Inquiry Report

SUO MOTO INQUIRY AGAINST JJVL AND LPGAP

BACKGROUND

1. This report has been prepared pursuant to the *suo moto* inquiry conducted by the Competition Commission of Pakistan (the '**Commission**') under Section 37 (1) of the Competition Ordinance 2007 (hereinafter '**Ordinance**') against Jamshoro Joint Venture Limited (hereinafter '**JJVL**') and LPG Association of Pakistan (hereinafter '**LPGAP**').

2. On 29 July 2008, the Commission received a letter by Progas Pakistan Limited (hereinafter '**Progas'**) addressed to the Chairman Oil and Gas Regulatory Authority (hereinafter '**OGRA**') and copied, among others, to the Chairman of the Commission. The letter highlighted possible cartelization and predatory pricing in the Liquefied Petroleum Gas (hereinafter '**LPG**') sector.

3. The Commission, taking cognizance of this letter, approached Progas to obtain further information in this regard. In response Progas provided the Commission with pricing and other information that shed further light on the matter. After scrutinizing these submissions, meeting of the Commission with Progas took place on 29 September 2008 and 6 November 2008. Officers of the Commission also met with Progas again in December 2008.

4. The inquiry committee also took into consideration the official report of OGRA regarding LPG[1] and a number of media reports and news items. It also considered the views of Mr. Irfan Khokhar, Chairman of the informal[2] LPG Distributor's Association of Pakistan (hereinafter '**LPGDAP**').

FACTS

5. LPG is a mixture of the gases propane and butane, usually in a ratio of 60, 40. Occurring naturally in oil and gas fields, LPG is extracted directly or is produced as a by-product of crude oil refining.

6. LPG is used predominantly as cooking fuel and for transportation. It is increasingly replacing chlorofluorocarbons as an aerosol propellant and a refrigerant to reduce damage to the ozone layer in the developed world.

[1] State of the Regulated Petroleum Industry 2007-2008, OGRA

[2] There are two LPG Distributors Associations of the same name. One, headed by Mr. Hadi Khan is registered. The other one led by Mr. Irfan Khokhar is informal. Mr. Irfan Khokhar claims that the distributors he represents do not have the financial resources to register the association but nevertheless his association represents a larger number of distributors compared to the registered one.

7. In Pakistan, usage of LPG is prevalent in the less-accessible northern areas where natural gas and petroleum products are not easily available.

8. Currently, there are ten local producers of LPG (hereinafter collectively referred to as '**LPG producers'**), namely;

   a. JJVL, Oil and Gas Development Company Limited (hereinafter '**OGDCL**'),
   b. Pak-Arab Refinery Company (hereinafter '**PARCO**'),
   c. Pakistan Petroleum Limited (hereinafter '**PPL**'),
   d. Pakistan Refinery Limited (hereinafter '**PRL**'),
   e. Attock Refinery Limited (hereinafter '**ARL**'),
   f. Orient Petroleum International (hereinafter '**OPI**') ,
   g. Pakistan Oilfeilds Limited (hereinafter '**POL**'),
   h. National Refinery Limited (hereinafter '**NRL**') and
   i. **BOSICOR**,.

9. The supply chain of LPG is as below:

Producers\Importers
↓
Marketing Companies
↓
Distributors
↓
Retailers
↓
Consumers

10. LPG producers have given allocations to some marketing companies who then sell LPG onwards to distributors and other marketing companies that do not have allocations with local producers. There are currently around 71 marketing companies[3] registered with OGRA. Those companies who do not have allocations have to either buy LPG from marketing companies that have allocations or from importers.

11. The largest association of LPG marketing companies appears to be the LPG Association of Pakistan (hereinafter 'LPGAP') comprising most of the 71 registered marketing companies. Another less known association of marketing companies goes by the name of LPG 70. LPG 70 claims to be a grouping of LPG marketing companies in Pakistan purporting to represent 70 % of the market share[4].

12. The price of LPG is set at three stages; first at the production level, secondly at the marketing stage and finally at the consumer level.

[3] OGRA's official list of marketing companies available on their website.
[4] LPG70's advertisement. Daily Times, July 11, 2007.

13. Currently the local producer price is set by LPG producers within the price ceiling[5] set by OGRA. The marketing companies are allowed a profit margin of $150 per MT by OGRA above the producer price. The actual retail price is set by market players and is normally above the 'reasonable consumer price' OGRA sets.

14. Pakistan does not produce adequate LPG to meet local demand hence LPG is also imported in the country through companies such as Progas.

15. The price of imported LPG is based on the international price of LPG *i.e.* the Saudi Aramco Contract Price (hereinafter '**Saudi CP'**). On this price freight, transportation, handling, and other customs and excise duties are added to give the landed import price. LPG importers usually sell LPG to marketing companies with no local allocations, and distributors at the landed import price plus a profit margin. With the de-linking of LPG prices with Saudi CP, the quantity of imports has come down as it is unprofitable for the importers to sell LPG at the current reasonable consumer price set by OGRA.

RELEVANT MARKET

16. The relevant product market is the market for the production and supply of LPG. LPG is used domestically in areas where natural gas is not available, as well as in the transportation, commercial, and industrial sector. LPG is a fuel that is not easily substitutable with other fuels. There are a number of reasons for this including those relating to intended usage, price and switching cost.

17. LPG is intended to be used as an alternative fuel domestically. The rationale for using LPG is to fill gaps in the supply of natural gas. So, while theoretically LPG does have substitutes, the question of substitutability in domestic usage does not arise as there is no practical alternative. LPG use is prevalent in the northern areas of Pakistan.

18. In the transport sector LPG is used in *rikshaws* and cars, along with diesel, petrol and CNG. LPG cannot be used as fuel in diesel engines. In petrol based vehicles, modified fuel systems must be installed in order to use LPG. Once the system is installed the vehicle can still run on petrol but LPG is generally preferred due to the difference price of LPG and petrol and consequently between cost per mile. Vehicles running on LPG cannot substitute LPG with less expensive CNG while the LPG system is in place. To use CNG, a vehicle owner has to remove the LPG system and install a CNG kit. Converting vehicles to run on cheaper CNG entails a considerable investment and is a switching barrier. This means that the demand substitutability is very low.

