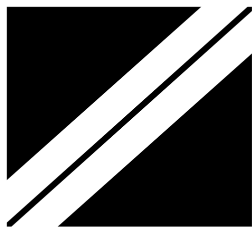

Motor Trades Association of Australia

Submission to:

Australian Competition and Consumer Commission Inquiry Into the Price of Unleaded Petrol

July 2007

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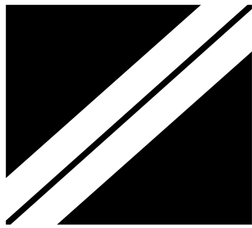

Motor Trades Association of Australia

Mr Graeme Samuel
Chairman
Petrol Price Inquiry
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

Dear Mr Samuel

This submission to the ACCC's Petrol Price Inquiry has been prepared by the Motor Trades Association of Australia (MTAA).

Introduction

MTAA is the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry. The Association is a federation of the various state and territory motor trades associations and automobile chambers of commerce, as well as the New South Wales based Service Station Association Ltd (SSA) and the Australian Automobile Dealers Association. Members of the MTAA Federation include:

- the Australian Automobile Dealers Association (AADA)
- the Motor Trades Association of the ACT (MTA ACT)
- the Motor Traders Association of NSW (MTA NSW)
- the Motor Trades Association of the Northern Territory (MTA NT)
- the Motor Trade Association of South Australia (MTA SA)
- the Motor Trade Association of Western Australia (MTA WA)
- the Service Station Association Limited (SSA Ltd)
- the Victorian Automobile Chamber of Commerce (VACC) [incorporating the Tasmanian Automobile Chamber of Commerce]

MTAA also has a number of Affiliated Trade Associations (ATAs), which represent particular sub-sectors of the retail motor trades, ranging from motor vehicle body repair to automotive parts recycling and relevantly for this Inquiry the Australian Service Station and Convenience Store Association (ASSCSA). MTAA represents the interests, at the national level, of over 100,000 retail motor trade businesses with a combined turnover of over $120 billion and which employ over 316,000 people. The vast majority of businesses represented by MTAA employ five or less people.

MTAA has had a long history of engagement with the issues associated with the retail petroleum sector, including petrol pricing. MTAA/ASSCSA represents, nationally, single site franchises, multi-site franchises, commission agents, branded independent operators and unbranded

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independent operators. As a consequence of that representative role, the Association has a strong interest in matters relating to the price of petrol in Australia and has been actively involved in petroleum industry policy development for many years. This involvement might be evidenced by the number of submissions the Association has made to a number of fora that have conducted inquiries into the petroleum industry and pricing over the years, the executive summaries of some of which are attached to this submission at Attachment 1.

In this submission, MTAA intends on providing a broad view on petrol pricing based on its long involvement in petroleum policy debates and on information provided by its Members. The Association appreciates that there are other parties to the inquiry that possess more detailed specialist knowledge of each of the main areas of the inquiry's focus. Much of the detail sought by the ACCC in its Issues Paper is probably more appropriately and accurately provided by those other parties. However I have addressed a number of the points raised in the Commission's Issues paper and MTAA's views on those are set out below.

Import Parity Pricing and Singapore Benchmark

Australia introduced import parity pricing for all Australian-produced crude oil in August 1978. At that time it was said that import parity pricing was being introduced to encourage energy conservation, oil exploration in Australia and the development of alternative energy sources. It has also been argued that import parity pricing is needed to avoid potential fuel shortages in Australia as, without it, international prices may be higher than Australian prices and Australian refiners may, therefore, have an incentive to export their refined product overseas. Similarly, international refiners might, in the circumstances described, also have no incentive to export petroleum products to Australia. MTAA continues to support import parity pricing; but not on its present terms.

Singapore, as I understand, was chosen as the relevant price benchmark because at that time it was the major trading centre in Asia for petroleum products the most likely source of fuel imported into Australia and the closest major refining centre to Australia. While MTAA understands the reasons behind the use of import parity pricing, and the reasons leading to the Singapore price having been chosen as the benchmark, the Association has for some time held the view that the continuing appropriateness of the Singapore price as the Australian benchmark needs to be evaluated. There are a range of reasons for this, which in the main are concerned with more recent changes to Australian fuel standards, and the development of new refineries in Asia.

It is unclear to MTAA as to whether or not, or to what extent, Australia's introduction of fuel standards has been a factor contributing to increases in fuel prices in recent years. Some of the Association's Members are of the view, however, that the changes in Australian fuel standards that disallowed the use of Methyl Tertiary Butyl Ether (MTBE) may have removed the source of supply for viable importation of unleaded petrol by independent fuel suppliers. It should be recorded though that MTAA supports the Australian fuel standards on environmental and social grounds.

If Australian fuel standards do inadvertently create difficulties in sourcing fuel from overseas refiners, the volumes of fuel imported might suggest otherwise. It must be acknowledged, though, that the volumes of fuel imported represent about 25 percent of all Australian fuel sales and it is imagined that in terms of overseas refiners that the quantity of fuel produced by them meeting Australian import demands and fuel standards might not comprise a significant portion of their overall refining output. Production cost efficiencies according to scale could then become a

consideration. It might also be possible for there to be a number of refineries in other parts of Asia that are now capable of providing the Australian market with the fuel specification it requires.

Both of these aspects infer the need to re-evaluate whether the Singapore benchmark remains appropriate, or if there has been the development in the intervening years since parity benchmarking first commenced, within the Asia Pacific region, of a refining centre that better represents the circumstances appropriate for Australia's position in the market and its fuel import needs in terms of quantity and fuel standards. It might even be the case that the benchmark standard chosen employs an average of a 'basket' of ULP prices from around the Asia Pacific region – including Australia – thereby dampening any severe fluctuations in price that might be characteristic of any one nominated refining centre.

Imports of Fuel

An entity wishing to be an independent importer of fuel might need to overcome a range of challenges in order to establish a viable and competitive operation in Australia. MTAA understands that the majority of the infrastructure with the ability, or capacity, to be able to provide the services an independent importer might require is currently either owned or controlled by the major oil companies.

This control extends to aspects such as the locations at which fuel may be delivered at point of entry to Australia and access to the requisite tankage facilities. It is clear, therefore, that there would need to be either a massive investment made in those terms for an independent importation operation to be viable, or for there to be some form of regulatory control mandating a certain amount of tankage be made available for this purpose and for access to appropriate offloading and handling facilities to be made available under certain circumstances. This also suggests that the 'obstacles' that would need to be overcome for a truly independent fuel importer to establish operations in Australia would be considerable. The Association understands that there is a limited amount of independently controlled storage in Brisbane and Melbourne.

However the Association accepts that access to storage facilities alone will not be sufficient to sustain a viable independent sector. Importers need some certainty of distribution; in other words, access to retail outlets, at some scale. When considerations regarding available sources of fuel meeting Australian standards is added to this scenario, the 'obstacles' facing an potential independent importer become even more significant and, perhaps, insurmountable.

Competition in the Retail Petroleum Market

MTAA strongly supports the view that the best outcomes for consumers and society, are delivered by strong competition in the marketplace. To achieve this requires, however, a diversity of outlets/ownership with freedom of access to a number of competing and competitive suppliers. Another requirement, if this ideal is to be met, is for the market and its conditions to characterise a level playing field, and for the existence of stable and fair rules for activity between all parties. This latter aspect can be obtained through the operation of a strong Trade Practices Act, for which the MTAA has a long history of support and advocacy.

It is uncertain, however, if the retail petroleum market is one which exhibits characteristics aligned with this ideal. Superficial observations of the market might lead an observer to consider that this market offers a variety of choice to consumers, is highly competitive, and that it is under sufficient

scrutiny from a number of bodies as to render many of its functions transparent. The reality, in MTAA's view is quite different.

The retail petroleum market is highly complex, and in our view highly concentrated, lacking, at some levels, competition and transparency, is highly vertically integrated and it is at present questionable as to whether the best outcomes are being delivered to motorists. For example, while there appears to be adequate transparency in regards to retail pricing structures, the same can not be confidently said for wholesale pricing. Anecdotal evidence suggests that Terminal Gate Prices (TGPs) claimed by the major refiners may – in some manner – be 'contrived' by refiners so as to arrive at a particular market outcome in relation to purchasers from them. That is, TGPs may be set so as to 'encourage' franchisees, for example, not to move to the TGP arrangements available under the OilCode. Mandated TGP arrangements have not introduced either the wholesale pricing transparency or competition that the Australian market so requires. While MTAA is not privy to such information, it would be very interesting to note what proportion of fuel is sold at wholesale at the various posted terminal gate prices. MTAA suspects that a significant portion of fuel would be sold below the posted terminal gate prices.

Highly competitive markets also tend to be highly efficient markets. It might be argued, then, that the marked decline in the number of fuel retailers in past decades – from somewhere in the order of 20,000 in the 1970s to around 6,500 at the present – to be a market response from increased competition and efficiencies gains. While MTAA would agree that there was some need for a rationalisation of site numbers from the 1970s levels to allow for improvements in site throughput and scale of operations, anecdotal evidence suggests that there has been a marked decline in retail site numbers since the entry into, and increased prominence in, the market of the Coles / Shell and Woolworths / Caltex operations. It is this latter decline and the manner of it which concerns MTAA and its Members.

It is arguable that the entry of the supermarket chains into the retail petroleum industry has seen the development of market circumstances that place 'independent' fuel retailers at a competitive disadvantage - even collectively – in their dealings with the major oil companies. The entry into the market of Coles and Woolworths has seen a large concentration of market volume and market power fall into their control, along with a demonstrated willingness to exercise it on occasion. Independent operators have been removed from their position of price leaders, and now have to maximise their retail price to remain afloat. In effect, independent operators have become – in the main – price takers rather than price makers.

MTAA supports the views of its Member, the Service Station Association (SSA) that each supermarket company represents a large customer for its respective oil company supplier. The volume discounts that they are able to negotiate, therefore, are significant and larger than individual or small groups of independent fuel resellers are able to negotiate. Tied franchisees of course are completely unable to negotiate the terms of their supply arrangements and are thus 'price-takers'; irrespective of prices offered, by their supplier, to any other class of wholesale customer.

MTAA Members have observed circumstances in the market where the selling price, of a supermarket held site, for ULP, in a particular location was less than the posted TGP at which a nearby independent reseller could purchase at from the same fuel supplier. Circumstances such as these might suggest that the marked decline in independent fuel resellers since the entry into the market of supermarkets may be due less to matters of market efficiency and more to matters of simple viability and the exercise of market power by both the refiners and the supermarkets.

It ought to be hardly surprising, then, that as the Association understands matters, the two supermarkets' market share of petrol retailing has reached close to 50 percent; despite the fact that, combined, they account for only around 15 percent of the total number of sites in Australia. In a price-driven consumer market with a large uptake and utilisation of the 'shopper-docket' concept, it is understandable that the supermarket fuel retailers have attained such dominance in the market. It also reinforces, however, the difficulties involved for the non-supermarket aligned sites to be competitive on price. It has long been the Association's view that the supermarkets interest in petrol is not as a product itself, but because of the frequency and, mostly, necessity of its purchase, as a 'device' through which consumers' buying patterns can be influenced (that is, to ensure a greater flow of customers to their respective supermarket).

At Attachment 2 is a copy of a paper prepared for MTAA by Professor Joshua Gans on the shopper docket schemes.

MTAA records here its concern that shop-a-docket promotions which provide large discounts (up to 20 cents per litre) for motorists who purchase other goods (such as wine) from supermarket owned outlets are contributing to the decline in the numbers of retail sites. Non-supermarket branded retail outlets cannot compete against service stations where motorists can present a docket and secure up to 20 cents per litre off the price of the fuel. Either the supermarket outlets are making a substantial loss on those retail sales (and thus one would wonder how they remain in business; if not for cross-subsidisation) or the wholesale price paid by those sites is significantly lower than that available to franchised and independent operators. This distortion of the retail market is of real concern to the Association and is not in our view conducive of long-term sustainable retail competition.

Discount Cycles

One of the most frustrating elements of the retail petroleum market, for both retailers and motorists, is the price cycle and the difference (mostly significant difference) between the highs and the lows of the cycle. While MTAA supports competition, the opaqueness of wholesale pricing in Australia had lead to a system of selective retail price fluctuations and selective, at best, price support being provided by the oil majors, which confuses and frustrates both motorists and retailers. It is not clear to MTAA that motorists generally (as opposed to those 'locationally lucky' motorists) benefit from these price cycles.

Current Regulatory Regime

As is well know, the two Commonwealth Acts regulating the petroleum retail sector, the *Petroleum Retail Marketing Sites Act (1980)* and the *Petroleum Retail Marketing Franchise Act (1980)* were repealed on 1 March 2007 and a mandated (under the *Trade Practices Act 1974*) code of conduct for the oil industry (OilCode) was introduced. MTAA, has to date, been particularly disappointed with the operation of the OilCode. It is far from clear that the terminal gate pricing regime has increased transparency in the market and it most certainly has not proved to be an attractive or competitive alternative wholesale pricing arrangement for franchisees. Anecdotal reports to the Association indicate quite some concern about the manner in which at least one oil company has approached the dispute resolution process.

In addition the Association has significant concerns about some of the fundamental elements of OilCode, such as the tenure provisions and the lack of ability to address in either the OilCode or the Trade Practices Act the concerns about pricing behaviour mentioned earlier in this submission.

Conclusion

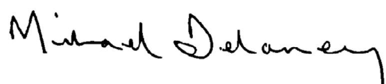
In summary it is a fair assessment that can be made that the theory of a fair an equitable playing field in the retail petroleum sector is, simply, and no more than, a theory. The four major oil companies in Australia control virtually the entire infrastructure and distribution network for the retail fuel market. In addition, Shell and Caltex combined with their supermarket partners' control (based on industry estimates) about 75 per cent of the retail market (by volume). This leaves the remainder of the retail market to be shared by Mobil (which in recent years has reduced its retail presence), BP and independent operations. However because the level of independent imports is relatively low, in reality the influence on the market of the four refiners is substantial.

In conclusion, MTAA is unsure if the Singapore benchmark price remains appropriate in light of the changes in Asia Pacific refining capacity since its introduction and the volumes of fuel imported compared to refining output. The Association suggests there to be the need to evaluate other regional markets with a view to identifying if there may be a more appropriate benchmark.

MTAA fully supports the sentiments expressed in the submission made to this inquiry by the SAA. In essence, that submission provides a very accurate depiction of the realities facing independent operators in the market as it currently operates. The SSA submission also provides an accurate assessment of the impact upon the market that has resulted as a consequence of the supermarkets' entry to it.

I would be happy to clarify any issues raised in this submission.

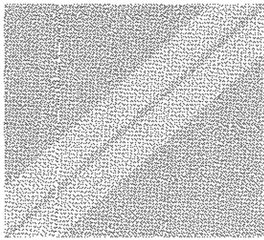
Yours sincerely



MICHAEL DELANEY
Executive Director

27 July 2007

ATTACHMENT 1



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Motor Trades Association of Australia

Mr Peter Hallahan
Secretary
Senate Economics Legislation Committee
Suite SG.64
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Mr Hallahan

Please find attached a copy of the Motor Trades Association of Australia's (MTAA's) submission to the Senate Economics Legislation Committee Inquiry into the price of petrol in Australia.

The Motor Trades Association of Australia (MTAA) is the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry. The Association is the largest 'stand-alone' small business association in Australia, representing over 115,000 businesses in a sector which turns over more than $120 billion each year and employs over 316,000 people. As part of its representative role, MTAA represents the interests of service station operators and the Association therefore has a strong interest in matters relating to petrol pricing and welcomes the opportunity to make a submission to the Inquiry.

In its submission, MTAA has provided a brief overview of the factors which, in its view, influence the retail prices of petrol in Australia, including the wholesale price of petrol, refiner and retailer margins and the size and nature of the local market. MTAA also notes that the influence of some of those factors will vary from location to location and that variation may contribute to price differentials between certain locations.

MTAA also believes that the structure of the industry itself also plays an important role in influencing the level of retail petrol prices in Australia. At this point in time, the diverse nature and large number of industry participants has resulted in a highly competitive sector which in turn has helped to ensure that motorists pay the lowest prices possible for their petrol. However, recent structural changes, including the trend towards vertical integration and the more recent trend towards horizontal integration, threaten that diversity and price competition. In particular, MTAA would question how, in such a highly vertically and horizontally integrated market, the level of price competition is to be maintained unless there is access to fuel at a competitive wholesale price.

While MTAA is not an expert in the setting of wholesale prices, the Association has also provided some brief comments on the factors which, in its view, may influence the level of wholesale petrol prices in Australia.

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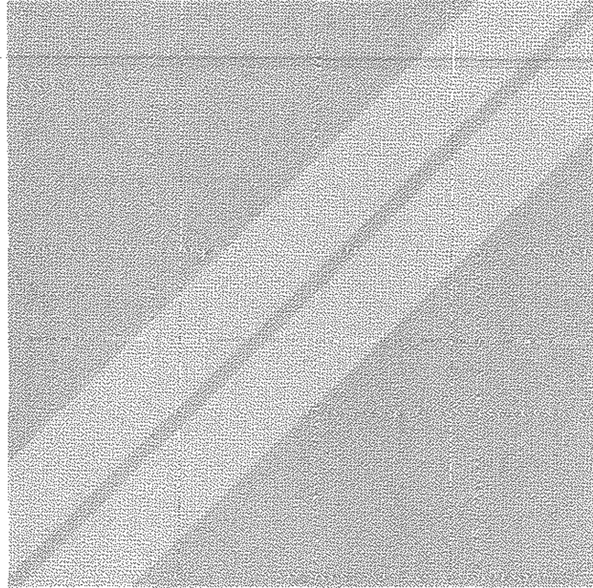
I trust that these comments are of assistance in your consideration of this matter.

Yours sincerely

MICHAEL DELANEY
Executive Director

26 July 2006

Motor Trades Association of Australia



Submission to the Senate Economics Legislation Committee Inquiry into the Price of Petrol in Australia

July 2006

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INTRODUCTION

Overview of the Motor Trades Association of Australia (MTAA)

MTAA is the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry. The Association represents the interests, at the national level, of over 90,000 retail motor trade businesses with a combined turnover of over $120 billion and which employ over 316,000 people. MTAA is therefore the largest 'stand-alone' small business association in Australia. The Association is a federation of the various state and territory motor trades associations and automobile chambers of commerce, as well as the Service Station Association (SSA) and the Australian Automobile Dealers Association (AADA). MTAA also has a number of Affiliated Trade Associations (ATAs), which represent particular sub-sectors of the retail motor trades ranging from motor vehicle body repair to automotive parts recycling. Those ATAs are as follows:

> *Australian Motor Body Repairers Association (AMBRA)*
> *Australian Motorcycle Industry Association (AMIA)*
> *Australian National Radiator Repairers Association (ANRRA)*
> *Australian National Towing Association (ANTA)*
> *Australian Service Station and Convenience Store Association (ASSCSA)*
> *Australian Tyre Dealers and Retreaders Association (ATDRA)*
> *Auto Parts Recyclers Association of Australia (APRAA)*
> *Automotive Repairers Association of Australia (ARAA)*
> *Automotive Transmission Association of Australia (ATAA)*
> *Engine Reconditioners Association of Australia (ERA of A)*
> *Farm and Industrial Machinery Dealers Association of Australia (FIMDAA)*
> *National Brake Specialists Association (NBSA)*
> *National Heavy Vehicle Repairers Association (NHVRA)*
> *National Rental Vehicle Association (NRVA)*
> *National Steering and Suspension Association (NSSA)*
> *National Vehicle Airconditioning Association (NVAA)*

All of the ATAs listed above are composed of the relevant sections of each of the MTAA Member bodies and are represented, at a national level, by MTAA.

The Association's affairs are directed by a Board on which each of MTAA's Member bodies is represented. The role of the Association is to:

- raise awareness in the community of the retail motor trades' significant contribution to the Australian economy (the trades have a turnover of over $120 billion and employ over 316,000 people);

- convey and promote to governments the interests of the retail motor trades;

- promote improved working relationships and practices with the motor trades' unions;

- on behalf of the Members of the Association, provide information about the trades to governments, the public and the trades' employees;

- work with governments to plan the future of the retail motor trades and their role in the economy and other areas of national planning;

- extensively enhance training and to develop work opportunities within the trades in co-operation with education and training authorities, the unions and government generally; and

- promote and enhance the reputation of the trades with its customers and the general public.

The range and depth of the activities of the membership of the Association can be seen from the following list of recognised trades, skills and tasks in the retail, service and repair sector of the automotive industry:

Air-conditioning Technicians	Dynamometer Operators
Auto Electricians	Engine Fitters
Automotive Accessory Retailers	Engine Performance Specialists
Automotive Dismantlers/Parts Recyclers	Engine Reconditioners
Automotive Engineers	Exhaust System Specialists
Automotive Glass Fitters	Farm Machinery Dealers
Automotive Parts Cataloguers	Fuel Injection Specialists
Automotive Radio and Stereo Specialists	Gas Fitters
Automotive Service Managers	Hire and Rental Vehicle Operators
Automotive Trimmers	Marine Automotive Engineers
Automotive Upholsterers	Motor Boat and Marine Dealers
Automotive Transmission Specialists	Motorcycle Dealers
Battery Makers and Reconditioners	Motorcycle Mechanics
Body Builders	Motor Mechanics
Brake Specialists	Panel Beaters
Car Alarm Fitters	Petrol Pump Attendants
Caravan Dealers	Radiator Repairers
Car Dealers	Spray Painters
Car Salespeople	Tow Bar and Trailer Fitters
Car Wash Operators	Tow Truck Operators
Chassis Builders and Repairers	Truck Builders and Operators
Commercial Vehicle Body Fabricators	Tuning Specialists
Detailers	Tyre Fitters
Diesel Engineers	Tyre Retreaders
Diesel Injection Technicians	Wheel Alignment Specialists

MTAA's Interest in the Inquiry

As part of its role as the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry, MTAA represents the interests, at a national level, of service station operators, including single site franchisees, multi-site franchisees, commission agents, branded independents and unbranded independents. As a consequence of that representative role, the Association has a strong interest in matters relating to the price of petrol in Australia and has been actively involved in petroleum industry policy development for many years.

