EN

Case No COMP/M.3543 - PKN ORLEN / UNIPETROL

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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,

<u>Subject</u>: Case No COMP/M.3543 - PKN Orlen/Unipetrol
Notification of 11.03.05 pursuant to Article 4 of Council Regulation No 139/2004[1] (Merger Regulation)

1. On 11 March 2005, the Commission received a notification by which the undertaking Polski Koncern Naftowy ORLEN Spółka Akcyjna ("PKN Orlen") notified its intention to acquire control of the whole of the undertaking UNIPETROL, a.s. ("Unipetrol") by way of purchase of shares.

I. THE PARTIES

2. PKN Orlen is a public company incorporated under the Polish law mainly active in crude oil processing and the manufacture of petroleum and petrochemical products as well as their storage, transport, distribution, wholesale and retail.

3. Unipetrol is a company incorporated under the laws of the Czech Republic, established in 1994 by a Czech government resolution approving the process of privatizing and restructuring the Czech oil refining and petrochemical industry. Unipetrol is mainly active in the fuels and petroleum refinery sector as well as petrochemicals, fertilizers and plastic industries.

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1 OJ L 24, 29.1.2004 p. 1.

II. THE OPERATION AND THE CONCENTRATION

4. The operation is part of the process of privatizing Unipetrol[2] and consists of the acquisition by PKN Orlen of 62.99% of all of the issued and outstanding shares of Unipetrol from the National Property Fund of the Czech Republic. Following this first step, PKN Orlen will launch a mandatory tender offer for the remaining shares held by minority shareholders of Unipetrol and by two of Unipetrol's subsidiaries. PKN Orlen assumes that the tender offer could lead to the acquisition of up to 100% of Unipetrol shares.

5. The acquisition of 62.99% of Unipetrol shares, which constitutes the first step of the transaction, will confer to PKN Orlen sole control over Unipetrol. Therefore, the transaction constitutes a concentration under the Merger Regulation.

III. COMMUNITY DIMENSION

6. The undertakings concerned have a combined aggregate world-wide turnover of more than EUR 5 billion[3] in 2003 (PKN Orlen, EUR 5,647 million; Unipetrol, EUR 2,322 million). Each of the undertakings have a Community-wide turnover in excess of EUR 250 million (PKN Orlen, EUR 5,589 million; Unipetrol, 2,209 million), and Unipetrol does not achieve more than two-thirds of its aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension.

IV. COMPETITIVE ASSESSMENT

7. PKN Orlen used to be a state-owned company, which prior to Poland's opening up to an open market economy, was the only company able to produce and sell petroleum products and its derivates. Unipetrol, on the other hand, is still a state-owned company, hence the present attempt to privatize it. However, like PKN Orlen, Unipetrol used to enjoy the same market position prior to the liberalization of trade in the Czech Republic. This operation will lead to the creation of a large regional player in the oil sector but still of a limited size compared to its main competitors, the multinational oil companies.

A. Relevant product and geographic markets

8. In line with past decisions in the petroleum and petrochemical sectors[4], the parties submit that the product markets affected are the following:

   i. Non-retail sales of refined oil products (distinct for gasoline and diesel);
   ii. Bitumen;
   iii. Lubricating petroleum oils (distinct for industrial and automotive lubricants).

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2 The European Commission decided on 1 December 2004 that the privatization process did not constitute a state aid (N 535/04 Czech Republic).

3 Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C66, 2.3.1998, p25).

4 Cases COMP/M.1628 – TotalFina/Elf , IV/M.727 – BP/Mobil, IV/M.1383 Exxon/Mobil, COMP/M.3516 – Repsol/Shell Portugal and COMP/M.3375 – Statoil/SDS.

i. Non-retail sales of refined oil products (distinct for gasoline and diesel)

9. The Commission has dealt on several occasions with the distribution of refined oil products[5]. In its practice, the Commission has distinguished the retail channel from the non-retail-channel. Non-retail sales are made to independent resellers and high volume end consumers. As stated in previous cases, it is not possible to aggregate the different types of fuels into one category. The different fuels are supplied for different uses to different types of customers. Therefore non-retail sales of fuels are further subdivided into sales of gasoline, diesel, fuel oil and LPG[6].

10. Since the transaction has no significant effect on the non-retail sales markets of fuel oil and LPG as mentioned before, only the non-retail sales markets of gasoline and diesel will be further discussed.