[5] Currently the cap is the ARAMCO Saudi Contact Price published every month. This price is the global standard in international trade.

19. The relevant geographical market is Pakistan. The conditions within the country are fairly homogenous. The differences between price of LPG in the northern and southern regions of the country can be attributed to the transportation charges.

20. The LPG market is structured on basis of allocations or quotas. The bulk of LPG is produced within Pakistan and there has been a gradual increase in local LPG production, though not sufficient to meet domestic demand. In addition, imports are currently not commercially viable due to the current pricing policy. Domestically there are high sunk costs associated with setting up a refinery or exploring new oil & gas fields. Moreover, the unpredictable nature of the pricing policy of the government has made imports unlikely in the future. All these factors contribute to a restricted market with high entry barriers.

ALLEGATIONS AGAINST JJVL & LPGAP

VIOLATION OF SECTION 4(1) READ WITH SECTION 4(2)(A)

21. According to the information available with the inquiry committee, it appears that JJVL and other LPG producers are working together and operating as a cartel that artificially keeps the producer price of LPG low. It is also alleged that JJVL colluded with its associated marketing companies to remove the import price parity regime and since its removal has been colluding with the latter to keep the official consumer price low.

VIOLATION OF SECTION 3(1) READ WITH SECTION 3(2) AND 3 (3)(F) & (G)

22. JJVL and its associated marketing companies, it appears, are engaged in predatory pricing with the aim of driving out importers, preventing new entry, and monopolizing the relevant market. It is alleged that, by engaging in low pricing schemes, the cartel is aiming to purposefully exclude importers from the sale and distribution of LPG in the relevant market.

VIOLATION OF SECTION 3(1) READ WITH SECTION 3(2) (D) & (E) AND SECTION 3(3)(D)/VIOLATION OF SECTION 4(1) READ WITH SECTION 4(2)(F) & (G)

23. According to the record made available during inquiry, JJVL asked Progas to sign commission agreements with some of its associated marketing companies before agreeing to allocate it LPG. This practice constitutes supplementary conditions for entities who want to have LPG allocations from JJVL and have, by their nature and commercial usage, no nexus with the subject of the main contract. JJVL and its allottees also charges premium from some marketing companies. This is tantamount to applying dissimilar conditions to equivalent transactions on parties, thereby placing them at a disadvantage.

SUBMISSIONS AND ANALYSIS

24. In Pakistan, LPG production cost is not uniform across the board. Progas explained that production costs vary depending on the source from which LPG is produced. The process of producing LPG from crude oil is costlier than extracting it from gas and oil fields. This is primarily because crude oil has to be imported at international rates. This means that LPG producers producing LPG from gas fields incur fewer costs and can produce cheaper LPG. Records indicate that JJVL uses a third and unique way of producing LPG. It has installed an LPG extraction project at Sui Southern Gas Company's Liquid Handling Facility at Jamshoro, Hyderabad, Sindh, (hereinafter '**SSGC**') whereby JJVL 'skims' off LPG from a number of pipelines already laid out by SSGC. This places JJVL at an advantage because it can produce LPG at a very low cost as very little investment was initially required compared to other producers.

25. SSGC has a fixed return of 17 percent on its asset base. Any amount of income above this level is paid to the government as Gas Development Surcharge. The SSGC is not interested in increasing its royalty income since it does not get to keep anything above the limit. It hence offered JJVL a very favourable deal which enables JJVL to keep its costs low. The royalty that JJVL pays to SSGC is linked to a reference price of other LPG producers. If the ex-plant prices of LPG of other reference producers go down, the royalty payable to SSGC also goes down. This in turn means that JJVL's cost of production goes down.

26. The LPG industry was deregulated in September 2000. LPG Rules 2001 allowed producers to sell LPG to marketing companies at mutually agreed price which meant that the price was essentially being set by market forces. However OGRA was authorized to intervene if a price fixed by a licensee was not reasonable.[6]

27. In September 2004, LPG price was capped by OGRA in accordance with local producer price. However in April 2006 the price was gradually increased to bring it in accordance with the Saudi CP and finally in December 2006 the producer price was linked with the Saudi CP. The decision to introduce import price parity was welcomed by most LPG producers and the importers. However JJVL was the sole dissenter and argued for de-linking the prices with the Saudi CP. In November 2007, the Ministry of Petroleum and Natural Resources (hereinafter 'the **Ministry**') invited comments of the producers on de-linking the price of LPG with Saudi CP. On December 27 2007 the prices were de-linked from the Saudi CP and producers were allowed to set any price as long as they did not exceed the Saudi CP.

28. After the de-linking, OGRA continues to set a reasonable consumer price which is always priced slightly below the landed import price. This price makes it impossible for the importers to continue doing business. However, due to the reduced supply of LPG following the inability of the

[6] LPG Rules 2001 Rule 18 (2)

importers to bring in LPG at uncompetitive prices, the local producers and marketing companies, especially JJVL and its associated companies, are able to sell LPG at a price above the reasonable price set by OGRA by charging illegal premiums, entering into profit sharing agreements or by simply owning the marketing companies directly.

VIOLATION OF SECTION 4 (1) READ WITH SECTION 4 (2) (A)

29. On inquiry, Progas alleged that JJVL was unhappy with attempts to link producer price with the Saudi CP because it made LPG imports competitive and allowed LPG importers to enter the market. JJVL felt threatened by the introduction of new player and the erosion of its market share. It was also alarmed by the shrinking margins[7] of its marketing companies, many of which are owned JJVL directors and their relatives owned. Since the linking of prices, the imports were producing competition in the market forcing existing marketing companies to reduce their margins in order to compete. In order to maintain its dominant position JJVL and its associated marketing companies, owned by influential people, convinced LPG pricing policy makers to de-link LPG price with the Saudi CP. LPG 70, the association of LPG marketing companies which have allocations from JJVL, issued public appeals contending that de-linking would reduce the price of LPG for the end consumers and that local supply was enough to fulfil local demand. Similar stance was taken by LPGAP. Through their efforts JJVL, LPGAP and LPG 70 were able to de-link local producer price from the Saudi CP.

