definition open[34]. In other cases, depending on the member state, the Commission suggested local markets[35]; national markets[36] and even regional markets[37].

26. The parties submit that both in Poland and Lithuania conditions of non-retail sales of diesel and gasoline are to a large extent homogenous throughout each national territory; in particular, there are no areas within these countries where competitive conditions for the non-retail supply of gasoline and diesel differ significantly. Although the radius around each point of supply is usually in the range of 100-150 km,

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[27] See questionnaires to cargo competitors, question 15 and questionnaires to cargo customers, question 13.
[28] See questionnaires to cargo competitors, question 16 and questionnaires to cargo customers, question 14.
[29] See questionnaires to cargo competitors, question 17 and questionnaires to cargo customers, question 15.
[30] See questionnaires to cargo competitors, question 18 and questionnaires to cargo customers, question 17.
[31] See questionnaires to cargo competitors, question 13 and questionnaires to cargo customers, question 12.
[32] See questionnaires to cargo competitors, question 13 and questionnaires to cargo customers, question 12.
[33] See questionnaires to cargo customers, question 10.
[34] M. 3543 PKN Orlen/Unipetrol, paragraphs 18-19.
[35] M.1383 Exxon/Mobil, paragraphs: 443, 445.
[36] M.4002 OMV/Aral, paragraphs: 19-22; M.3516 Repsol YPF/Shell Portugal, paragraph 12
[37] M.3291 Preem/ Skandinavska Raffineradi, paragraphs: 16 and 17

the trade areas and storage facilities overlap to a large extent, with the consequence that it is difficult to isolate one regional area from the others. The contracts for the supply of gasoline and diesel to non-retail customers are negotiated at national rather than local level.

27. Since, in the previous decisions, the exact market definition was left open the market test focused on the parties' competitive position in North-East Poland where Maziekiu is more active. In the market investigation none of the customers pointed to any region in Poland where PKN and Mazeikiu are the only viable suppliers[38]. Finally all the competitors and customers who expressed their view pointed out that the non-retail market for gasoline, diesel is most likely to be national in scope, and for LPG some respondents pointed out that it could be even wider than national[39]. For the purpose of this transaction is not necessary to conclude on the exact geographic market dimension of non-retail sales of gasoline/diesel/LPG as irrespective of the exact geographic market definition, the current transaction does not give rise to competition concerns.

28. In a previous decision concerning the Polish market (PKN Orlen/Unipetrol) the combined non-retail/ex-refinery markets for sales of gasoline and diesel (including both primary and secondary level of distribution), were considered to be national. The current market investigation tends to support this view. As a result the hypothetical combined markets for sales of gasoline and diesel will be assessed at national level.

Retail sales

29. In line with the Commission's previous practice, the notifying party regards the market for retail sales as being at the widest national in scope[40]. On the one hand, a geographic market for fuel retailing is characterised by a local element in so far as the demand is constituted by motorists who are normally supplied by the service stations near to their centre of activity. On the other hand, there is normally a overlap between service stations' catchment areas, which will not only determine the competitive interactions between geographically neighbouring service stations, but will also have a "knock-on" or "chain-reaction" effect on more distant service stations.

30. In the present case the question of whether the geographical market should be defined as local or national can be left open, as no competition concerns arise under any of these alternative market definitions. Moreover due to substantial taxation differences the retail market is by no wider than national.

LPG

Ex refinery/cargo

31. The notifying party submits that the geographic market for ex-refinery LPG encompasses at least the territories of the EEA and, in all likelihood also Russia and the other CIS[41] countries. The arguments in favour of this market definition are the following: (i) large trade flows within the EEA and between the EEA and the CIS countries[42]; (ii) price inter-dependence within the EEA and between the EEA and the

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38 See questionnaires to non-retail competitors, question 23 and non-retail customers, question 25.

39 See questionnaires to non-retail competitors, question 16 and non-retail customers, question 17.

40 M.1383 Exxon / Móbil, M.3516 Repsol YPF / Shell Portugal; M.3291 Preem/Skandinaviska Raffinaderi

41 Commonwealth or Independent Sates

42 Imports of LPG to Poland amount to almost 88% of total sales.

CIS countries; (iii) overlapping catchment areas of the refineries trading activity due to large transportation distances (up to 600 km).