THE RELATIONSHIP BETWEEN THE LANDED PRICE OF CRUDE OIL, REFINING COSTS, THE WHOLESALE PRICE AND THE RETAIL PRICE

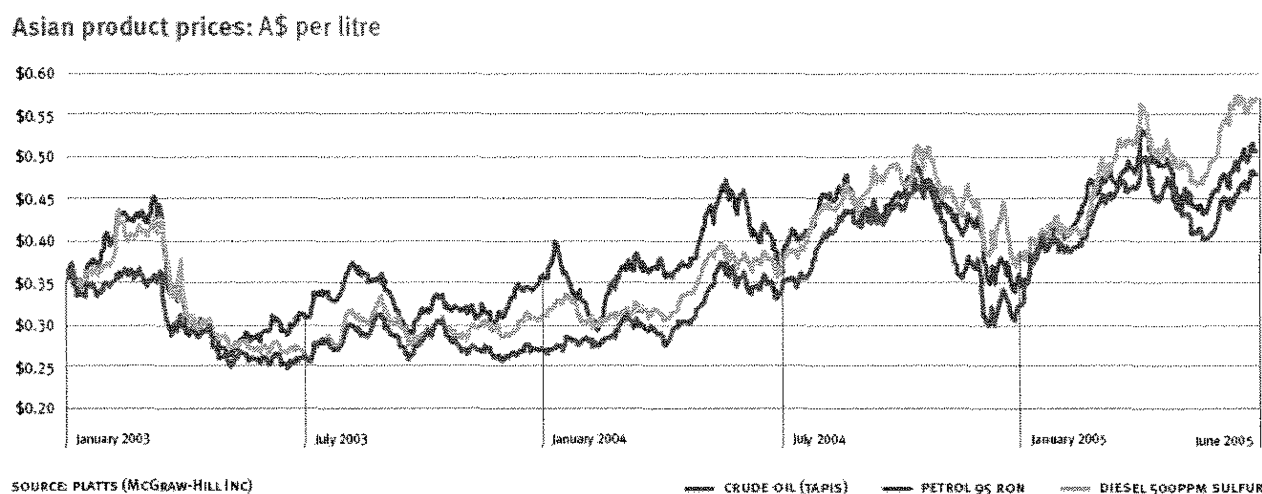
Overview of Current Pricing Arrangements

Prior to 1 August 1998, the Australian Government, through the Prices Surveillance Authority (PSA), regulated the maximum wholesale price of petrol and diesel. In order to determine the maximum endorsed wholesale price, the PSA used an import parity indicator which consisted of three components: the import parity component (the landed cost of ex-refinery petrol from Singapore which consisted of the spot price of fuel, shipping, wharfage, and insurance costs as well as an adjustment for the exchange rate), the assessed local component (costs associated with downstream activities including terminal, marketing and distribution costs as well as a return on assets employed in that sector) and a government charges/subsidies component. Following the de-regulation of pricing in the industry, prices are now determined by individual industry participants but MTAA understands that those prices are still determined on an import parity price basis.

The wholesale price of petrol (the ex-refinery price) produced at refineries in Australia is therefore, as MTAA understands matters, not based on the actual cost of the crude oil that has been refined to produce the petrol or the actual cost of importing refined product into Australia. Wholesale prices in Australia are instead determined by a theoretical import price parity calculation, which involves adjusting an international benchmark price for refined petrol (an average of the spot price of Singapore Mogas 95 Unleaded) for Australian fuel standards, wharfage, insurance and shipping to Australia. This calculation is undertaken in US dollars and the calculated wholesale price is then converted into Australian dollars. This means that movements in the relevant international benchmark and the Australian/US dollar exchange rate exert considerable influence over the wholesale price of petrol in Australia irrespective of whether the petrol is refined domestically or imported from overseas.

While there is a strong correlation between the price of crude oil and the price of refined petrol products, there also are a range of other supply and demand factors which influence the price of refined petrol products. Consequently, the Singapore Mogas 95 Unleaded benchmark does not always closely follow movements in the relevant Asian benchmark for crude oil, Malaysian Tapis, and as can be seen from Figure 1 below, the movement of the two benchmarks can, at times, be quite different.

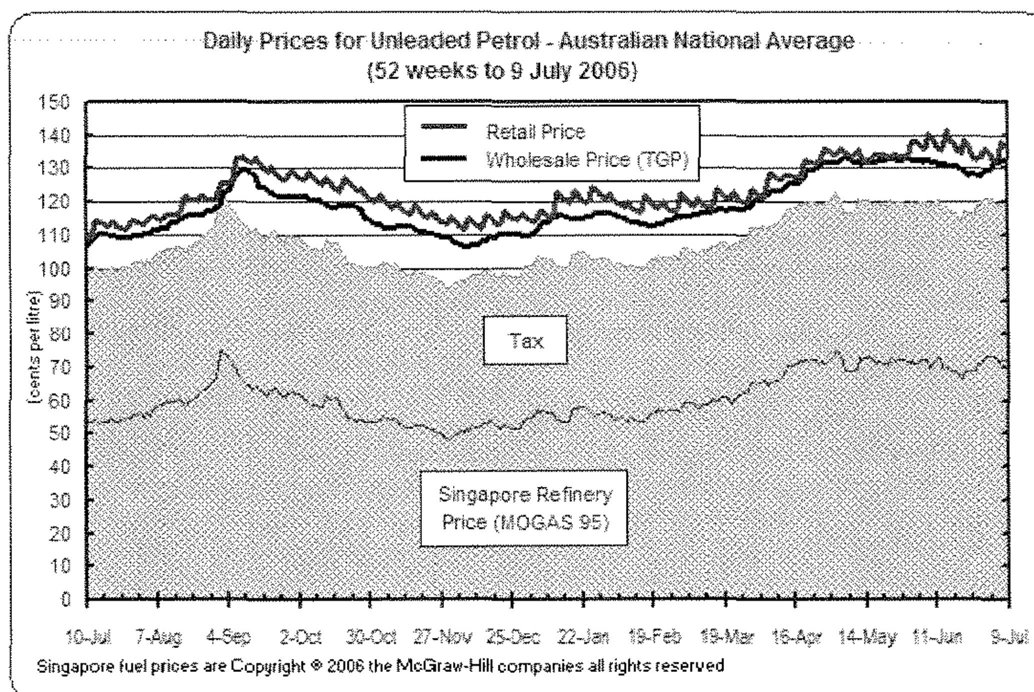
Figure 1 - Asian Product Prices (A$ per litre)



Source: Australian Institute of Petroleum 2006, *Downstream Petroleum 2005*, AIP, Canberra, 8.

The retail price of petrol is largely determined by the wholesale price of petrol and the level of government taxation, but it is also affected by the level of government subsidies (for example, the Queensland Government's 8.354 cents per litre subsidy) and the level of gross retail and refiner margins. As the wholesale price of petrol is largely determined by movements in the relevant international benchmark, retail petrol prices in Australia will also be influenced by movements in the international benchmark, although those movements may take one or two weeks to flow through to the retail price. Figure 2 below highlights the relationship between retail petrol prices, wholesale petrol prices and the relevant international benchmark, Singapore Mogas 95 Unleaded.

Figure 2: Daily Prices for Unleaded Petrol – Australian National Average (52 weeks to 9 July 2006)



Source: Australian Institute of Petroleum 2006, *Market Snapshot*, AIP, Canberra, viewed on 10 July 2006, http://www.aip.com.au/pricing/snapshot.htm.

A breakdown of the retail price of petrol also highlights the importance of product cost and government taxation in the overall composition of retail petrol prices. For example, the average cost of a litre of fuel in Sydney on 11 July 2006 could be broken down into the following components:

Product Cost	79.5 cents per litre (cpl)
Tax (excise and GST)	50.3cpl
Retail and Refiner Margin	4.3cpl
Retail Price Per Litre	134.1cpl

Source: Shell Australia Limited website (www.shell.com.au), viewed on 11 July 2006.

The retail price of petrol in particular locations will also be affected by other factors, including the size of the market, the number of competitors and distribution, storage and transportation costs. These factors and their impact on retail petrol prices are discussed in more detail below.

The significant impact that the wholesale price of petrol has on the overall level of retail petrol prices in Australia highlights the importance of a competitive wholesale sector of the petroleum industry. MTAA considers that a nationally consistent and transparent terminal gate pricing regime is a key component in ensuring that the wholesale sector is competitive, as such a regime improves

pricing transparency and thereby reduces the ability of market participants to engage in anti-competitive behaviour. While the Australian Government's proposed amendments to the regulatory framework governing the retail petroleum sector purport to introduce a truly transparent terminal gate pricing regime, the proposed arrangements still allow suppliers to discount the wholesale price at the terminal gate. In MTAA's view, any arrangement that allows for discounts at the terminal gate is hardly transparent, is little different from the current opaque wholesale pricing arrangements and is therefore unlikely to improve the transparency of wholesale pricing in the market.

MTAA also considers the competitiveness of pricing in both the wholesale and retail petroleum sectors is also dependent on the ability of all service station operators, particularly independent service station operators, to access supply at competitive wholesale prices. Without access to supply, service station operators cannot remain in the industry and the ability of market participants to secure supply will therefore have a significant impact on the number and diversity of competitors in the industry. Service station operators will also be unable to remain in the industry in the longer term if they cannot access a supply of *competitively priced* petroleum products as they simply will not be effective competitors if their wholesale price is uncompetitive in comparison to the wholesale prices paid by other market participants.

In that regard, MTAA and its Member bodies recently undertook a survey of their service station members and seventy-one per cent of the respondents to that survey indicated that they had previously paid a wholesale price which was higher than the price at which their closest supermarket/oil company joint venture site was retailing their fuel. Fifty-three per cent of respondents had also previously purchased fuel at a wholesale price which was higher than the retail price of their closest oil company site. While the survey respondents represented a relatively small percentage of market participants, the survey results are consistent with previous anecdotal advice provided to MTAA.

MTAA therefore notes that transparency of wholesale pricing arrangements and the ability of market participants to secure access to a competitively priced supply of petroleum products will have a significant impact on the level of retail prices and the degree of retail price competition in the market. In that regard, MTAA strongly believes that a greater number and diversity of competitors is more likely to encourage retail price competition than a smaller number of highly vertically integrated larger competitors.

Historical Reasons for the Use of Import Price Parity

Australia introduced import parity pricing for all Australian-produced crude oil in August 1978. It was said at the time that import parity pricing was being introduced to encourage energy conservation, oil exploration in Australia and the development of alternative energy sources. It has also been argued that import parity pricing is needed to avoid potential fuel shortages in Australia as without import parity pricing, international prices may be higher than Australian prices and Australian refiners may therefore have an incentive to export their refined products overseas to take advantage of those higher prices and international refiners may also have no incentive to export petroleum products to Australia.

Singapore was apparently chosen as the relevant price benchmark because it was the major trading centre in Asia for petroleum products, the most likely source of fuel imported into Australia and the closest major refining centre to Australia.

Issues with the Use of Import Price Parity

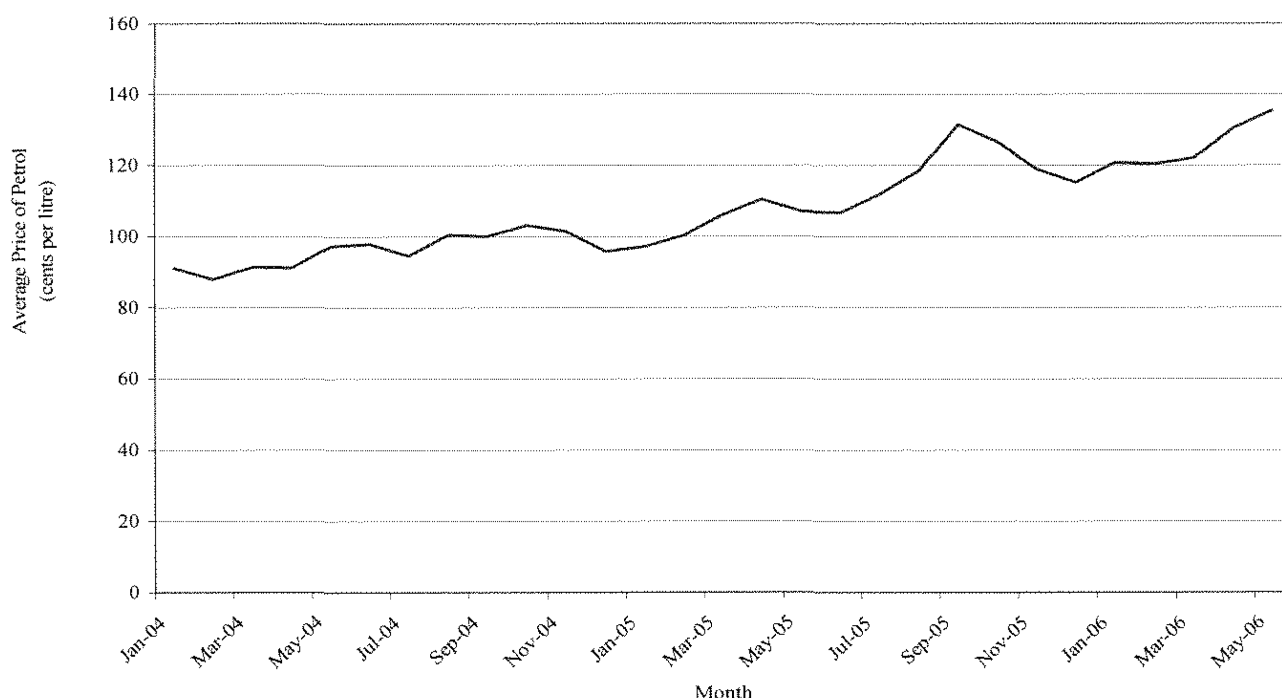
While MTAA understands the reasons behind the use of import parity pricing, the Association suggests that, in light of new refineries in Asia and Australia's fuel standards, the Committee may wish to consider addressing the following issues during the course of its inquiry:

- is Singapore is still the appropriate benchmark? and
- if not, is there another regional market which may be a more appropriate benchmark?

Overview of Current Trends in Prices and Margins

As Figure 3 highlights, the average retail price of petrol in Australia has increased quite significantly over the last few years and there appears to be a general upwards trend emerging in relation to retail petrol prices. The increase in the retail price of petrol has been caused by a range of factors, including higher world oil prices and tighter international and domestic supply and demand conditions (both temporary and ongoing).

Figure 3: Average Retail Price of Petrol in Australian Metropolitan Areas 2004-2006



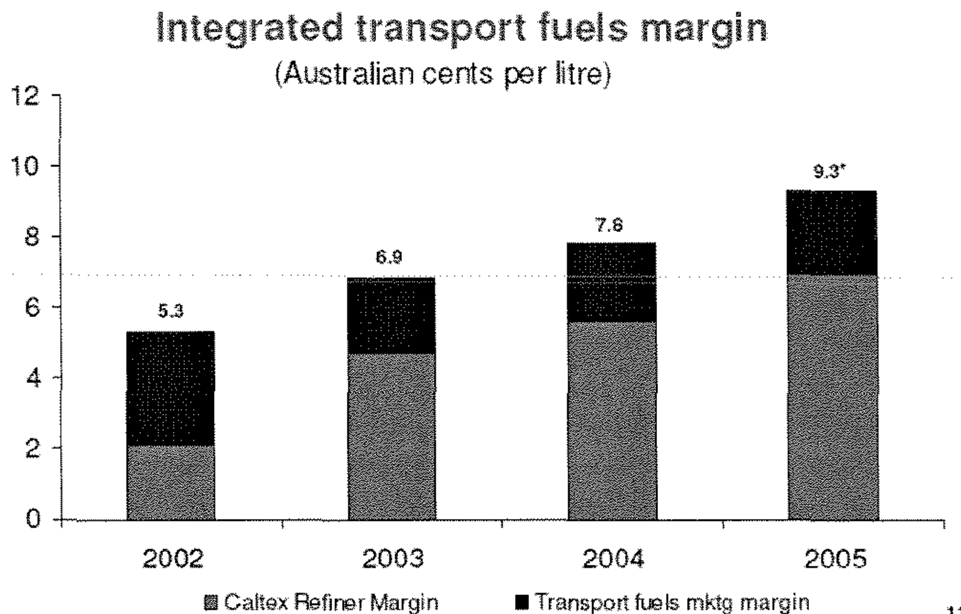
Source: Department of Industry, Tourism and Resources 2006, *Petrol – Frequently Asked Questions*, DITR, Canberra, viewed on 11 July 2006, www.industry.gov.au.

The tighter supply and demand conditions have also delivered improved wholesale margins to refiners over the last few years. In contrast, retail margins have remained fairly consistent over the same period due to intense competition at the retail level. For example, the Caltex Refiner Margin[1] rose from US$1.82 a barrel in 2002 to US$8.40 a barrel in 2005 – an increase of 361 per cent. In

[1] According to the Caltex website, the Caltex Refiner Margin represents the difference between the cost of importing a standard basket of Caltex products to Eastern Australia and the cost of importing the crude oil required to produce that basket of goods. It equals the average Singapore refiner margin + a product quality premium + a crude discount / (premium) + product freight – crude freight – yield loss.

contrast, Caltex's transport fuels marketing margin has remained fairly consistent since 2003 (see Figure 4).

Figure 4 - Caltex Integrated Transport Fuels Margin: 2002-2005



Source: David Reeves 2006, *2005 Full Year Results Presentation*, Caltex Australia Petroleum Pty Ltd, Sydney, viewed on 12 July 2006, http://www.caltex.com.au/corporate_inv_res.asp.

Regional Differences in the Retail Price of Petrol

It is not uncommon for the retail price of petrol to differ, sometimes quite significantly, between different locations in Australia. Those regional differences occur because of the influence of a number of factors, including the volume of petrol sold at a site, the level of non-petrol sales at a site, the capacity of the service station operator to use discounting to generate increased traffic and sales, the level of distribution and storage costs, government subsidies and the level of competition in the local market.

The retail price of petrol will be influenced by the volume of fuel sold at the site, as a higher volume of fuel sales will increase the capacity of the service station operator to accept lower margin on each litre of fuel sold. The volume of fuel sold at a particular site will also affect the service station operator's ability to spread its costs which will, in turn, affect the retail price of petrol sold at the site. A high volume of fuel sales will enable the service station operator to spread its operating costs over a greater volume of fuel, thereby reducing the impact that those costs have on the per litre price of fuel sold at the site. In contrast, the operator of a low volume site will have to allocate its operating costs over a smaller volume of fuel, thereby increasing the impact that those costs have on the per litre price of fuel sold at the site. The volume of fuel sold at a particular site may also affect the ability of the site's operator to negotiate discounts with its fuel supplier(s) and that in turn may have an impact on the retail price of petrol sold at that site. In that regard, it is likely that operators of higher volume sites will be in a better position to negotiate discounts due to their superior bargaining position (in comparison to operators of smaller volume sites).

The price of petrol sold at a particular site may also be influenced by the site's level of non-fuel sales. This is because high levels of non-fuel sales will enable the service station operator to spread its operating costs over a broader range of products and to thereby reduce the impact that those

costs have on the price of individual products sold at the site, including fuel. In contrast, low levels of non-fuel sales will limit the operator's ability to spread its costs and will likely mean that the operator will need to rely more heavily on its retail margin on fuel products to recover its operating costs. In those circumstances, the operator is likely to require a higher retail margin on fuel products and that in turn may result in a higher retail price. The profit margin on non-fuel products is also traditionally higher than the profit margin on fuel products and a high level of non-fuel sales may therefore improve the capacity of a service station operator to reduce its margin on fuel products (either on an ongoing basis or as part of a short term price discounting strategy) without affecting the financial performance and viability of its business. The level of non-fuel sales at a particular site is therefore likely to influence the retail price of petrol at the site and may also affect the ability of the site's operator to engage in price discounting.

The size and composition of a service station's potential customer base may also influence a service station operator's pricing behaviour and the retail price of fuel sold at the site. For service station operators located in some areas of Australia, the small or less transient nature of their potential customer bases will mean that deep price discounting is unlikely to be an effective commercial strategy to generate increased customer flows and sales. As a result, the price cycle in those areas is likely to be smoother and, to a certain degree, less volatile than the price cycles which occur in areas where price discounting is more common.

The distribution, transport and storage costs incurred by a service station operator will also influence the retail price of fuel sold at its site. In some areas of Australia, service station operators will not be able to source fuel supplies directly from the terminal and will instead have to rely on a distributor to supply their fuel products. In those circumstances, the service station operator is likely to incur additional costs in sourcing the fuel (in comparison to operators who source their fuel directly from the terminal) as the distributor will incorporate its own retail margin into the price it charges the service station operator and those additional costs are likely to be passed through to the retail price of petrol. For example, MTAA is aware of a small country service station operator whose fuel prices increased by around 4 cents per litre when its distributor was taken over by a distributor which MTAA understands is majority owned by a major oil company. The operator had previously paid the terminal gate price plus delivery costs, but following the change in ownership, the operator's cost of fuel was the terminal gate price plus delivery costs plus a distributor margin of around three to four cents. The higher cost of fuel was, understandably, passed on to motorists in the form of higher prices.

The cost of transporting and storing fuels will also vary from location to location and it is likely that those costs will be passed on to consumers by the service station operator. Service stations which have high distribution, transportation and storage costs are therefore likely to have higher retail prices of petrol than service stations with low distribution, transportation and storage costs.