30. Progas explained further that once the producer price was de-linked from Saudi CP, JJVL influenced other LPG producers to keep prices low with the aim of making imports commercially unviable. JJVL has an advantage where by it is cheaper for JJVL to produce LPG because it uses a unique method of producing LPG. While other producers, who use the more expensive crude oil, did not agree with the de-linking as it would mean making a loss or reduced profits, they nevertheless complied with the request due to political arm twisting and after realizing that there were other avenues for recovering profits.

31. Based on the information available with the inquiry committee, it appears that JJVL allegedly implemented various schemes designed to partially recoup lost profits due to low producer price. In one variation of the scheme, JJVL sells LPG at a low price to its associated marketing companies who then sell the LPG at very high margins to LPG distributors. The marketing companies repay JJVL and its directors either through third party commissions,[8] premiums,[9] or by virtue of being a subsidiary.[10] Hence, JJVL and its directors partially recover the lost profits. The distributors/marketing companies with no allocation have to

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[7] Indicated by the graph provided by Progas

[8] Commissions are paid to third parties for services rendered by those parties in facilitating the contract between the two contracting parties.

[9] Premiums are payments made directly to a contracting party and are for the product or service procured.

[10] Mehran Gas and Lub Gas are subsidiaries of JJVL

pay the higher prices since they have no alternative source of LPG. LPG allocations are limited in number and without imports there is no option for a distributor or marketing company but to buy LPG at higher prices.

32. It was pointed out to the inquiry committee that JJVL and LPG70 are the main culprits and instigators of the anti competitive activities in the LPG industry. According to Progas, other LPG producers are unwilling partners of this cartel and have been compelled by market conditions to comply with the demands of JJVL. Private sector LPG producers are making up for their losses via the profit sharing arrangements[11] or wholly owned subsidiaries while public sector LPG producers have less incentive to operate at a high profit in any case.

33. According to documents available to the inquiry committee, the benefits of this cartel to its members are that:

a) LPG producers pay very little tax; the tax on company income is 35 percent while the tax charged to middlemen on commissions is 10 percent. By posting a lower producer price, cartel members pay less tax, which is a loss to the national exchequer.

b) JJVL pays less royalty to SSGC; under the implementation agreement entered in to by JJVL and SSGC, in return for LPG extracted by JJVL from SSGC's Liquid Handling Facility, JJVL would pay SSGC royalty. The royalty was to be calculated with reference to the highest ex-plant/ex-refinery price of LPG in Pakistan posted by PARCO, OGDCL, NRL and PRL. By keeping LPG producer prices low, the reference price for royalty calculation is also kept low and as a result JJVL pays less royalty to SSGC which is a loss to the national exchequer.[12]

c) Most importantly, LPG importers are kept out of the market since they cannot compete at the reasonable consumer price set by OGRA while the former continue to reap huge profits. The aim of the cartel is to ensure its dominance and control of LPG supply in the market.

34. The inquiry committee received the following arguments as indicators of cartelization:

a) That the instability in the LPG pricing policy is an indicator of the political power of the cartel. LPG pricing policy has been regulated and de regulated arbitrary and inconsistently, seemingly with out any concrete basis. The Ministry and OGRA do not justify or provide reasons why the linking and de-linking of local LPG producer price with international prices have taken place.

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[11] POL has profit sharing agreements with its allotee Sungas

[12] Details are available at http://www.ogra.org.pk/images/data/downloads/1189755778.pdf. It can be noted from the document that royalty payments to SSGC have been decreasing.

b) That the LPG prices between December 2005 and August 2008 indicate that, generally speaking, LPG producer price is very low as compared to the Saudi CP. However the actual consumer price is higher than the Saudi CP. The difference between the low producer price and the high actual consumer price indicates that there are supra profits being made at the marketing stage especially before linking and after delinking. The point in time when there was some stability in the price of LPG was when the producer price was linked with the Saudi CP. During the period of linking, the marketing companies, especially those associated with JJVL, were facing a lot of competition from exports and their margins shrank, even in the negative at times. Hence they started acting together to delink the prices and remove the importers from market.

c) That JJVL's lead role in the cartel is established by the exchange of communication[13] between the Ministry of and LPG producers. In December 2007 before de linking the price of the local LPG with the Saudi CP, the Ministry called in the opinion of all the LPG producers. Apart from JJVL, all LPG producers expressed their satisfaction with the linking of the Producer price with the Saudi CP as being a fair and effective mechanism of determining the price of LPG. JJVL was the sole dissenter and claimed that Producer prices should be de linked, which was subsequently done by the Ministry.

d) That despite offers from Progas to buy LPG from local producers at Saudi CP prices (which are higher than the local producer price) no producer is willing to sell to them. They are willing to give LPG to Progas at a lower price but with a commission or premium. The fact that local producers are unwilling to sell at a higher price and increase their profits is highly unusual. Progas believes this to be an evidence of the operation of the cartel and the clout it has where by LPG producer won't sell their product to certain buyers even if the they are giving higher price.

e) That since delinking there has been almost perfect synchronization of LPG producer prices. Moreover, in December 2007 PARCO tried to raise prices to bring it at par with the Saudi CP but was stopped by the Ministry from doing so even though this would mean increased revenue for the government. It does not make any business sense for refinery-based LPG producers to keep such low prices. The only way that most LPG producers are able to sustain lower profits is because LPG production is not their primary source of business. They can afford lower profits in LPG production, which is compensated by other business areas. Furthermore, some LPG producers are able to function like this is because they have implemented schemes to recoup lost profits.

