

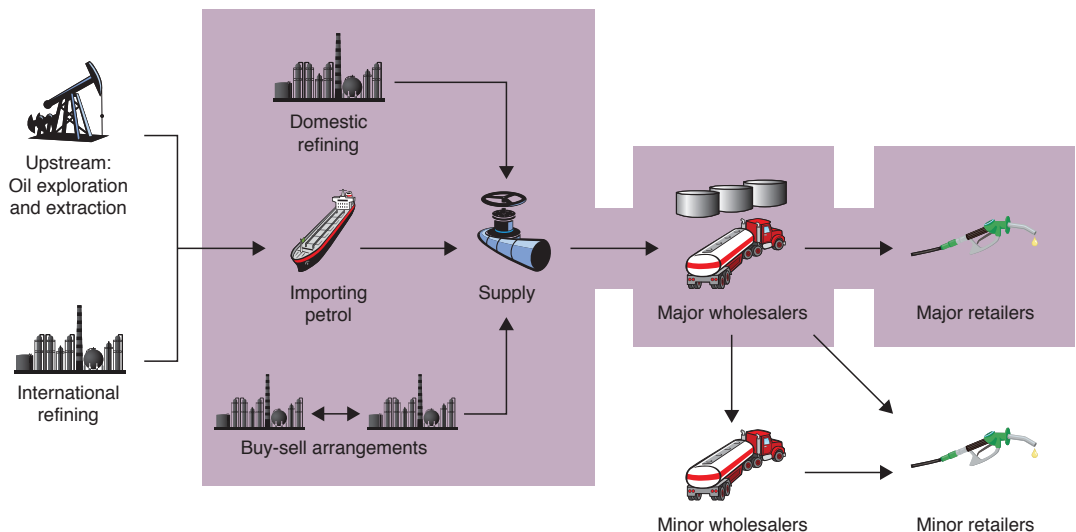
# 1 Background and objectives

This monitoring report on the petrol industry by the Australian Competition and Consumer Commission (ACCC) has been prepared pursuant to a direction issued on 13 May 2010 by the Minister for Competition Policy and Consumer Affairs, the Hon. Craig Emerson MP. This is the fourth monitoring report on the petrol industry prepared by the ACCC since the original direction by the Minister for Competition Policy and Consumer Affairs in December 2007. This report follows monitoring reports provided to the minister in December of 2008, 2009 and 2010.

## 1.1 Scope of the monitoring report

This monitoring report is broadly similar in approach and framework to previous monitoring reports and again covers the three major segments of the Australian petrol industry: refining and importing, wholesaling and retailing. These are illustrated in figure 1.1.

Figure 1.1 Scope of the 2011 ACCC petrol monitoring report



The ACCC has not sought data from overseas suppliers of crude oil or refined product, domestic producers of crude oil or from minor wholesalers and retailers.

The report analyses data on wholesale and retail prices and volumes of petrol products including regular unleaded petrol (RULP), premium unleaded petrol (PULP), ethanol blended petrol (EBP), automotive liquefied petroleum gas (LPG) and diesel.

The report presents detailed cost, revenue and profitability data for the supply (refining and import), wholesale and retail sectors. The report also considers international factors that influenced the Australian industry, developments in the market for biofuels and the latest trends in the industry.

In addition, the 2011 monitoring report:

- explains the key factors that have driven the evolution of the current industry structure
- considers how Australia's experience with wholesale and retail prices compares with other countries.

## 1.2 The current role of the ACCC in the petrol industry

Presently, the ACCC has three main roles in the petrol industry:

- enforcement and compliance: ensuring compliance with and enforcing the provisions of the *Competition and Consumer Act 2010* (the Act) in the petrol industry
- monitoring: including preparing annual monitoring reports as directed by the minister
- public information and education: informing the public about the petrol industry.

In addition, there are other specific functions under the Act that the ACCC may be required to fulfil in the petrol industry. These include responsibilities to hold price inquiries. A full account of the ACCC's activities in relation to the petroleum industry over 2010–11 is set out in chapter 2.

### 1.2.1 Monitoring

The ACCC monitors the prices, costs and profits of unleaded petroleum products, including RULP, PULP and EBP, as well as the prices of diesel and automotive LPG.