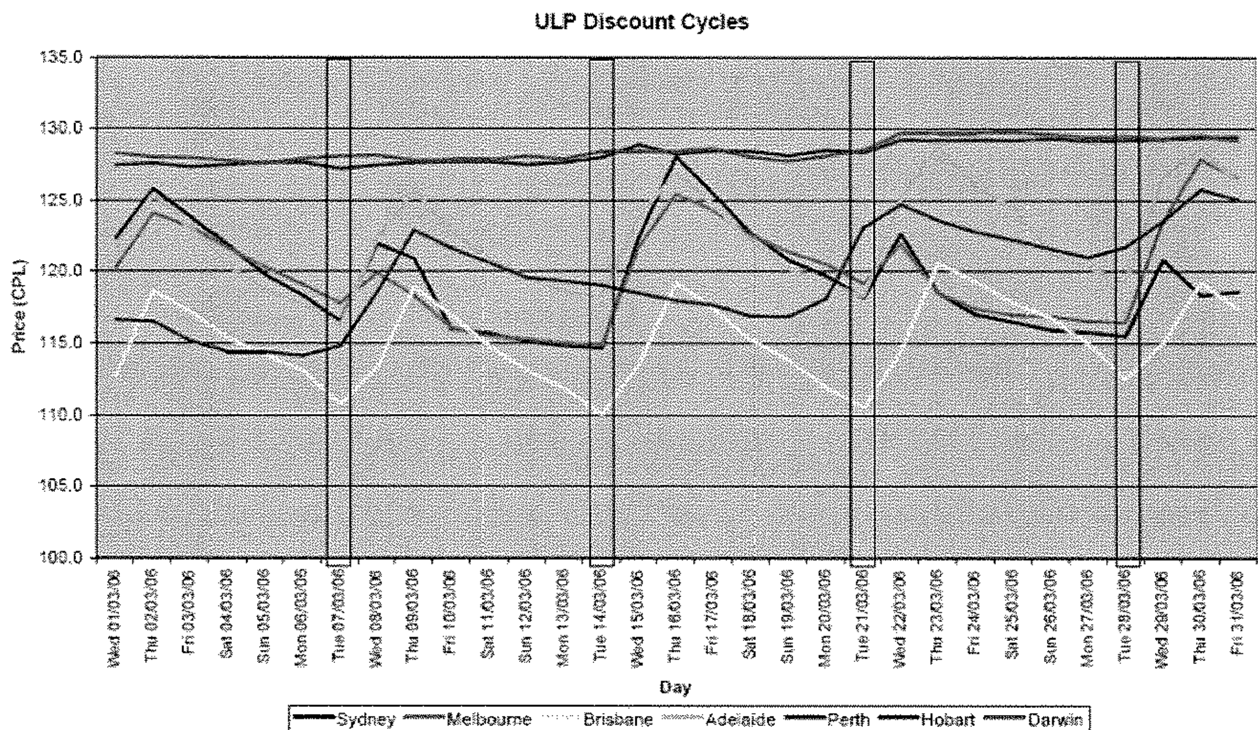
The influence of each of the above factors will vary from location to location and that in turn will cause the retail price of fuel to differ, sometimes quite significantly, between different locations in Australia. In that regard, it is worth noting that service stations located in rural and regional tend to have lower levels of fuel and non-fuel sales and higher costs associated with distribution, transport and storage than service stations located in metropolitan areas and it is therefore likely that retail prices at many rural and regional service stations will be higher than prices at their metropolitan counterparts. It is also worth noting that some governments also provide subsidies which reduce the cost of fuel (the most notable being the Queensland Government) and which may therefore create price differentials between various states or between different locations within a state or territory.

VARIATIONS IN THE RETAIL PRICE OF PETROL AT PARTICULAR TIMES

The retail price of petrol can fluctuate, sometimes quite significantly, during the course of a day or a week. While retail price fluctuations are a matter of irritation and confusion to some motorists, they are also confusing and irritating for service station operators (for the physical changing of prices on boards and pumps and also because of the complaints from motorists that the fluctuations inevitably and understandably generate). However, for all the publicity that retail price fluctuations attract, it needs to be made clear that not all motorists experience the highs and lows of the price cycle.

The fluctuations (or price discounting) are more prevalent in the major metropolitan areas and much less prevalent in rural and regional areas. The extent of price discounting within the major metropolitan areas however also varies quite significantly from suburb to suburb. It is also worth noting that some metropolitan areas, such as Darwin and Hobart, do not experience the marked price cycles experienced in other major metropolitan areas of Australia (as highlighted in Figure 5 below). It is therefore motorists in particular locations, rather than all motorists, who benefit from price fluctuations in the retail price of petroleum.

Figure 5: Unleaded Petrol Price Discount Cycles in Major Metropolitan Areas (March 2006)



Disclaimer : FUELtrac information is believed to be correct at time of printing. FUELtrac accepts no liability for ommissions or other errors associated with the use or distribution of any information contained herein.

Source: FUELtrac Pty Ltd 2006, *ULP Discount Cycles*, FUELtrac, Brisbane, viewed on 11 July 2006, http://www.fueltrac.com.au/zone_files/news_images/ulp_price_cycles.pdf.

Fluctuations in the retail price of petroleum occur for a variety of reasons, including competition between sites and the increased price competition caused by the use of shopper dockets. Competition in the retail petroleum sector is essentially based on price because of the fairly homogenous nature of petroleum products and because consumers are relatively indifferent to brand but highly sensitive to price. As a result, service station operators rely heavily on price competition to increase and to protect their market share.

Service station operators will therefore drop their prices to attract additional customers and increase their sales volumes of both fuel and non-fuel products or to match their competitors' prices to ensure that they do not lose market share. A recent report on automotive fuel pricing in Victoria by Consumer Affairs Victoria noted that, in Melbourne, the supermarket/oil major alliances generally led retail prices down but also frequently led market prices up as well.[2] While different market participants may fulfil that leading role in other Australian markets, service stations in those areas will be forced to match the discounted prices set by their competitors or they will lose market share. At some point however the discounting will reach a point at which it is commercially unsustainable and prices will then begin to increase and the cycle will repeat itself.

The provision and withdrawal of franchisee price support (or rebates) by some of the major oil companies also contributes to fluctuations in the retail price of petroleum. Price support basically involves a major oil company providing their franchisees with a rebate on the wholesale price of their fuel. This type of support is given selectively and is not available in all areas. In order to receive price support, eligible franchisees also must not set their retail price above a specified maximum price. Price support tends to be greatest during periods of heavy discounting and once it is withdrawn, prices tend to rise again. It is worth noting that the Australian Competition and Consumer Commission has previously suggested that price support schemes might be a long-term strategy by participating oil companies to maximise profits by controlling the retail prices set by franchisees and by removing or limiting competition from independents.[3] MTAA would support the Commission's views in that regard.

The introduction of shopper docket schemes has also provided additional price competition in the retail petroleum market, which is placing enormous pressure on all operators in the market, including independent operators and franchisees in particular. As Committee Members will be aware, those schemes are designed to increase traffic at participating supermarkets and to drive higher grocery sales at those supermarkets. However, MTAA acknowledges that at time of high petrol prices, the schemes are providing some apparent relief, albeit minor, to motorists assuming, which it may not be appropriate to do, that that is not recovered through higher grocery and other prices. The Association is concerned however about the long-term prospects for competition in the market if the schemes contribute to the exit of substantial independent operators from the market and Australia is left with a market dominated by the oil major/supermarket alliances, BP and Mobil. To that extent, it is MTAA's view that such an outcome would result in the loss of the substantial benefits of strong competition in the market and while the shopper docket schemes may survive that rationalisation, the real question will be "off what price will the cents a litre discount be given?".

It is also worth noting that the broad combination of shopper dockets, price support, the need to secure supply and the impact of commercial arrangements applied to the ownership of fuel delivered to service stations by some major oil companies means that the ability to set and control retail petrol prices is, with very few exceptions, effectively in the gift of the major oil companies.

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[2] Consumer Affairs Victoria 2006, *Report on Automotive Fuel Prices in Victoria*, State Government of Victoria, Melbourne, 10.

[3] Australian Competition and Consumer Commission 2001, *Reducing Fuel Price Variability*, ACCC, Canberra, 34.

THE INDUSTRY'S INTEGRATED STRUCTURE

The Australian petroleum industry is highly integrated, with strong links between the refinery, wholesale, distributor and retail levels. The major oil companies participate in all components of the supply chain, although their direct operation of retail sites has been limited, until recently, by the operation of the *Petroleum Retail Marketing Sites Act 1980* (Cth) and its regulations. Those restrictions have however been removed by the amendment of the relevant regulations and there are therefore no longer any controls on the number of retail sites that can be directly operated by the oil majors. The level of vertical integration in the industry is therefore likely to increase as some oil majors (BP in particular[4]) move to directly operate an increased number of their sites.

As can be seen from Figure 6, the major oil companies dominate the wholesale level of the market, with those companies operating all of Australia's major refineries. Those refineries produce the vast majority of Australia's petroleum supplies, although an increasing amount of refined fuel is being sourced from overseas refineries. The oil majors however also dominate the importation of refined petroleum products through their control of the vast majority of the suitable storage facilities at Australia's ports. As such, the wholesale sector of the industry is highly concentrated and the major oil companies wield a significant degree of influence over the sector.

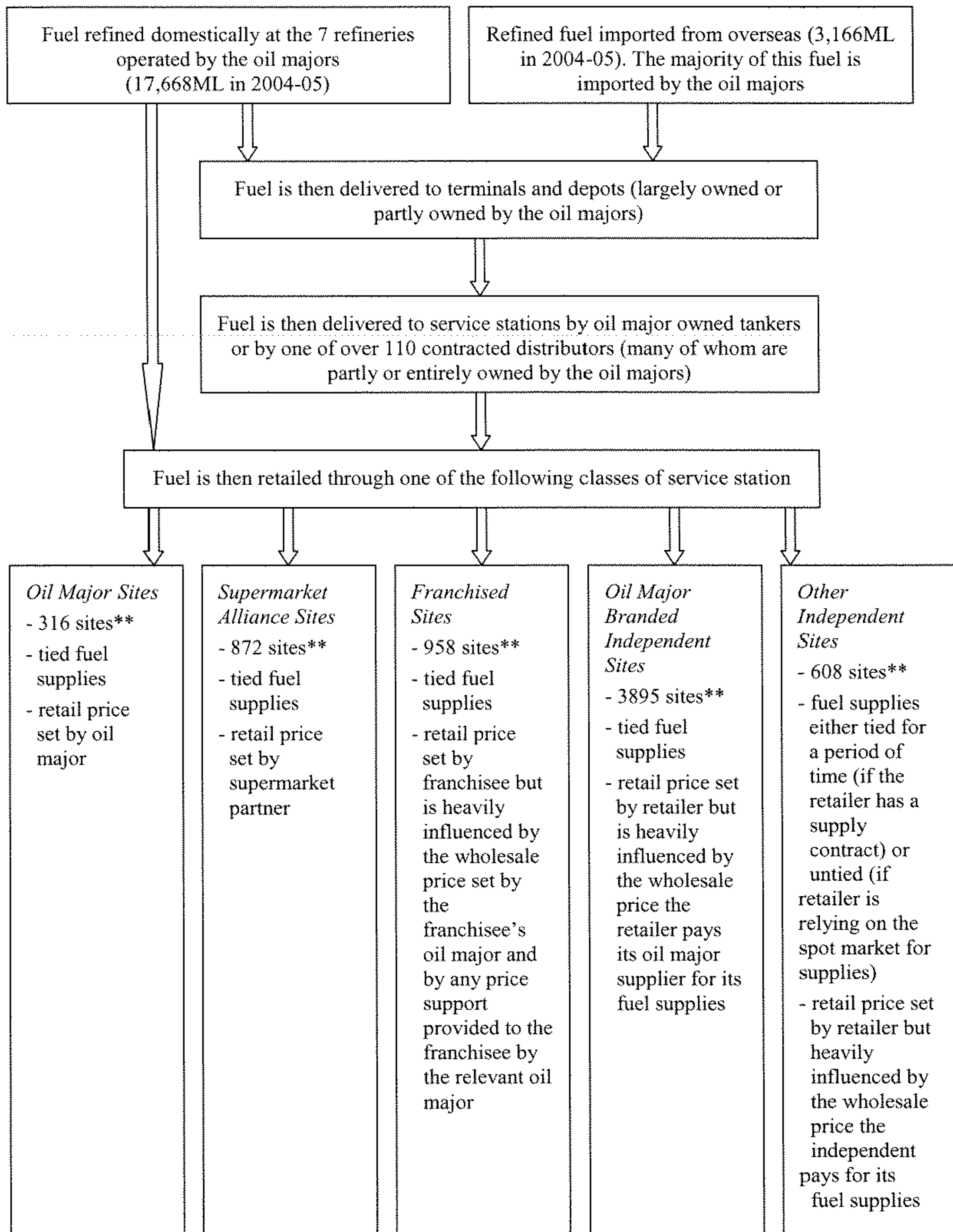
The oil majors' control of the wholesale sector also enables them to wield a significant degree of influence over the retail sector of the industry. While oil companies may not directly control the setting of prices at many sites, the vast majority of retail sites are tied to a particular oil major for their fuel supplies. The oil majors can therefore wield a significant degree of influence over the prices at the retail level through their control of wholesale prices and the inability of many retailers to source fuel suppliers from an alternative supplier.

According to the Australian Institute of Petroleum, there were 6649 service stations operating in Australia in 2004.[5] While MTAA expects that the number of service stations has declined since then, MTAA understands that as of July 2006 there are around 488 Caltex/Woolworths sites, 1400 Caltex/Ampol branded sites, 602 Shell/Coles sites, 513 Shell branded or supplied sites, 1453 BP branded or supplied sites and 1048 Mobil branded or supplied sites (figures based on information obtained from oil company websites and publications). Around 800 other sites are operated under the major independent brands (7-Eleven, United, Gull, Matilda, Neuman and so forth) located around Australia. There are also a number of smaller non-branded service stations located throughout Australia.

[4] Evidence to the Senate Economics Legislation Committee, Parliament of Australia, Sydney, 19 April 2006, E33 (Gerald Hueston).

[5] Australian Institute of Petroleum 2006, *Submission to the Inquiry into the Provisions of the Petroleum Legislation Repeal Bill 2006*, AIP, Canberra, 6.

Figure 6 – Australia's Fuel Supply Chain

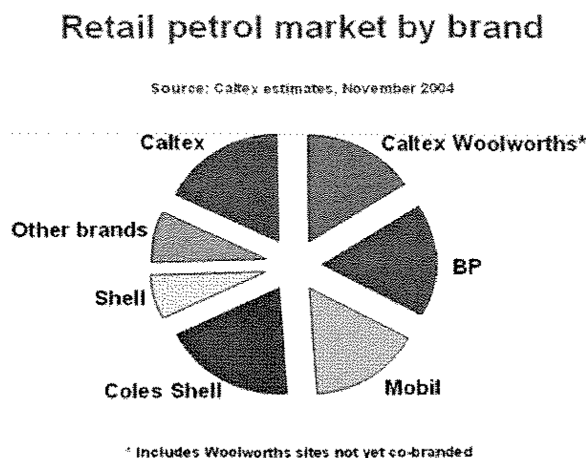


** These figures are 2004 figures and the structure of the market has evolved since then. (Source: Australian Institute of Petroleum 2006, *AIP submission to the Senate Economics Legislation Committee Inquiry into the Provisions of the Petroleum Legislation Repeal Bill 2006*, 8; Department of Industry, Tourism and Resources 2006, *Petrol – Frequently Asked Questions*, DITR, Canberra, viewed on 11 July 2006, www.industry.gov.au).

Compiled by MTAA for the Australian Service Station and Convenience Store Association, July 2006.

In terms of market share, it is quite difficult to obtain accurate market data as market share figures are commercially sensitive. That said however it is MTAA's understanding (based on information provided by confidential industry sources) that Caltex, Shell and the two joint venture supermarket alliances have at least sixty per cent of the Australian retail petroleum market. That view is supported by Figure 7 which provides a breakdown of the Australian retail petroleum market by brand based on the estimates of Caltex Australia Petroleum Pty Ltd.

Figure 7: Market Share of Australian Retail Petroleum Market by Brand (November 2004)



Woolworths recently announced that its comparable sales of petrol for the fifty-two weeks to 25 June 2006 were 21.6 per cent higher than its comparable sales of petrol for the fifty-two weeks ended 25 June 2005. Coles Myer Limited has also announced similar increases in sales volumes in the recent past. While some of that increase in sales is attributable to higher petrol prices, some is also attributable to increased market share, with Woolworths' weekly sales volume reaching 76 million litres in the final week of the year ended 25 June 2006. As such, the market shares of the supermarket alliances are likely to be significantly higher than those illustrated in Figure 7.

Source: Caltex Australia Petroleum Pty Ltd, *Petrol Pricing – The Plain Facts*, Caltex, Sydney, viewed on 12 July 2006, http://www.caltex.com.au/pricing_pla.asp; Woolworths Limited, 'Full Year Sales Results: 52 weeks to 25th June 2006' (Press Release, 18 July 2006).

In relation to the above market share estimate, it is worth noting that the supermarket/oil company alliances have probably increased their market share at the expense of other market participants since 2004 and they are therefore likely to have a larger market share than that illustrated in Figure 7.

In such a highly vertically and horizontally integrated market, the Association would question how the level of price competition is to be maintained unless there is access to fuel at a competitive wholesale price.

ANY OTHER RELATED MATTERS

MTAA considers that the regulatory framework governing the retail petroleum sector also has the potential to affect the level of retail petrol prices in Australia. As the Committee will be aware, the Australian Government is currently seeking to alter that regulatory environment by repealing the two retail petroleum sector-specific Acts; the *Petroleum Retail Marketing Sites Act 1980* ('the Sites Act') which limits the number of sites that an oil company may operate, and the *Petroleum Retail Marketing Franchise Act 1980* ('the Franchise Act') which provides tenure and other rights to petrol franchisees, and introducing a mandated oil industry code of conduct under the *Trade Practices Act 1974* ('the Oilcode').

The Committee will also be aware that MTAA considers that the Australian Government's proposed amendments to the retail petroleum sector's regulatory framework will not deliver a more competitive, transparent and efficient retail petroleum sector. MTAA holds that view because it believes that the proposed 'reforms' do not adequately address a number of key issues, including the transparency of terminal gate pricing arrangements, access to supply and protections against

misuse of market power. Each of these factors has, in MTAA's view, a significant impact upon either the level of transparency in the sector or the ability of individual businesses within the sector to compete effectively and therefore impacts upon the level of competition and pricing transparency in the market as a whole.

MTAA is also concerned that the repeal of the Sites and Franchise Acts will allow the major oil companies to exert increased influence over the retail market by removing the final constraints on vertical integration in the industry. The Oilcode, as drafted does not address continuing concerns about vertical or more recent concerns about the degree of horizontal integration across the whole retail market. MTAA considers that increased vertical integration and market concentration are not in the best interests of Australian consumers in the longer term as it will allow the larger market participants to exert a greater degree of influence over the product supply chain and to potentially manipulate the price of petrol. It will also threaten the level of competition in the industry and create barriers to entry which may preclude other more efficient competitors from entering the market in the future.

MTAA also believes that the proposed Oilcode, in its current form, will not provide a framework that ensures that the current level of competition in the market will continue in the long term. This is because the Oilcode does not address the fundamental threat to competition in the retail petroleum market; that is, the increasing dominance of the supermarket/oil company alliances, which now account for well over fifty per cent of the market, and their ability to use grocery operations to cross-subsidise fuel retailing activities and to consequently drive more efficient and effective competitors, both large and small from the retail petroleum market. Unless the proposed amendments address that issue, there is a significant possibility that the structure of the market will reflect that of the retail grocery market: a duopoly. Such an outcome will be of detriment to motorists in the longer term as a duopoly is likely to mean less price competition and higher retail prices for petrol.

In MTAA's view, the significant structural changes which have occurred in the retail petroleum sector over the last decade, including the growing market power of Coles and Woolworths, the trend towards vertical integration and the more recent trend towards horizontal integration, mean that it is imperative that any reform package for the sector includes appropriate amendments the misuse of market power provisions contained in Part IV of the *Trade Practices Act* to ensure that the Act deals effectively with all types of anti-competitive behaviour, including predatory pricing and the misuse of financial power. The Government's petroleum sector reforms as currently proposed do no include such amendments.

The proposed reforms therefore do not adequately address the concerns that service station operators have in relation to anti-competitive behaviour in the retail petroleum sector; in particular, predatory pricing, the misuse of financial power and the misuse of market power in one market to gain substantial power and reduce competition in another market. MTAA strongly believes that section 46 of the *Trade Practices Act* needs to be strengthened to address those concerns. The strengthening of the *Trade Practices Act* will allow for more effective competition in the market, the potential benefits of which will be passed on to consumers in the form of price competition.

In that regard, the Association is aware that the Australian Government has foreshadowed amendments to section 46 of the *Trade Practices Act* which it proposes will address the issue of predatory pricing. It is, however, MTAA's view that the Government's proposed amendments to the *Trade Practices Act* will not address our service station members concerns about below-cost selling practices in the retail petroleum market.

Biofuels/Ethanol Blends

MTAA considers that the proposed Oilcode will result in small competitors, namely the independent operators, leaving the petroleum retail market. Such an outcome will be of detriment to motorists not only due to the lessening of price competition, but due to its potential to limit access to biofuels and blended fuels such as ethanol.

In 2001, the Federal Government announced its commitment for Australia to produce 350 million litres of biofuels by 2010. While some of the major oil companies have begun selling biofuels and blended fuels at some service stations throughout Australia, it is the independent sector which has being the driving force behind attempts to increase the presence of those fuels in the Australian retail petroleum sector. One of the ways in which independent service station operators have been attempting to make biofuels and blended fuels more appealing to motorists is by passing on the Government subsidies to the consumer.