[13] The inquiry committee has seen the official communication between the Ministry and LPG producers regarding opinions on import price parity regime.

f) That the strongest indication of cartelization of LPG marketing companies with JJVL is the letter issued by the OGRA to the Chairmen LPGAP dated September 19, 2008 where OGRA strongly condemns the action of the LPGAP in announcing an end-consumer price which it is not entitled to do. The letter clearly states that the actions of the LPGAP "tantamount to cartelization." This letter was in response to an advertisement that the LPGAP published in the Daily Express Islamabad on September 10, 2008 where they set the end-consumer price of LPG at Rs 72 per Kg.

g) That back on January 16, 2008 the spokesman for the LPGAP and director of JJVL, Fasih Ahmad, who is also the son of JJVL's chairman, gave an interview in The Nation,[14] where he urged LPG users not to pay more than Rs 65 per kg for LPG; hence setting the end-user consumer price without having the authority to do so.

h) That the activities of LPGAP and LPG70 are, *prima facie,* indicative of vertical cartelization. Both associations criticize the high LPG producer price and demand that they be lowered. The group also speaks out against import price parity saying that it increases consumer prices. However, due to lack of competition the producers make ever more profits, especially in the winters when demand outdoes supply. Hence, LPG70 acts as a pressure group to seemingly advocate consumer welfare while in fact it merely helps the cartel to maintain its hold on the market. These activities, coupled with the fact that the spokesman for LPG70, Belal Jabbar is the CEO of Noor Gas, an associated gas company of JJVL, are strong indications of the nexus between JJVL and LPG70 and their vertical integration. Belal Jabbar authored the article 'LPG Import Parity Pricing: Tried, Tested, Failed' in the December 2007 issue of the Energy Update,[15] severely criticizing the policy of facilitating the importers. The article mentions that the author is the spokesman of LPG70.

i) That LPGAP has its headquarters in the office of JJVL *i.e.* Associated House in Lahore. Both its chairman and spokesman are directors in JJVL.

Analysis

35. There are two sets of allegation that have arisen regarding cartelization. One that there is horizontal cartelization between producers and two, that there is vertical collusion between JJVL and marketing companies. While there are strong indicators of a vertical cartel that is led by JJVL, there are not enough indicators to confirm a horizontal cartel exists.

[14] Read news item 'LPG users asked not to pay more than Rs. 65/kg'
[15] The article can be found at www.energyupdate.com.pk

36. The consistency of prices by all LPG producers is an indication of horizontal cartelization. Without regulation it would make sense that producer prices vary to reflect competitive levels but this is not the case and LPG prices are almost uniform. JJVL arguably operates at a much lower cost of production. There should at least be a disparity between the prices of JJVL vis-à-vis other producers, however this is not the case. Absent a concerted attempt by LPG producers to maintain a uniform price there is no reason for all LPG products to be similarly priced. Combined price fixing is not a new concept as far as LPG producers are concerned. Before the import price parity regime was introduced, a LPG Producers Advisory Committee used to set the producer prices of LPG.[16]

37. It has been alleged that JJVL works to ensure lower producer price because LPG producer price is directly linked to the amount of royalty that it has to pay. Even though JJVL's own production costs are low, the amount of royalty that it pays to Sui Southern Gas Company is directly proportional to the prices quoted by other refinery producers. If other producers keep high prices, JJVL has to pay more royalty by virtue of its agreement with SSGC which means that its costs go up. The converse is also true. It is being alleged that to avoid such a scenario JJVL induced other producers to keep a low price and this way JJVL avoided paying higher royalties. It is possible that JJVL impressed upon the producers that it was in their interest to keep importers out and cartelize the market. However, this claim is not substantiated. It is difficult to ascertain charges of non-commercial pressure or behind the scenes arm wringing. It is evident though that a low producer price, de-linked from Saudi CP is beneficial to JJVL. It is clear from the perusal of the JJVL-SSGC agreement that lower prices of other producers translate into lower costs for JJVL.

38. However, the manner in which the policy was reversed and LGP pricing de-linked with the Saudi CP in the end of 2007 is important. The deregulation of prices meant that producers were free to keep their own prices. Correspondence between the Ministry and producers shows that none of the producers were interested in removing import price parity except JJVL and despite an overwhelming majority of LPG producers advocating linking the price of LPG with the Saudi CP, the policy was reversed. This fact must be reconciled with similarity of prices. It seems logical that producers apart from JJVL, which has a low producer price, reduced their official prices to survive. They, however, implement profit recoupment methods to ensure that they do not sustain a loss in LPG. One method of recoupment is by adopting profit sharing agreements like the one between POL and Sungas.[17] Other producers have hundred percent owned subsidiaries or sister concerns that are marketing companies. For example OPI owns OPI Gas, and ARL and POL are in the same group as

[16] 'LPG association concerned about rising prices', Daily Times, 12 May 2006.
[17] Sungas is a LPG marketing company with allocations from OGDCL and POL.

Capgas.[18] Through these agreements, producers are able to shield themselves from losses as a result of keeping a lower producer price.

39. In consideration of the discourse above, it cannot be concluded for certain that there is a horizontal cartel in the LPG industry.

VERTICAL COLLUSION

40. The influence of JJVL and its vertically integrated components is evident from the reversal of the pricing mechanism of 2006. Almost 30 marketing companies out of the estimated 35 that have allocations are associated with JJVL. Under the banner of LPGAP and LPG70 this group was able to have the decision of linking LPG prices with international prices reversed by citing unbearable higher prices for end consumers. Moreover, this linking/de-linking was not the only time there was an unexplainable shift in the Government's policy. In January 2009, OGRA devised a new price policy which would have allowed importers like Progas to sell LPG at a price reasonable to them. Within days of the correspondence with marketing companies, this policy was rejected[19] at the highest levels of the Government quite possibly under the lobbying of the vertical cartel which wished to keep the importers out. There does not seem to be any other explanation.

41. Perusal of pricing data[20] reaffirms the contention that, before the linking, marketing companies were enjoying huge profit margins in the absence of worthwhile competition and the benefits of lower prices are not being passed on to the consumer. The local market is designed on the basis of limited allocations which ensure that only the existing players get a piece of the pie while domestic production remains inadequate, especially in winters, to meet demand. By linking the prices, imports were supported, which led to the abundance of LPG in the country especially in winters. Due to more availability, the local marketing companies were forced to reduce their margins and compete in the market. However, this situation became untenable to the marketing companies, many of which are owned by influential people including JJVL's directors, who then sought the de-linking of the prices on the pretext of helping the consumer. It is a fact that actual consumer prices have never been lowered no matter what the OGRA determined reasonable prices appear like on paper. Only the marketing companies margins change. By de-linking the price, JJVL and its marketing companies were able to enjoy higher profits. This clearly shows that these schemes are not meant for the benefit of the public as advocated by JJVL, LPG 70 and LPGAP but are merely to cartelize the market and keep out importers.