The ACCC's monitoring activities include preparing an annual monitoring report for the government. This monitoring report (the 2011 ACCC petrol monitoring report) has been prepared in response to a direction issued in May 2010, by the Minister for Competition Policy and Consumer Affairs, the Hon. Craig Emerson MP, to monitor the prices, costs and profits of unleaded petrol in Australia. The direction is to monitor for a period of 12 months and report to the minister by 17 December 2011. A copy of the letter and direction is attached at appendix A1.

This direction followed a direction issued on 17 December 2007 by the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, the Hon. Chris Bowen MP, to undertake monitoring for three years to the end of 2010. The minister made this direction after receiving *Petrol prices and Australian consumers: report of the ACCC inquiry into the price of unleaded petrol* (the 2007 ACCC petrol inquiry report) in December 2007. A copy of this direction is at appendix A2.

In February 2008, the minister had asked the ACCC to increase its focus on diesel and automotive LPG prices.

In May 2011, the Parliamentary Secretary to the Treasurer, the Hon. David Bradbury MP, subsequently extended the direction to monitor the unleaded petrol industry for one further year to the end of 2012. A copy of this direction is at appendix A3.

## 1.2.2 Enforcement and compliance

The ACCC enforces competition and consumer protection laws in the petrol industry, as with other sectors of the Australian economy. The ACCC pays particular attention to the operation of competition to ensure that petrol companies are complying with the Act. The Act prohibits conduct such as price fixing, predatory pricing, misleading advertising and mergers that substantially lessen competition. Since March 2007, the ACCC has also had responsibility for ensuring compliance with the Oilcode.

Chapter 2 provides a full account of the ACCC's activities in relation to the petroleum industry for the year 2010–11.

## 1.2.3 Other functions

Under Part VIIA of the Act the ACCC can undertake the following functions:

- hold price inquiries
- examine proposed price rises for goods and services that have been declared by the minister
- monitor prices, costs and profits of an industry or business that the minister directs it to monitor, and reporting the results to the minister and making them publicly available.

The minister's direction to the ACCC to monitor prices, costs and profits in the unleaded petroleum industry was issued pursuant to section 95ZE in Part VIIA of the Act.

Under section 95ZK of the Act, the ACCC can compel the provision of information and documents relevant for the ACCC's functions under Part VIIA.

# 1.3 The 2011 monitoring report

## 1.3.1 Objectives of the monitoring program

The key objectives of the monitoring program for the petrol industry derive from the minister's letter and direction as well as the ACCC's responsibilities under the Act. Accordingly, through the monitoring program, the ACCC has sought to:

- increase the level of information available and improve consumer awareness regarding the petrol industry
- provide a description and analysis of trends in prices, costs and profits as directed by the minister
- focus on information that sheds light on those sectors of the industry where competition may be less than fully effective and on industry conduct that may warrant further consideration by the ACCC.

Furthermore, and consistent with the requirements under subsection 95G(7) of the Act, the ACCC has had ‘particular regard’ to the following matters in establishing an appropriate methodology for examining prices, costs and profits in the petrol industry:

- a) The need to maintain investment and employment, including the influence of profitability on investment and employment.
- b) The need to discourage a person who is in a position to substantially influence a market for goods or services from taking advantage of that power in setting prices.
- c) The need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.

In general, the ACCC considers that the requirements under subsection 95G(7) can be fulfilled by economically efficient prices that reflect an efficient cost base and a reasonable rate of return on capital.<sup>14</sup>

The matters in subsection 95G(7)(a) and (b) are generally satisfied where prices include a component for a reasonable rate of return on capital. This ensures appropriate incentives for firms to maintain profitable investment, while at the same time discouraging firms from charging prices based on profits above a reasonable rate of return.

The significance of subsection 95G(7)(c) has diminished since these provisions were enacted in the *Prices Surveillance Act 1983* (PS Act) and subsequently subsumed into the *Trade Practices Act 1974* (TP Act) and later into the *Competition and Consumer Act 2010*. Following changes to industrial relations legislation in 1996, which had the effect of replacing centralised wage fixing tribunals with negotiated enterprise agreements, subsection 95G(7)(c) has become less relevant for the ACCC’s monitoring functions.

The object of the *Workplace Relations Act 1996* was to give ‘primary responsibility for industrial relations and agreement making to employers and employees at the enterprise and workplace levels’.<sup>15</sup>

### 1.3.2 Data collection

#### Process

The approach to data collection for the 2011 monitoring report was similar to previous monitoring reports.