11. As regards the geographic market definition of the non retail sales of refined oil products, in previous decisions, the Commission suggested local markets[7], the radius around each point of supply being usually in the range of 100-150 km. In other cases[8], the Commission found indications of national markets. In a recent case[9], the Commission even proposed that the scope of the non-retail markets in Scandinavia could be regional in scope (i.e. Denmark, Finland, Norway and Sweden) due to the intensity of imports and exports within the region.

12. The parties argue that the markets are national in scope since uniform non-retail prices are charged on a national level and contracts with non-retail customers are negotiated and signed at a national level. Furthermore, there would be overlaps between the supply points and it would appear to be difficult to isolate one area from others.

13. It was confirmed by most companies in the market investigation that neither in Poland nor in the Czech Republic there are regions where the conditions of competition for non-retail sale of gasoline and diesel fuel differ significantly. There are also various factors indicating homogeneous conditions of competition in Poland and the Czech Republic respectively.

14. The market investigation confirmed that storage facilities (i.e. depots) are available across the entire territory of Poland and the Czech Republic.

15. The market investigation also revealed that in most cases contracts with non-retail customers are negotiated and signed on a national level.

16. Furthermore, in the Czech Republic most competitors seem to set their prices to non-retail customers in a consistent way across the whole of the Czech Republic. Prices are based on the contracted volumes, credit terms and the type of product.

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5 Case IV/M.727 – BP/Mobil; IV/M.1383 Exxon/Mobil; COMP/M.1464 – Total/Petrofina (II), COMP/M.1628 – Totalfina/Elf.

6 Case IV/M.1383 Exxon/Mobil paragraph 438,439; COMP7M.3516 Repsol YPF/Shell Portugal paragraph 11.

7 Case IV M.1383 Exxon/Mobil paragraph 443, final market definition left open, paragraph 445.

8 Case COMP. M.3516 – Repsol YPF / Shell Portugal, paragraph 12; final market definition left open.

9 Case COMP M.3291 Preem/ Skandinavska Raffineradi, 1/12/2003, paragraph 16 and 17.

17. As regards transport costs in the Czech Republic, producers pay for the primary transport through the Czech pipeline system owned by the state owned company CEPRO which covers the entire territory of the Czech Republic. Only the secondary transport means (e.g. truck, rail tank car) are usually paid for by the non-retail customers. Moreover, the Cepro-pipeline system in the Czech Republic operates on the basis of a uniform tariff.

18. Therefore and for the purpose of the present transaction, the non-retail markets for gasoline and diesel fuel in Poland and the Czech Republic appear to have a national geographic dimension.

19. However, even an analysis based on local markets would not change the competition analysis. In particular the market investigation confirmed that due to the location of the refineries and the logistic infrastructure neither of the parties is particularly strong in the border region of Poland and the Czech Republic.

ii. Bitumen

20. Bitumen is primarily used in asphalt production (road bitumen) and in the construction industry and paper production (industrial bitumen). However, from the supply side all types of bitumen are substitutable and for the purpose of the present case can be treated as constituting one product market. This is in line with the Commission's past practice where it considered bitumen as a separate product market on the basis of its characteristics and specific use[10].

21. Transportation costs play an important role in the geographic definition of the market. Bitumen requires transportation at temperatures above 130C°, which allows it to be transported within 400-500km, and in some cases even up to 700km radius from where it is sourced. In the past, the Commission considered the geographic dimension of the bitumen market on national and regional basis while leaving the exact definition open.

22. According to the parties, transportation cost amounts to up to [0-10]% of the final price. However, given that the prices are homogenous across Poland and Czech Republic, and that contracts are concluded on national basis, the parties argue in favour of a national market. The market investigation has widely confirmed the parties' arguments. Further, it did not indicate any regions, either in Poland or Czech Republic, where conditions of competition would differ significantly from the rest of the country.

23. Therefore, for the purpose of the present transaction, the market for bitumen can be assessed at the national level.

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[10] Case IV/M. 1464 - Totalfina/Petrofina ; Case COMP/M. 3516 – Repsol YPF /Shell Portugal.

iii. Lubricating petroleum oils (industrial and automotive lubricants)

24. In line with past Commission decisions[11], the parties support the view that the market for lubricating petroleum oils, because of very limited demand side substitutability, should be distinguished between automotive lubricants and industrial lubricants.