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[18] OPI Gas, and Cap Gas are marketing companies.

[19] News item ' OGRA withdraws LPG prices letter' dated January 10, 2009 in Business Recorder

[20] The Commission has data from the official OGRA reports, along with market data provided by Progas and Mr. Irfan Khokhar.

42. The fact that OGRA has also taken cognizance of the activities of JJVL and LPGAP and terms it "tantamount to cartelization" is a substantial indicator of the dubious activities that LPGAP is engaged in. Seeing that the letters sent to the Chairman of the LPGAP are sent to the JJVL headquarters, it seems that a JJVL director or official is also the chairman of LPGAP, suggesting that LPGAP functions are greatly influenced by JJVL. This is unusual and substantiates the argument that JJVL is the strongest driving force behind the cartel.

43. The control that LPGAP has over the price of LPG is demonstrated by the frequent announcements by the LPGAP as to what should be the retail price of LPG. LPGAP has been given no authority by OGRA to do so and it is unclear how LPGAP arrives at its own best consumer price. Regardless of whether this is done through consultation or whether it is merely a unilateral decision of JJVL, it is clear that LPGAP has exceeded its authority as an association and is resorting to price fixing as a cartel of marketing companies lead by JJVL. Its advertisement on September 10, 2008, referred to by OGRA, is a *prima facie* violation of Section 4 of the Ordinance as it aims to fix LPG prices. Moreover, on January 12, 2009 the spokesman Fasih Ahmed was quoted by Business Recorder in saying that 'LPG prices in Karachi were the lowest anywhere in Pakistan in consonance with the fair pricing methodology evolved by LPGAP.' This statement is another clear admission by LPGAP that it is engaged in price setting.

44. LPGAP continually talks about measures aimed at ensuring compliance of its fair consumer price mainly through its spokesman, Fasih Ahmed, Director JJVL, including media and banner campaigns for social boycott of dealers and retailers who do not sell LPG at the association's recommended price. It will be pertinent to mention here that LPGAP has spoken openly in the media about 'resolve to reign in the market.'[21] The association has also punished errant distributors by 'suspending and canceling agencies' in an 'aggressive manner.'[22] This is classic cartel implementation behaviour. It must also be clarified that the rationale given by JJVL, LPGAP or LPG70 is of no consequence and does not change the fact that a cartel of competitors has been created to foreclose the market through the so called 'fair pricing methodologies'.

45. LPG70 appears to be another association in control of JJVL. As mentioned above, the CEO of Noor Gas, Belal Jabbar, which is an allottee of JJVL, is the only known spokesman of this otherwise little known association. The association or group works out of the office of Noor Gas. Its commentary in the media is indicative of its support to the cartel run by JJVL. It seems that LPG70, whether or not they have 70 percent of the market, is acting like a pressure group within the marketing and distributor markets to

[21] News item 'LPG users asked not to pay more than Rs.65/kg', The Nation on January 16, 2008.
[22] News item 'OGRA sets LPG retail price ceiling at Rs. 61/kg', Daily Times on December 26, 2007.

ensure compliance with the producer cartel's decisions and also to create acceptance in the public about an illegal activity by praising the producers.

46. One must also keep in mind that both the formal and informal LPG Distributers Association of Pakistan has complained[23] that the prices are being controlled by the producers and marketing companies at will and that the prices go up in the winters in times of shortages.

47. After perusal of all the evidence present, it appears that JJVL is managing a cartel of marketing companies through LPGAP, LPG70 and its associated marketing companies aimed at fixing LPG prices at levels that suit JJVL and which reduce competition in the relevant market by keeping importers away.

VIOLATION OF SECTION 3(1) READ WITH SECTIONS 3(2), 3 (3) (F) AND 3 (3) (G)

48. Allegedly JJVL is using the vertical cartel to engage in predatory pricing. The aim of this predatory pricing is to drive out importers from the market and to ensure JJVL's dominant position. Predatory pricing is occurring at the consumer retail stage. At the producer price stage, JJVL has forced the producers to artificially lower the producer price. This results in a lower reasonable consumer price for LPG set by OGRA.

49. LPG production currently stands at around 1,600 metric tons per day. Out of this JJVL produces 450 metric tons which constitutes 28 percent of local production. In addition JJVL's subsidiary marketing companies, Mehran Gas and Lub Gas, have an allocation of 150 metric tons of LPG from PARCO and OGDCL. This combined total brings JJVL's share in the LPG market to 600 MT or 37.5percent. This fact combined with the ability of JJVL to consistently act independently and even affect government policy matters proves that it is a dominant undertaking.

50. It is alleged that the primary function of the cartel, both horizontal and vertical, is to engage in predatory pricing in order to drive and keep out competitors. The cartel colludes to keep the official retail price artificially low. The producers sell LPG to marketing companies at a low price. The marketing companies add on huge profit margins and then sell LPG to distributors. However, at the same time, OGRA sets the reasonable consumer price based on the local producers' price. That price is always lower than the landed import price of LPG. Hence LPG importers are foreclosed from the relevant market. For LPG importers, after taking out the margin for marketing and distribution companies, the profit it makes on the reasonable price set by OGRA based on producer's prices is insufficient to sustain imports. Consequently, the cartel is able to maintain

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[23] News item 12 August 2008 Ajj Tv available at http://www.aaj.tv/news/Business/113510_7detail.html, news item 'Outsiders blamed for creating LPG shortage' dated January 12, 2009 in Business Recorder along with news item 'LPG distributors threaten strike' dated February 18, 2009 in The News.

its monopoly over the relevant market making supra profits at the same time.

51. The inquiry committee received the following arguments with regard to predatory pricing:

a) That the historical comparative trend of prices shows that falls in producer prices or marketing prices coincides with the import of LPG since the import price parity was removed. For example after de-linking with Saudi CP, the prices started going down when the Progas imported LPG in January 2008 and August 2008. In both instances, the prices of LPG fell steeply in during the period following the imports.

b) That the data also shows that since the de-linking of prices, the cartel is free to set the producer price of LPG. As a result it has manipulated the prices such that the average consumer price of local LPG is always lower than that of imported LPG hence undercutting the price of the importers.

c) That the actual producer and consumer prices remain above the official rate due to the pricing mechanism used by producers and marketing companies. This is indicated by historical pricing data.