During February and March 2011, the ACCC met with representatives from all major industry participants to discuss the 2010 ACCC petrol monitoring report and the data requirements and monitoring processes for 2011. On 16 March and 20 April 2011 data templates were provided to the refiner-marketers, independent wholesalers, importers, terminal owners/operators and retailers. Data sought included wholesale, import and retail transaction data, pricing benchmark data and financial data. The templates sent to terminal owners and operators sought information on the operation of import terminals.

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<sup>14</sup> See ACCC, *Statement of regulatory approach to assessing price notifications*, June 2009, pp. 12–13, for guidance on the ACCC’s approach having regard to the matters in s 95G(7).

<sup>15</sup> Commonwealth Department of Industrial Relations, *Changes in federal workplace relations law: legislation guide*, December 1996, p. 1.

Data was collected in two tranches on prices, volumes, costs, revenues and profits from major industry participants operating in the supply (refining and importing), wholesale and retail sectors of the industry. In addition, data on terminals was collected from owners and operators of major import terminals. The following companies have provided information for the 2011 monitoring report:

- refiner-marketers: Mobil, Shell, BP and Caltex
- supermarket chains: Coles Express and Woolworths
- independent wholesalers: Liberty, United, Gull and Neumann
- large retail chains: Gull, United, Neumann, 7-Eleven and On The Run
- terminal owners/operators: Vopak, Marstel, Gekko, Terminals Pty Ltd and Coogee Chemicals.

On The Run is the trading name of a retail chain owned and operated by Peregrine Corporation in South Australia. In October 2010, Peregrine Corporation purchased from 7-Eleven retail sites in South Australia which 7-Eleven acquired from Strasburger Enterprises (Properties) Pty Ltd (SEP). These sites were part of the network of sites that SEP operated under the Mobil brand and sold to 7-Eleven. Previously, data for the Quix sites had been collected from SEP. This is the first year that the monitoring program has included the On The Run retail chain. The ACCC also obtained retail price information from Informed Sources.

The ACCC wishes to thank the companies for the information provided for this report.

#### Data issues

The ACCC encountered a number of issues in collecting and processing data from monitored companies. These are outlined below.

#### Cost basis

As with previous monitoring reports, the main objective of the 2011 monitoring program is to report on unleaded petroleum products (RULP, PULP and EBP). Focusing exclusively on these unleaded products, however, presents only a partial picture of the petrol industry. In order to provide broader industry context, data has also been collected on other products and services, mainly diesel, automotive LPG and non-fuel retail sales.

Presenting cost and profitability data for individual products is complicated by the fact that petrol products are produced jointly. That is, refinery processes and staff are not dedicated to the production of individual products but rather are employed to produce a suite of petrol products. As refineries do not measure profits for individual products and thus do not themselves allocate costs on this basis, it has been necessary to collect information on the full range of petrol products. At the retail level, similar issues emerge: companies do not report costs separately for fuel and non-fuel sales. In most cases, retail cost data has been reported for the entire retail operation and not split between fuel and non-fuel items and between different types of fuel.

To estimate the level of profits associated with the supply of a particular petrol product, it has been necessary for the ACCC to allocate refinery common costs across the various petrol products. In retail, the ACCC has had to allocate total retail expenses between fuel and non-fuel items, and between the different types of fuel sold.

The ACCC has allocated costs on the basis of well-accepted rules and conventions. Allocators used include production volumes, sales volumes and sales values. It is relevant to note, however, that there is no economically meaningful way of allocating joint and common costs to individual products and services. When interpreting data presented in this report, it is therefore pertinent to exercise caution and to be cognisant of the limitations of cost allocators.

Financial data has been reported to the ACCC on a historical cost basis. An alternative basis for reporting data is replacement cost. Theoretically, replacement cost represents a closer approximation to current costs. In an environment of relative price stability, the two measures are likely to produce roughly approximate results. However, in industries where prices are volatile, the measures produced by historical cost and replacement cost can be expected to diverge. The petrol industry can be subject to rapidly changing prices for its major input, that is, crude oil. Crude oil is a globally traded commodity and subject to price volatility. With replacement cost data, the effects of changing crude prices are excluded from profit measures.

That said, not all companies typically report data on a replacement cost basis. Since historical cost reporting is consistent with Australian and international accounting standards, the ACCC has accepted data based on historical cost.

