



## **Fertilizer Producers Come Out Smelling Like Roses: Competition Board's Fertilizer Decision Goes Knee Deep into Market-Specific Dynamics**

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At the end of 2020, the Turkish Competition Board (“**Board**”) finalized its assessment on the investigation regarding the price increases in the fertilizer industry, conducted against six undertakings active in the fertilizer manufacturing market in Turkey to determine whether the relevant undertakings had violated Article 4 of the Law No. 4054 on Protection of Competition (“**Law No. 4054**”) (“**Investigation**”).<sup>1</sup> The investigated parties, Bandırma Gübre Fabrikaları A.Ş. (“**BAGFAŞ**”), EGE Sanayi A.Ş. (“**EGE**”), Gemlik Gübre (“**GEMLIK**”), Gübre Fabrikaları T.A.Ş. (“**GUBRETAS**”), İstanbul Gübre Sanayi A.Ş. (“**IGSAS**”) and Toros Tarım Sanayi ve Ticaret A.Ş. (“**TOROS**”) represented 80% of the industry. Published recently in April 2021, the decision contains some outstanding analyses on the sector dynamics and the relevant market.

Indeed, in this matter, the Board goes knee deep into determining the market structure of fertilisers, which is an oligopoly with high transparency, where pricing behaviours of the undertakings are significantly affected by factors such as imports, fluctuations in the exchange rates and seasonality. The assessment shows that product substitutability was considered thoroughly and very detailed economic analyses were conducted on prices in order to eliminate the slightest possibility of cartelistic behaviour in the market that had ultimately been merely implied by a single document. It was actually unclear whether this document referred to an exchange of sensitive information among competitors, or a discussion based on information gathered from market research. Thus, the case demonstrates the lengths that the Turkish Competition Authority (“**Authority**”) is willing to go to eliminate potential competition law infringements, but also sets an ideal bar for analyses on sectors determined with homogenous products and high transparency that may require an abundance of market-specific assessment.

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<sup>1</sup> The Board’s decision dated 26.11.2020 and numbered 20-51/718-317.

*i. Assessment on the General Structure and the Characteristics of the Fertilizer Sector in Turkey*

Within the scope of its decision, the Board provided an in-depth analysis on the dynamics of the fertilizer market, including the domestic and international prices, exchange rates, substitutability, and seasonality. In light of these factors, the Board pointed out that while there are approximately 1200 undertakings in Turkey active in the production or import of fertilizer, the six producer/importer undertakings subjected to the Investigation comprised approximately 80% of this market.

The Board defined the fertilizer sector as an oligopolistic market, considering that the majority of the trade volume belongs to the six undertakings that are under Investigation; there is no brand recognition in the fertilizer sector; and that the products are generally considered homogenous. The Board further analysed the sector through charts showing the commercial flow of the goods, which begins with procurement of raw materials and imported fertilizer by the domestic fertilizer producers (which engage in both production and import) from abroad, and then distributed to dealers, wholesalers, and/or the end consumer. The Board also indicated that there is a two-way relationship between the domestic fertilizer producers and the domestic fertilizer importers. Based on this trade network, the Board further scrutinized that the sector may show the characteristics of a dual-sided market and that flow of trade may differ, from time to time. Considering the above, the Board analysed that having a limited number of players, homogenous products and oligopolistic nature, lead to a transparent and easy-to-follow sector.

As to the pricing in the sector, the Board also dove deep into the effects of the foreign parameters. For instance, the Board analysed that in addition to the transparent nature of the market, the players also access shared forecasts of price and costs, since the players can monitor the fertilizer markets abroad for raw materials and finished products, and order through the same channels, if necessary. Thus, the Board concluded that the prices outside of Turkey also play a significant role in determining the domestic prices. Also considering that the imports are generally made in foreign currency, the foreign prices and the corresponding exchange rates play an important role in the determination of the domestic prices in the

fertilizer sector. Further, the Board also noted the effect of the import delivery process and any fluctuation in the exchange rates during the shipment of the product; as it generally takes a period of two months (from order to delivery and payment) for products to be exported to Turkey, any fluctuation in the exchange rates during this period would be borne by the undertakings and directly affect their profitability.

