

FS 2021 - 2 - Consultation

Proposed Fuels Market Economic & Regulatory Assessment



Launch Date: 16 April 2021

Closing Date for comments: 14 May 2021



Table of Contents

A. INTRODUCTION.....	3
B. LEGAL FRAMEWORK.....	4
C. DRAFT MARKET ASSESSMENT REPORT CONCLUSIONS	5
D. CONSULTATION QUESTIONS	7
E. HOW TO RESPOND TO THIS CONSULTATION	10
APPENDIX 1.....	12

A. Introduction

1. The Utility Regulation and Competition Office ('OfReg' or the 'Office') is the independent multi sector regulator with responsibility for the key utilities providers in the Cayman Islands, including the fuel sector ('Fuel Sector'), in addition to the electricity, information and communications technology ('ICT'), water, and wastewater sectors.
2. Different decisions by the Office will affect persons and organisations throughout the country in different ways. It is therefore important that the Office makes regulatory decisions and proposes new regulations with the appropriate input from persons with sufficient interest or who are likely to be affected by the outcome of such decisions. Consultation is an essential aspect of regulatory accountability and transparency and provides the formal mechanism for these persons to express their views in this manner. The requirement for the Office to consult is mandated in its enabling legislation.
3. Under its enabling and foundational legislation, the Office has several principal mandates. One of these principal mandates is to assure competition, transparency, efficiency and innovation in the Fuel Sector, along with its continuing function of ensuring safety and compliance across the Fuel Sector. The Office may do so by making administrative determinations, decisions, orders and regulations.
4. The Office is in the process of considering options for a comprehensive regime to effectively monitor and regulate the Fuel Sector, in order to achieve the Office's mandate in respect of the Fuel Sector. As a part of this process, the Office is undertaking a comprehensive market study of the Fuel Sector with the objective of defining the relevant markets within the Fuel Sector, and then assessing the extent and effectiveness of competition within these markets, reflecting the types and grades of fuels currently and potentially on the market in the Cayman Islands. The first element of the market study was the assessment of and report on the market definitions for the purposes of competition assessment for the various fuels markets in the Cayman Islands: the Office published the draft Market Definition Report as part of its Consultation on Proposed Fuels Market Definition (FS 2020 – 1) in March 2020 and published its response and draft final determination¹ to adopt the Proposed Fuels Market Definition Report² in 28 January 2021. The second element of the market study is a comprehensive competition assessment of the relevant markets and assessment of the potential options (if any) for regulatory reforms of those markets.
5. The purpose of this consultation paper is to seek the views of operators, the general public, and other interested parties, regarding the draft Market Assessment Report in relation to the Fuel Sector ('the draft Market Assessment Report').

¹ <https://www.ofreg.ky/fs-2021-1-consultation-draft-final-determination-on-proposed-fuels-market-definition>

² <https://www.ofreg.ky/fs-2021-1-draft-final-determination-on-proposed-fuels-market-definition>

B. Legal Framework

6. The Office is guided by its statutory remit in developing the draft Market Assessment Report, notably the provisions which follow.
7. The Utility Regulation and Competition Act (2021 Revision) (the ‘URC Act’) is the principal legislation governing the Office’s mandate in respect of the Fuel Sector. Alongside the URC Act, the sector-specific legislation governing the Fuel Sector are the Dangerous Substances Act (2017 Revision) (the ‘DS Act’) and its supporting Regulations (‘DS Regulations’), and the Fuel Market Regulation Act (2017) (the ‘FMR Act’).
8. Section 6(1) of the URC Act outlines that the principal functions of the Office, in the markets and sectors for which it has responsibility, include “*to promote appropriate effective and fair competition*”, “*to protect the short and long term interests of consumers in relation to utility services*”, and “*to promote innovation and facilitate economic and national development*”.
9. Section 5(1)(b) of the FMR Act provides that one of the functions of the Office in relation to the Fuel Sector is to “*promote fair competition in the fuel sector*”.
10. Section 5(1) of the FMR Act states in part:
 5. (1) *The Office shall supervise the fuel sector in accordance with its jurisdiction under the Utility Regulation and Competition Act, 2016 and, in doing so, the functions of the Office are as follows–*
 - (a) *To implement policy objectives set out in directions issued by Cabinet pursuant to the Utility Regulation and Competition Act, 2016;*
[...]
 - (b) *promote fair competition in the fuel sector;*
[...]
 - (e) *to monitor the prices of fuel;*
[...]
 - (k) *to prevent discrimination against, or preferential treatment of, any person in the fuel sector, and to prevent monopolistic control of any segment of the chain of supply of fuel; and*
 - (l) *to minimise barriers to entry for new participation and investors in the fuel markets.*
11. Section 6(2)(o) of the URC Act states that the Office, in performing its functions and exercising its powers under the URC Act or any other Act, may “*conduct research and studies into any matter or technology which may be relevant to its functions and publish its findings, if appropriate*”.
12. Section 7(1) of the URC Act requires the Office, before issuing an administrative determination which in the reasonable opinion of the Office is of public significance, “*... to allow persons with sufficient interest or who are likely to be*