In that regard, it is worth noting that in a recent interview with Prue Adams for the ABC television series Landline[6], Mr John Honan, Managing Director of the Manildra Group, estimated that ethanol can be sold for approximately forty cents less than the price of petrol and that therefore petrol blended with ten per cent ethanol (E10) should be four cents less than the price of regular petrol. While the Australian Government is calling for fuel producers to pass on the subsidy they receive from the Federal Government[7], the Landline report also noted that while the independent service station operators are more likely to be passing those savings on to consumers, BP was defending its move to sell its ethanol blended petrol at the same price as regular petrol.

Meeting the Government's target of 350 million litres of biofuels by 2010 is not just about production but also consumption, which means that the products need to be widely available for motorists. The viability of independent service station operators is central to encouraging consumer consumption of biofuels and blended fuels because those retailers sell a significant proportion of the total amount of those fuels that are sold in Australia each year and have been more receptive to the concept of biofuels and ethanol blends than other market participants. The proposed changes to the regulatory environment of the retail petroleum sector threaten the viability of independent service stations and therefore have the potential to threaten the effectiveness of biofuels and ethanol blended fuels in the Australian market.

The future of biofuels and ethanol blends in the Australian market is also dependent on the ability of independent retailers who retail those fuels to secure access to a competitively priced supply of petroleum products, as there are statutory limits on the composition of some biofuel and ethanol blends. For example, ethanol blends may only contain up to ten per cent ethanol which means that suppliers or retailers of those fuels must be able to secure sufficient fuel supplies to be able to produce and retail their E10 blend. Those supplies must also be competitively priced if E10 and other biofuel blends are to be an attractive and viable alternative to conventional fuels for Australian motorists. At this stage, the current and proposed regulatory frameworks for the retail petroleum sector do not address the important issue of access to supply and it is therefore possible that some biofuel and ethanol suppliers and retailers may experience difficulties in securing the fuels supplies they require in order to be able produce and sell certain biofuel and ethanol blends.

[6] ABC Television, 'Fuel for Thought, *Landline*, 9 July 2006 http://www.abc.net.au/landline/content/2006/s1679589.htm (viewed on 12 July 2006).

[7] 'Biofuels subsidies should be passed on', *The Sydney Morning Herald* (Sydney), 9 July 2006.

CONCLUSION

MTAA trusts that these comments and observations have been of assistance to the Committee in its consideration of this matter.

MTAA
National Secretariat
Canberra

July 2006

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Motor Trades Association of Australia

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19/7 01

Ms Margaret Arblaster
General Manager – Transport and Prices Oversight
Australian Competition and Consumer Commission
GPO Box 520J
MELBOURNE VIC 3001

Dear Ms Arblaster

The Motor Trades Association of Australia (MTAA) is the national representative association of the various state and territory motor trade associations, automobile chambers of commerce and the NSW based Service Station Association Ltd. MTAA represents all those who sell, service and repair Australia's motor vehicles; including service station operators. The Association represents service station operators across the broad spectrum of operations, from single site franchisees, to multi-site franchisees, commission agents and branded and unbranded independent operators.

MTAA is pleased to be able to provide comment on the ACCC's discussion paper on Reducing Fuel Price Variability. The Association has of course contributed to the many past inquiries into the petroleum sector, including to the ACCC's 1996 inquiry into the declaration of petroleum products. Should the Commission require copies of any of the Association's submissions to previous inquiries we would of course be happy to provide them.

In its Discussion Paper, the Commission has canvassed a range of options which might be employed to reduce the fluctuations in retail petrol prices observed/experienced by some, particularly those in metropolitan areas, but not all, motorists. The options presented for discussion by the Commission range from an education but no market intervention option, to at the other extreme options for regulation to control either retail or wholesale prices.

The Commission is seeking comment on the options outlined in its discussion paper as well as on a range of other matters. The views expressed below are presented on behalf of all of the Members of MTAA and reflect the long-standing policy position of the Association and its Members.

Retail price fluctuations, while a matter of irritation and confusion for motorists are equally as confusing and irritating for service station operators (for the physical changing of prices on boards and pumps and also, but not least, for the complaints from motorists that the fluctuations inevitably and understandably generate). However, for all the publicity that retail price fluctuations attract, it needs to be made clear that not all motorists experience the highs and lows of the price cycle.

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The fluctuations (or price discounting) are most prevalent in the major metropolitan areas and much less prevalent in rural and regional markets. Having said that within the major metropolitan areas the extent of discounting also varies quite considerably. For example, the North Shore of Sydney does not experience the same discounting as is experienced along say Parramatta Road. It is then the 'locationally lucky' motorists, rather than all motorists, who benefit most from the current chaotic pricing arrangements in the petroleum market.

The retail price fluctuations result of course from the application and subsequent withdrawal of price support (or price rebates) arrangements to their franchisees, by the oil majors. Thus in periods of heavy price discounting, price support to franchisees and on occasions to other branded retailers is greatest and once withdrawn or reduced by the oil majors, retail prices rise again.

While this odd pricing arrangement manifests itself on price boards at (mainly) metropolitan service stations around the country each week, it is, MTAA believes, symptomatic of a more substantial problem at the wholesale level of the market; which if resolved would we believe result in more equitable pricing arrangements at both the wholesale and retail levels of the market.

The current wholesale petrol pricing market could best be described as opaque and oligopolistic. Service station operators pay an inflated wholesale price for their fuel. Fuel is generally required to be paid for on the day of delivery; credit terms are not normally extended for fuel purchases. In the past, non-franchisee service station operators had a slight wholesale buy price advantage over franchisee operators. For the past 18 months or so the oil majors have withdrawn that advantage and anecdotal evidence suggests that any retail margin advantage now rests with franchisees.

However irrespective of which class of operator buys at the "better" price, the fact is that the oil majors manipulate the market by controlling the retail price at their franchised sites by providing (or withdrawing) price support/rebates. That support is of course provided retrospectively and sometimes weeks in arrears. Thus at any given time, franchisees in a period of discounting may well be selling fuel below their buying price. Of course for those operators who do not receive price support the financial impact of the oil majors' activities is severe.

Advances in technology and other structural changes in the market (such as the emergence of multi-site franchising) have allowed the oil majors to have a much greater influence over retail pricing than ever has been experienced in the past. Technology allows the oil majors, through their own controlled sites and their franchisee operated sites, to monitor daily and in some cases more frequently than that, the prices of their competitors. Pricing decisions for their own sites and franchisee sites can then be made relatively quickly and any adjustments communicated to the sites by e-mail or other electronic communication. Franchisees are advised of the maximum price at which they can retail their fuel in order to receive price support from their franchisor. Withdrawal of some or all of that price support results in retail prices rising. At some point in the future support is restored and prices fall; thus resulting in the otherwise inexplicable retail price fluctuations. Discounting (leading to retail price fluctuations) is not generally initiated by service station operators; the setting of retail prices is now almost entirely controlled by the oil majors. This point seems not to have been recognised in the Discussion Paper. In some markets independent resellers are more active than in others and may at times be active in discounting.

While technology certainly allows the oil majors to react much more quickly to price movements in the market; this system of rebates/discounts/price support is made entirely possible by the wholesale pricing policies of the oil majors. Because there is now no surveillance of wholesale prices there is no 'benchmark' against which to measure movements in prices. If there was some contestability in the wholesale market the lack of a 'benchmark' might of itself be of less importance. However, franchisees and indeed all resellers with supply contracts, are price takers; they buy at a price set by the oil majors. In addition, supply contracts are exclusive and long term, invariably, and no or very little information is provided to resellers on the various components of the wholesale price.

As a result, wholesale pricing is not transparent, it is not contestable either at the point of delivery to the service station or at the terminal or depot and because of the exclusive nature of the supply agreements access itself is not contestable for probably well over 90 per cent of the fuel sold at retail.

Because of all of these factors and the conscious price parallelism evident in today's retail pricing, MTAA believes that the wholesale fuel market is not as competitive as the oil majors suggest. The maximum wholesale price (MWP) regulations in Western Australia lend support to that view. Therefore rather than addressing the retail price fluctuations, per se, MTAA believes the more appropriate course of action would be for the Commonwealth Government to address the problem of the lack of competition and transparency in the wholesale market.

Against that background MTAA offers the following comments on the options for limiting price fluctuations as set out on page 2 of the Discussion Paper:

- *educate consumers about the price cycle*

In theory this would appear to be a sensible approach. That is, in reality, educate consumers so that those that are locationally lucky know at what stage of the price cycle to buy their fuel. However it does nothing to address the fundamental and structural problems of the Australian petroleum market. While not discarding this option entirely, there are other options which could achieve a more equitable outcome for all motorists.

- *allow prices to be changed only once in 24 hours*

The reforms recently introduced in Western Australia require prices, once notified to the Prices Commissioner, to remain unchanged for the next 24 hours. This applies to both the maximum wholesale price at declared terminals and to retail prices. The Victorian terminal gate pricing regulations due to come into effect on 1 August will also only allow the terminal gate price to be adjusted once in a 24 hour period. However while limiting price changes to once in 24 hours may address some of the daily price fluctuations it again does not address the fundamental concerns that MTAA has about the wholesale market. Experience in Western Australia suggests that there is potential for such a system to be manipulated; leaving both retailers and consumers confused. Anecdotal evidence in Western Australia suggests that for smaller sites in off-highway locations, volume has decreased by up to 30% as a result of the introduction of the legislation which only permits prices to be changed once in a 24 hour period.

The major oil companies now control so much of the retail networks that they are able to direct volume through selected strategically located sites and the website listing of prices, by the Government, assists that. Many of the adversely affected sites are independent operators, but there are also a considerable number of franchisees in the Ampol/Caltex network that are very badly affected.

Although they are the worst affected, these circumstances are not confined to smaller sites. Even operators with several sites doing large turnovers are complaining. Volumes are so erratic and unpredictable.

The market is extremely competitive and there has been no compensating influence of a market based on the Maximum Wholesale Price. Not one litre of fuel has changed hands at the MWP because the oil majors have been unwilling to supply at that price. Margins are at rock bottom and there are many service station operators in dire circumstances.

The key to the reform process is an effective spot market trading off a realistic wholesale price as well as transparency of pricing. The absolute worst outcome for the industry would be for a 24 hour restriction to be introduced in isolation. MTAA does not favour the introduction of a 24 hour price restriction.

- ***limit price increases to only a certain amount each day***

Again MTAA does not favour the introduction of this option. It does not address resellers concerns about the wholesale price and the lack of competition at the wholesale level.

- ***retail price regulation***

Retail price regulation is an option available to all state and territory governments. While retail price regulation may remove price fluctuations it provides only (and most likely at some cost to all in the industry as well as to motorists) a 'cosmetic' solution to the problems in the petroleum industry which we have identified. However, in the absence of any national progress on petroleum industry reform, MTAA believes that it is increasingly likely that the states and territories will each introduce their own regulatory regimes which may involve retail price caps. MTAA does not support the introduction of retail price caps and would instead encourage the Commonwealth Government to address the issues of access to fuel supply and price transparency in the wholesale market.

- ***reintroduce wholesale price regulation***

MTAA did not oppose the withdrawal of wholesale price surveillance in 1998. However, we had previously made the point to the ACCC that if the MEWP was to end, then appropriate price monitoring at all levels of the supply chain would be required. We do not believe that there has been adequate monitoring of prices since August 1998 and the Association and its members have concerns about the current level of the wholesale price. MTAA would not oppose the re-introduction of a maximum wholesale price.

- ***terminal gate pricing, accompanied by open access and no price discounting***

In MTAA's view this is the option which has the most potential to provide the most equitable pricing arrangement at both wholesale and retail levels of the petroleum market. The oil majors dominate the pricing arrangements, in fact control them, at both levels of the market. While it is claimed there may be a 'threat' of imports, in reality present import volume is low, as it always has been and in our judgement it has little impact on the overall market. In selling fuel to resellers, the oil companies do not provide any break-up of costs in relation to those incurred pre the refinery gate (such as import parity cost, return on assets) and those incurred past the refinery gate (such as transportation, brand fees, credit (if any), return on assets and so on). Currently all of these elements of the wholesale price are unknown and are not contestable. Resellers in this matter are invariably and always price takers. Fuel is delivered to them at a stated price and that is the price that they pay.

The introduction of a terminal gate price would introduce transparency into fuel pricing. The components of the wholesale price would be known; the price at the terminal would not include any costs incurred post the terminal. Where those costs were incurred they would be identified and charged to the reseller. A terminal gate price arrangement would work most effectively with an open fuel supply access arrangement. Such an arrangement would provide for access to fuel at terminals by all buyers, subject to satisfying appropriate occupational health and safety and environmental concerns. Despite the Government obtaining so-called 'undertakings' from the oil majors in 1998 in relation to access to terminals the current reality is that any reseller with a supply contract is denied access to oil company terminals. Miners, farmers and transport companies may well be able to gain access to terminals; they however are not in the business of retailing fuel. Secondary marketers, such as Gull and Matilda also have access to terminals. However, the oil majors deny access to terminals to any party, without a supply contract, that intends to engage in fuel reselling at retail and in doing so ensure that the oil majors retain control of the wholesale and retail pricing of petrol.

Australia has not for a generation had a spot or 'jobber' market for petrol. The introduction of a terminal gate price and an open fuel supply access regime would assist in securing such a market. It in turn would provide some competition in the wholesale market and that would inevitably be reflected at the retail level.

Retail price fluctuations occur because the oil majors charge inflated wholesale prices to their resellers and then discount away (through the provision of rebates or price support) the excess. The introduction of a true wholesale price, through the establishment of a terminal gate pricing regime, would considerably lessen the ability of the oil majors to engage in retail price wars. This does not necessarily mean that the average retail price would rise. In fact, the introduction of a true wholesale price, coupled with an open fuel supply access regime, is more likely to result in a more competitive wholesale market and the benefits of that will flow to motorists. The introduction of a terminal gate price and an open fuel supply access regime is more likely to provide long terms benefits to a greater number of motorists than the current chaotic selective discounting arrangements do for the few motorists who are locationally lucky.

MTAA believes that at the terminal gate the price of fuel should be the same to all buyers. Costs post the terminal gate should be charged for (and identified on invoices) only where they are incurred.

If the Commission was to recommend to the Government that it re-convene negotiations between oil industry parties on the introduction of a mandatory OilCode, MTAA would be pleased to participate in any such discussions. However, our long standing policy that we cannot accept repeal of the *Petroleum Retail Marketing Sites Act 1980* remains unchanged.

If you have any queries about any of the issues discussed above I would be pleased to discuss this submission with you or other officers of the Commission at your convenience.

Yours sincerely

MICHAEL DELANEY
Executive Director

19 July 2001

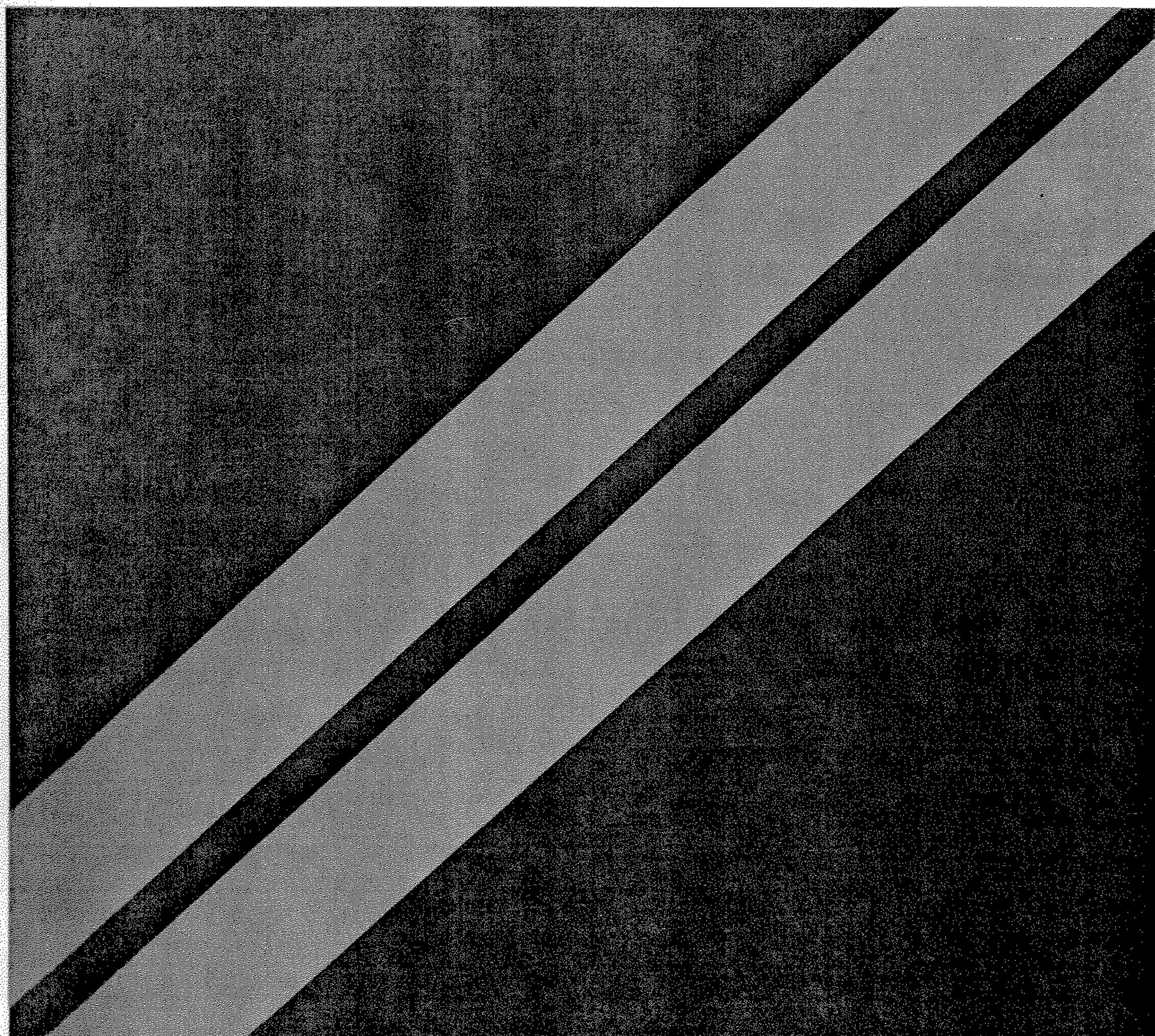
1.3

Motor Trades Association of Australia

MTAA SUPLEMENTARY SUBMISSION TO THE SENATE RURAL AND REGIONAL AFFAIRS AND TRANSPORT LEGISLATION COMMITTEE

INQUIRY INTO THE PETROLEUM RETAIL LEGISLATION REPEAL BILL 1998

11 MARCH 1999



Conclusion

In the short time available to it MTAA has attempted to provide a solution to the current "stalemate" facing the industry; one party desires above all else repeal of the two Acts; the other party requires fairness and equity and access to its primary product on a transparent, open, known and disclosed basis. Neither party proposes that the status quo arrangements are acceptable. Indeed both parties believe it to be a most unsatisfactory state of affairs.

As indicated in the introductory section of this supplementary submission, providing there is an agreed oil industry code of conduct, mandated under the Trade Practices Act, that code could be "swapped" for the Franchise Act. However, it must be clear that we do not yet have such a code and agreement is therefore some way off. A swap of that nature then is also some way into the future.

We have also indicated that provided certain access arrangements were put in place and included in the to be agreed and mandated code then we would be prepared to "swap" those arrangements for the **regulations** under the Sites Act.

If however a new section were to be included in the Trade Practices Act which provided generic regulation of competition in "deregulated industries" then over time the Association could be prepared to "swap" that for the Sites Act itself.

This supplementary submission is necessarily brief. However it does set out what MTAA believes should be the parameters for moving forward in the oil industry. We can only reiterate what was said by the Association's representatives in evidence to the Committee; the status quo is of no assistance to anyone. What MTAA cannot support or allow to happen is a return to the status quo ante – the situation prevailing prior to 1980. It was those circumstances which lead to the enactment of these two petroleum Acts initially. Were those circumstances to prevail again it would be natural for agitation for similar redress as is now sought to be repealed to be restored.

MTAA
NATIONAL SECRETARIAT
Canberra

11 March 1999

1.4

Motor Trades Association of Australia

SENATE ECONOMICS REFERENCES COMMITTEE

INQUIRY INTO IMPROVING COMPETITION IN THE WHOLESALE SECTOR OF THE PETROLEUM MARKET IN AUSTRALIA

SUBMISSION PREPARED BY THE MOTOR TRADES ASSOCIATION OF AUSTRALIA©

NOVEMBER 1999

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6. CONCLUSIONS AND RECOMMENDATIONS

6.1 Conclusions

The then Government's intention in enacting in 1980 the Petroleum Retail Marketing Sites Act was to enhance competition by reducing the number of retail sites operated by the oil majors (there were then nine of them) and hence reducing the control that those companies exerted over the retail prices in the oil industry.

The Act constrains the now four major oil companies to directly operating 426 sites nationally. The Government and the oil companies have indicated their desire for repeal of the Sites Act and its companion Act the Petroleum Retail Marketing Franchise Act. The Government intends that both Acts be replaced by a mandatory OilCode. MTAA has indicated that on completion of the now draft OilCode it would be prepared to endorse repeal of the Franchise Act, but not the Sites Act. The Government has recently determined that as the two major industry parties (MTAA and the oil majors) are unable to agree on the future of the Sites Act it is withdrawing from the industry reform process and will not be proceeding with repeal of the two petroleum Acts or the introduction of an OilCode until such time as the parties can reach agreement on future regulation of the industry.

It is MTAA's belief that since the early 1990's the oil majors have been actively and deliberately structuring their corporate affairs so as to circumvent the provisions of the Sites Act. The result has been the reduction of competition, the virtual destruction of small business operations in the retail sector of the petroleum industry and the securing of much greater control over retail outlets (and hence retail prices) by the oil majors than had previously been believed possible.

