

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

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Working Party No. 2 on Competition and Regulation

**ROUNDTABLE ON COMPETITION POLICY FOR VERTICAL RELATIONS IN GASOLINE
RETAILING**

-- Japan --

20 October 2008

The attached document is submitted to Working Party No. 2 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 20 October 2008.

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1. In Japan's gasoline retail sector, most service stations (hereinafter referred to as "SSs") are run by business entities other than oil wholesalers. There has been no national legislation or regulation calling for a separation of the management among oil wholesalers, distributors and retailers. The same applies to the local and municipal administration.

2. Although there are still a limited number of cases where SSs are directly managed by wholesalers, the relative proportion of SSs run by wholesalers' subsidiaries and SSs that act as commission agents (see 1(1) below) has been rising in recent years in contrast to the decline of the total number of SSs. This situation has prompted a business organization mainly comprising the affiliated agencies of wholesalers to voice requests for regulations to restrict the involvement, etc., of oil wholesalers and their subsidiaries in the management of SSs, but the development of such regulation has yet to be realized.

3. Moreover, a resale price maintenance system for gasoline is not permitted in Japan.

4. The following section gives an outline of the oil retailing industry in Japan and the Japan Fair Trade Commission's (JFTC) efforts concerning it.

1. Types of gasoline distributors

5. SSs are largely classified by sign pole into three types: (1) "Wholesaler affiliated SSs" which show the brand names of specific gasoline wholesalers, (2) "Private Brand SSs" (hereinafter "PBSSs") which use private brands developed by energy trading firms and other major business entities, and (3) "Non-brand SSs" (independent gasoline stations) which do business without using any brand names.

1.1 Wholesaler affiliated agencies and affiliated stores

6. Wholesaler affiliated SSs are managed by business entities to which the wholesaler grants a license to use its trademark and where the design of SSs is standardized by each wholesaler.

7. There are two types of business entities that a wholesaler grants a license to use its trademark: (1) wholesaler affiliated agencies that sign contracts to directly purchase gasoline from the wholesaler (hereinafter "affiliated agencies"), and (2) wholesaler affiliated stores that purchase gasoline via the affiliated agencies (hereinafter "affiliated stores").

8. The number of business entities and SSs that are either affiliated agencies or affiliated stores has been on the decline in recent years. Still, wholesaler affiliated SSs account for approximately 80% of all SSs.¹ In terms of the business scale of the affiliated agencies, business entities with capital of less than 10 million yen or those that have less than two SSs account for nearly half of all affiliated agencies. Thus, many affiliated agencies are relatively small-scale business entities. At the same time, it is supposed that there are many affiliated stores that are smaller in size than affiliated agencies which trade directly with oil wholesalers.

1.1.1 Equity holding relationships, etc., between affiliated agencies and wholesalers

9. Among affiliated agencies that are not subsidiaries of wholesalers, only a few have received equity investments or executive officers from wholesalers. However, SSs that adopt the following management practices have emerged in recent years: (1) wholesalers' subsidiaries run SSs as their

¹ Of all gasoline distributors, the number of SSs and business entities declined to 45,792 locations (22,952 business entities) by the end of FY 2006 after reaching a peak in 1994 (60,421 locations and 31,599 business entities) (Annual Energy Report 2008).

affiliated agencies; and (2) affiliated agencies undertake the outsourcing of the management of SSs from the wholesalers under the so-called “commission agent system.” Under the commission agent system, a wholesaler outsources the management of SSs by paying commission fees to its affiliated agencies for managing such SSs, while the wholesaler has the right to make decisions on business policies and selling prices charged by SSs, etc. Except for these business models, there are few business arrangements in which wholesalers directly manage SSs.

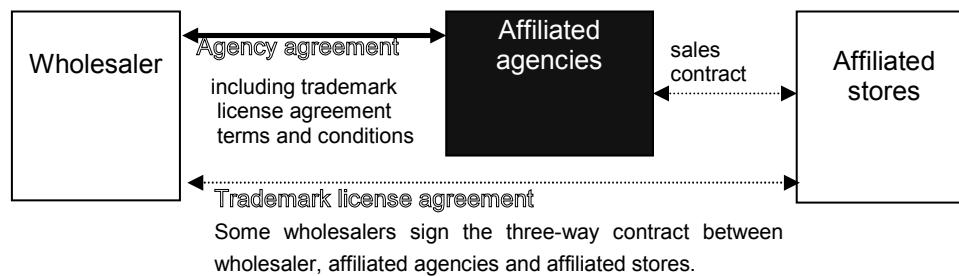
10. In recent years, wholesalers have been proactively utilizing their sales subsidiaries. The sales share of gasoline sold by wholesalers directly and through their subsidiaries in the domestic market has nearly tripled in the past 10 years².