Analysis

52. Moving on to the second set of allegations, it must first be seen whether JJVL is a dominant undertaking. The facts about production and allocation set out in the documents available with the Commission are verifiable from the Ministry's website[24] along with JJVL's own website.[25] Even though the JJVL's share in the relevant market appears to be less than the 40 percent required to deem it a dominant entity, there are a number of factors that prove its ability to work independently of its competitors, consumers etc. To begin with, JJVL is the single largest producer of LPG. Combined with its subsidiaries, it controls around 37.5 percent of the supply of LPG. In addition, JJVL incurs lower costs compared to other producers due to a favorable deal with SSGC. This allows it to operate at a level different to that of other competitors. It can also be established from this deal that JJVL is able to manipulate its supplier and act independently of it.

53. Moreover, JJVL, through its officers, has control over the marketing companies association LPGAP over the past many years. A director of JJVL is the chairman of LPGAP while another director is its spokesman. Interestingly, the spokesman is also the son of the Chairman of JJVL. Furthermore, many JJVL directors and their relatives own marketing companies that have allocations with JJVL. All of this shows that JJVL has control over its customers *i.e.* marketing companies. Lastly, there is

[24] Read document available at http://www.pakistan.gov.pk/divisions/petroleum-division/media/LPG_Policy.pdf
[25] Read company information available at http://www.ag.com.pk.

evidence that indicates that JJVL was able to convince the Ministry to de-link local LPG prices with international ones despite the opposition of all the other producers. Due to this de-linking, the official consumer price is now set according to local producer prices. These factors combined indicate that JJVL satisfies the condition of dominance set by the Ordinance *i.e.* ability to act independently of its competitors, customer, consumers, and suppliers.

54. LPGAP is the largest association of LPG marketing companies. Even on a very conservative calculation, it has members which control more than 40 percent of the relevant market. As an association, it has control over its members, with the latter following its policy. Hence, LPGAP can be deemed to be a dominant undertaking under the Ordinance with control of over 40 percent of the relevant market.

55. It appears from the material available that JJVL and its associated marketing companies are working together to ensure that the official LPG prices remain low enough at retail levels so that imported LPG remains uncompetitive, while practically the prices are high as a result of various schemes and the working of the market.

56. The working of the market is very crucial to the analysis. The local market for supply of LPG is very limited in nature. The system of allocations not only gives immense control to the producers to determine who gets the LPG at the marketing stage, but it also restricts the number of players in the sub market of marketing. Once the allocations are given out, the entry of new players is very hard since there is no more LPG to be distributed. Out of the 71 registered marketing companies, only about 35 have allocations with the local producers. Some of these marketing companies are subsidiaries/sister concerns of the producers *e.g.* OPI own OPI Gas, ARL and POL are in the same group as Capgas, while JJVL owns Mehran Gas and Lub Gas. This structure makes entry into the market very difficult. In fact, the only avenue of entry may well be imports.

57. There are two options for those marketing companies without allocations. One is to buy imported LPG, which they did while the import price parity regime was in place since LPG import was abundant. The other is to negotiate with the producers and marketing companies that have LPG allocations. This became relevant after the imports dried up in the aftermath of the delinking.

58. The second option mentioned above, and one which has become increasingly prevalent since the December 2007 delinking, gives producers and marketing companies with allocations the ability to demand from marketing companies without allocations a price which is above the allowable limit[26] in form of premiums and third party commissions on

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[26] Under the existing price regime, the Ministry has capped the producer's price at Saudi CP and OGRA regularly determines a reasonable consumer price based on the actual producer prices. The reasonable margin determined by OGRA for marketing companies is currently 150 dollars per MT.

account of short supply specially in the winters. The marketing companies then pass on this higher price to the distributors who pass it on to retailers down the supply chain. Hence while the official consumer prices stay at a level which is prohibitive for imports, the actual prices are way higher, enabling producers and marketing companies to make massive profits.

59. Both JJVL/LPGAP and the distributors/retailers contend that premiums and commissions are being charged in the market which keeps the prices high.[27] However, there are reasons to believe that the onus lies on the end of the JJVL and its marketing companies. Foremost, there is the statement of the Non-Quota Holders Association Chairman, Taseef Gilani, that marketing companies without allocations have to pay premiums to marketing companies in order to get LPG.[28] This is the most direct evidence in this regard.

60. However, even without the statement there are indicators which prove the same point. Charging of premiums and commissions seems to be more widely rampant before and after the import price parity regime. Price data provided by both Progas and by the Chairman of LPGDAP, Mr. Irfan Khokhar, indicates that consumer prices were stable at a low level during the period import price parity was in place. This indicates that there was little to no charging of premiums and commissions at the lower levels of the supply chain when there was abundant supply of LPG in the market. In contrast the consumer prices are high before and after the import price parity when there is a shortage of supply. Had only the distributors and retailers been involved in overcharging, prices would have been exceptionally high even during the time of the import price parity. However, this is not the case. It clearly shows that the overcharging activities originate at the production level.

61. Moreover, on their own admission, LPGAP and JJVL have aggressively gone after those who are allegedly overcharging at the distributor and retail level. However, even after suspending and cancelling licenses of many distributors they have not been able to control the increase in prices. A plausible reason is that the problem does not lie at the distributor’s end. In fact the distributors closed their businesses for a week in January 2008, right after the delinking, and came out on the streets to protest the fact that producers and marketing companies were giving them LPG cylinders at hiked up prices and yet expecting them to sell at official prices. In any supply chain, the ability to manipulate prices and supply decreases downwards. This is especially true in a market where there are only a handful of producers, a few dozen marketing companies but thousands of distributors and retailers. It is inconceivable that small independent retailers can store enough LPG to create a country wide shortage. On the other hand, it is more conceivable and logical that shortages and

[27] Read news item ‘LPG users asked not to pay more than Rs.65/kg’, Daily Times on January 16 2008 and news item ‘Outsiders blamed for creating LPG shortage’, Business Recorder January 12, 2009

[28] Read news item ‘Stakeholders differ over LPG price’, The News February 19, 2009.

overcharging are created at the production or marketing level where there is ample ability to alter supply in the market.