The oil majors have devised corporate structures which test to the very limit the control provisions of the Sites Act. While in some cases it would seem that those provisions have been ignored altogether, it is abundantly clear that the companies have to a significant degree succeeded in their attempt to circumvent the Sites Act. As MTAA has consistently argued the fact that the Act is being so circumvented does not mean that it should be abandoned. It is in our view rather a compelling case for a review and strengthening of the relevant provisions of the Act to ensure that it does enhance competition and deny oil company control of the market from refinery to bowser.

The companies have sought to avoid the provisions of the Sites Act primarily through two different sets of corporate arrangements. The first of these is multi-site franchising, which was introduced first in Australia by Shell in 1993. Since that time Shell has expanded its multi-site network so that 6 franchisees now control about 370 Shell sites. MTAA believes that Shell exerts control over the operations of each of the multi-site franchisees – it has registered charges over the business and must approve changes to the memorandum and articles of association of the franchisee's companies. Given the information MTAA has provided to the Committee on the operation of the Perth based Shell multi-site franchisee, the question must also be asked whether the multi-site network has been established to not only avoid the provisions of the Sites Act but to reduce as well company tax liability.

Both BP and Mobil have also introduced multi-site franchise networks – though of a different character to Shell's, though the continued existence of the Sites Act has meant that BP has not been able to introduce its multi-site network in the manner it originally planned.

The second set of corporate arrangements by which the major oil companies have sought to avoid the Sites Act is through equity holdings in either or both of distributors and third party retailers. This arrangement appears to have been a particularly successful strategy for Mobil. As is discussed earlier in this submission in reality an oil major can secure effective control over a company without an equity holding of more than 50 per cent. The problem of course is that an equity holding of 50 per cent does not trigger the control provisions of the Sites Act and service stations operated by commission agency or engaged labour under that equity arrangement do not need to be declared.

Thus MTAA believes that while the question of breaches of the Sites Act is an important one for the Committee to consider, the issue of whether the companies are employing corporate structures to reduce competition, gain control of the retail market and at the same time seeking to avoid or evade the provisions of the Sites Act is equally as important.

Of course the provisions of the Sites Act apply only to the companies declared under the Act. Currently the Act therefore applies only to the four refiner marketers. Other independent marketers such as Burmah, Liberty, Gull, and Matilda are free to operate in the market in a way that the major oil companies are not. MTAA acknowledges that this causes a distortion in the marketplace. Again however MTAA does not consider that this is a reason to repeal the Act, rather the more appropriate course of action would be to widen the ambit of the Act to include all marketers.

The oil companies during the course of the Senate Rural and Regional Affairs and Transport Legislation Committee inquiry into the repeal of the two petroleum Acts offered certain so-called "undertakings" in relation to the future operation of their sites (in a "deregulated" world). The "undertakings" were of course offered on a 'trust me' basis as they would not be able to be enforced by any party. At the time the "undertakings" were offered MTAA was sceptical about the oil majors' intentions. We remain so today. One of the reasons that we are in fact sceptical is because of the oil companies behaviour in relation to the Sites Act. The oil majors are proposing that we trust them in a deregulated environment, when in the current regulated environment they seek to avoid, circumvent and evade the legislation wherever possible.

Consequently MTAA believes that the Sites Act must be vigorously enforced and amended to prevent the companies from circumventing the restrictions placed on them by the Act.

The lack of an ability to access competitively priced wholesale fuel is one of the biggest problems facing service station operators. The exclusive ties in supply agreements have resulted in there being no competition at the wholesale level. Service station operators are very much price takers and that is then reflected in retail prices. Service station operators have for many years been seeking the right the "shop around" for the most competitively priced wholesale fuel. That of course has been resisted by the oil majors on the grounds of "passing-off" and their rights to exclusive supply as provided in their franchise agreements.

MTAA considers that concerns about "passing-off" can easily be overcome. Appropriate notices can be displayed on pumps and in addition it is well known that all of the majors are involved in horizontal arrangements which sees product swapped between them on a regular basis. Thus we do not believe any claims as to the uniqueness of product can be sustained.

MTAA therefore supports the principles contained in the Fitzgibbon Bill and urges the Committee to endorse it.

6.2 Recommendations

Accordingly MTAA recommends to the Committee the following:

1. that the *Petroleum Retail Marketing Sites Act 1980* be amended so that any equity holding by the declared companies in any other company falls within the provision of the Sites Act relating to "related bodies corporate" and thus the operation of service stations operated by the related body corporate would be governed by the provisions of the Sites Act;

2. that the Petroleum Retail Marketing Sites Act 1980 be amended to include multi-site operations within the ambit of Sites Act;

3. that the non-refiner marketers be declared corporations for the purposes of the Petroleum Retail Marketing Sites Act 1980; and

4. that the Committee endorse the provisions of the *Fair Prices and Better Access for All (Petroleum) Bill 1999* including the provision to amend the Trade Practices Act 1974 as set out in Schedule 1 of the Bill.

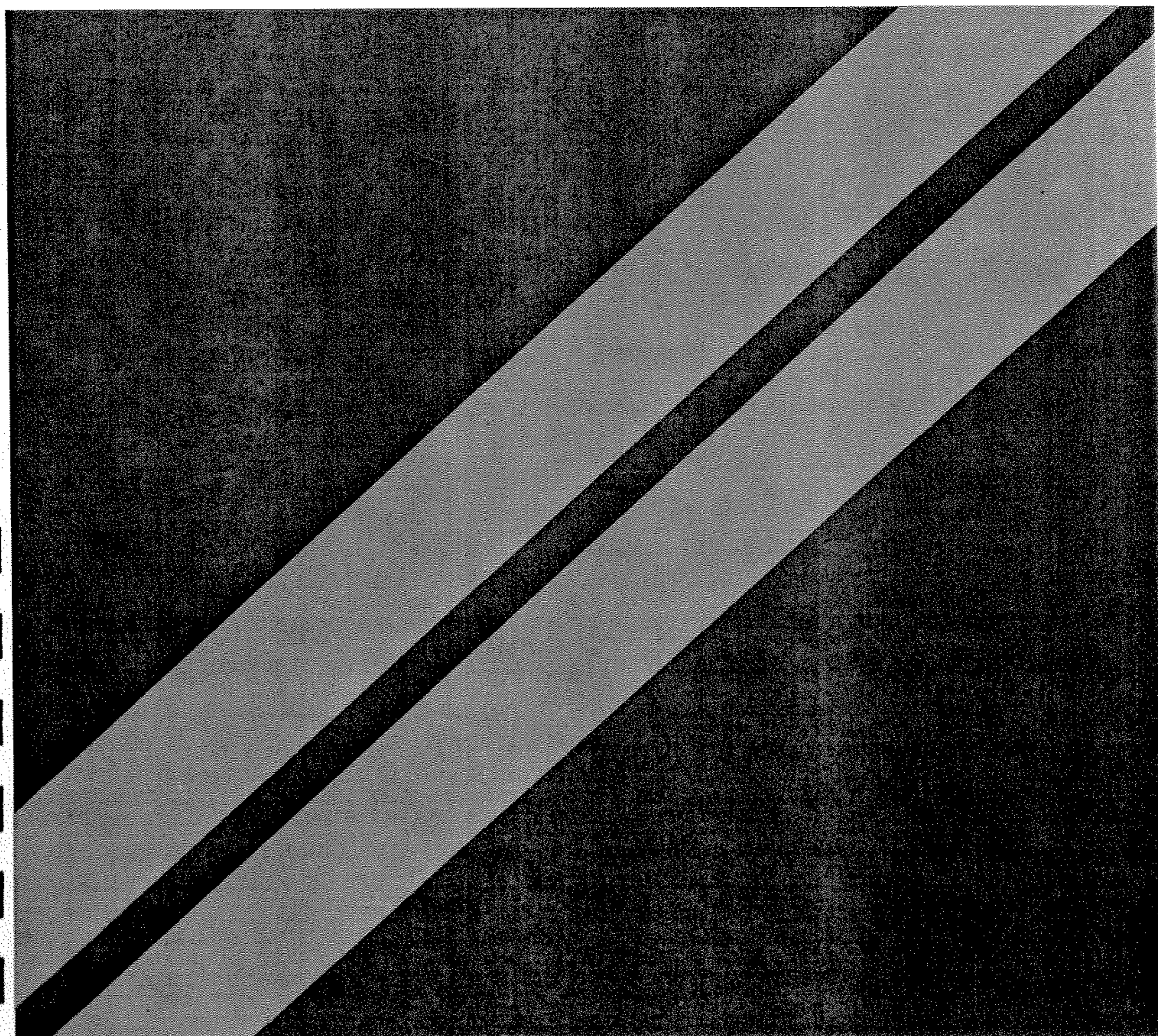
1.5

Motor Trades Association of Australia

MTAA SUBMISSION TO THE SENATE RURAL AND REGIONAL AFFAIRS AND TRANSPORT LEGISLATION COMMITTEE

INQUIRY INTO THE PETROLEUM RETAIL LEGISLATION REPEAL BILL 1998

FEBRUARY 1999



9. Conclusions and Recommendations

The petroleum industry has a notorious history. Petroleum is always contentious and has often been the fluid upon which much of the struggles of history has flowed.

> *" It is a struggle that has shaken the world economy, dictated the outcome of wars and transformed the destiny of men and nations."*[52]

The issues before the Senate are not of that grand character or impact. Nevertheless, they are truly significant for the Nation.

MTAA and its service station operator members are naturally self-interested in the matter of repeal of the petroleum Acts. They are not though solely self-interested and in any case MTAA would propose that their self-interest and the public interest in this matter largely consist.

The existence of a robust and numerous franchised petroleum reseller population has served the community well. Those businesses have been invariably multi-faceted, locally owned and operated and of centrality to the widely dispersed communities in which they have operated.

The legislation currently being considered by the Senate, that is the Bill which if agreed to by the Senate will repeal the two petroleum Acts, is about more than just the removal of two pieces of legislation from the statute books. In determining its view on the Bill the Senate will determine the future structure of the petroleum industry in Australia, the role of the Australian government in relation to it and the role of small business within that industry.

Should the Senate simply agree to the Government proposal that the Acts should be repealed and do nothing more, there will be no opportunity in the future to redress or retrieve matters. The retail petroleum market will be dominated by the four majors, who wish to become no more than two, who will ultimately gain direct control over much greater volumes of fuel (and thus the price at which that fuel is retailed). Small business operators will be increasingly forced from the market and those that remain will be without many of their current, albeit limited, protections against the market power of the oil majors. Those operators will have no security of tenure and few rights in relation to their commercial arrangements. As a society, we do not encourage such circumstances in other sectors of the economy and MTAA does not believe that they should be allowed to arise in the petroleum sector. Petrol after all, in a nation as dispersed as ours, is essential to all of our daily lives.

We would urge the Senate to consider carefully the wider implications for Australian society of repeal of the petroleum Acts. Is an open and competitive petroleum market best secured by providing the opportunity for the four oil majors, multi-national companies, to gain greater control over volumes of fuel sold and the price at which that fuel is sold? Or is such a market best secured by the principles of the national competition policy being applied to this most essential utility good?

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[52] Yergin D, The Prize, Simon and Schuster, New York, 1991

MTAA seeks not to prohibit the oil majors from operating in the retail sector of the petroleum market; we do however seek a much more transparent market for all operators. We seek a market in which all retailers have access to the best available wholesale price and where there is true competition between all parties at each stage of the production, distribution and marketing chain.

Regulation of the petroleum market is not new, nor is it, as is so blithely portrayed, an outdated fashion. Governments in all parts of the world regulate the petroleum industry in many ways from well-head to bowser. The fact that the oil majors themselves are largely responsible for the current structure of the market (which they claim contributes to their poor financial returns) should be no reason to endorse their calls for repeal of the petroleum legislation; particularly in the absence of other measures.

MTAA understands why there have been repeated calls, particularly by the oil majors, for repeal of the petroleum Acts. The Acts have operated as if "the market has been locked up in time", but the reality is that the market has changed considerably since 1980. Resellers sincerely believe though that the worst outcome for them and for consumers would be for the Acts to be repealed without countervailing measures being put in place to restrain the market power and vertical integration aspirations of the oil majors and to provide them, all resellers, with some mandated statutory rights and protections in their dealings with the oil majors.

MTAA therefore makes the following recommendations:

1. **MTAA recommends that the Senate before making any recommendations seek to investigate the following:**
   * **multi-site franchising;**
   * **the New Zealand deregulation experience; and**
   * **the parties to be included in and the content of any new OilCode.**

2. **MTAA recommends that in the public interest any increase in the degree of vertical integration in the petroleum industry not be permitted until alternative and transparent horizontal and vertical arrangements which promote greater competition have been established thus allowing all retailers to have access to the best available wholesale price.**

3. **MTAA recommends that as a first step towards genuine reform the Government negotiate to obtain agreement for a mandatory OilCode to be tabled as a disallowable instrument in the Senate. MTAA recommends that the Senate only consider the repeal legislation once the code has been agreed to by all parties and come into force.**

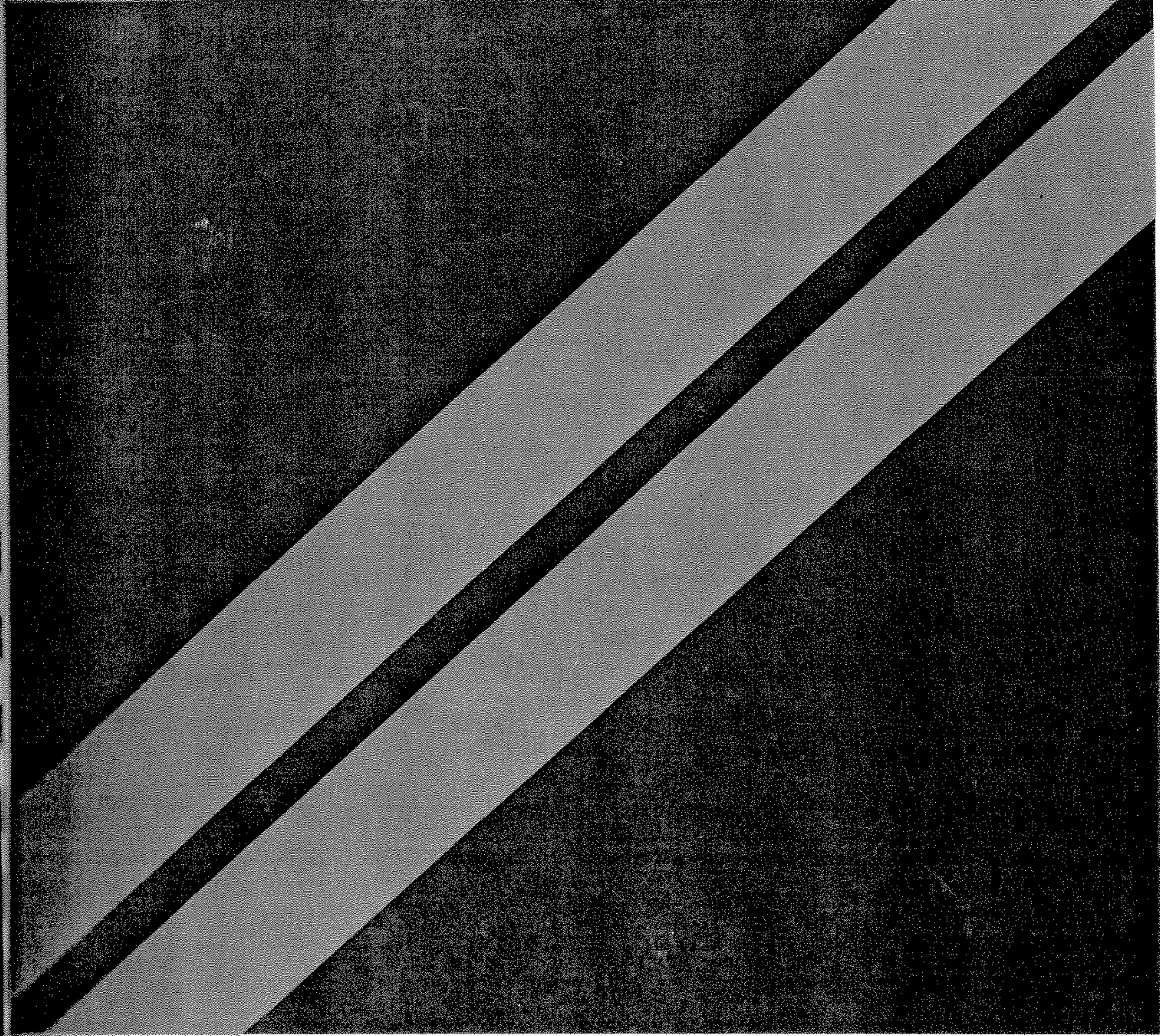
4. **MTAA recommends that repeal be made subject to the establishment under Part IIIA of the Trade Practices Act (1974) of an effective access regime (such as has been legislated for the telecommunications and other sectors) on the grounds that petroleum products are essential goods and the petroleum infrastructure represents an essential facility.**

1.6

Motor Trades Association of Australia

SUBMISSION TO THE
AUSTRALIAN COMPETITION AND CONSUMER COMMISSION
INQUIRY INTO THE PETROLEUM DECLARATION

25 MARCH 1997



3.7 *If some form of prices oversight is appropriate, which market participants should be subject to prices oversight and what form of oversight (surveillance or monitoring) should be applied in each case? Which institution should conduct prices oversight? [The costs (including administration and compliance) and benefits of each option should be commented upon, including the possibility of lower or higher prices in various markets.]*

The MTAA position is that all stages of the market should be monitored by the ACCC. This would include transactions that fall within that part of the market comprising oil company credit cards. This should guard against the possibility of collusion in price fixing and the costs should be negligible in relation to the value and pervasiveness of the industry.

3.8 *If surveillance (involving declaration and price notification under the Prices Surveillance Act) is advocated, is cost-based or price-based surveillance appropriate? Is price capping at the "terminal gate" stage of supply feasible?*

MTAA does not advocate price surveillance and therefore has no comment to offer, other than to observe that "price capping at the terminal gate" is a contradiction in terms.

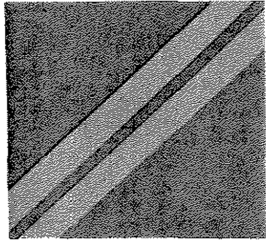
CONCLUSION

MTAA does not believe that in the petroleum industry vertical integration is benign or virtuous and it does not believe that vertical integration results in a more competitive wholesale or retail market. MTAA believes that the prime, and possibly sole, motivation for increased vertical integration (including the exclusive supply arrangements) within the petroleum industry is the securing, for the company concerned, of increased market share. By this means more of the available share of the pool of profits may be captured by the company so behaving, recognising that demand is near enough to inelastic, the product is undifferentiateable and growth of the market is negligible and economically insignificant, or alternatively such behaviour must be engaged in by all companies to maintain the status quo; at a minimum.

MTAA believes that the removal of price surveillance and the introduction of price monitoring, access to terminals and the introduction of a more transparent wholesale pricing system would result in a more efficient market for petroleum products.

MTAA
NATIONAL SECRETARIAT
Canberra

25 March 1996



Motor Trades Association of Australia

1.7

RESPONSE BY THE

MOTOR TRADES ASSOCIATION OF AUSTRALIA

TO THE

DRAFT REPORT OF THE INDUSTRY COMMISSION INQUIRY INTO PETROLEUM

MAY 1994

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7. CONCLUSION

It should be evident that MTAA regards the Draft Report as very much a curate's egg. There are some conclusions and recommendations that we support, either without reservation or in some modified form. Others we reject as inconsistent with the interests of our members and/or the public interest.

Our greatest concern is that the Commission, in order to establish its proposition that there would be a healthy competitive market but for government intervention has so readily accepted unsubstantiated assertions made by oil companies. (e.g. *"The oil majors, however, state that they do not practice transfer pricing between refineries and affiliated crude oil suppliers"*[54]. We note that there is no further discussion of this possibility, no reliance on contemporary taxation literature or even evidence of the Australian Taxation Office view on this possibility.

Petrol retailers are like most small business people – they have no enthusiasm or wish for government intervention in their affairs. At the same time, too many bear the scars of callous and arbitrary treatment to put their trust in their very unequal partners, the oil majors. The Collins' Royal Commission well documented the attitude of the oil majors to their unprotected retailers: generally he found that relations could be seen as paternal but only in the sense of involving widespread child abuse. It is the inequality of such relationships which makes the retailers so apprehensive of returning to the pre–1980 situation; which is thought apparently to be one of glorious days of free markets, uninhibited by regulation, involvement or intervention. The prospect of their living, their capital and their future, becoming dependent upon a voluntary code of practice, OilCode, and thus that they must rely upon the goodwill of the major oil companies fills them with understandable unease.

Our members know that without government to provide some balance, the retail petroleum market will once again be self–interestedly regulated by the major oil companies. They have a better sense of history than the Commission proposes. Solus trading was introduced on a brutal, take it or leave it (the industry), basis. Possibly not even the Industry Commission could believe that the extraordinary proliferation of sites that followed was in anyone's interest in the medium or long term. There is nothing in the Draft Report to indicate why the Commission believes that if governments were to ignore or reject the condition of the industry similar bouts of madness would not occur; driven by imperatives beyond the ken of the victims.

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54 Petroleum Products, Draft Report of the Industry Commission Inquiry into Petroleum Products, March 1994 p 97

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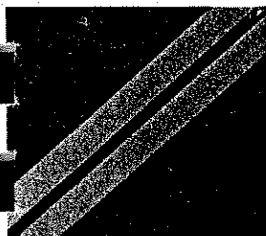

Motor Trades Association of Australia

SUPPLEMENTARY SUBMISSION TO THE INDUSTRY COMMISSION INQUIRY INTO THE PETROLEUM INDUSTRY - JANUARY 1994

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Site Remediation

Another important issue is that of site remediation. MTAA expects oil companies should fund site remediation, should it be required. Achieving a satisfactory level of remediation will undoubtedly require consultation between the PMRA and relevant environmental bodies such as the Commonwealth Environment Protection Authority (CEPA).