32. According to the results of market investigation, ex refinery/cargo sales of LPG appear to be EEA-wide or even wider, including CIS countries. Suppliers from CIS countries already supply cargo customers in the CEE region.[43] Moreover, the quality considerations that currently limit competitive pressure from the CIS countries on gasoline and diesel markets are less important for LPG.[44] However, according to some customers, suppliers from the CIS countries often do not meet quality regulations.[45] Also, the market test has confirmed that at least some customers already import substantial volumes of LPG from the CIS countries. This tends to support parties' definition. However, for the purpose of the present decision, it can be left open whether the relevant geographic market definition for cargo sales of LPG is EEA wide or wider.

IV. COMPETITIVE ASSESSMENT

<u>Horizontal aspects</u>

33. The proposed transaction gives rise to horizontal overlaps (i) on the EEA-wide market for ex-refinery/cargo sales of diesel, gasoline and LPG, and (ii) on the Polish market for non-retail sales of diesel and gasoline.

Ex-refinery/cargo sales of diesel, gasoline

34. The total EEA production capacity of crude oil amounts to 740 million tones annually. PKN owns three refineries in Poland (Plock, Trzebinia and Jedlicze refineries) with annual production capacity of […] tons annually and two refineries in the Czech Republic (Unipetrol's refineries: Litvinov and Kralupy) with annual production capacity of […] tons of crude oil. The parties estimate that PKN/Unipetrol's share of the EEA-wide capacity is below [<5]%. Mazeikiu operates production capacity of approximately […] tons of crude oil annually (Mazeikiu refinery), hence its share of the EEA-wide capacity is below [<5]%.

35. The parties submit that the size of the EEA market for ex-refinery/cargo sales of diesel amounted to 175 million tonnes and of gasoline amounted to 105 million tonnes in 2005. The EEA-wide market is stable and no new refineries are expected to be built in the EEA. Growth in diesel demand (approaching 2 % per year) is partially offset by a decline in gas oil demand. Furthermore it is predicted that the gasoline demand will continue to decline (declining by 0.5 % per year).

36. On the EEA-wide market for ex-refinery/cargo sales of diesel and gasoline, the combined entity would achieve market shares of [<5]% for diesel (PKN [<5]% and Mazeikiu [<5]%) and [0-10]% for gasoline (PKN [<5]% and Mazeikiu [<5]%). PKN and Mazeikiu are small players in a fragmented market (with the biggest players Exxon Mobil, Total, and Shell each holding market shares of between [10-20]% and [10-20]% of the EEA-level, and the rest of competitors each representing 5% or less of the EEA sales). On narrower geographic market defined as CEE including Baltic States the transaction would not give rise to any competition concerns, either, as the

43 See questionnaires to cargo customers, question 10.

44 See questionnaires to cargo competitors, question 18 and questionnaires to cargo customers, question 17.

45 See questionnaires to cargo customers, question 15.

combined entity would have a market share smaller than 15% ([10-20]% for diesel, [10-20]% for gasoline).

37. According to the parties, switching costs are insignificant for customers at the ex-refinery/cargo level. In particular, supply contracts are of limited duration of one year at the most, and agreements often provide for the possibility of early termination at the end of each quarter without any financial consequence for the terminating party. As a result, there are examples of ex-refinery/cargo customers having switched suppliers in response to a small increase in price.[46] The market investigation has confirmed that the majority of contracts are of short duration (1 year or spot contracts).[47] Also, there is substantial evidence that customers have changed their suppliers.[48]

38. Moreover, the parties submit that there is a considerable buyer power as customers at the ex-refinery/cargo level include non-retail branches of vertically integrated oil companies and large traders. Additionally they usually own or lease storage infrastructures that allow them to import and store large quantities of fuels from different suppliers. This was largely confirmed by the results of market investigation.[49]

39. The parties submit that refineries from outside the EEA, mainly in CIS countries exercise strong competitive pressure on European market for cargo/ex refinery sales of fuels. However, as imports of gasoline from outside the EEA must satisfy EEA quality standards the current volumes of imports of gasoline from outside the EEA are low. It is expected that volumes of diesel/gasoline imports from CIS countries will increase due to quality improvements resulting from investments being made or planned. According to the results of market investigation, half of the parties' customers and majority of competitors expect that import from CIS countries would intensify; however, upgrading of refineries might take some time.[50]