62. Before import price parity was removed in December 2007, LPG imports provided marketing companies without allocation an alternate source of LPG. The abundance of LPG in the country, however, led to a decrease in the profit margins of marketing companies as they were forced to slash prices to compete. This is clearly established by the perusal of verified pricing data available with the inquiry committee. This situation was understandably unacceptable to JJVL and its allotees.

63. As mentioned earlier in the report, there is a very close nexus between JJVL, its allotees, and LPGAP – an almost symbiotic relationship. Out of the marketing companies with allocation, 30 of them are allotees of JJVL. Almost all the marketing companies are members of the LPGAP which is headed by a JJVL director. The spokesman for LPGAP is also a director of JJVL. The newspapers are replete with indications that JJVL and LPGAP were not happy with the decision to link the prices as it enabled imports to enter the market.[29] The cover they assume is that imports are higher priced and hurt the end-consumer. However, it is a fact that in reality LPG consumer prices in the market are above the reasonable price set by OGRA and are even higher than the prices that existed during the period when imports came in. Even more surprisingly, while JJVL and its directors say that imports should not be allowed since they are pricey and unwarranted due to low demand, they themselves import LPG to overcome shortages in the market.[30]

64. On being contacted by the inquiry committee, Mr. Irfan Khokhar, Chairman of the informal LPGDAP further confirms these assertions.[31] He claims that in his capacity as Chairman LPGDAP, he attended meetings of the marketing companies where JJVL directors stressed the need to curtail imports in order to protect the local market. He reports that there was talk about joining hands to get the prices de-linked so that low prices could be maintained which would drive out importers. This assertion is in accord with the information available in the print media as detailed at various points in this report and verifies the latter.

65. Communication between the Ministry and LPG producers in the matter of import price parity sheds further light on the role of JJVL. It shows that all the producers except JJVL wanted the import price parity to remain. In fact PARCO suggested in their letter of 26 November 2007 that 'any intervention by any quarter in the approved LPG producer pricing mechanism to keep LPG prices on the lower side will not be acceptable to LPG Producers especially the refineries as they may not breakeven due to lower LPG prices.' This suggests that refineries do have a higher level of

[29] Read advertisement by LPG70 in Daily Times on July 11 2007
[30] Read news item 'LPG users asked not to pay more than Rs. 65/kg', Daily Times on January 16, 2008
[31] He disclosed this information during a meeting with some officers of the Commission. Mr. Khokhar was approached by the Commission to present his point of view on the matter.

cost as opposed to JJVL. This also shows that JJVL and its marketing companies managed to get the prices de-linked despite concerns by other producers. This view of JJVL was actively advocated by its director Fasih Ahmed, who is also the spokesman for LPGAP, the association of the marketing companies. In the 26 September 2007 edition of the Dawn newspaper[32] Fasih Ahmed said that 'the company firmly believed that the LPG producer pricing policy must be rescinded and obstacles in the way of new local production should be removed.' He further said that 'producers and marketing companies should be allowed to negotiate prices and OGRA, if it must, should set a cap on producer prices at a maximum of 80 percent of each month's CP.'

66. It is important to note that consumers have never paid lower prices for LPG except when LPG was being imported in the country. Pricing trends indicate that in January 2008 the gap between producer price and consumer price peaked after the delinking. The peak fell after Progas' pre-ordered imported LPG arrived in Karachi in January-February. The margins jumped back once the imports stopped coming. It must be reemphasized that it is mainly the margins of the marketing companies that registered a change after the prices were de-linked. During the linking period, imports were encouraged and there was availability of LPG throughout the year. Due to increased supply the competition in that market increased thereby compelling marketing companies to reduce their own margins. However, after de-linking, the margins of the marketing companies have gone up again.

67. It is pertinent to mention here that there is a shortage of LPG in winters which is coupled by an increase in prices by the producers and marketing companies.[33] LPGAP admits that there is a shortfall in LPG supply in winters which remains despite JJVL's meagre imports.[34] JJVL and its marketing companies, which normally advocate lower prices, are the ones to increase prices to take advantage of the shortage. This shortage is primarily due to the fact that local production is not sufficient to meet the demands of the market. The exclusion of the importers is creating inefficiency in the market, causing harm to the consumers in terms of short supply and high prices as well as harming the business of the marketing companies and distributors who do not have any alternate choice of supply apart from local production.

68. While it cannot be ascertained if JJVL and LPGAP are engaged in predatory pricing due to lack of industry wide production and cost data, it clear that their actions of have the deliberate aim of excluding other competitors, especially importers like Progas, from participating in the relevant market. By colluding, JJVL and LPGAP were able to remove the import price parity regime and are now able to influence prices in such a

[32] Read news item 'LPG producers asked to maximize production', Dawn on 26 September, 2007
[33] Read news item 'LPG price goes up by Rs. 4 per kg', The News on January 4, 2009
[34] Read news 'LPG users asked not to pay more than Rs. 65/kg', Daily Times on January 16, 2008

way that imports remain unfeasible. The current pricing mechanism, and JJVL led campaign to fix lower consumer prices, inhibits importers from being able to market their products thereby excluding them from the relevant market.

VIOLATION OF SECTION 3(1) READ WITH SECTION 3(2) AND SECTION 3(3) (D)&(E)/VIOLATION OF SECTION 4(1) READ WITH SECTION 4(2)(F)& (G)

69. By requiring Progas to sign commission agreements with marketing companies and other individuals before agreeing to sell LPG, JJVL has abused its dominant position by making the conclusion of a contract subject to supplementary obligations which have no commercial nexus with the subject of the contract. Progas further submits that JJVL is not willing to sell at a higher price it offers but is willing to sell at a lower price but with commissions to third parties.