In addition to these assessments, the Board went above and beyond in leaving no point untouched and analysed the planting seasons in Turkey, as well. Based on the prevalent agricultural products in Turkey, the Board explained that the plants require the most nutrients for development in the spring months, and therefore seasonality is also another determinative factor in the fertilizer consumption. Therefore, although the fall and spring months are expected to show increased fertilizer consumption, the producers are active all year round to meet the demand, and thus required to carry a certain amount of stock as well as the stock risk that comes with it.

Thus, in light of the above explanations, the Board determined the characterizing factors of the fertilizer sector as: the limited number of solid players and the oligopolistic structure resulting from the product homogeneity; significant dependence on import with regard to raw materials; international product prices, and the determining factor of the exchange rates; non-exclusive agency structures and the transparency of the market provided by the similar players in import, and lastly, seasonal fluctuation of consumption and the related stock risk.

*ii. Relevant Market Analysis*

In addition to sectoral analyses, the Board also analysed different types of fertilizers to determine the scope of the relevant product market. It assessed both demand and supply side substitutability and considered different raw materials, usage areas and seasonality of the products, possible competition constraints and investment requirements. Further, the Board took notice of the approach of competition authorities in different jurisdictions on fertilizer market and made references to the European Commission and the Competition and Markets Authority.

Ultimately, the Board considered the relevant markets to be "nitrogen fertilizers," "phosphorus fertilizers," "potassium fertilizers," and "compound fertilizers," and the geographical market as the Turkish Republic; however, it did not provide a definitive market definition as it would not change the result of the case file. Nonetheless, the Board went into a deeper breakdown by using the base and top fertilisers as suggested by the economic analysis, as well as urea, since the document that led to the initiation of the investigation specifically referred to this fertiliser which has the largest consumption in Turkey.

*iii. Findings from the On-Site Inspections*

During the on-site inspections carried out at each of the investigated undertakings, a total of 26 documents were collected by the Board, including ones where the investigated undertakings discussed the market prices and the effects thereof.

The Board noted that certain of the documents collected also indicated that they may be evidence of an Article 4 of the Law No. 4054 violation. However, further inspection of the relevant market price activity by the Board yielded non-conclusive results for the possible effects of the communications about the alleged conduct included in the documents obtained. Thus, the Board could not deduce if the market is being restricted.

More specifically, the Board pointed to one document collected during the on-site inspections that could possibly show anti-competitive conduct. The said evidence included phrases as follows: "*İgşaş told Gemlik people that they would set Urea prices at (...) TRY/tonnes FOT for Tuesday (tomorrow), and Gemlik increased its prices last week accordingly. They said that if they do not increase tomorrow, the market can come down in urea.*" This correspondence was made between the BAGFAŞ`'s regional representative and EGE`'s advisor to the Chairman of the Board.

The Board noted that EGE and BAGFAŞ belong to the same economic entity and any conversation between undertakings in the same economic entity cannot be considered to be against Article 4 of Law No. 4054. In addition, the Board also investigated whether the prices mentioned within the correspondence had been put into effect, by analysing the declared and

applied prices to the relevant products and concluded that none of these reflected the prices mentioned within the abovementioned document. The Board then assessed and compared the prices as well as the price changes of İGSAŞ and GEMLİK during a set period of time. As a result, the Board found that the prices of these two entities showed similarities on the same or approximate dates. However, the Board stated that the oligopolistic structure of the market and the homogenous products directed the undertakings to closely monitor the prices of the competitors.

In light of the above, the Board assessed that the applied prices of the undertakings vary from one and other, and that the competitors can show different pricing behaviours even within the same day. Also considering that the price increases can be made due to reasons outside of the undertaking itself, the Board concluded that there was no evidence that showed a violation.

*iv. Economic Analysis*

Within the scope of both the preliminary investigation and the full-fledged investigation, the Board conducted economic analyses to determine whether the investigated undertakings violated Article 4 of the Law No. 4054, including the examination of price correlation and evaluating the effect of cost shocks on price. The Board explained that shock analysis is commonly used in defining the relevant market and evaluating the unilateral effect of a certain event/shock (*i.e.*, new product, brand, innovation, special promotions, advertising campaigns, instant exchange price, cost and sales in case of exchange rate changes, etc.) and the various fluctuations it causes on undertakings` variables, such as changes in sale and costs volumes or uncertainty in prices. The competitive conditions of the relevant market are determined based on the findings of these shock analyses.