Ex-refinery/cargo sales of LPG

40. According to the parties' estimates the size of the EEA, Russia and CIS cargo market for LPG is of 40 million tonnes. The combined market share of the parties would be [<5]% (PKN [<5]%, Mazeikiu [<5]%). If a narrower, EEA-wide market were to be established, the parties would have [<5]% of the cargo sales of LPG (PKN [<5]%, Mazeikiu [<5]%). If national markets were to be considered, the parties submit that PKN and Mazeikiu are simultaneously present at ex-refinery/cargo level only in Poland, where they would hold market shares of [0-10]% and [0-10] % respectively.[51] The parties would face strong competition from such players as BP, Primagaz and Baltikgaz. No competition concerns arise on these markets.

Non-retail sales of diesel and gasoline

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46 For example Mazeikiu recently lost […], which switched to imported gasoline from […] due to [<5]% price increase per ton.

47 See questionnaires to cargo customers, question 24.

48 See questionnaires to cargo customers, question 26.

49 See questionnaires to cargo customers, question 9 and 22.

50 See questionnaires to cargo competitors, question 36 and questionnaires to cargo customers, question 30.

51 It needs to be noted that the PKN's market share might be overestimated by the parties, as majority of PKN cargo sales are internal. PKN sells LPG at ex-refinery/cargo level to its subsidiaries Orlen Gas, which operates at non-retail level. There is no overlap between the parties' activities on non-retail level for LPG in Poland as Mazeiku only sales LPG to Polish customers at cargo level.

41. The total size of Polish market for non-retail sales of diesel amounts to 6.8 million tonnes, while the volume of sales of gasoline is 4.3 million tonnes. Both PKN and Mazeikiu are present on the Polish markets for non-retail sales of diesel and gasoline, with the combined market shares of respectively [50-60]% and [60-70]% in 2005 (PKN [40-50] % and Mazeikiu [<5]%for diesel; and PKN [60-70]% and Mazeikiu [<5]% for gasoline).

42. PKN is the biggest company active on these markets. The main competitor of PKN is Lotos (the second largest refinery and petrochemical producer in Poland) with market shares of [20-30]% for diesel and [20-30]% for gasoline. The rest of competitors are much smaller including J&S Energy S.A. ([0-10]% diesel, [<5]% gasoline), Slovnaft ([<5]% diesel, [0-10]% gasoline) and BP, Shell with market shares around [<5]%. As it can be seen from above, Mazeikiu is not a large player on these markets.

43. The total non-retail sales in a potential local market made up of North Eastern Poland, close to Polish-Lithuanian boarder are relatively small: 329kt of gasoline and 750 kt of diesel. According to the parties' estimates, their combined market shares for gasoline would amount to [40-50]% (with only [<5]% overlap due to Mazeikiu's position) and for diesel [40-50]% (however with Mazeikiu's market share of [0-10]%). Their main competitor in North East Poland is Lotos, which also is the biggest player in this region (gasoline – [50-60]%, diesel – [40-50]%). It is worth noting that the Belarusian company - Mozyr has some sales of diesel in this region ([<5]% market share).

44. The market test has confirmed that the proposed transaction would not significantly impede competition on a narrower geographic market such as North Eastern Poland. The Commission finds that this market is characterised by: (i) ease of entry (most of the infrastructure belongs to an independent operator Naftobazy); (ii) potential competition from refineries located in the CIS (iii) buyer power from vertically integrated branded petrol stations (such as BP, Shell, etc.). Morover: (iv) wholesalers from the rest of Poland would create a significant constraint on the parties if they decided to raise prices above national level; (vi) due to the small size of the market even a very small entry could completely change the status quo. The last two arguments make also any coordinated behaviour unsustainable.

45. With respect to storage infrastructure, PKN has the biggest and the most wide spread network in Poland, including the network of pipelines, […] storage facilities throughout Poland for a total capacity of […], and additionally PKN leases storage capacity in five Naftobazy[52] storage depots. Mazeikiu does not own storage facilities in Poland, instead it leases storage capacity from Naftobazy.

