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The Chairman
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

Dear Sir,

Please accept this letter as SSA's submission into the ACCC inquiry into the price of unleaded petrol in Australia.

The Issues Paper issued by the Commission calls for data and information about the petrol industry, most of which the SSA is unable to provide with any accuracy. There are other organisations that can provide this information and we are confident that such co-operation will ensue. The SSA will, therefore, confine its comments to those sections of the industry where our members are active and these comments will be reflective of our members' experiences in the market.

The SSA firmly believes that a deregulated market will produce the best outcome for consumers and is therefore a desirable objective. The obvious proviso to this statement is that the deregulated market must be free of constraints and distortions so that vigorous competition can persist and indeed flourish. SSA's members seek no guarantee from governments and agencies regarding profitability or viability; however, our members do expect governments to use their legislative powers to ensure that the market in which they participate is a healthy and naturally competitive one. The biggest single barrier to this desired state is a concentration of market power, not only in the retail sector, but in the supply sector as well.

While no system can ever be described as "perfect", the retail petrol industry in Australia has, in the past, been efficient and effective based on comparisons with other western counties. Therefore, our members, who all agree that the competition is getting tougher, see maintaining the current mixture of extent and diversity of competition as necessary for the Australian industry to be able to continue to deliver to consumers. Events and trends over recent years are threatening to damage this important balance. Excessive competition can result in businesses becoming unprofitable and therefore ceasing to exist. The natural extension of this phenomenon can lead to a loss of efficiency and a sameness of business models. Efficient competitive industry structures evolve over time and cannot be successfully

"created" just by wishful thinking. The environment needs to be well managed if the market is to flourish.
The following trends that have become evident in recent years and which threaten the future of the market are:

- **Lessening Competition in the Supply Sector**

The four oil majors do not have sufficient refining capacity to meet Australia's refined product needs. All four majors import refined product to some extent. Whether oil major sources this product from one of its own off-shore refineries or simply buys cargoes from the market is immaterial as in both cases, all four majors price the product the same way, and that is at a price linked directly to Singapore Posted Prices. Spot cargos can have discounts or premiums relative to the SPP built in but these variations are normally quite small. Therefore, the "value" of imported product, estimated to be approximately 25% of total demand, is, in effect, identical. Furthermore, the four Australian oil companies use the same Import Parity Pricing concept as the basis for wholesale product pricing, even though 75% of their sales are not actually imported from Singapore. This quantity is produced from crude oil in Australia's seven oil refineries.

On first examination, one could take the view that four oil companies and seven oil refineries is an effectively diversified industry to be competitive. However, if all participants adopt the same business models and use the same market philosophy, the essential diversity ingredient is lost. Furthermore, because the four oil majors in Australia have been able to establish a high degree of vertical integration, most of the output from the seven Australian oil refineries is allocated directly to secure outlets. Therefore, there is no need for any of the four oil majors to compete in the wholesale market to quit their refinery production. It therefore follows that the only product that is put into the wholesale market is that which has been actually imported. Since this product is all valued the same way, there is no scope or incentive for any oil company to try to obtain some market advantage.

The above is certainly true for Caltex and Shell where their supermarket alliances have resulted in large market share gains. BP and Mobil are less so, although Mobil is reacting to its significant reduction in refining capacity by exiting large sections of its retail and distributor networks. Long term supply contracts to large networks such as 7-Eleven, Metro and United account for that portion of production volume not required by the oil companies' own outlets.

Several years ago, Australia had eight oil refineries and was a net exporter of refined product. It was therefore necessary for refiners to actively compete at the wholesale level to quit all their refinery production. In addition, there was a significant quantity of product imported by non oil companies, which had the effect of intensifying wholesale competition as the local industry responded to its physical presence. The opportunities for non oil company imports have been severely reduced in recent times to the extent that they are virtually non existent.

The disappearance of these two features has had serious and far reaching impacts on the Australian market. It is no coincidence that the oil companies have moved to lock in the benefits of the current scenarios to increase their dominance of the market. The repeal of the Sites Act was a further step on this path.

The changes to the wholesale market over the past two to three years have occurred against a backdrop of significantly increased refiner margins, due mainly to the short term shortage of refining capacity in the Asia Pacific region. The result has been the disappearance of cargoes of "cheap" gasoline that had underpinned the aggressive independent service station sector in the late 1990's and the earlier part of this decade.

This shortfall in refining capacity is expected to end soon (2008/2009) as new refineries, mainly in India, come on stream. The ability of the Australian independent sector to gain access to this surplus production and to be able to land it in Australia will be necessary for a return to a competitive structure in the wholesale market.