25. The relevant geographic markets for automotive and industrial lubricants are, as consistently assessed in the above mentioned Commission's decisions[12], at least national and probably as wide as the EEA as these lubricants are specified according to international standards and bought across Member States. The parties argue that the markets should be defined EEA wide. However, for the purpose of this case, the exact geographic scope of the industrial and automotive lubricants markets may be left open, since the operation does not raise competition concerns if assessed at national level.

iv. Other markets

26. Other markets on which the parties are active include the markets for retail sales of refined oil products, medium oil kerosene including JET fuel, fuel oils, wholesale of liquid petroleum gas ("LPG"), caustic soda, base oils, polyolefin, PVC, nitro-chalk and soda lye. As confirmed by the investigation, none of these markets are substantially affected by the proposed concentration.

27. With regard to soda lye, the liquid form of caustic soda, in the case COMP/M.2690 – SOLVAY/MONTEDISON-AUSIMONT[13], the Commission, while leaving the exact definition open, had noted that some elements pointed towards two distinct markets for soda lye and caustic soda in its solid form. The respondents to the market investigation conducted by the Commission in the present case have largely confirmed that soda lye is not substitutable with caustic soda. However, the exact product market definition may be left open since Unipetrol does not sell or produce caustic soda in its solid form.

28. With regard to the geographic market definition, the parties argue that it is EEA wide. In past decisions, the Commission, while leaving the exact geographic market definition open, has not excluded in its competition assessment a national dimension[14]. However in the present case the market investigation has shown that the markets are wider than national, and most likely EEA-wide or even wider. It may also be added that the parties provided data that show that imports are representing a large part in the soda lye and caustic soda market (for example 70% of the volume sold in the Czech Republic) and the prices are relatively homogeneous across EEA.

29. With regard to base oils, polyolefin, PVC and nitro-chalk markets, the Commission had in the above mentioned decisions found that these markets had an EEA wide

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11 Case COMP M.1891 – BP Amoco/Castrol, paragraph 11; COMP M.2208 - Chevron/Texaco, paragraph 14.

12 Case COMP M.1891 – BP Amoco/Castrol, paragraph 18; COMP M.2208 - Chevron/Texaco, paragraph 14.

13 See paragraphs 93 and 94.

14 Case COMP/M.2690 - Solvay /Montedison-Ausimont, paragraph 97.

dimension. It was verified in the course of the market investigation that this approach remains valid and that it can already be considered to include also the territories of, at least, Poland and the Czech Republic. The parties also support this view. The markets for base oils, polyolefin, PVC and nitro-chalk will not be further examined in this decision, since these markets are not affected according to the Merger Regulation.

B. Competitive Effects

30. Based on the above-mentioned product and geographic market definitions, and as shown in the table below, the proposed transaction will result in the following horizontally affected markets: non-retail sales of gasoline, non-retail sales of diesel, bitumen, automotive and industrial lubricants.

Product market	Polish market (in volume, 2004[15])			Czech market (in volume, 2004)		
	PKN Orlen	Unipetrol	Combined	PKN Orlen	Unipetrol	Combined
Non-retail sales of gasoline	[55-65]%	[0-5]%	[55-65]%	[0-5]%	[20-30]%	[25-35]%
Non-retail sales of diesel	[40-50]%	[0-5]%	[40-50]%	[0-5]%	[20-30]%	[25-35]%
Bitumen	[50-60]%	[0-5]%	[55-65]%	[0-10]%	[20-30]%	[30-40]%
Automotive lubricants	Not affected			[0-5]%	[20-30]%	[20-30]%
Industrial lubricants	Not affected			[0-10]%	[30-40]%	[35-45]%

i. Non-retail sales of refined oil products (distinct for gasoline and diesel)

Poland

31. Although the market positions of the parties on the non-retail markets for refined oil products in Poland are strong with PKN Orlen's market shares of [55-65]% for gasoline and [40-50]% for diesel fuel (respectively [55-65]% and [45-55]% in 2003), the concentration does not raise competition concerns with regard to Poland, or in any region thereof in particular the Southern part of Poland on the border to the Czech Republic (Silesia).

32. The overlap on the Polish market is minimal with less than [0-5]% overlap for gasoline and diesel sales by Unipetrol. Therefore, the transaction does not have a significant impact on the current market structure.