46. The market test confirmed that the access to storage facilities, which is the prerequisite for any successful wholesale activity, does not give rise to competition concerns in the North Eastern Poland where the investigation focused. In North Eastern Poland most of the storage depots is operated by an independent operator – Naftobazy, who lets the capacity to several wholesalers. The capacity is not constrained and capacity allocation rules are transparent.

47. The parties' customers on the Polish non-retail market include integrated service stations that belong to large fully vertically integrated oil companies such as BP, Shell

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52 Naftobazy Sp. z o.o. ("Naftobazy"), a subsidiary of the Polish State Treasury, owns 22 warehouse bases throughout Poland with a total capacity of 1.5 million m3. Naftobazy leases space in its facilities to all market players in Poland.

and ConocoPhilips, but also non-integrated networks, wholesalers, and transportation companies. The parties' customers at the non-retail level are relatively concentrated, with three largest customers for diesel accounting for around 40% of their sales, and more than 50% of gasoline sales. According to the parties, these customers can easily switch to other non-retail suppliers.[53] The parties submit that switching is relatively easy as contracts are usually signed for a period of one year to cover certain volumes of deliveries throughout the year and are non-exclusive. The ease of switching was confirmed by the market test, indeed in most of cases the contracts run for a year or shorter. Moreover most of the non-retail respondents switched their suppliers several times in the last 3 years.[54]

48. The market investigation showed that at least two integrated oil companies imported fuel into Poland from refineries located in neighbouring EU countries. The parties submit that two companies, located in the East, are likely to enter the Polish non-retail markets. One is a Belarus oil refinery, Mozyr, which already has some small sales of diesel in Poland. However, according to the parties, the quality of gasoline produced by Mozyr is too low, but it may change in the near future as Mozyr is currently investing to improve the quality of its fuels. Another potential competitor likely to enter the Polish market is Russian company, Lukoil. At present Lukoil Polska is active in LPG sales at retail level but is likely to expand its activities to other fuels. Most of the respondents to the market test expect that in the oncoming years the pressure from the suppliers located in the CIS will increase[55].

49. The competitive assessment would not be significantly different on combined non-retail market (including non-retail and cargo sales) in Poland. The parties combined market shares would be [40-50]% for diesel and [50-60]% for gasoline in 2005 (PKN [40-50]% and Mazeikiu [<5]% for diesel; and PKN [40-50]% and Mazeikiu [<5]% for gasoline).

50. To conclude, although the parties will have high combined market shares in Poland the proposed operation will not give rise to competition concerns. This is because the additional market shares are relatively small, customers are able to source supplies form neighbouring EU countries, supplies from CIS are likely to increase their sales as refineries in these countries are being upgraded, storage facilities are available and there is considerable buyer power.

53 […] which represented [0-10]% of PKN's overall sales in gasoline on the Polish non-retail market and [<5]% of its overall sales in diesel, has, in 2005, switched from PKN to supply itself with […] which offered a lower price. This had followed another significant customer loss for PKN in 2004 when […] switched from PKN to supply itself with […].

54 See questionnaires to non-retail competitors, question 21 and non-retail customers, questions 22-25.

55 See questionnaires to non-retail competitors, question 26 and non-retail customers, question 29.

Vertical aspects

51. The parties' ex-refinery sales to the Polish, Lithuanian, Czech, and Estonian non-retail markets for sales of diesel and gasoline are vertically affected markets. Although, apart from the Polish non-retail market, there are no horizontal overlaps on the non-retail markets for sales of diesel and gasoline, these markets are vertically affected as either PKN or Mazeikiu holds a market share in excess of 25 % on these markets, while both parties are active on the upstream markets for ex-refinery sales of diesel and gasoline.

52. The other vertically affected market concerns the retail sales of motor fuels in Poland. Although Mazeikiu is not active on this market, both PKN and Mazeikiu hold a combined market share in excess of 25 % on the upstream markets for non-retail sales of diesel and gasoline in Poland.