Divorcement and Divestment

In the context of the petroleum industry, divorcement is the exclusion of a refiner/oil company from direct operation of service stations through direct management or commission agency arrangements. By denying the oil companies this final link in the chain of vertical integration MTAA believes it would remove the opportunity of suppliers to set retail prices for motor fuels. Initially this would increase competition at the retail level. However, at a second tier it is likely to increase competition at the wholesale level leading to even further competition at the retail level. Divestment take this process one step further, in that it constitutes the denial of ownership by refiner/oil companies of service station sites. A policy of divestment would have all the advantages of divorcement, and in addition it is likely to see the end of 'solus' trading and 'tied-retail networks. The end result of this would be that service station proprietors could purchase their fuel from the cheapest source which would undoubtedly lead to increased competition and possibly the resurrection of multiple brand sites.

It is interesting to note that Queensland in 1957 passed *The Motor Spirits Distribution Act* which "sought to prevent the further growth of tied sole brand service stations on the grounds that this represented attempted monopolization." It was argued at the time that solus marketing arrangements led to over-capitalisation and a waste of resources which had to be recouped from the consumer.[25]

If the Industry Commission were to recommend and the Government were to endorse the need for divorcement and divestment, it would be appropriate for the implementation of these policies to be supervised by a PMRA.

Achievement of the objectives of the voluntary codes of practice.

MTAA believes a PMRA would be able to actively support the achievement of the objectives of the voluntary codes which have been developed co-operatively in the petroleum industry.

CONCLUSION

In our original submission to the Commission we argued for the retention of the Petroleum Retail Marketing Sites (PRMS) Act (1980) and the Petroleum Retail Marketing Franchise (PRMF) Act (1980).

Following consideration of submissions put forward by other industry parties and after a review of the transcripts of evidence given by others in the industry, it is MTAA's opinion that no one party has yet put forward a convincing argument for the repeal of either the PRMS or PRMF Act. This is despite the fact that all of the oil companies have expressed to the Commission their desire to see an end to the Sites Act, and that four of the five companies have indicated that they wish to have the Franchise Act repealed.

[25] See Appendix 2.

Indeed AIP was forced to admit during questioning that the PRMS Act was not a constraint on rationalisation and that the PRMF Act was "not quite" a constraint on the oil companies. Ampol also admitted to the Commission that the PRMF Act was of less concern now than in the past. The Commission also heard evidence from the Department of Industry, Technology and Regional Development, the administrator of the Acts, to the effect that if the PRMS Act was such a problem to the oil companies, the question needed to be asked why were they not taking full advantage of their quota limits at all times. Currently only about 300 of the permitted 426 sites are operated directly by the companies. Indeed the Commission has also heard that the PRMS Act has in the past (and there is no evidence to suggest that it will not be so in the future) been administered in a flexible manner where circumstances necessitate it; such as for example the Ampol take-over of Solo.

Indeed, Dr Parker commented on the Caltex evidence that

> *"... you seem to be saying that it is the drive for throughput and not the Franchise Act or the Sites Act that is determining the rate of rationalisation."*[26]

MTAA argued in its original submission that the drive for market share is one of the, if not the main, determinants of oil company retailing and marketing policy. Evidence presented to the Commission, to date, would appear to support our argument on that point.

It may also have been perceived by the Commission that no convincing argument has been put forward by the retail sector for the retention of the Acts. Indeed, we merely argued in our original submission for the two Acts to be retained and did not present any evidence for a strengthening of the legislation (a situation which MTAA prefers). We have not done that because at the time of the introduction of the 1985 amendments to the Act the then Minister announced that further changes to the Acts would not be contemplated unless they had the support of all concerned. It was also agreed at the inception of OilCode that

> *"... because of its emphasis on communication and conciliation, the code should over time provide the basis for reaching consensus within the industry on desirable efficiency initiatives, including the need to propose changes to the marketing legislation."*[27]

However, it appears that in calling for the repeal of both of the Acts, the oil companies have moved away from the position of consensus, as outlined above. Because of that MTAA has presented the additional arguments in this supplementary submission which call for a strengthening of the current legislation in relation to the activities of oil companies in the retail market.

While arguments have been presented to the Commission for the removal of the PRMF Act because of the existence of OilCode, its supplementary codes and the Franchising Code of Practice, it is stated in the OilCode Administration rules (rules which have been agreed to by all signatories to OilCode) that

> *"... the legal rights conferred by those Acts may still be exercised through litigation at the discretion of either party. Rather, the code will operate "in front of' the Petroleum Retail Marketing Franchise Act"*[28]

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[26] Industry Commission Public Hearings, 26 July 1993
[27] Foreword to Background Paper on OilCode, October 1993
[28] Foreword to Background Paper on OilCode, October 1993

At no time prior to the announcement of the Industry Commission Inquiry have the oil companies indicated, through OilCode, that they wished to change the Act, let alone repeal it.

In addition, service station franchisees do not share the view (that oil companies tend to have of themselves) as benign, good citizens. The behaviour of the oil companies prior to the enactment of the two Acts in 1980 and more recent predatory pricing at company operated sites has suggested to franchisees that rather than any lessening of regulation of the oil companies, the Government needs to look at further, and more stringent, control of the activities of the oil companies in the retail market.

The successful efforts of oil companies to circumvent the PRMS Act through the operation of equity sites and secondary retail chains and the role that those sites often play in price discounting wars suggest that there is a need for tighter controls on the major oil companies.

There have in the past been calls by retailers for the removal of oil companies from the retail sector of the market. These calls have been for both the removal of the oil companies from operating retail outlets (divorcement) and also for the prohibition of the companies from owning petroleum retail property (divestment).

It can be argued that complete deregulation of a market will not necessarily be better for competition in that market. Full scale deregulation of the petroleum market may simply mean that rationalisation occurs through predatory pricing forcing a number of the "weaker" retailers out of the market - backwards and with no compensation. This has been a situation which MTAA and its Member bodies, on behalf of petroleum retailers, have been striving to avoid for many years now.

We are of the view that rationalisation of the market must occur, however, as we suggested to the Commission in our original submission this must occur in an organised way, with those retailers leaving the market doing so other than through financial ruin.

As mentioned elsewhere is this submission, it is possible that without regulation governing the activities of the oil companies in the retail sector of the market, the companies may over time strengthen their presence in the retail sector to such an extent that they are able to act as a cartel and in fact increase (rather than decrease) the retail price of petrol.

In terms of the argument in favour of total divorcement (the PRMS Act imposes partial divorcement on the companies today) in the retail sector, the benefit of such a move is that the immediate control over retail prices by the oil companies is removed. No longer could they determine the retail prices to be set at company operated sites, because there would not be any, or the retail prices to be charged by franchisees because they would have no control over the margins charged by franchisees.

When a situation of excess supply arose, the oil company would be forced to reduce the wholesale price to its franchised dealers, not offer margin support, or rent rebates as currently happens. The setting of the retail price would then be entirely up to the retailer.

In situations where a retailer chose to take beyond normal profits following a drop in the wholesale price, other competing dealers/franchisees would be able to take advantage of the distortion in the market to increase their throughput and hence profits by selling at a price which undercut those retailers earning beyond normal profits. Therefore competitive market forces would dictate that such market distortions were short-lived and that consumers were not disadvantaged.

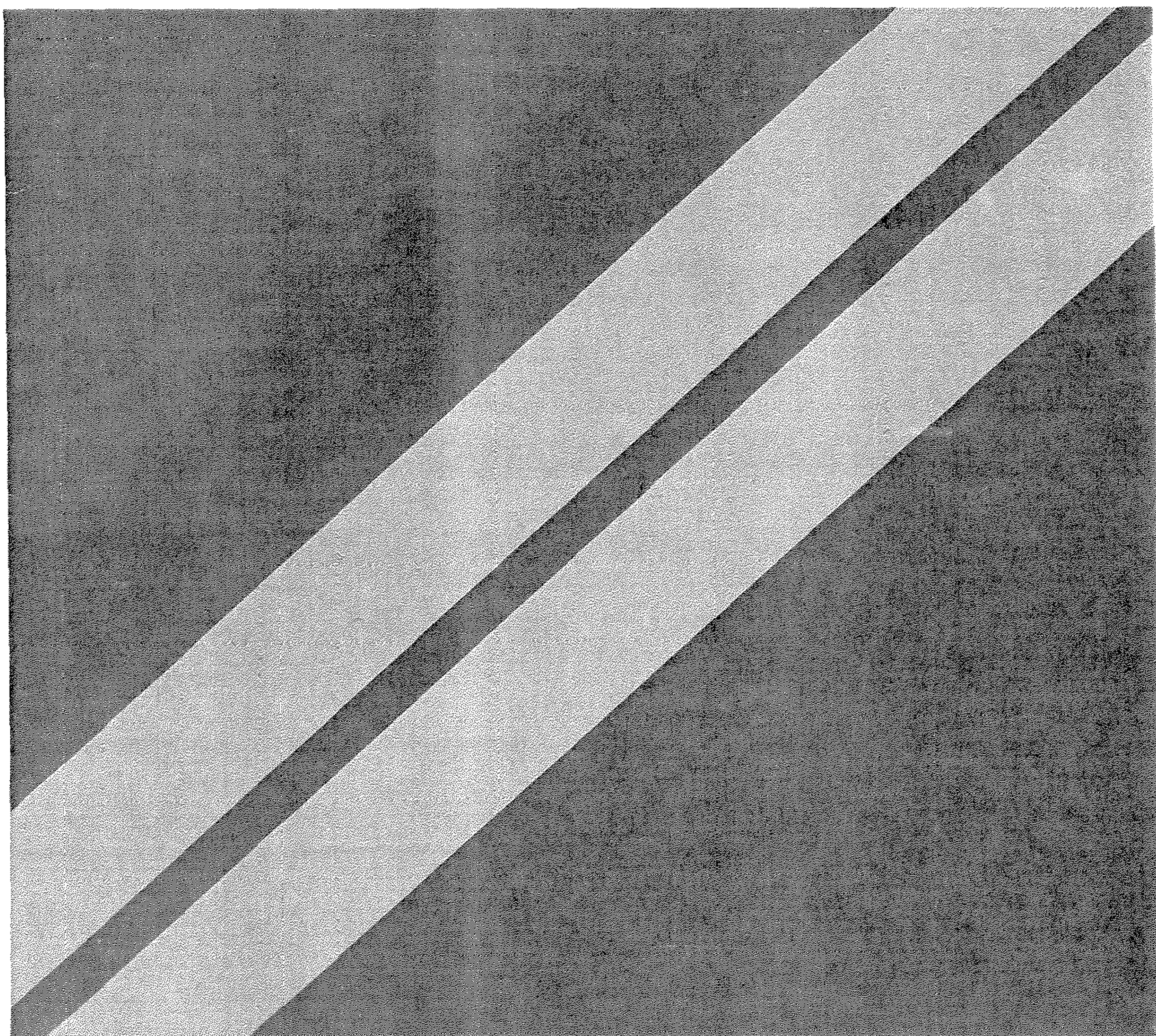
In terms of the PRMS Act and our argument for total divorcement of the oil companies from the retail market, the question has been raised as to why the oil companies are not currently taking advantage of their full quota entitlements under the Sites Act.
The answer to this would appear to be that current market circumstances dictate that it is more profitable for the major oil companies to increase their market share through their involvement in, and operation of, secondary retail chains and through their control over franchisee retail margins (by offering margin support), and hence the volume of fuel being pumped by franchisees, than it is to operate sites directly.
However, that is not to say that circumstances will not change in the future - when it may become more advantageous for the companies to operate to the limit of the quota - or in its absence to significantly increase the number of outlets directly operated.
The only guaranteed way to avoid such circumstances occurring in the future is to prohibit the oil companies from operating in the retail market - at any level.

MTAA
National Secretariat
Canberra
4 January 1994

1.9

Motor Trades Association of Australia

SUBMISSION TO THE INDUSTRY COMMISSION INQUIRY INTO THE PETROLEUM INDUSTRY – JULY 1993



CHAPTER 16

CONCLUSION

The propositions put by the MTAA in this submission are basically simple. We believe that there are two major impediments to the efficiency of petrol retailing.

The first is that there are too many retailing sites representing a significant misallocation and under-utilisation of resources. This situation is the "overhang" of a major market distortion caused by oil company pursuit of market share in the past. The situation will not be corrected quickly as most petrol retailers cannot walk away from their businesses and, in any case, if they did there is no guarantee that the site will not immediately be taken over by a new operator with access to cheap supplies of petrol.

That raises the second impediment: discriminatory pricing by the oil companies. The biggest group of customers, the franchised dealers, always pay the highest price. Cheaper petrol is always available to other customers who sometimes can sell at a price lower than the franchisees' buying price. All resellers should be able to access the same price at the terminal gate and all loadings on the price beyond that point should be transparent and agreed.

Removal of these impediments, together with some additional reforms we have suggested, would lead to a healthier, more financially viable retail sector and lower prices and improved service for the consumer.

SUMMARY OF RECOMMENDATIONS

Set out in this section are the recommendations which are to be found in the text of MTAA's Submission. They have been numbered sequentially in the order in which they appear in that text for ease of reference.

1. The Petroleum Retail Marketing Franchise Act 1980 be retained as a central element of any new regime for the supervision and monitoring of the petroleum industry.

2. The Petroleum Retail Marketing Sites Act 1980 should remain intact, but companies' allocated quotas should be reviewed at least annually in consultation with MTAA and with full regard for the market of the day.

3. Large independent retail chains and secondary marketers which operate sites as commission agencies should fall within the ambit of the Sites Act.

4. No action should be taken to amend the Trade Practices Act to separately address petroleum industry problems but present provisions, especially sections 45D and E should be enforced against anti-competitive arrangements long operated in the industry.

5. No authority should be provided or allowed for the Trade Practices Commission (TPC) to arbitrarily declare that petroleum prices are high or low; as distinct from the quality of competition over petrol.

6. The TPC must address the issue of price discrimination, and issue a Price Discrimination Guideline as soon as possible.

7. The PSA's role should be limited to that of monitoring wholesale prices. On no account should the PSA be permitted to interfere in or seek to affect the levels of retail prices.

8. Oil companies should move to a more transparent form of wholesale competition and pricing which at a minimum should be our proposed terminal gate pricing arrangement.

9. All parties to the industry should recommit themselves to working within the code of practice known as OilCode and acknowledge that the existence of OilCode is a great advance in relations in the oil industry.

10. There should be established a permanent Oil Industry Forum, in which industry parties could discuss matters of mutual interest and matters of concern to specific parties without fear of breach of the Trade Practices Act 1974.

11. The Oil Industry Forum should continue to be convened and Chaired by an officer of the Department of Industry, Technology and Regional Development and it should meet on a regular basis.

12. The issue of discriminatory pricing and the 18 quarantined recommendations of the Government Special Caucus Committee of Inquiry into Aspects of the Australian Petroleum Industry Report should be permitted to be addressed by OilCode.

13. The Industry Commission Inquiry should examine the range of franchise agreements offered and consider whether they are contractual documents designed to produce competitive outcomes in the market place or something else.

14. That the flawed concept of rack pricing presently operated by oil companies should be abandoned and that the companies should introduce a transparent terminal gate pricing system.

15. The PSA should assume a price monitoring role rather than a price setting role.

16. The current petroleum products freight differential system should be abandoned; the related Ministerial Directions removed and the PSA should only in the result require oil companies to notify it of the costs of freight.

17. The practice of discriminatory pricing should be outlawed or, at the very least, that the TPC should again issue its previously withdrawn price discrimination guideline.

18. The Laidely Agreement between the Transport Workers Union and the Australian Petroleum Agents and Distributors Association should be declared anti-competitive and therefore voided; and failing this that the TPC should prosecute to the full extent of the law.

19. The Petroleum Products Freight Subsidy Scheme (PPFSS) should be abolished.

20. The principle of 'users pays' in relation to government imposts should apply to the petroleum industry and more generally to the retail motor trades sector. Taxation revenue should be collected from the consumption side of the industry, rather than the production, distribution, marketing and retailing sides. An alternative arrangement might be to levy higher taxes on other goods or services, or perhaps to introduce a new tax.

21. The consumer, or at least the motorist, should pay for any costs associated with the introduction or application of higher environmental standards.

22. There should be no attempts by Government at any level to raise current impost levels for reasons other than those canvassed here.

23. The practice of automatic excise indexation should be abandoned as it is clearly inflationary and cyclically reinforcing.

24. The current requirement for pre-payment of fuel purchases and the associated excise by service stations both of which are collected at the same time by oil companies should be ended.

25. There be immediately introduced a process for national collection, collation and dissemination of statistics relating to the petroleum industry, including the retail sector, such as might inform and guide economic policy making.

26. That the Inquiry should find that the retail petroleum sector is characterised by over-capitalisation in, and under-utilisation of, infrastructure because of low average volume throughput.

27. The Inquiry should find that the following steps to reform the petroleum industry are essential:

   * reduction of site numbers;

   * increased price competition at the wholesale level;

   * uniform application of environmental standards across all sites irrespective of type of operation or ownership;

   * the ending of price discrimination against certain classes of buyers;

   * generally, reduction of Government intervention and regulation; and

   * release of the surplus capital locked within the retail petroleum industry.

28. Establishment and operation of a Petroleum Industry Reform Authority, at least for a period of time, to supervise these changes and report upon them to the Commonwealth Parliament.

29. The following problems be addressed to improve the efficiency of the retail petroleum sector:

   * lack of uniform site audit standards for service station inventory. This results in unsatisfactory controls of service station finances, thereby impeding competition as well as rendering indeterminate the levels of compliance with environmental standards;

   * unsatisfactory occupational health and safety practices such as having to visually inspect open road tanker hatches where fuel is delivered COD;

   * service stations being forced by their supplying oil company to accept responsibility for actual and apparent losses occasioned by the delivery, storage and other practices of their equipment owners, again usually their supplying oil company; and

   * the keenness of the NSC for additional regulation and therefore the imposition of costs upon the industry without sufficient regard to the preponderance of costs over any perceived benefits.

30. These problems be addressed by the implementation of a ***Voluntary Code of Practice - Fuel Stock Management*** (Such a code which exists in draft form at present, is seen by MTAA as the beginning of a consensus approach which may allow all of the concerns expressed in this chapter to be overcome. MTAA has not yet provided comment on its contents.)

    The code mechanism is capable of providing, after some modification of the draft:

    * centralised administration of inventory, auditing and overall stock management;
    * a framework for the equitable introduction of consignment fuel;
    * acceptable standards of industry work practice;
    * increased competition and industry efficiencies;
    * savings to industry and government through self regulation; and
    * resolution of the unacceptable operating loss concept (currently set by oil companies at 0.5%) through the setting of a more realistic level in line with current engineering measurement tolerances and a more comprehensive stock management system. This would be expected to be at a level of 0.1% as a maximum operating loss to be borne by dealers operating in compliance with the Code.

31. The Commonwealth Government should adopt policies that will see a gradual reduction in the average age of the car fleet. Policies to achieve this should include consideration of the current indirect taxation arrangements, more stringent pollution testing during registration inspections and the sponsoring of research into and development of improved emission control systems.

32. The Commonwealth Government should not increase the rates of Wholesale Sales Tax on new vehicle purchases.

33. The consumer, or at least the motorist, should pay for any costs associated with more stringent environmental standards.

34. In conjunction with the introduction of economic instruments which oblige the consumer or motorist to pay for higher environmental standards, Government should consider the simultaneous introduction of a system of tradeable permits as part of proposals to address the urgent problem of site remediation and contamination within Australia. These should be the subject of further research and precise costing.

35. Measures to increase recycling, waste minimisation and the disposal of waste oil should be introduced immediately in such a way that the true cost of disposal is recognised.

36. The Inquiry should note that throughout the developed world the same problems that are facing the petroleum sector in Australia, including environmental problems, are apparent.

37. The Inquiry should note that in most industrial countries Governments of all political character have found it essential for national economic purposes to intervene in the

petroleum industry to ensure outcomes consistent with the needs of a modern productive and efficient economy.

38. The Inquiry should note the details of the operation of typical Australian service stations and take these into account in any proposals it may propose for the restructuring the petroleum sector.

39. The Inquiry should note the existence of certain localised features of the petroleum sector and take these features into account should it develop any proposals to restructure the petroleum sector.

1.10

SUBMISSION TO

THE TRADE PRACTICES COMMIS

INQUIRY INTO THE EFFECT OF MARKET

AND

DISTRIBUTION PRACTICES IN THE PETROL

INDUSTRY ON THE PRICE OF PETRO

BY

THE AUSTRALIAN SERVICE STATION ASSOC

SUMMARY

It is irrefutable that, had the Trade Practices Commission succeeded in ending the exclusive supply arrangements forced on "tied" lessee dealers by the introduction of the "fifty percent" ruling in 1976, then the overwhelming need for wholesale price reform would not be so acute.

In the light, however, of the Commission's frank admission that exclusivity of supply has been successfully maintained by the oil companies in terms of eighty percent of the retail network, the only viable solution would be the introduction of some form of price reform which would provide all retailers with the opportunity of purchasing their supplies in a competitive environment.

Our Association believes that the best alternative under the present oil company equity arrangement is lowest current wholesale pricing (rack pricing).

The only other alternative that would accomplish non-discrimination in petrol marketing, apart possibly from total divorcement of oil companies from the retail sector, would be a total divestment of sites by oil companies so that each proprietor would be able to negotiate the best possible buying price for his products free of any encumbrances.

On the assumption that the latter option is unlikely, and given that the current attitude of the Federal Government is firmly against full "divorcement", the only recourse is to limited price regulation so that the eighty percent of the retail network currently unfairly discriminated against and effectively controlled by oil company price support schemes will all be able to buy their supplies at the best available price and market in a truly competitive manner.