- **Concentration of Market Power in the Retail Sector**

The changes in the wholesale sector outlined above, combined with the entry of Coles and Woolworths into petrol retailing has resulted in a significant shift in the complexion of the petrol retailing sector. There has been a large concentration of market power and a demonstrated willingness to exercise it by some participants. Even though service station numbers have been in decline in recent years as a result of increasing industry efficiency, the rate of service station closures has doubled in the period since the supermarkets entered petrol retailing. The facts speak for themselves.

In two short years the two supermarkets' market share of petrol retailing has reached close to 50%; yet, combined they account for only around 15% of the total number of sites in Australia. The market is almost totally price driven and the success of the shopper docket petrol discount concept is the main reason for this phenomenon. However, the supermarket dominance highlights another issue, and that is the ability of the non supermarket sector to compete on price.

Each supermarket company represents a very large customer for their respective oil company supplier. Therefore, it follows that the volume discounts that each supermarket has been able to negotiate is large, and is significantly larger than individual or small group of independents can negotiate. In addition, both supermarkets have vast financial resources to fund their shopper discount schemes which further diminish the independent sector's ability to compete on price. These large volume discounts are not supported by expense reduction efficiencies as deliveries to individual service stations remain the largest single cost component of the supply operation. The recently enacted Oilcode has done nothing to secure independents access to more competitively priced product.

At the same time, we have witnessed periods of extreme discounting at the retail level in various parts of the country. SSA members report regularly to our secretariat when these occurrences happen and advise us the deep discounting is being driven by the supermarket sites. When these episodes occur, the supermarkets' retail price can sometimes be up to 10 cpl lower than the nearby independents' buying prices, which are invariably based on prevailing terminal gate prices posted by the oil companies. The attractiveness of the additional shopper docket discount pushes the nearby independent further out of the market.

In May of this year, the NSW market experienced one of these episodes and it was particularly evident in the Illawarra and south coast region. An SSA member in a town north of Nowra complained that the two supermarket sites in Nowra had been selling ULP at $1.199 per litre for over six weeks, at a time when his buying price, based on a posted TGP, was about $1.30 per litre. The reduction in trade due to his inability to match the supermarkets' pricing was such that he wasn't able to fully recover his operating expenses during the period. Had that situation continued indefinitely, he would have been forced to quit the business and sell the site for its real estate value. Independents in Australia are facing these dilemmas regularly and this episode is a typical example of the processes that have contributed to the increase in service station closures. There is genuine concern in the industry that in many locations, the number of independent service station operators has fallen below the critical mass necessary for them to be able to influence the market. Therefore, there is widespread concern that this vital component of competition diversity is disappearing. The ramifications for robust competition continuing into the future are alarming.

In response to this marketing initiative, the SSA conducted a survey of its members to gauge the extent of their inability to compete. During late May 2007 (May 29), 80% of respondents reported that the current purchase price for their fuel was higher than the selling price for ULP at their nearest Shell/Coles or Caltex/Woolworths site. The average price differential across these respondents was 3 cpl. 55% of respondents reported that their current purchase price for fuel was higher than the selling price of their nearest oil company operated site. The average price differential was 2.75 cpl.

In addition, 83% of respondents reported that their purchase price for fuel had been higher than the selling price at their nearest supermarket sites on previous occasions. The period over which their purchase price has been higher that the nearby supermarket selling price was: less than 5 days – 8%, 6 to 15 days – 35%, 16 to 25 days – 26% and more than 25 days – 31% of affected respondents. The survey also revealed that the time periods when the independents' purchase price was higher than their nearest oil company operated site was much shorter than for the supermarket sites, indicating that the supermarkets are the driving force behind these periods of deep discounting.

It is therefore clear to us, and more importantly, to the independent operators directly affected, that the two supermarkets do have the capacity to dominate the market and do exercise that ability from time to time. It also demonstrates that the supermarkets have the capacity and the mechanisms to engage in predatory pricing if they so choose. The SSA is unable to determine whether the supermarkets are actually engaging in predatory pricing or not; however, the impact their current marketing strategies are having on independents is identical to that flowing from a decision to engage in predatory pricing.

It would seem to us that the ACCC should use its powers of discovery to fully and better understand the various levels of transfer pricing that occur from the oil companies to off-takers and to determine if these structures are basically anti-competitive. The ACCC should also examine in detail the price settings of the supermarket sites and their impacts on the local area competition to determine for itself if supermarket pricing policies are harmful in the long term.

If the current trend continues, traditional independents will cease to be a factor in the petrol retailing industry. The role that this sector has played in bringing intense competition to the market will be lost and be replaced by a smaller number of large groups with common supply points and pricing stances. There is no evidence that this new order will be as effective as that which it is replacing. Legislators and regulators need to understand the extent of the changes taking place and the implications for the future and act to preserve a truly competitive framework for Australian consumers.

I trust you find the above helpful.

Yours faithfully,

RBowden

Ron Bowden
Chief Executive Officer