The Board further assessed that for cases where a cartel is suspected in a particular market, but the existence and timing cannot be confirmed, a regression model (reduced form price model) explaining the price of relevant products should be implemented in order to determine the suspicious price movement. The regression model explains the price of the relevant products by adding in those factors that affect the cost, demand, and supply as explanatory variables.

The Board also noted that one of the foremost behavioural analyses for uncovering cartels is the structural break test, which evaluates the structural fractures in prices with the understanding that these may be an indication of the existence of an agreement that restricts competition. Although these tests are not conclusive evidence, they are important for shedding light on which sectors require a more in-depth analysis. In this context, the Board found the ordinary least square based cumulative sum test to be the most appropriate structural fracture test, due to its high compatibility with the relevant market in the case at hand. As for the variables, since the fertilizer market in Turkey is heavily dependent on imported resources both in raw material and in the final product market, the prices of the final products are invariably affected by the TRY/USD exchange rates. Energy (natural gas) prices are also very significant because it is used as a source of energy and as raw material in production of fertilisers. Therefore, considering all of the sector specifics above, the Board used foreign exchange rates, producers` price index in energy, international FOB prices for urea and ammonia in USD, and seasonality as the explanatory variables in the reduced form price regression method for the i) base fertilizer, ii) top fertilizer and iii) urea fertilizer prices.

Within the scope of the analysis, although statistically significant coefficients were reached as a result of the regression made for base and urea fertilizer varieties, it was not possible to reach a meaningful result for top fertilizers with alternative model determination experiments and different combinations of explanatory variables and / or delayed values. In this regard, analysis and evaluations were carried out on the estimation results for base and urea fertilizers.

As a result, the regression analysis for base fertilizer and urea fertilizer did not reveal any structural fracture findings of the type that could indicate an explicit or implicit price-fixing agreement for these fertilizers during the observation period, thus the Board determined the price fluctuations could be explained by the change in the explanatory variables.

In addition to the above primary substantive assessments of the Board, this decision also contains valuable points regarding the concept of “same economic entity.” In fact, the Investigation set out that EGE and BAGFAŞ belong to the same economic entity; but interestingly, while this was acknowledged by EGE, BAGFAŞ opposed such analysis.

BAGFAŞ stated that EGE and BAGFAŞ are two separate and independent entities; and that while BAGFAŞ can be considered to be part of the same group of companies with EGE, their decision-making mechanisms are completely different and they were in cut-throat competition with each other.

The Board assessed that having different members in the board of directors does not change the fact that EGE and BAGFAŞ are within the same economic entity, since they are both controlled by the same family. Additionally, the Board also found correspondences during the on-site inspections which show that EGE and BAGFAŞ are in communication with each other regarding attendance in each other`s general assemblies. Thus, the Board found that they belong to the same economic entity.

v. *Conclusion*

Finally, based on the evidence collected, the defences and the scope of the file examined, the Board decided that the investigated undertakings did not violate Article 4 of the Law No. 4054.

The decision is one of the best examples of how and why a concerted practice should be analysed and tested thoroughly and why the standard of proof should be significantly high. In oligopolistic markets with homogenous products and high transparency may result in similar behaviour of the undertakings, but it may not always result from cartel behaviour.

The assessment reveals that the Board had a particular focus on market specific dynamics including product substitutability of fertilizers and, through meticulous economic analyses on prices, eradicated the slightest probability of cartel behaviour. Thus, it demonstrates the lengths that the Turkish Competition Authority will go to eliminate potential competition law infringements.

On the other hand, it may be also argued that the chemical fertilizer has been one of the sectors (like cement) that the Board has periodically focused on over the years, and accumulated considerable expertise and knowledge since their first investigation back in



2002<sup>2</sup>. Furthermore, the homogenous products, transparent and oligopolistic nature of the market, availability of extensive and historical price data for raw materials and final products in foreign markets, are also conducive for detailed statistical analysis.

In any case, the decision sets an ideal bar in terms of legal certainty and the lack of such in-depth analysis in subsequent investigations in other sectors –particularly in sectors which are good candidate for detailed statistical analysis with extensive accessible data- could be a strong counter-argument against unfavourable decisions.

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*The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.*

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<sup>2</sup> The Board's decision dated 8.2.2002 and numbered 02-07/57-26 was annulled by the 13<sup>th</sup> Chamber of Council of State. The Board reevaluated the case with its decisions dated 05.01.2006 and numbered 06-02/45-7 and dated 26.07.2007 and numbered 07-62/738-266.