1.1.2 Contractual relationships between affiliated agencies/affiliated stores and wholesalers

11. Affiliated agencies generally conclude an “agency agreement” with a wholesaler, which requires the wholesaler to ensure a continuous and stable supply of gasoline and contains “trademark license agreement terms and conditions³” to the effect that affiliated agencies can sell gasoline using the wholesaler’s trademark.

12. Affiliated stores conclude both a “trademark license agreement” with a wholesaler and an agreement concerning sales and purchases of gasoline with affiliated agencies (Figure 1).

Figure 1. Contractual relationship concerning gasoline sold at Wholesaler Affiliated SSs



1.2 Private Brand business entities and PB stores

13. PB business entities are business entities that operate SSs (PBSSs) with their own trademarks different from those of wholesaler affiliated SSs. They are, namely, energy trading firms, ZEN-NOH (National Federation of Agricultural Cooperative Associations), home-center stores, etc⁴. PBSSs include both those directly operated by PB business entities and those operated by PB stores.

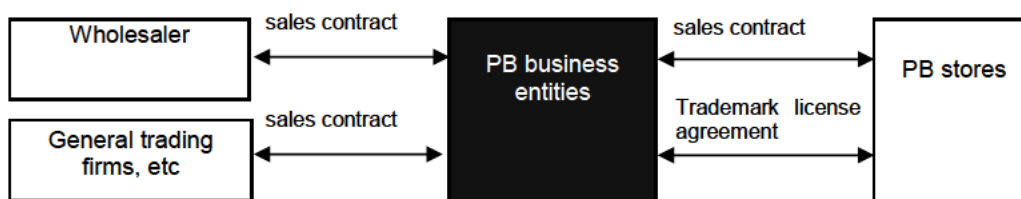
14. PB business entities purchase gasoline for PBSSs from wholesalers or general trading companies and subsequently either sell the gasoline at their directly operated PBSSs or supply it to PB stores. As the contract between the PB business entities and wholesalers in purchasing gasoline for PBSSs is a general sales and purchasing contract, PB business entities do not have the same contractual assurance of a continuous and stable supply of gasoline as affiliated agencies do (Figure 2).

² Their share of the market was 5.5% in FY 1997 and 15.6% in FY 2006 (from a survey of the Agency for Natural Resources and Energy).

³ Some wholesalers conclude a separate agreement dealing with trademark license in addition to an agency agreement.

⁴ There have been entries from different industries; for example, major distributors (large supermarkets, etc.) establish joint investment companies with energy trading companies to develop private brand businesses.

Figure 2. Contractual relationship concerning gasoline sold at energy trading firms' PBSSs



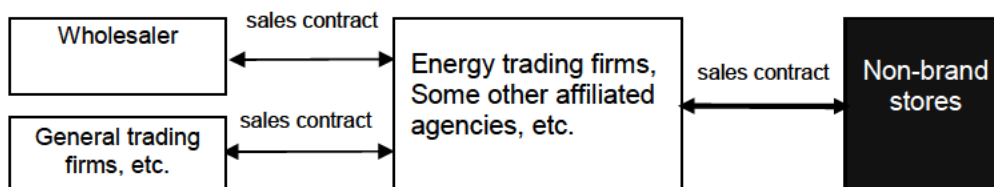
1.3 Non-brand stores

15. Non-brand stores are the business operators that purchase gasoline from energy trading companies, etc. and sell it to consumers without using either a wholesaler’s brand or a private brand of energy trading companies, etc. Some non-brand stores are profitable as they can reduce the purchase price of gasoline or costs by using such measures as securing cheaper gasoline by futures contracts, large volume purchases from energy trading companies by tanker, and distribution to the SSs by their own tanker trucks, while they also make efforts to improve services to their customers.