affected a reasonable opportunity to comment on the draft administrative determination.”

C. Draft Market Assessment Report Conclusions

13. The Office considers that it is in the interest of the public to consider options for a comprehensive regime to effectively monitor and regulate the Fuel Sector, in order to achieve the Office’s mandate in respect of the Fuel Sector including to promote fair competition in the Fuel Sector. This process will ensure that the Fuel Sector delivers the most competitive and desirable outcomes possible for residents, businesses, and other stakeholders in the Cayman Islands.
14. The draft Market Assessment Report is attached to this consultation document as “APPENDIX 1”, and is summarised in the paragraphs below. The Office strongly encourages respondents to read the draft Market Assessment Report prior to submitting comments, or to answering the consultation questions in the next section, as this summary below is not intended to be exhaustive.
15. The Market Definition Report defined the relevant markets in the fuel sector for regulatory purposes; these market definitions are captured in Section 3 of the draft Market Assessment Report.
16. The draft Market Assessment Report in Section 4 analyses the effectiveness of competition in those markets, concluding as follows:
 - a) The wholesale/bulk markets for gasoline and diesel (including blends up to the “blend wall”) are assessed as being highly concentrated and not strongly competitive. Rubis Cayman Islands Limited, Rubis Eastern Caribbean SRL, and other entities controlled within the Rubis corporate group (together, “Rubis”), and Sol Petroleum (Cayman) Limited, Antilles Trading Company SEZC, and other entities controlled within the SOL corporate group (together, “SOL”), each have significant market power in these markets;
 - b) The retail markets for gasoline and diesel (including blends up to the “blend wall”) on Grand Cayman are assessed being as moderately concentrated and moderately competitive. Individual retail stations on Grand Cayman do not have significant market power in these markets;
 - c) The retail markets for gasoline and diesel (including blends up to the “blend wall”) on Cayman Brac and Little Cayman are assessed as being highly concentrated and not strongly competitive. Retail stations on Cayman Brac and Little Cayman have significant market power in these markets;
 - d) The markets for jet fuel/kerosene and avgas are assessed as being highly concentrated and not strongly competitive. Rubis and SOL have significant market power in the market for jet fuel/kerosene, and Rubis has significant market power in the market for avgas;
 - e) The market for propane (LPG) is assessed as being highly concentrated, and modestly but not highly competitive. Home Gas Limited (“Home