As far as the existing petroleum retail marketing legislation is concerned there is no doubt that it has been partly successful in preventing oil company dominance in the retail sector by guaranteeing some degree of security of tenure to dealers, redressing the imbalance in bargaining position (particularly in respect of rental increases) and limiting the number of company operated sites. Indeed there is ample evidence at the moment, with the end of the first nine year security of tenure period approaching, that oil companies are exerting unreasonable pressure on dealers to conform to their demands on a range of issues with implicit threats of non-renewal for any non-compliance.

It is not hard to imagine, therefore the situation that would exist without current legislation.

Having said that, any benefits that the legislation might have provided, have been negated by lessees' inability to purchase competitively. This is highlighted by the widespread lack of profitability of lessees, many of whom face bankruptcy through no fault of their own.

It is to be hoped, therefore, that with the benefit of hindsight, the Commission will be able to address the real issues so that, as the industry enters the second period of tenure afforded by the PRMFA, both lessor and lessee might benefit from a mutual relationship and be better able to pass on those benefits to the consumer.

ATTACHMENT 2

CoRE research
Competition & Regulatory Economics
MELBOURNE ~ AUSTRALIA

The Competitive and Welfare Implications of Shopper Docket Schemes in Petrol and Grocery Retailing

A Report on behalf of the Motor Trades Association of Australia

Professor Joshua Gans

The analysis here represents the views of CoRE Research Pty Ltd (ACN 096 869 760) and should not be construed as those of the MTAA.

16th August, 2004

Executive Summary

This report examines the competitive and social welfare implications of the shopper docket schemes entered into recently by Coles/Shell and Woolworths/Caltex. The schemes each allow consumers a 4 cent per litre discount on petrol if they redeem a recent docket for groceries of more than $30 spent at the allied supermarket chain.

While at first blush, these schemes appear to represent a favourable deal for consumers, current economic research suggests that there are some important reasons for concern:

- *Exclusivity*: while many consumers purchase both petrol and groceries, the schemes are between particular chains in each sector. This means that only those consumers who happen to shop at two allied chains will benefit from the discount. For the remainder, the discount is not available or alternatively, their behaviour will be distorted towards allied chains (perhaps incurring other costs such as travel and inconvenience to achieve this).

- *Headline price changes*: while a discount is offered, headline prices are likely to adjust to compensate. A discount allows a competing chain to raise its headline prices without fear of loss of customers who shop at its ally. Given this, it is likely that, even in the short-run, headline prices of allied chains will rise. This will lead to some consumers who purchase from only one of them paying higher prices. Moreover, it will put increasing pressure on non-allied chains to either ally if possible or, in the alternative, scale down their operations (over the long-run).

- *On-going ramifications*: if the effects on consumer behaviour of these exclusive shopper docket schemes become large, then in the long-run, independents will be more likely to exit, competition will be reduced, and even consumers obtaining a discount may end up paying higher prices for groceries and petrol. In addition, as the alliances involve closer operations of convenience stores in petrol outlets, the competitive pressure from these stores on supermarket chains is likely to be reduced.

In the end, we may be left with a picture of a retail economy, where consumers must ally themselves with a group of retailers in each sector and where competition in each falls to its lowest common denominator. The great Australian duopoly may become a reality over many previously competitive retail sectors.

Given this worrisome assessment, it is my opinion that the ACCC too quickly lauded the apparent benefits of shopper docket arrangements without considering the potential competitive effects. In particular, the ACCC conducted no assessment of the exclusivity of the arrangements, the effect of the large installed base of the participants of the schemes in their respective sectors nor of the implications for pricing as conducted by independent firms. These features drive the potential competitive and social welfare concerns of shopper docket schemes. For this reason, the ACCC should revisit their authorisation – particularly of the exclusive nature of these schemes – as well as their third line forcing guidelines that give the impression that such schemes (even though potentially prohibited by the *Trade Practices Act*) would never raise a competition concern.

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1 Background

In the past year, both of the Australia's major supermarket chains (accounting for almost 80 percent of the market) have moved to form exclusive alliances with major petrol chains. The Coles/Shell and Woolworths/Caltex[1] have differing governance (one is a co-branding arrangement, the other is a joint venture) but each has a similar offering for the customer: buy $30 or more of groceries at a supermarket outlet and you can redeem the docket for a certain period of time for a 4 cent per litre discount at the petrol outlet. While these schemes are still rolling out, there is considerable anecdotal evidence that their utilisation has been significant and many analysts have attributed the sales and profit growth of Coles-Myer to the existence its arrangement with Shell.

What is interesting about these schemes is that there is no obvious customer-side or supply-side driver of the arrangement. There are no shared inputs (e.g., a shared distribution network) nor is there an obvious intrinsic relationship between customer demands for particular brands of petrol and groceries. To be sure, most households consume both petrol and groceries but that is a very different proposition from a relationship between one brand of each. As such, the usual efficiency arguments for product bundling do not appear to apply (see Gans and King, 2004c).

Nonetheless, in 2004, the Australian Competition and Consumer Commission (ACCC, 2004) cleared both shopper docket schemes. These schemes potentially raised issues of third line forcing and joint venture concerns. On each, however, the ACCC did not see any harm to the competitive process and saw potential consumer benefits. While acknowledging that the schemes could harm smaller independent retailers, the ACCC could not separate this from other pressures that were rationalising that sector.

It is in this context, that the Motor Trades Association of Australia have asked me to take a closer look at shopper dockets. Prior to this, Stephen King (now a member of the ACCC) and I conducted independent academic research on this topic (Gans and King, 2003,

[1] Coles includes the BiLo and Liquorland chains and Woolworths also includes the Safeway chain of supermarkets.

2004a, 2004b).[2] We examined shopper docket and related arrangements in a formal set of economic models and derived a number of results strongly indicating poor competitive and social outcomes that might arise from these schemes. The purpose of the present paper is to translate that work to understand the full competitive and welfare implications of shopper docket schemes and also evaluate whether the ACCC has properly assessed them in this regard.

The remainder of this paper proceeds as follows. In the next section, I examine why supermarket and petrol chains have chosen to introduce shopper docket schemes as opposed to straight discounts and non-exclusive arrangements. Section 3 then considers the short-run implications of the scheme for prices, competition and social welfare. Section 4 then turns to the long-run issues of entry, location choice and the evolution of both sectors. Section 5 then evaluates the ACCC's analysis and argues why it has erred in its quick clearance of the scheme. That section offers suggestions as to how to flag problematic shopper docket schemes over those that would not raise competitive concerns.

[2] While the research underlying the findings in the present paper reflect work with Stephen King, all views and conclusions here are strictly my own.

2 The Incentives to Introduce Shopper Dockets

To understand the competitive and welfare implications of shopper dockets, it is useful to begin by considering why a pair of firms would choose to introduce them in the first place. Specifically, (1) we must ask why a shopper docket scheme would be preferable to a straight discount? (2) why a shopper docket scheme should be an exclusive arrangement between specific chains rather than a broader arrangement? and (3) why supermarket chains should align themselves with petrol retail chains rather than alternative consumer arrangements?

2.1 Shopper Docket Schemes versus Straight Rebates

Recall that an offer to reduce petrol prices by 4 cents per litre in exchange for the presentation of the $30 or higher supermarket receipt is, at first glance, equivalent to offering to reduce a consumer's supermarket bill by roughly $2.[3] For a $30 purchase, this represents a discount of 6.67%. Of course, for larger supermarket bills the discount is more modest. For a $200 docket, the discount would be just 1%. Nonetheless, it is important to ask why giving this discount in the form of a discounted petrol price would be preferred to a straight rebate of $2 for every purchase of $30 or more?

There are, of course, several key differences between a straight rebate of $2 and a 4 cent per litre discount on petrol.

- *Differing preferences for petrol relative to groceries*: not all consumers have the same level of petrol purchases per dollar spent at the supermarket. Some consumers – those without cars – consume no petrol at all and would not benefit from this discount. Even amongst those with cars, some consumers have large supermarket bills relative to their petrol purchases. Finally, some consumers will purchase very high volumes of petrol relative to their supermarket bills (e.g., single individual

[3] Based on filling a 50 litre tank.

households who commute by car). Thus, a petrol discount will disproportionately attract 'large tank, small shopping cart' consumers relative to 'small tank, large cart' consumers.

- *Consumer gaming*: if a $2 rebate was offered for each purchase of $30 or more, some consumers may divide their grocery purchases so as to maximise the total discount. To be sure, this is also possible for a petrol discount. However, the shopper dockets usually expire a few weeks after they are issued. There is only so much petrol some consumers can purchase in that time and therefore, a limited incentive to divide the bill.

- *Higher transaction costs*: to obtain a docket, hold on to it, and then redeem it at a petrol station, involves some consumer costs relative to a simple rebate paid at the supermarket check-out.

- *Shared costs*: if the petrol discount brings new customers to the petrol retailer, that retailer is likely to want to share the costs of the discount with the supermarket. From the supermarket's perspective, this means that they receive all of the benefits of a discount on their own goods at only a fraction of the cost.

Of these four key differences, higher transaction costs are a clear disadvantage[4] to petrol discounts over direct rebates while shared costs are a clear advantage. While a petrol discount may have an advantage in reducing consumer gaming, this may be limited as one could imagine other ways of packaging a rebate to achieve a similar effect.[5] As such, it seems unlikely that this issue is a driving force behind the use of shopper docket schemes.

In terms of differing consumer preferences, the profitability of using a petrol discount depends upon each consumer types' price sensitivity with regard to the supermarket's products. In principle, a firm can improve profits by charging its customers who are less price sensitive a higher price than those who are more sensitive to price. This allows them to attract more sales from the latter without losing sales revenue from the former.

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[4] Of course, this disadvantage may become an advantage if some consumers forget to utilise their dockets at the petrol pump. Nonetheless, if this were the case, issuing a redeemable coupon of any kind – such as a mail-in rebate – would confer the same advantage.

[5] Indeed, if shopper dockets could be traded (as in principle they could be), there may be no assistance in diminishing consumer gaming.

Therefore, if the 'large tank, small cart' consumers were more price sensitive than the 'small tank, large cart' consumers, then a petrol discount – by reducing the grocery bill of the former type – can improve a supermarket's profits. On the other hand, if the reverse were true, then a straight rebate would be preferable to a petrol discount as a means of attracting customers.

I do not have at hand any evidence to suggest what the relative price sensitivities of different types of customers are. Moreover, it is not difficult to envisage situations in which either customer class could be more or less price sensitive than the other. Nonetheless, exploiting these differences could be a driving force of the current schemes.

2.2 Exclusive versus Non-Exclusive Arrangements

The above analysis of why to offer a petrol discount over some more direct rebate does not take into account a key feature of the two major petrol-grocery schemes introduced in Australia: that they are *exclusive* arrangements between a particular supermarket and petrol retail chains.

To see why this is an issue, contrast the Coles/Shell and Woolworths/Caltex arrangements with the shopper docket scheme introduced by Metcash – a group of independent supermarket outlets. In early 2004, IGA stores in Queensland offered to pay shoppers, who purchased $30 or more, 4 cents per litre for petrol purchased regardless of where that petrol was purchased. This stands in contrast to the other schemes where a discount applied only at specific petrol stations.

Apart from the operational detail that for IGA the discount was redeemed at the supermarket checkout rather than the petrol pump, the IGA scheme was dramatically non-exclusive. However, because it was a petrol discount on essentially the same terms as Coles/Shell and Woolworths/Caltex, it shared (almost) all of the advantages of providing this type of discount over a direct debate. The only advantage IGA did not appear to receive was any sharing of the discounted costs. Nonetheless, in exchange for this, they received a key advantage: consumers did not have to worry about where they bought their petrol.

To be sure, having a non-exclusive arrangement with a number of petrol chains is not a barrier to cost sharing. Coles or Woolworths could have made a similar offer to IGA – to redeem petrol dockets – subject to have coming to an agreement with particular petrol chains.

This may have entailed additional negotiation costs but it also might have been able to encompass all petrol chains and not simply those with a more limited market share. Moreover, petrol chains would have wanted to agree to share costs so as not be left out of a wider arrangement.

Given this, what are the advantages to exclusivity? It all comes down to whether more costs would be borne by the petrol chain in an exclusive versus a non-exclusive arrangement. A petrol chain is likely to share more costs associated with a shopper docket scheme if the net advantage of so doing is large. This net advantage is the number of additional sales it expects to receive less than sales it will lose by not being part of the scheme.

In a non-exclusive arrangement, the potential loss in sales might be large but the gain is relatively small as many chains have a similar shopper docket arrangement. An exclusive arrangement reverses this on one front with a larger movement in expected sales gain from being the only chain part of the scheme. On the other, however, the potential loss in sales from not being part of the scheme is probably similar to the loss that would be incurred when arrangements are non-exclusive.

Thus, exclusivity potentially allows the supermarket chain to reduce its burden of cost sharing of the discount scheme. So long as the petrol chain it has an arrangement with is ubiquitous, then the potential detriment from exclusivity – less convenience to customers – may not be large.

Indeed, exclusivity can work both ways. By tying in a ubiquitous petrol chain, this prevents other supermarket chains from reaching an agreement with it. Given this, the burden of cost sharing is likely to flow in favour of the supermarket or petrol chain that has the greatest market power in its respective market. For Australia, there is good reason to suppose that that favour lies with supermarkets.

Nonetheless, as I will explain later, exclusivity is likely to impose more costs and fewer advantages on consumers than non-exclusivity.

2.3 Why Petrol?

The final issue that is useful to consider is why a supermarket chain like Coles and Woolworths would choose to discount its products through an arrangement with petrol retailers rather than some other means?

It should be noted that there are other arrangements in place. There are credit card alliances and also loyalty points schemes. Flybuys offers a range of consumer benefits in travel and consumer products. Indeed, a few years ago it offered redemption vouchers at Shell (but no longer). In this respect, petrol is yet another alliance rather than something new.

What makes the current alliances more unique is: (a) its transparency and (b) its regularity. The transparency arises because it is very clear what discount will be payable for what level of purchases. Loyalty points tend to require the accumulation of a large number of purchases and it is difficult for an individual consumer to compute the precise discount they are receiving. In contrast, if you know your petrol consumption (in litres per week) you can work out how much you are saving each week from purchasing at a particular supermarket chain.

In addition, loyalty points generally allow redemptions fairly infrequently. The shopper dockets schemes are utilised weekly and so can be more easily built into the habits of consumers. For this reason, as petrol purchases match the regularity of grocery purchases, there is an advantage to linking the two.

However, petrol is also a natural candidate for an exclusive arrangement; allowing the supermarket to bear a smaller share of the discount. Petrol retailing involves the sale of a relatively homogeneous product – consumers care little about the brand of petrol they purchase – in a segment that is broadly competitive.

What this means is that petrol retailing margins are thin while consumer price sensitivity (at a brand level) is high. Thus, if one petrol chain can develop an advantage in attracting consumers – after all, once you have a docket you might as well use it – then those consumers' behaviour is likely to change dramatically. And consumers do care about petrol prices. It was only a few years ago that a 1.5 cent per litre tax was a major back-down issue for the Federal government. Think about what 4 cents per litre can do.

Moreover, when margins are thin because of competitive pressures, any change that makes one customer segment more loyal can tip the balance towards being able to raise prices. If a large number of your outlet's customers shop at one of the major supermarkets, then even if you discount 4 cents per litre to them, you are able to raise your pump price by a similar amount without losing too many sales. Even if the increase in margin is nominally slight (say 1 cent) that means a very high boost to outlet profitability.

For these reasons, petrol can be seen as a desired candidate for this type of alliance. However, there are other industries with similar characteristics – electricity and gas retailing, some aspects of telecommunications, and water – all of whom might be future sources of shopper docket schemes.

2.4 Summary

While there are possible explanations of the current arrangements in terms of exploiting heterogeneous customer preferences and sharing costs, this does not explain why the schemes were exclusive and involved a relationship between supermarket and petrol retailing.

On exclusivity, supermarket chains (who have a relatively large installed retailing base relative to particular petrol chains) potentially benefit from using their size to obtain the benefits of the discount without bearing as much of the costs. However, this private benefit is not a benefit to consumers of either groceries or petrol.

On the relationship with petrol, both share a habitual purchase nature. However, petrol demand is also highly inelastic at the product level even if it isn't at the brand level. This means that any discount is likely to flow to greater supermarket sales rather than greater consumption of petrol over the entire market. However, as the discount is effectively a rebate over the entire cart of grocery purchases, it is unclear that this will lead all but marginal customers to consume more groceries.

What this suggests is that the incentives to introduce such schemes are more strategic as opposed to some broader product or marketing innovation that would lead directly to consumer benefits. Strategic benefits may impact upon the nature of competition but do not necessarily translate into higher social efficiency. Nonetheless, this is admittedly a starting point and in Sections 3 and 4 a more complete competitive analysis is described.

3 The Short-Run Effects of Shopper Docket Schemes

The above analysis of the incentives to introduce shopper docket schemes is partial in the sense that it neither includes changes in the prices of groceries and petrol by participants to the scheme nor price reactions by others in the industries concerned. Gans and King (2004a) provide a complete analysis of the oligopolistic outcomes of shopper docket schemes. In this section and the next I translate those technical results, describe and explain the short and long-run effects of such schemes on prices, competition and social welfare.

3.1 Competition Without Shopper Dockets

The appropriate starting point for analysis is to consider what happens in the absence of shopper docket schemes. In this situation, we have numerous brands of both supermarkets and petrol. While most consumers tend to purchase groceries *and* petrol, the co-branded alliances that have formed between Coles/Shell and Woolworths/Caltex do not appear to be related to some intrinsic affinity on the part of consumers to purchase from those groups. That is, a current shopper at Woolworths (Coles) is no more likely to purchase petrol at Caltex (Shell) as opposed to any other petrol chain.[6]

Given this, competition and pricing is confined to particular markets. Supermarkets set their prices with regard to the prices set by other supermarkets. Petrol outlets set their prices with regard to the prices set by other petrol outlets. The pricing decisions of participants in the other market do not feature and do not influence competition or consumer behaviour.

What this means is that consumers will choose their brand in each market with regard to their preferences over those brands. For the

[6] The FlyBuys scheme which is available for purchases at both Coles and Shell does create some relationship in consumer preferences. Given the broader nature of that scheme I am going to assume throughout this analysis that this factor is not the main driver of individual choices. Of course, nothing in the analysis below hinges upon this assumption.

most part, this will be based on locational convenience. Consumers will tend to shop at supermarkets and purchase petrol from locations closest to them or on their commuting paths. For this reason, we would expect to see Coles and Woolworths consumers purchasing petrol from all chains roughly in proportion to their market shares. And we would expect to see Shell and Caltex consumers shopping at supermarkets according to their market shares.

Importantly, this state of affairs constitutes a good social advantage. From a social welfare perspective, for regular purchases, we want consumers to be making purchases at their most preferred locations and brands. This minimises the costs of 'shopping' and travel.

3.2 Unilateral Introduction of Shopper Dockets

Now consider what happens when one pair of supermarket and petrol chains introduces a shopper docket scheme. If the firms are independent – as they are with Coles and Shell (Woolworths/Caltex is murkier) – then what they do is set the petrol discount[7] and then choose on a weekly and sometimes daily basis, their prices for their respective products.

3.2.1 Pricing Impacts

However, while a supermarket would have previously set its prices only with regard to the prices of other supermarkets, now it realises that in the eyes of some consumers – those who purchase or intend to purchase from its allied petrol chain – its products are more valuable. Consequently, the supermarket can afford to raise its own prices without losing as many customers.

The same is true for the petrol chain offering the docket discount. It now knows that some of its customers will still come to it even if it charges up to 4 cents per litre more than rival chains. Thus, the headline price of petrol will rise as well.

What is interesting about this situation is that the prices set by the allied supermarket and petrol chains are now related to one another. The higher the price charged by the allied petrol chain, the lower the incentive of the supermarket chain to raise its prices. Similarly, the

[7] Of course, it could easily be a grocery discount but this is harder to measure given the multi-product nature of supermarkets.

higher the supermarket price, the lower the incentive of the allied petrol chain to raise its prices. However, as they are independent firms, each will, in its own pricing, neglect the effect of their actions on the other. For this reason, the allied supermarket and petrol chain will end up with a higher headline price than before – although after the discount – for those consumers who take advantage of it – prices will be lower.

Thus, from each firms' perspective, where before they sold unrelated products, the existence of the shopper docket scheme between them makes their products *complements*. Not surprisingly, this will mean that consumers treat them like complements as well and become more likely to buy from one when they buy from the other. But this also has an impact on the pricing decisions of other firms.

3.2.2 Competitive Impacts

What impact does this scheme and its resulting price changes have on the behaviour of other firms? In both supermarkets and petrol, those firms will find their market shares eroded as consumers who previously did not purchase from both chains, start to purchase from the allied chains. This means that, at the margin of competition, the discount is putting pricing pressure on other firms. As a result, they will reduce their prices to protect the erosion of their market share.

In the eventual equilibrium, the profits and headline prices of the allied petrol and supermarket chains will be higher while the prices and profits of non-allied chains will be lower. Indeed, according to the calculations in Gans and King (2004a), the margin earned by allied chains on their headline price could rise by 22 percent while those earned by non-allied chains could fall by 6 percent. In terms of market shares, perhaps 3 percent will shift in favour of the allied chains. Finally, on the profit side, taking into account the discount paid, the allied firm's profits may rise by 4 percent while those of non-allied firms may drop by 8 percent.[8]

3.2.3 How Large a Discount?

Of course, the above calculations include a consideration of the setting of the discount itself. Recall that this discount is set prior to

[8] It should be emphasised that these calculations, while based on an equilibrium model, should be considered very sparingly as the model itself has key assumptions regarding the number of competing chains as well as their differentiation in the eyes of consumers.

prices being determined by all firms. In effect, one would expect that the discount itself will be set far less frequently than the headline prices of petrol and groceries.