16. The number of non-brand SSs is not exactly known, but it is thought to be growing. There are also cases in which entities formerly operating as affiliated agencies or affiliated stores transform their businesses into non-brand stores, partly because of the effect of the abolishment of the Provisional Measures Law⁵ and the certificate system of supply sources⁶.

17. Because wholesalers do not sell gasoline directly to non-brand stores in principle, non-brand stores purchase their gasoline from energy trading companies and large affiliated agencies. Vice versa, energy trading companies and large affiliated agencies selling gasoline to non-brand stores purchase gasoline for non-brand stores from wholesalers and general trading companies, etc. (Figure 3).

Figure 3. Contractual relationship concerning gasoline sold at non-brand stores



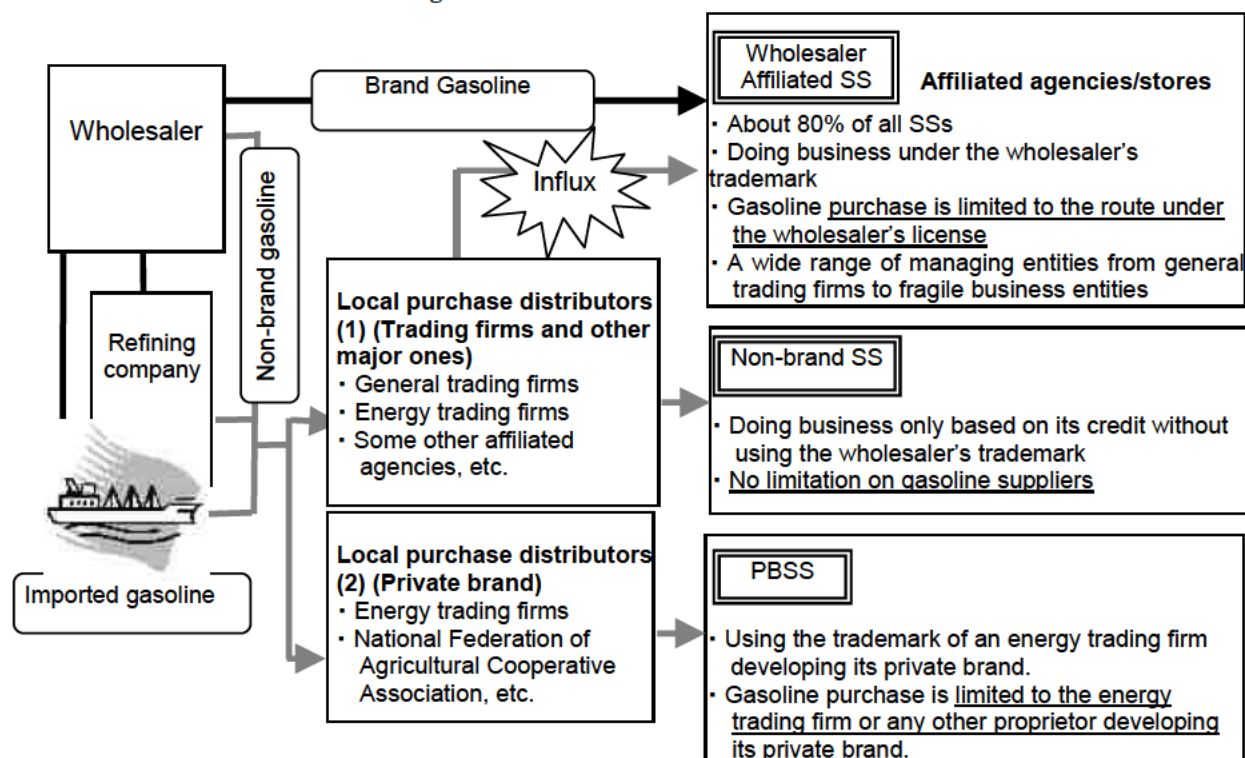
⁵ The Law Concerning Provisional Measures for the Importation of Specified Refined Petroleum Products was repealed in March 1996 and the importation of petroleum products such as gasoline, which had been permitted exclusively to petroleum refining companies/wholesalers, has now been liberalized subject to stockpiling and quality assurance obligations.