- Gas”) has significant market power in this market, but Clean Gas Limited (“Clean Gas”) does not have significant market power; and
- f) The market for acetylene is assessed as being highly concentrated and not strongly competitive. PM Industrial Gas Limited (“PMIG”) has significant market power in this market.
 - g) There is currently not sufficient commercial activity in the following product markets to make an assessment on the degree of competition in these markets: ethanol and gasoline-ethanol blends above the “blend wall”; biodiesel and diesel-biodiesel blends above the “blend wall”; natural gas (LNG and CNG); butane; hydrogen; and methanol.
17. The fuel sector is assessed as being generally highly concentrated and not highly competitive. However, the number of viable competitors is limited by economies of scale and the small market size, and in this context competition is at least partly “workable” and can potentially work to a satisfactory degree. Nevertheless, competition in the fuel sector is only partly effective and can be improved further by targeted policy interventions detailed in Section 6 of the draft Market Assessment Report.
18. The Market Assessment Report in Section 5 then considers the current regulatory regime in the fuel sector, and in Section 6 considers a number of options regarding potential regulatory models, intervention strategies, potential market rules, and regulatory determinations to be considered and implemented in the relevant markets in the fuel sector. These options and recommendations are:
- a) Adopting guidelines and policy procedures in relation to different areas of anti-competitive conduct, including mergers control and abuse of dominance, as a means of increasing stakeholder awareness and fostering increased enforcement of the competition laws;
 - b) Retaining the current guidelines on market definition and significant market power but amending them to permit for clearer determination of significant market power on the basis of high market shares by amending them so that a market share of 40% or above may give rise to a rebuttable presumption of significant market power, rebuttable by circumstances where barriers to entry to that sector are not appreciable;
 - c) Enhancements to the Office’s price monitoring activities, and the rules applying to retailers;
 - d) Consideration of a mandated open access regime for certain critical, “bottleneck” infrastructure, particularly infrastructure required to import bulk fuels;
 - e) Careful consideration of the available policy options that can make competition work effectively, before resorting to the introduction of direct price controls;
 - f) Consideration of enhanced mechanisms to reduce barriers to entry and to take into increased account barriers to entry and competition considerations in exercising the Office’s wider regulatory functions; and

- g) mechanisms to improve the cooperation of stakeholders and outcomes in the Office's information gathering functions.

D. Consultation Questions

19. Based on the above, the Office invites all interested parties to submit their comments, with supporting evidence, on the following questions:

Question 1:

What are your views on the conclusions that:

World market prices of crude oil are a primary factor in determining the prices of refined products and changes in those prices, and that small markets such as the Cayman Islands as price takers in world market for refined products are thereby susceptible to the volatility of world market prices for crude oil.

Question 2:

What are your views on the conclusions that:

- a) Barriers to entry in the wholesale/bulk gasoline and diesel markets are relatively high and these market are highly concentrated and are not strongly competitive.**
- b) Rubis and SOL have significant market power in the wholesale/bulk markets for gasoline and diesel.**

Question 3:

What are your views on the conclusions that:

- a) Barriers to entry in the retail markets for gasoline and diesel are moderately high but not as high as in the wholesale/bulk market levels.**
- b) The retail markets for gasoline and diesel on Grand Cayman are moderately concentrated and are not strongly competitive.**
- c) The retail markets for gasoline and diesel on Cayman Brac and Little Cayman are highly concentrated, and are not strongly competitive.**
- d) None of the retail stations on Grand Cayman has significant market power in the retail markets for gasoline and diesel.**
- e) Each of the retail stations on Cayman Brac and Little Cayman has significant market power in its retail markets for gasoline and diesel.**

Question 4:

What are your views on the conclusions that:

- a) The barriers to entry to the markets for aviation fuels, namely jet fuel/ kerosene and avgas, are moderately high, and these markets are highly concentrated and are not strongly competitive.
- b) Rubis and SOL have significant market power in the markets for jet fuel/kerosene, while Rubis has significant market power in the market for avgas.

Question 5:

What are your views on the conclusions that:

- a) The barriers to entry to the market for propane (LPG) are moderate for small scale market entry but substantially higher for larger scale market entry.
- b) The market for propane (LPG) is highly concentrated and modestly but not highly competitive.
- c) Home Gas has significant market power in the market for propane (LPG) but Clean Gas does not have significant market power in this market.

Question 6:

What are your views on the conclusions that:

- a) The market for acetylene is highly concentrated and not competitive.
- b) PMIG has significant market power in the market for acetylene.

Question 7:

What are your views on the conclusions that:

- a) Economies of scale in the fuel sector in the Cayman Islands are significant relative to the market size.
- b) The fuel sector in the Cayman Islands in general is not highly competitive but competition is at least partly effective or workable.