Polish non-retail market for sales of diesel and gasoline

53. Both parties are active on the Polish non-retail market for sales of diesel and gasoline as well as on the EEA-wide market of cargo/ex refinery sales of these fuels. However, the parties' combined position on the upstream markets both at the EEA and regional levels is moderate and it appears that their customers already multi-source and would be able to secure supplies in case of price increases on the upstream market.

Lithuanian non-retail markets for sales of diesel and gasoline

54. On the Lithuanian markets for non-retail sales of diesel and gasoline Mazeikiu holds respectively [40-50]% and [40-50]% of sales. However, according to the parties, the transaction will not give rise to any downstream foreclosure issue in relation to the markets for non-retail sales of diesel and gasoline, as many of Mazeikiu's customers already multi-source. Moreover, with a moderate combined position of Mazeiku and PKN on the upstream EU markets for ex-refinery sales of diesel and gasoline, Mazeiku's customers would be able to secure supplies in case of price increases or foreclosure on the upstream market.

Czech non-retail markets for sales of diesel and gasoline

55. On the Czech markets for non-retail sales of diesel and gasoline PKN (Unipetrol) holds respectively [20-30]% and [30-40]% of sales. However, according to the parties, the transaction will not give rise to any downstream foreclosure issue in relation to the markets for non-retail sales of diesel and gasoline, as Unipetrol's customers ([…]) are vertically integrated oil companies and source most of their needs from Unipetrol's competitors at upstream level. Moreover, with a moderate combined position of Mazeiku and PKN on the upstream EU markets for ex-refinery sales of diesel and gasoline, Unipetrol's customers would be able to secure supplies in case of price increases or foreclosure on the upstream market.

Estonian non-retail markets for sales of diesel and gasoline

56. On the Estonian market for non-retail sales of gasoline Mazeikiu holds a market share of [20-30]% and [30-40]% respectively. However, according to the parties, the transaction will not give rise to any downstream foreclosure issue in relation to the market for non-retail sales of gasoline, as Mazeikiu's customers ([…]) belong to vertically integrated oil companies and already multi-source. Moreover, with a moderate combined position of Mazeiku and PKN on the upstream EEA markets for

ex-refinery sales of diesel and gasoline, Mazeiku's customers would be able to secure supplies in case of price increases or foreclosure on the upstream market.

Polish retail market for sales of motor fuels

57. The other vertically affected market in relation to the markets of non retail sales in Poland on which both PKN and Mazeikiu are present, is the downstream market for retail sales of motor fuel in Poland, where only PKN is active.

58. The total size of the Polish market for retail sales of fuels (gasoline, diesel and car LPG) amounts to 11 million tonnes in 2005. PKN is the biggest player on this market and its sales represent [20-30]% of the total retail motor fuels. PKN has also the biggest network of service stations. However, the parties submit that PKN's market share in the retail fuel market is decreasing (from [30-40]% in 2003 to [20-30]% in 2005) due to competitive pressure from integrated oil companies (BP, Shell, Statoil), which together represent [20-30]% of the retail motor fuel market; private operators ([20-30]%), Lotos ([0-10]%) and hypermarket fuel stations ([0-10]%).

59. According to the parties, the combined entity would have no incentive or ability to refuse to supply diesel and gasoline to its competitors on the Polish market at the retail level because it would not be able to sell the additional volumes released. The combined entity would not have the incentive or the ability to raise its competitors' costs by increasing the price of diesel and gasoline at the cargo level because their competitors would easily switch suppliers. In Poland PKN supplies only its non-retail arm, while Mazeikiu supplies both its non-retail arm in Poland, as well as competitors such as Ortus, a large Polish wholesaler. Moreover, the main non-retail operators either import their diesel and gasoline needs or produce them themselves.[56]

60. Therefore, under all alternative geographic and product market definitions the present transaction does not seem to alter the existing competitive conditions and does not give rise to any competition concerns on the markets for cargo/ex refinery, non-retail and retail sales of gasoline/diesel/LPG.

IV. CONCLUSION

61. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EC) No 139/2004.

For the Commission,
signed
Neelie KROES
Member of the Commission

56 For example J&S imports about 90% of its diesel and gasoline needs, and Lotos produces and sells its own products on the non-retail market. Also, Slovnaft Polska is the business subsidiary of the Slovakian producer Slovnaft and is located in Poland in order to sell Slovnaft products on the Polish market.