⁶ Registration procedures for gasoline distributors under the Law to Secure the Quality of Volatile Oils, etc., previously required gasoline distributors to submit a document (a certificate of supply source) that identified the transaction flow that can track back to petroleum refining companies or importers. However, the requirement to submit a certificate of supply source was abolished at the end of December 1997 due to a concern that it might hinder the smooth entry of new businesses or might have certain side effects, such as causing the rigidification of business relationships, etc.

2. The distribution channel

18. The distribution channel of gasoline sold to consumers at SSs is divided into two routes depending on the customer of the wholesalers: a route mainly via affiliated agencies and another route. The gasoline that is sold through each route is respectively called “brand gasoline” (“*Keiretsu-gyoku*” in Japanese) and “non-brand gasoline” (“*Gyoten-gyoku*” in Japanese). Part of the gasoline provided by wholesalers as non-brand gasoline is conceivably sold to wholesaler affiliated SSs operated by affiliated agencies, etc. (Figure 4).

Figure 4. Distribution Channels of Gasoline



(Note) Some trading firms and major affiliated agencies turn over non-brand gasoline while trading brand gasoline as affiliated agencies. Moreover, some wholesalers and general trading firms, etc. turn over non-brand gasoline in other departments from those dealing with brand gasoline.

2.1 Brand gasoline (“*Keiretsu-gyoku*” in Japanese)

19. “Brand gasoline” is sold via gasoline distribution channels in which gasoline is supplied from wholesalers to their affiliated agencies and affiliated stores based on agency agreements.

20. As a way of streamlining the distribution of petroleum products, wholesalers jointly distribute, facilitate the trading of petroleum products (through barter transactions or swap transactions), share oil tank facilities, etc., with other wholesalers.

2.2 Non-brand gasoline (“*Gyoten-gyoku*” in Japanese)

21. Non-brand gasoline is sold via distribution channels in which wholesalers sell to general trading companies, etc., and which are separate from the distribution channels for brand gasoline. Gasoline sold at PBSSs and non-brand SSs belongs to this category.

22. The characteristic of petroleum products is such that different kinds of petroleum products are produced at the same time by the refining of crude oil, so specific products cannot be produced as much as required. Therefore, there are situations in which wholesalers cannot sell all of the gasoline produced to their own affiliated agencies, etc., so that they sell such unsold gasoline, etc., to general trading companies, etc., as non-brand gasoline.

23. However, for trademark protection reasons, in an attempt to prevent their non-brand gasoline from being distributed to their affiliated agencies or affiliated stores, wholesalers request that general trading companies, etc., refrain from selling non-brand gasoline sold by wholesalers to their affiliated agencies or affiliated stores. The practice that general trading companies, etc., do not sell non-brand gasoline to agencies and stores affiliated to the supplier of the gasoline has in fact become customary among wholesalers and general trading companies, etc. (Some wholesalers have instituted a policy whereby they will cease trading with any trading company that sells non-brand gasoline to the wholesaler's affiliated agencies or affiliated stores.)

24. Some wholesalers request that general trading companies, etc., refrain from identifying the supplier of non-brand gasoline as the business relationships with their affiliated agencies, etc., may be harmed if it is revealed that they are selling non-brand gasoline to general trading companies, etc.

25. Non-brand gasoline is basically traded by way of spot trading and the trading price of non-brand gasoline is more susceptible to factors such as supply and demand conditions than brand gasoline that is traded both continuously and in a stable manner. Therefore, while the trading price of non-brand gasoline may at times exceed that of brand gasoline, the trading price of non-brand gasoline is generally lower than that of brand gasoline. This is thought to be attributable to the following factors: (1) the system for the sharing of distribution costs is different - for example, while brand gasoline is, in general, transported to SSs by wholesalers⁷, non-brand gasoline is basically picked up from storage tanks by general trading companies, etc.⁸, and (2) the cost of the various services⁹ provided by wholesalers to their affiliated agencies, etc., is added to the price of brand gasoline.

2.3 *The inflow of non-brand gasoline into brand gasoline channels*

26. Under trademark license agreements, wholesalers require their affiliated agencies and affiliated stores to refrain from selling non-brand gasoline at wholesaler affiliated SSs.