Question 8:

What are your views on the functioning of the fuel sector in the Cayman Islands in general, including:

- a) The effectiveness of competition and market outcomes in the fuel sector.
- b) The relevance and effectiveness (if any) of countervailing and buyer power in moderating any significant market power by sectoral providers.
- c) The extent to which (if any) sectoral providers may engage in collusive or other anti-competitive conduct.
- d) Any difficulties in detecting anti-competitive conduct by sectoral providers.

- e) Any other issues you consider to be relevant in evaluating the functioning of competition and market outcomes in the fuel sector.

Question 9:

What are your views on:

- a) The conclusion that increased clarity in the use of market share thresholds in determinations of significant market power may increase legal certainty and administrative tractability, for more accurate administrative determination.
- b) The ensuing recommendation that a market share of 40% or higher may result in a presumption of significant market power, which may be potentially rebutted by evidence that barriers to entry are low.

Question 10:

What are your views on:

- a) The conclusion that the Office's initiatives to increase price transparency in the fuel sector likely enhance the state of competition in the relevant markets.
- b) The corollary recommendation that the Office may further enhance price transparency by considering options for temporary price lock-in mechanisms at retail stations coupled with retail stations reporting their prices to the Office.

Question 11:

What are your views on:

- a) The conclusion that there may be critical importation and other infrastructure "bottlenecks" in the supply chain of the fuel sector that may have an adverse impact on the ability of competition to work effectively in downstream and other related markets.
- b) The ensuing recommendation that, in line with the practice in other jurisdictions, the Office consider options for a structured mandated access or "essential facilities" regime, under which an access seeker may gain access to certain critical infrastructure facilities, if those facilities are declared under a structured process to meet certain cumulative criteria (including that they cannot be economically or feasibly duplicated, and that access to them would promote competition in related markets).

Question 12:

What are your views on:

- a) **The conclusion that the material disadvantages to regulated price control regimes outlined in the report outweigh the potential advantages.**
- b) **The ensuing recommendation that price control mechanisms is not the preferred option given the other effective regulatory option outlined in the findings.**

Question 13:

What are your views on:

- a) **The conclusion that low or absent barriers to entry to a market generally enhances competitive outcomes in markets, and can do so even if there is no competitive entry, as long as there is a realistic threat of competitive entry.**
- b) **The ensuing recommendation that the Office consider mechanisms to take into account barriers to entry and other factors influencing the level of competition when making decisions more generally.**

Question 14:

What are your views on measures to reduce the compliance burden on reporting stakeholders.

Question 15:

Please provide your views on any other matters you consider relevant to this Consultation.

E. How To Respond To This Consultation

- 20. This consultation is conducted in accordance with the Consultation Procedure Guidelines determined by the Office and found on the Office's website³.
- 21. The Office considers that because the draft Market Assessment Report is published as part of this consultation, this consultation will be conducted as a single-phase consultation over a period of twenty-eight (28) days. Where, upon review of the responses to this consultation, it becomes clear that a second phase of consultation is required, a further notice will be issued accordingly.
- 22. All submissions on this consultation should be made in writing, and must be received by the Office by 5 p.m. on 14 May 2021 at the latest.
- 23. The Office will post any comments received within the stated deadline on its website by 5 p.m. on 28 May 2021.

³<https://www.ofreg.ky/upimages/commonfiles/1507893545OF20171DeterminationandConsultationProcedureGuidelines.pdf>

24. Submissions may be filed as follows:

By email to:

consultations@ofreg.ky

or by post to:

Utility Regulation and Competition Office

P.O. Box 10189

Grand Cayman KY1-1002

Cayman Islands

or by courier to:

Utility Regulation and Competition Office

3rd Floor, Alissta Towers

85 North Sound Rd.

Grand Cayman

Cayman Islands

25. The Office expects to publish a determination regarding the draft Market Assessment Report by 11 June 2021.



APPENDIX 1

Proposed Market Assessment Report

The proposed Market Assessment Report is attached as an appendix.