33. Furthermore, there are no indications that Unipetrol would have been able to expand its market position in Poland to a considerable extent. After Unipetrol had entered the market of non-retail sales of gasoline and diesel fuel with an own affiliate refinery and storage facilities in Southern Poland in 1999, its market share never exceeded [0-5]% on a national level. Since 2001 the market shares have been decreasing, mainly due to a

[15] For the non retail sales of gasoline and diesel fuel and soda lye markets in Poland, the data indicated in the table corresponds to the first 11 months of 2004.

new logistical infrastructure built by Polish' competitors. In mid 2003 Unipetrol terminated the activity of its affiliates in Poland, since it did not prove to be successful.

34. Moreover, PKN Orlen faces competition[16] from Grupa Lotos, a strong competitor (gasoline: [15-25]%; diesel: [10-20]%) on the Polish market. Other competitors are Slovnaft (gasoline: [0-10]%; diesel: [0-5]%) which has access to a large refinery in Slovakia and J&S Energy (diesel: [0-5]%).

35. Grupa Lotos is the largest company in the Region of Pomerania and operates countrywide on the wholesale level and on the retail level (349 fuel stations). Grupa Lotos has access to own refineries in Northern and Southern Poland. In February 2005 Grupa Lotos acquired control over three refineries in Southern Poland: Rafineria Czechowice, Rafineria Nafty Glimar and Rafineria Jasło. The strategy of Grupa Lotos is based on using the refineries' potential in order to develop the company's logistics capability in fuel trade in Southern Poland (Silesia).

36. It should be also noted that Silesia is considered to be one of Poland's fastest and most dynamically developing local regions. Due to the economic development it can be assumed that the demand of gasoline and diesel fuel in this region is likely to increase.

37. Finally, it should be mentioned that imports are significant with a share of all imports in total sales on the Polish market of 13% in 2003 for gasoline and 26% for diesel fuel gasoline and diesel products. These products are imported into Poland from a number of countries as e.g. Slovakia, Germany, Russia and Belarus.

38. Therefore, the concentration neither creates nor strengthens a dominant position on the Polish markets for non-retail sale of gasoline and diesel fuel and does not lead to a significant impediment of effective competition.

The Czech Republic

39. The combined market share of the parties would be [25-35]% in the non-retail market for gasoline and [25-35]% in the non-retail market for diesel fuel in 2004 (gasoline: [30-40]% and diesel: [35-45]%, in 2003).

40. The largest competitors[17] are state-owned Cepro (gasoline: [10-20]%; diesel: [10-20]%), Slovnaft (gasoline: [5-15]%; diesel: [5-15]%), OMV (gasoline: [0-10]%; diesel: [5-15]%), AGIP/ENI (gasoline: [0-10]%; diesel: [0-10]%), ConocoPhillips (gasoline: [0-10]%; diesel: [0-10]%) and Shell (gasoline: [0-10]%; diesel: [0-5]%).

41. The overlaps are small with PKN Orlen's market shares of [0-5]% for gasoline and [0-10]% for diesel. Therefore the transaction has only a limited impact on the current market structure.

42. Furthermore, there are no indications that PKN Orlen would have been able to expand its current market position in the Czech Republic to a significant extent. It operates in the Czech Republic on a limited scale through […] independent

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16 All market shares on the basis of 2003.

17 All market shares based on 2003.

distributors. Moreover, responsibility and costs of the load are borne by PKN Orlen only up to […].

43. It should be mentioned that PKN Orlen owns Poland's most important refinery in Płock (more than 70% of the production capacity and approximately 60% of crude oil processed in Poland) and it is the only company in Poland that owns and utilizes product pipelines in its distribution network. However, neither the refinery in Płock nor the pipelines seem to be a specific competitive advantage with regard to entering the Czech Republic. PKN Orlen's pipelines do not reach the border regions of Poland and the Czech Republic. It has also been argued by the parties that it is more costly for PKN Orlen to transport gasoline and diesel from the refinery in Płock to Southern Poland by pipeline and then reload it onto rail or truck than to use rail as a transport means in the first place. Hence, PKN Orlen uses rail as a means to transport gasoline and diesel from its refinery in Płock to Southern Poland, including for the sales that are made to the Czech distributor.

44. Although PKN Orlen owns two refineries in the South of Poland, Rafineria Nafty Trzebinia and Rafineria Nafty Jedlicze, the combined production capacity of these refineries is below 5% in relation to the production capacity of all refineries in Poland. Gasoline (below 1% of total sales in Poland) and diesel (below 2% of total sales in Poland) are only produced to a very limited extent. No gasoline and an insignificant amount of diesel ([…]tons) are exported into the Czech Republic.