27. However, according to the survey on gasoline distributors undertaken by the JFTC in 2004, many affiliated agencies (about 47%) do in fact purchase non-brand gasoline either "continuously" or "sometimes", which indicates that approximately half of them buy non-brand gasoline and sell it at SSs under the wholesaler's brand name. Affiliated agencies most frequently (85.3%) cited the fact that "wholesalers' brand gasoline is expensive" as the reason for purchasing non-brand gasoline. The ratio of non-brand gasoline to the total volume of gasoline purchased was less than 50% for many of the affiliated agencies that purchase non-brand gasoline.

⁷ Wholesalers deliver gasoline to SSs in tank trucks on which the wholesaler's trademark is displayed.

⁸ General trading companies and affiliated agencies, etc., arrange for tank trucks to pick up gasoline at wholesalers' refineries.

⁹ The services and support offered by wholesalers to their affiliated agencies, etc., include granting the right to use trademarks widely recognized by consumers, providing sales promotion programs, providing emergency response support when accidents occur, and bearing the cost of painting affiliated SSs.

3. Recent JFTC activities

28. The JFTC surveyed the actual conditions of gasoline distribution and published a report in 2004. In 2005, the JFTC conducted a follow-up survey and published the results of the survey. The 2004 report highlighted the actual conditions of gasoline distribution, and showed the viewpoints on the Antimonopoly Act (“AMA”) concerning issues such as the difference in the wholesale price of wholesalers to distributors, restraints on the trade of non-brand gasoline and the imposition of non-transparent business terms, etc.

29. For example, in terms of the restraints on the trade of non-brand gasoline, the following cases can be regarded as raising problems under the AMA (Trading on Exclusive Terms, Discriminatory Treatment, Trading on Restrictive Terms, Abuse of Superior Bargaining Position, etc.) in that the act of the wholesaler may not be regarded as the exercise of trademark rights by deviating from or infringing the spirit and purpose of the trademark protection system.

- Where the wholesaler exercises its trademark rights in an arbitrary and discriminative way and exerts a direct and serious effect on the competitiveness of affiliated agencies treated in a disadvantageous way: e.g., asking only some of its affiliated agencies to stop trade in non-brand gasoline (and terminating the agency agreement for the reason of such trade if they do not comply) while not asking others among the affiliated agencies of the same wholesaler.
- Where the wholesaler inhibits the free business activities of its affiliated agencies and consequently brings unfair disadvantages to them by preventing them from purchasing the wholesaler’s brand gasoline for a lower price from such entities as a major agency affiliated to the same wholesaler; and
- Where the wholesaler inhibits the free business activities of its affiliated agencies and brings unfair disadvantages to them by forbidding them from selling non-brand gasoline by way of exercising its trademark rights in such a case where the wholesaler fails to promote a consistent distribution of its properly trademarked brand gasoline by allowing and overlooking its brand gasoline to be mixed with different brands of gasoline from other unspecified companies and neglecting quality control by not separating brand gasoline from non-brand gasoline in the process of distribution.

30. Furthermore, the following views regarding transactions between wholesalers and affiliated agencies involved in gasoline distribution were expressed on 1 June 2007:

- Wholesalers who make unilateral decisions on the wholesale price for affiliated agencies may be infringing the AMA (Abuse of Superior Bargaining Position);
- Wholesalers who prohibit their affiliated agencies from purchasing the wholesaler’s products from other affiliated agencies may be infringing the AMA (Trading on Restrictive Terms, Abuse of Superior Bargaining Position) because they suppress price competition for the relevant branded product in the sense that affiliated agencies are unable to purchase cheaper gasoline and at the same time they impose a trade condition that is detrimental to the interests of affiliated agencies.

31. The JFTC subsequently instructed the relevant wholesalers to improve conditions regarding agency agreements, etc. that stipulate contents contrary to the above viewpoints.

32. With respect to Discriminatory Consideration, the following view, which has been expressed in the past, was stated again:

- Where the fair competitive order may be adversely affected by a wholesaler who sells to other business entities with a markedly lower wholesale price than the market price provided to general affiliated agencies, in that the differences between them are beyond those in trading conditions and arrangements, and thereby has a direct and significant influence on the competitiveness of affiliated agencies, the wholesaler may raise a problem under the AMA (Discriminatory Consideration).

33. The JFTC indicated to the parties concerned that if the JFTC faces any facts as mentioned above, it would carry out the necessary investigations and take rigorous measures on the cases that may involve problems under the AMA.