As the allied chains raise the discount, their market share rises but there is also a stronger pricing response from non-allied chains. For this reason while some discount is desirable, going too far (a) intensifies price competition and (b) reduces the overall revenue received by the allied chains from consumers who purchase both of their products. A greater discount increases that set of consumers but at the same time diminishes the allied chains' incentives to set the discount even higher. Thus, in equilibrium, only some portion of the petrol chain's average mark-up over the wholesale cost of petrol will be discounted. Indeed, if that mark-up is m, then according to Gans and King (2004a), the unilateral discount will be about $m/2$.

3.2.4 Welfare Impacts

What are the welfare impacts of all of this? On the winning side, consumers who previously purchased from both allied chains are better off. Even though the headline prices they pay are higher, with the discount, their overall expenditures are lower. Similarly, those consumers who previously purchased from neither of the allied chains are better off as the prices charged by non-allied chains fall.

Alongside them, the shareholders of the allied chains will be better off as their profits rise.

On the losing side are the non-allied firms whose profits and market shares diminish. More significantly, however, are the consumers who purchase from only one of the allied chains. Those consumers will not receive the benefit of the discount but will pay a higher headline price. Overall, Gans and King (2004a) demonstrate that their total expenditures on both groceries and petrol will be higher.

Finally, however, as noted earlier, the discount will mean that some consumers who previously purchased from only one (or neither) of the allied chains will be motivated by the discount to purchase from both of them. This is the source of the increase in the allied chain's market shares. However, with this comes a social cost. Absent any increase in grocery or petrol purchases, those consumers are no longer purchasing from their preferred mix of petrol and supermarket brands. Those will be the consumers who travel further to purchase petrol or groceries.

3.3 Competing Shopper Docket Schemes

The existence of one shopper docket alliance will create pressure for others to form. However, for these to be worthwhile – especially on an exclusive basis – the alliance must involve at least one participant who has a high market share in their respective market. This is because the consumers it will attract through the alliance will only be significant if at least one chain already has a substantial customer base. It is only by doing this that an additional alliance could counter the competitive effects of any first movers in this regard.

In Australia, this appears to mean that only two petrol-grocery alliances will be developed on an exclusive basis. While there are four large petrol retailing chains, there are only two major supermarket chains. The smaller chains have individual market shares far smaller than the large petrol retailers and so do not represent a natural fit: that is, a large petrol retailer who is not part of an alliance will do little to protect its market share by allying with a smaller supermarket chain. The customers it could attract through this would be limited and so it would be merely offering a discount to its own more loyal customers.

3.3.1 Effect on Prices

To see what will happen if there are two shopper docket alliances rather than one, note that for any given set of petrol discounts, this will allow allied chains to raise their headline prices and will lead to more consumers purchasing both products from one allied chain or the other rather than from one of them alone. The higher the discount offered, the more likely consumers will sort themselves into these two classes.

From the perspective of the remaining non-aligned petrol and supermarket chains, the existence of two schemes rather than one will put further pressure on market shares, causing them to reduce their prices even further in order to compete. Their profitability will diminish further.

3.3.2 Effect on the Discount

Not surprisingly, the existence of two competing shopper docket schemes creates pressure on each to offer a higher petrol discount. Recall, however, that this will still lead each to raise its headline prices for petrol and groceries. In this respect, setting a higher petrol discount, allows an allied chain to soften price competition overall.

Gans and King (2004a) demonstrate that, in the extreme, all consumers may end up purchasing from one set or the other of allied chains. At this point, the discount is substantial, equal to the entire petrol margin, m. However, the overall price (including the discount) they pay for petrol and groceries ends up being exactly the same as it was before any shopper docket scheme was introduced. It may well be that the discounted price of petrol is lower than before (by about $m/2$) but this is made up for in higher grocery prices.

3.3.3 Welfare Implications

Of course, this extreme outcome is not necessarily something we would observe in the short-run. What will occur is an increasing disadvantage to consumers who purchase only a single product from any one allied chain (e.g., Coles customers who don't purchase from Shell, etc.) will face much higher prices than before. However, the existence of two schemes may well reduce the pricing benefit otherwise realised by some consumers when there was only one scheme.

In addition, the presence of two schemes will put further pressure on non-allied grocery and petrol chains in terms of market share and profits.

However, the main welfare cost will be a continued distortion of consumer shopping behaviour away from their most preferred product bundles. More travel time, more shopping time and even some change of consumption away from what those consumers would otherwise have preferred. All this for a highly ambiguous benefit in terms of price competition.

3.4 Summary

Shopper docket schemes will have an immediate impact on consumer behaviour and market shares and will, as a consequence, lead to welfare losses as consumer behaviour moves away from what would otherwise be the case. The pricing benefits will be mixed. Some consumers will gain while others will lose.

Importantly, however, pressure will be put on the profitability of non-allied firms. While in the short-run this is a problem for them, in the long-run, it becomes a problem for competition; something I turn to consider next.

4 The Long-Run Effects of Shopper Docket Schemes

While shopper docket schemes have immediate impacts on pricing and consumer behaviour, their longer-term impacts will involve potential changes in the structure of petrol and grocery retailing as well as habitual changes in consumer behaviour.

In this section, I outline some of the long-run decisions that will be impacted upon by shopper docket schemes if they persist. To be sure, given the myriad of factors that impact upon long-run decisions, this analysis is inherently more speculative. However, what it does suggest is that there are real long-term competitive implications of these schemes and that they cannot be simply dismissed by policy-makers and regulators.

4.1 Exit and Entry Decisions

Given the impacts upon the profitability of non-allied supermarket and petrol chains, the existence of shopper docket alliances will contribute to decisions by such chains to exit their respective industries. At the same time, it will make it more difficult for new entrants to build the necessary market share to cover the costs of entry. Because most areas include one or both of a Coles or Woolworths outlet, entry into either supermarkets or petrol retailing will be more difficult.

What this means is that most new outlets will tend to be associated with one alliance or the other. Moreover, there will be some upstream impacts. Shell and Caltex are vertically integrated into petrol refining and beyond. As is often the case, internal trade within a vertically integrated organisation involves more favourable terms than external trade. Thus, as BP and Mobil lose market share, their upstream entities will have to rely increasingly on external trade. Given the existence of imports, this will increase pressures to rationalise those upstream operations. It will also make it more difficult for independent terminals that compete with such refineries to continue and also expand capacity. As the total supply of petrol in and into Australia is a key determinant of downstream petrol prices, this type of rationalisation is a concern. This is especially so given that it may

be driven by the exclusivity of shopper docket arrangements and the relatively higher concentration of Coles and Woolworths in the supermarket industry.[9]

4.2 The Petrol Discount

The ACCC (2004) argued that independent petrol retailing was subject to continual rationalisation even without shopper docket arrangements. My view is that such arrangements will accelerate such rationalisation and exit. Importantly, regardless of how it occurs, on-going movements towards branded chains in groceries and retailing will have an impact on the petrol discount itself.

As I noted earlier, the petrol discount that is part of shopper docket alliances, is limited by the fact that allied chains are able to command a higher headline price and indeed secure that price from some sets of consumers. Those consumers are more likely to be present where non-allied alternatives exist. As those independent alternatives are increasingly marginalised, then the allied chains themselves would be more likely to compete head-on in any given location.

The allied chains will be able to move to soften that head to head competition by increasing the petrol discount and reducing their own incentives to compete on price. Thus, the petrol discount will rise but at the same time, the rise in petrol and grocery prices will outweigh this. So far from a fear being that, following rationalisation, the discounts would go away. The explicit discount will likely become higher but overall price paid (including the discount) will become higher itself.

The end result of this will be closer to the extreme outcome forecast in Gans and King (2004a) whereby most consumers make their grocery and petrol purchases from one allied chain or the other with some consumers going to great lengths to avoid paying significantly higher headline prices. Again, this is where significant social cost from such schemes could be realised.

[9] Note that it is unlikely that the schemes will ever be clawed back even if there is substantial exit. This is because the presence of the schemes acts as an entry barrier – requiring an alliance in both grocery and petrol retailing. In any case, Gans and King (2004a) demonstrate the equilibrium incentives to have such exclusive shopper docket schemes even where potential exit and entry is not a consideration.

4.3 Location Decisions

It might be argued that over the long-term, allied petrol and supermarket outlets may locate closer together. As the ACCC (2004) noted, many supermarkets and petrol stations used to be on the same premises and in the UK, this is becoming an increasingly popular practice. That said, in each of those cases, the outlets were also co-owned providing a markedly differing set of incentives than the current shopper docket schemes.

Upon closer examination, the shopper docket schemes, if anything, work against than towards co-location. Recall that part of the scheme's profitability comes from being able to charge higher prices to those customers who do not take advantage of the petrol discount. By co-locating, the petrol and supermarket chain reduces their revenues from this source, turning the shopper docket into a straight discount to many customers. Thus, even if in the absence of such schemes, co-location may have been a trend, the existence of the schemes would likely work against rather than towards convergence on this front.

4.4 Convenience Stores

Given this, it is instructive to consider the role of convenience stores that have begun to co-locate with petrol outlets in recent times. One thing that stands out is that even though the convenience stores located on allied petrol outlets have begun to be operated by the supermarket chains – and in the case of Coles Express – branded as such, the shopper docket schemes do not apply to them. Again this is confirmation of my hypothesis that such schemes will not foster co-location. But it also rules out a supply-side synergy from these schemes in terms of utilising a common distribution network. Put simply, a customer is better off spending $30 of groceries at Coles and driving to a Shell petrol station than going simply to that station and shopping at Coles Express.

Nonetheless, the increasing presence of convenience stores at petrol outlets appears to be a new source of competition for services traditionally covered by supermarket chains. While the alliances do not at present appear to cover this, it is unclear what the new developments represent in this regard. It is possible that, in part, the new branding of convenience stores at petrol outlets is itself a defensive reaction on the part of supermarket chains to a growing competitive threat. If so, then that threat and the level of future

competition may in some respects be diminished as a result of shopper docket alliances.

4.5 More Alliances to Come

While petrol represents a natural means of focusing supermarket shoppers, it is not the only industry that matches both habitual consumer purchases with a fundamental inelasticity of demand. Basic household services such as gas, electricity and water, share these characteristics. For this reason, Coles and Woolworths may find it desirable to form exclusive alliances with competing retailers in these sectors. The retailers themselves may see such exclusivity as attractive as customers could be motivated to incur once-off switching costs to switch in their favour. However, in this case, discounts may not be likely to be on-going as they are with petrol.

In addition, there is a strong possibility that other sectors where market power is present and purchases are regular – such as telecommunications, pay TV and internet services – may approach petrol chains for alliances similar to those struck with supermarket chains. It is not clear whether these alliances would be struck with Shell or Caltex or other retailers such as Mobil and BP. A company such as Telstra may be able to assist in consolidating the position of Shell or Caltex or assisting Mobil and BP in restoring theirs. In any case, there would be social costs associated with unwelcome distortions in consumer behaviour. However, further alliances with Shell or Caltex may harm competition in petrol retailing more than the alternatives.

4.6 Summary

Shopper docket alliances between petrol and grocery chains are still in their infancy. While there are intentions to employ them throughout Australia, this is taking some time. Nonetheless, in many respects the short-term impacts on market shares and profitability are being felt.

This section has outlined some long-run implications of these schemes. In a worst case, the market structure of grocery and petrol retailing may converge to the lowest common denominator: a duopolistic structure in each industry. This arises as failure to access such schemes deters entry and accelerates the departure of smaller chains and independent outlets. Moreover, there would be flow on effects upstream as downstream markets rationalise.

It is important to emphasise that this outcome would be to the long-term detriment of most consumers. Consumers would find themselves habitually aligned in their grocery/petrol shopping with one alliance or the other. This is likely to impose travel and preference 'costs' on a significant proportion of them. Finally, as a duopolistic structure emerges, it is not clear even discounted prices will be lower than prior to such alliances establishing themselves.

That said, this outcome may not arise. The shifts in market share may be temporary and consumer preferences for particular chains may be stronger than any incentive to the contrary given by shopper docket schemes. In this case, the schemes will be relatively short lived. The main danger for competition arises as those schemes persist and expand in both size of discount and breadth across Australia.

5 Where the ACCC Erred

The ACCC has evaluated the shopper docket schemes. In the late 1990s, the ACCC approved Woolworths' entry into petrol retailing with Petrol Plus; fully-owned outlets of the supermarket chain that offered petrol discounts in return for Woolworths shopping receipts. The ACCC saw this development as a significant boost for independent entry into petrol retailing.

In 2003, the ACCC evaluated the Coles/Shell scheme in the context of third line forcing notifications and the Woolworths/Caltex arrangements as a joint venture. Some of the criterion for evaluation differed because of the differing governance arrangements of the two schemes – Coles and Shell remained independent while Woolworths and Caltex operated the scheme through a joint venture in Australian Independent Retailers (AIR). Nonetheless, many of the issues considered by the ACCC were similar.

The third line forcing claim is instructive. This issue potentially arises whenever two independent firms offer pricing discounts, vouchers or other bundled arrangements. In evaluating this, the ACCC will have regard to both negative competitive effects as well as potential public benefits that may offset these.

The ACCC saw the main detriment of these schemes falling on independent retailers; something consistent with the analysis in Section 3 above. However, they did not regard this is a key concern as it was, in their view, the result of competitive pressure and that there was on-going rationalisation in the industry in any case. In addition, the ACCC concluded that any price rise that would occur in groceries as a result of the scheme would be limited by competition in that sector. This is, of course, in distinct contrast to the analysis in Section 3 (something I comment on below).

The ACCC approved the scheme ultimately because it saw two potential benefits. First, it argued that petrol prices for consumers would be lower for both Shell and Caltex but also others as they respond. Second, the ACCC saw the potential for an increase in non-price competition as other retailers responded with their own schemes to attract consumers.

In making these claims, the ACCC applied what is termed the 'future with and without' test. This requires looking at the proposed conduct and assessing its outcomes with what would otherwise occur. In so

doing, it looked at a world with and without shopper docket schemes. In this regard, given the analyses in Sections 3 and 4, I believe the ACCC has only partially considered the full impact on consumers. Moreover, I am not at all sure that the 'without' part of the test should be a counterfactual exercise in terms of a world without shopper dockets. As I have already noted above, shopper dockets can be introduced with or without exclusivity and by integrated and non-integrated firms. Consequently, had the ACCC compared the current exclusive arrangements with alternative non-exclusive arrangements that could have been put in place, it would likely have reached a different conclusion as to their desirability. In what follows, I explain each of these points in more detail.

5.1 Is it really a discount?

The ACCC treat the shopper docket scheme as if it is offering consumers a real discount. What this neglects, however, is that if headline prices of groceries or petrol change, the 'discount' may quickly evaporate (see Gans and King, 2003).

On one level, this issue was considered by the ACCC:

> It was contended by some interested parties that petrol discount schemes would mean some corresponding increase in the price of groceries. The ACCC is satisfied that competition the retail supply of groceries would constrain the ability of grocery retailers to do this. Consumers tend to be very conscious of price competition when shopping for petrol and groceries, and will shop around for the best deals. (ACCC, 2004, p.46)

Upon closer examination, the ACCC's conclusion is not valid. Consider a situation where grocery competition was fierce and consumers shopped for the best price. A savvy consumer who intended to purchase petrol at Shell, for example, would bear up to $2 more in supermarket checkout bills before switching away from Coles to another chain. If there were sufficient numbers of Shell customers around, then Coles could – especially in a competitive market – get away with charging a higher price.

The ACCC then go on: "The ACCC considers that any detriment arising in the petroleum markets as a result of the notified conduct will be limited." (p.46) But in this case, the homogeneity of petrol products makes adverse price changes more likely. A consumer with a shopper docket will go to a Shell or Caltex outlet (as the case may be) over another petrol outlet even if the pump price was up to 4 cents

higher at Shell or Caltex. If there are sufficient numbers of Coles and Woolworths customers, then Shell and Caltex outlets will be able to raise headline prices – despite competitive conditions – and not lose many sales. In such a low margin business, there is a clear incentive to do this.

To be sure, the precise price rises under the current schemes are difficult to pin down. However, a petrol discount makes price rises possible in both groceries and petrol despite any strong price competition that may or may not exist. To simply dismiss the possibility suggests a very cursory economic analysis. Moreover, the greater the petrol discount offered, the more likely headline prices will rise. Thus, there is considerable danger that further petrol 'discounting' could bring price rises that harm a sizeable segment of the consumer population.

In reaching this conclusion, it is important to contrast this outcome with a situation where, instead, petrol stations offered a discount if purchases were made at their own convenience stores. In this situation, when someone comes to purchase petrol, the outlet can boost competition from convenience stores in the overall grocery market. In this case, because the products are related from a consumer perspective (i.e., the co-location makes them convenient) encouraging that behaviour is the interests of the firms involved and in the interests of competition. However, as noted earlier, this type of relationship is not part of the current schemes.

In my opinion, it is not appropriate to lump shopper docket schemes in the same class as petrol-grocery co-location. The latter yields a real consumer benefit and is a product innovation while the former is merely a form of pricing without apparently the creation of any new consumer benefit.[10]

5.2 Exclusivity

As noted earlier, a distinguishing feature of the shopper docket schemes is their exclusivity. It is not necessary for such agreements to be exclusive if the goal is to merely link petrol discounts with grocery purchases. Metcash's offer demonstrates this.[11] However, in its

[10] See Chen (2004) for a discussion of market innovations and their social costs.

[11] The ACCC (2004, p.45) claims to have 40 other similar petrol-grocery schemes notified to it since 1996. It is not clear if any of these other arrangements are exclusive or not.

analysis, the ACCC makes no mention of this and draws no distinction between exclusive and non-exclusive arrangements.

This lack of distinction is a serious omission. The above concerns I have expressed about the welfare implications of these schemes are related wholly to exclusivity. The costly changes in consumer behaviour to take advantage of the schemes, the potential rise in headline prices, as well as the impact on non-allied chains in both markets all arise because of the exclusive nature of the arrangements. Had Coles or Woolworths followed the Metcash path in providing a link between petrol and groceries, there may have been some headline price changes but from a consumer perspective net prices would have fallen. Only those consumers who purchased groceries and did not drive might be potentially harmed. However, this type of distributional concern arises from other decisions as well, such as discounts on bread or nappies to attract shoppers.

In my opinion, it is critical for the ACCC to consider carefully the details of shopper docket arrangements before clearing them. It did not ask: what if these schemes were non-exclusive? It did not require the participants to be open to approaches by others for similar schemes, in the same way it might open up a telecommunications network for use by other firms. In its written decision, it has not raised the issue of exclusivity at all. Given that the potential detriments are much higher for exclusive schemes than non-exclusive ones, this is very problematic and also unfair to those innovative firms developing non-exclusive schemes.

To be sure, the main issues with regard to exclusivity also arise because of the high market shares – in terms of installed outlets – of Coles and Woolworths. The two issues go hand in hand. As noted earlier, an exclusivity arrangement is unlikely to be valuable or result in serious competitive harm, when undertaken by two firms, each of whom has limited market share or market power in their respective industries.

5.3 Integration Matters

The final matter the ACCC failed to consider at all was that in these types of schemes integration matters. The ACCC likened the shopper docket schemes in Australia to ones implemented in the United Kingdom by J Sainsbury, Safeway and Morrisons. It is my understanding that in each of these cases the supermarket operates the petrol retailer and they are commonly owned. In contrast,

although Woolworths and Caltex are operating a joint venture, prices in each of the schemes are set independently.

Gans and King (2004a) considered the integration case. An integrated firm has a more limited incentive to introduce a shopper docket scheme than a pair of non-integrated firms. Put simply, in the non-integrated case, the discount is an imperfect way of controlling the pricing decisions of petrol and grocery chains that are related by the shopper docket scheme. In contrast, this advantage is not present for the integrated case and so the petrol discount acts more like a straight rebate. As such, for an integrated firm it intensifies rather than reduces price competition. In the end, shopper dockets schemes by an integrated firm will result in a lower petrol discount, lower headline prices but a higher market share for the integrated firm than they would earn if they were implementing the same scheme as non-integrated firms.

As such, in this situation, integration that allows explicit price coordination between the petrol retailing and supermarket chain, creates fewer social costs than the same scheme implemented by non-integrated chains. However, the ACCC does not appear to distinguish – in an economic case – the degree of integration. Again, this is an omission that unfairly lumps pricing innovations within a single firm with those operating between independent firms.

5.4 Summary

The ACCC's analysis of shopper docket schemes is seriously incomplete. Specifically,

- The ACCC fail to consider the full extent of price changes that might occur as a result of shopper docket arrangements.
- The long-term implications of the scheme on entry and competition as a result of the exclusivity of those arrangements.
- The greater harm that potentially results from shopper docket schemes implemented by independent as opposed to integrated firms.

Nonetheless, there is a sense in which the ACCC's evaluation is consistent with its guidelines on third line forcing (ACCC, 1998). In those guidelines, the ACCC suggests that, unless there is a consumer-level transparency issue – that bundled discounts that are similar to

the shopper docket schemes would be unlikely have an anticompetitive concern.

That said, in the case of the shopper docket schemes here, the ACCC's arguments for offsetting public benefits are, at best, weak and, in my opinion, probably wrong and overly simplistic. As such, I am not convinced that they should have been given clearance. At a minimum, a more thorough investigation of the potential competitive concerns is needed as well other public detriments (e.g., increased travel time) that may result. Only by doing this might the ACCC identify undertakings that might be given by allied chains to minimise these adverse impacts.

However, there is also a sense in which the guidelines themselves may not be correct. The schemes here do have the potential to create anti-competitive harm. Indeed, I can think of no better example of the type of discounting conduct envisaged in the third line forcing provision of the *Trade Practices Act*, than the current petrol-grocery shopper docket schemes. Put simply, if those provisions weren't meant to capture this conduct – exclusive bundles of unrelated products by firms with some degree of market power – what conduct would be captured? At present, the ACCC appears to argue that only tying provisions,[12] whereby a consumer is forced to purchase from both firms, would be third line forcing against the public interest. This approach appears to me to significantly weaken the intended force of our current trade practices legislation.

[12] See also Tirole (2004).

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[13] Many of these papers can be downloaded from www.core-research.com.au.