### *Consistency*

To ensure that data collected in the monitoring program is comparable across companies, the ACCC has standardised the data templates. The ACCC is aware, however, that different companies, in particular the refiner-marketers, use different business models, organisational structures and accounting systems. Even among companies that are sectorally similar—for example, the specialist retailers—there are differences in the way they operate and report data. As far as possible, the ACCC has taken into account the potential cost to companies of complying with its data requests. In some cases, comparisons across companies are complicated by differences in company reporting structures and accounting systems.

The coverage of the ACCC's monitoring program varies across sectors. Data has been collected on the refining operations of all four refiner-marketers. The wholesale and retail sectors include a large number of small and independent operators from which it was not possible to collect data. Data on these sectors was obtained from the four refiner-marketers, Liberty, United, Neumann, Gull, 7-Eleven, On The Run, Coles Express and Woolworths. Petrol price data for some of the smaller retailers was obtained from Informed Sources. Retail sales volumes of smaller operators can be estimated from the data provided by refiner-marketers on their wholesale transactions.

The design and conceptual basis of the financial and transactional data templates for 2011 were, with some minor exceptions, the same as for 2010.

### *Time series*

Data was collected from monitored companies for financial year 2010–11. This continues the time series for transactional data that began in 2007–08 and for financial data in 2002–03.

### *Confidentiality*

Much of the information provided to the ACCC is commercially sensitive and has been provided on a confidential basis. To protect confidentiality, the analysis of costs, revenues and profits is presented in this report at an aggregate rather than a company level.

## 1.4 History of ACCC involvement in the petrol industry

Prior to the commencement of the present series of formal monitoring reports in 2008, there is a history of involvement in the petroleum industry by the ACCC and, previously, the Trade Practices Commission and the Prices Surveillance Authority. This includes prices surveillance, public inquiries, informal price monitoring, public awareness and education as well as enforcement of the Act.

Between 1984 and 1998, the petrol industry operated under a prices surveillance regime whereby the Prices Surveillance Authority, and subsequently the ACCC, established maximum endorsed wholesale prices for petrol, including freight differentials. Prices surveillance was discontinued in August 1998.

Following deregulation, the ACCC maintained informal prices monitoring of the industry. This watching brief enabled the ACCC to provide information to consumers through various ACCC publications and the ACCC website. Information collected from informal monitoring also assisted with administering the provisions of the Act and helped the ACCC prepare analyses and reports for the Australian Government and Parliament.

The ACCC's 2007 inquiry into the petrol industry under Part VIIA of the *Trade Practices Act* was triggered by concerns about a discrepancy between movements in domestic petrol prices and international petrol prices. The ACCC inquiry covered the industry structure, an assessment of competition in the industry, the determination of prices and current impediments to efficient petrol pricing and possible methods to address them. The ACCC report made a number of key findings and recommendations to the government. A summary of the ACCC's major findings and recommendations, and the government's response, was presented in the 2009 ACCC petrol monitoring report.<sup>16</sup>

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<sup>16</sup> ACCC, *Monitoring of the Australian petroleum industry*, December 2009, p. 6.

## 1.5 Report structure

The 2011 monitoring report is largely based on Australia's downstream petrol industry structure and the various elements of the industry highlighted in the minister's direction.

The report's structure is as follows:

- **Chapter 2** outlines the ACCC's petrol-related activities in 2010–11
- **Chapter 3** notes developments in the industry structure
- **Chapter 4** discusses the evolution of the current industry structure
- **Chapter 5** sets out the international context for price-setting in Australia
- **Chapter 6** focuses on developments in the market for biofuels in Australia
- **Chapter 7** describes trends in the market for premium grades of petrol
- **Chapter 8** assesses pricing in the wholesale sector
- **Chapter 9** outlines prices in the retail sector
- **Chapter 10** considers retail pricing in regional locations
- **Chapter 11** analyses major retail pricing issues in 2010–11
- **Chapter 12** presents an international perspective on petrol prices
- **Chapter 13** considers the revenue, costs and profits in downstream petroleum
- **Chapter 14** considers the revenue, costs and profits in the refining and supply sectors
- **Chapter 15** considers the revenues, costs and profits in the wholesale and retail sectors
- **Chapter 16** describes broad trends in Australia's petrol industry.