Analysis

70. Coming to the last allegation, Progas has submitted three agreements that were concurrently signed in February 2005 which show that the sale of LPG was followed by the payment of commission to two third parties, namely Ms Saadia Ahmad, whose address is the same as JJVL's, and Mr. Ishtiaq Asid, CEO of Sehwan Gas (Pvt.) Limited. It is beyond comprehension as to why third parties should receive commission for a sale that JJVL is to make to a customer. A very plausible reasoning is that these commissions are a way to circumvent the cap on prices.

71. These agreements add weight to the argument that JJVL is engaged in activities that jack up prices of LPG unofficially enabling it to distort the competition in the relevant market.

72. These actions of JJVL tantamount to a *prima facie* violation of Section 3(1) read with Section 3(2) and Section 3(3) (d) as well as Section 4(1) read with 4 (2)(g) whereby the undertaking has deliberately made the conclusion of a contract i.e. selling LPG subject to receiving commissions through third parties over and above the producer price. However, since the Ordinance does not apply retrospectively, JJVL would probably not be apprehensible on this specific instance of the violation.

73. However, as noted in para 52-61, it appears that JJVL and its marketing companies are still charging premium and third party commissions from marketing companies that do not have allocation in the local market. This practice is tantamount to putting parties at a disadvantage by applying dissimilar conditions by a dominant player which is prima facie violation of Section 3(1) read with Section 3(2) and Section 3(3)(e) as well as Section 4(1) read with 4 (2) (f).

SUMMARY OF FINDINGS

74. JJVL is a dominant undertaking since it has the ability to act independently of its customer, consumers, suppliers and competitors to an appreciable extent. This ability is apparent from the following conduct:

a) JJVL and its subsidiaries control almost 37.5 percent of the relevant market.
b) JJVL has a unique method of production, and a favourable deal with SSGC, which enables it to produce LPG very cheaply as compared to other producers.
c) JJVL directors and officers control LPGAP which is the largest association of marketing companies. In addition, the market for supply of LPG is very limited. In this limited market almost 30 marketing companies have allocations with JJVL which makes them dependent on JJVL.
d) JJVL was able to get the prices of LPG de-linked from the Saudi CP despite opposition of all the other producers.

75. LPGAP is a dominant undertaking as an association since its members control over 40 percent of the relevant market.

76. JJVL and LPGAP have formed a vertical cartel with the aim of fixing LPG prices. This is indicated by the following:

a) Advertisements by LPGAP of September 10, 2008 which OGRA also deemed as cartelization and illegal.
b) Media reports of similar nature in which JJVL and LPGAP talk about desire to maintain 'fair price mechanism' in the relevant market.
c) JJVL's control over LPGAP and marketing companies through vertical linkages. Many directors of JJVL and their relatives are directors or owners of marketing companies.
d) Comparison of actual and official prices shows that the actual consumer prices are always above official consumer prices notified by OGRA on the input given by JJVL and other producers.

77. The vertical cartel is engaged in exclusionary behaviour with reference to importers. This is indicated by the following:

a) The structure of the existing market after de-linking is very limited. Marketing companies without allocations have to buy LPG from those marketing companies which have an allocation by paying an additional illegal premium that allows the latter and producers to keep making profits while importers cannot do business since its not feasible.
b) Actual consumer prices are always higher than the official OGRA determined prices. This is primarily due to the premiums charged by marketing companies.
c) During the period import price parity system was in place, the influx of imports had increased competition and reduced the margins of marketing companies. This was unacceptable to marketing companies and to JJVL. Hence they started campaign to de-link the prices. View supported by interviews with industry people and by reading many media reports.

d) Despite claims by JJVL and LPGAP that there is ample local production there are shortages in winters which lead to a price hike. JJVL blames hike on distributors though analysis indicates it is due to illegal black marketing by JJVL and marketing companies.

78. JJVL and JJVL allotees take premiums and charge third party commission from marketing companies that do not have allocations. This is tantamount to putting parties at a disadvantage by applying dissimilar conditions and conditioning the conclusion of a contract on terms which have no relevance to the subject matter of the contract respectively. This is indicated by:

a) The history of JJVL engaging in third party commission contracts.
b) Views of people associated with the industry
c) Analysis of supply chain behaviour and working of the relevant market

CONCLUSIONS

79. From perusal of all the information and evidence available, it is concluded that JJVL and LPGAP have abused their dominant position by violating Section 3(1) read Section 3 (3) and Section 3 (3) (g) of the Ordinance by creating conditions which exclude Progas from competing in the relevant market.

80. Moreover, JJVL has violated section 4(1) read with Section 4 (2) (a) of the Ordinance by being part of and leading a cartel engaged in price fixing.

81. However, while there is indication that other LPG producers might be involved in a horizontal cartel with JJVL, the same cannot be concluded with certainty.

82. JJVL, LPGAP and its members have violated Section 3 (1) read with Section 3 (2) and Section 3 (3) (d) & (e) of the Ordinance by charging premiums and third party commission from marketing companies without allocations. They have simultaneously violated Section 4 (1) read with Section 4 (2) (f) & (g) of the Ordinance on basis of the same actions.

83. Furthermore, LPGAP and members of LPGAP have violated Section 4(1) read with Section 4 (2) (a) of the Ordinance by being part of a cartel engaged in price fixing.

84. The associated marketing companies of JJVL, LPGAP and its members have violated Section 4(1) read with Section 4 (2) (a) of the Ordinance by being part of a cartel engaged in price fixing and by ensuring implementation of the price fixing decisions.

RECOMMENDATIONS

85. LPG is a very important fuel source for Pakistan. Million of people use LPG as a fuel to cook, heat water or run their vehicles. LPG is even more crucial for people living in the northern areas of Pakistan, where the former is the only reliable source of energy in the absence of natural gas. The production of LPG in the market is limited and is controlled by a handful of companies. Anti competitive behaviour in the market translates into higher LPG prices, short and volatile supply that affects the large portion of the public. Cartelization and exclusionary conduct which seeks to keep out importers, especially those who have already invested in the market, shakes the confidence of investors which negatively affects competition in the market. Ensuring competitive markets is in the public interest with regard to competition law.

86. It is, therefore, recommended that proceedings under Section 30 be initiated against the JJVL, LPGAP, and members of LPGAP on account of the contraventions mentioned in the conclusions and in light of the public interest surrounding the case.

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Syed Umair Javed
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