45. The parties face strong international competitors on the Czech markets for non-retail sales of gasoline and diesel as Shell, ConocoPhillips, AGIP/ENI and OMV. Furthermore, ExxonMobil purchases gasoline and diesel fuel on the non-retail market and is active as a seller on the retail market.

46. Moreover, non-retail prices for gasoline and diesel fuel are significantly higher in Poland than in the Czech Republic. In the market investigation it was mentioned that the non-retail price for diesel and gasoline could be up to twice as high in Poland than in the Czech Republic. Therefore, the incentive for PKN Orlen to enter the Czech market is limited.

47. Finally, there is a considerable amount of imports of refined oil products into the Czech Republic. In 2003 the share of all imports in total sales on the Czech markets amounted to 41% in gasoline and 36% in diesel fuel. The largest imports were from Slovakia (above 50% in case of gasoline and about 80% in case of diesel fuel), due to the Slovnaft refinery which is directly connected by pipeline to the Cepro pipeline and storage system, which is owned by the State and covers the entire territory of the Czech Republic.

48. Therefore, the concentration neither creates nor strengthens a dominant position on the Czech markets for non-retail sale of gasoline and diesel fuel and does not lead to a significant impediment of effective competition.

ii. Bitumen

Poland

49. The market position of the merged entity with a combined market share of [55-65]% will be significant on the Polish market. However, this can be primarily attributed to PKN Orlen's share prior to the transaction which amounted to [55-65]% in 2003 (for

the first 11 months of 2004 this amounts to [50-60]%) and it is not significantly changed as a result of the present transaction.

50. Moreover, PKN Orlen will continue to face competition from Grupa Lotos, which has a market share of [25-35] % and has bitumen producing refineries in Gdańsk (Northern Poland) as well as in Jasło (Southern Poland). Additionally, there are numerous importers such as BP and Nyanas which jointly hold approximately [0-10] % of the market.

51. Therefore, the concentration neither creates nor strengthens a dominant position on the Polish market for bitumen and does not lead to a significant impediment of effective competition.

Czech Republic

52. The parties combined market share in Czech Republic amount to [30-40]% with a [0-5]% overlap from PKN Orlen (in the first 11 months of 2004 these market shares were [0-10]% for PKN Orlen and [20-30]% for Unipetrol).

53. The main competitors include strong international companies and their subsidiaries as Total Česká with [10-20]%, Shell Czech Republic with [5-15]%, Agip, ConocoPhilips and Tonamo with [5-15]% each and OMV Česká with [0-5]%.

54. Furthermore, according to the information from the parties the price level for bitumen is approximately 7-10% higher in Poland than in the Czech Republic. The price differences limit the incentive for PKN Orlen to enter the Czech market for bitumen.

55. Therefore the transaction has only a limited impact on the current market structure and as such does not lead to a significant impediment of effective competition on the Czech market for bitumen.

iii. Lubricating petroleum oils (industrial and automotive lubricants)

56. On an EEA scale, the parties have combined market shares significantly below 15%[18] in each of the relevant lubricant product markets.

57. On the basis of national markets for industrial and automotive lubricants, the only affected markets would be in the Czech Republic, where the combined market shares of the parties would be [20-30]% (PKN Orlen, [0-5]%; Unipetrol, [20-30]%) for automotive lubricants and [35-45]% (PKN Orlen, [0-10]%; Unipetrol, [25-35]%) for industrial lubricants. In view of the minimal market share addition on the automotive lubricants market, it can be concluded that no competition problem arises out of the concentration on this market.

58. On the Czech market of industrial lubricants, the parties will face competition of Slovnaft, the Slovak subsidiary of MOL, the Hungarian oil and gas group ([5-15]%) and of several large international oil companies such as Shell ([5-15]%) and ExxonMobil, BP and Castrol ([0-10]% each). It should also be taken into account that ExxonMobil, BP and Shell are the top three suppliers at the European level for industrial lubricants market with a combined share of approximately [65-75]%.

18 [0-5]% for automotive lubricants and [0-5]% for industrial lubricants.

59. In the light of the above, the concentration does not lead to a significant impediment of effective competition on the Czech markets for automotive and industrial lubricants.

V. CONCLUSION

60. 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