Overview

Mobil Oil Australia Pty Ltd ("Mobil") is pleased to make this submission to the ACCC Inquiry into the price of unleaded petrol. We have reviewed the Issues Paper prepared by the ACCC and have structured our submission so as to respond to questions that are relevant to Mobil which have been raised in that paper. In general, Mobil has responded in relation to its own operations as it is not in a position to comment on what competitors have done or plan to do.

Mobil is a major refiner and marketer of petroleum products in Australia. Mobil and predecessor companies have marketed petroleum products in Australia for over 110 years, commencing operations in Melbourne in 1895. Mobil's wholly owned subsidiary, Mobil Refining Australia Pty Ltd, owns and operates the Altona refinery in Melbourne and also owns the currently mothballed Port Stanvac refinery in Adelaide. Through Standard Vacuum Refining Company (Stanvac), Mobil commenced refining operations in Australia at Altona in 1949 and subsequently built the Port Stanvac (Adelaide) refinery which commenced operations in 1963. Mobil operates bulk fuel terminals in Adelaide, Melbourne and Sydney and draws fuel from facilities operated by others in Brisbane, Darwin, Perth, Sydney and other seaboard locations.

Mobil owns or leases approximately 280 service stations, principally in major metropolitan markets around the southeast and east coast of Australia. All but one of these service stations are operated by a single multi-site franchisee, Strasburger Enterprises (Properties) Pty Ltd (SEP), which is 50% owned by Mobil. SEP owns or leases a further 30 service stations which it also operates under the Mobil brand. Mobil supplies fuel to a large number of independent branded distributors in regional areas of Australia who in aggregate supply an independently owned and operated network of over 500 Mobil-branded and unbranded service stations around the country. Mobil also supplies fuel to an even larger number of independent resellers and major industrial and commercial customers.

In this submission, where applicable, references to "Mobil" may mean Mobil Oil Australia Pty Ltd or Mobil Refining Australia Pty Ltd or both of these companies.

Last year the Senate Economics Legislation Committee conducted an exhaustive inquiry into the price of petrol in Australia. The terms of reference of the current ACCC Inquiry closely match those of the Senate Committee inquiry. The ACCC provided a substantial submission and extensive testimony to the Senate Committee. The Australian Institute of Petroleum Ltd (AIP) also made a comprehensive submission to that Senate Inquiry. The AIP submission to the Senate Committee provides a broad overview of the petroleum market in Australia and the major factors which influence the price of petrol and diesel fuel.

In its submission, AIP noted that:

- Australia cannot isolate itself from the international market for petroleum, where prices reflect global and regional availability and quality of crude oil and petroleum products
- There is a very close relationship between international prices and the wholesale price of fuel in Australia
- The volatility of pump prices is a function of the structure of the retail market in Australia and intense local area competition
- Analysis by the ACCC and others shows that most consumers are alert to and take advantage of the volatility which exists in the retail market
- The Australian fuel market is highly competitive and, as a result, Australian consumers pay among the lowest prices in the OECD for petrol and diesel

Much of that AIP submission is also relevant to the terms of reference of this inquiry.

The following addresses many of the issues on which the ACCC has sought information and comment in the terms of reference of the Inquiry. Further information which is commercially sensitive is being provided in a separate confidential submission.

As an initial comment, the ACCC Issues Paper asserts at the outset that "The refiner/marketers in Australia often state that movements in retail petrol prices in Australia closely follow movements in the international benchmark price for refined petrol (i.e. Singapore Mogas 95 Unleaded)". Mobil's view is that Australian <u>wholesale</u> prices do closely follow movements in this international benchmark. Over the long term, averaging out the daily fluctuations, <u>retail</u> prices also closely track the Singapore benchmark price, just as one would expect in an open, competitive market. However, on a day-to-day or week-to-week basis <u>retail</u> prices can and do vary substantially from this benchmark, due to local competitive factors. We will further explain our view in this submission.

The Supply of Petrol in Australia (Refining and Importing)

There are four principal suppliers of petroleum fuels in Australia - Mobil, BP, Caltex and Shell. Each of these companies owns and operates refineries and bulk fuel terminals in various parts of Australia and most of them also import fuel into Australia. There are also a number of other companies, e.g. Trafigura, who import petrol for wholesale within Australia from time to time. There are major non-oil company operated fuel terminals in Melbourne, Sydney, Brisbane, Darwin and Perth. In Mobil's view, there are relatively low barriers to entry for companies wishing to supply petrol into Australia.

While the barriers to entry are low, the refining business environment has been and remains challenging.

In 2003, after several years of poor results from it's refining operations at Port Stanvac (nominal 72 thousand barrels per day (KBD) crude processing capacity), Mobil made the decision to cease operations at the refinery. Rather than close down permanently and demolish the refinery Mobil chose to maintain the facilities at Port Stanvac in a condition which would enable a restart of refining operations (so called "mothballling"), subject to necessary investment to meet current fuel standards and other requirements, should future business conditions indicate that such operations could be viable and sustainable in the long term. In recent years there has been an improvement in the international refining business environment but at this time there is insufficient certainty for Mobil to make a final decision whether or not to undertake the investment necessary to meet applicable fuel standards and other requirements and resume operation of the refinery.

In late 2004 Mobil commenced a major restructuring of operations at Altona to enable the refinery to remain competitive into the future and support necessary investment in facilities to deliver higher specification products to meet the Commonwealth's post 2005 fuel standards. This restructuring entailed shutting down parts of the refinery and putting some existing equipment into new service. While this has reduced the capacity of the refinery from around 130 to 80 KBD (4.6 billion litres per annum), the alternative would most likely have been to shutdown the refinery altogether. The new and refurbished facilities at Altona were brought on stream successfully in late 2005 in time to meet the 1 January 2006 cleaner fuels requirements.

Mobil's Australian refineries are small and have a higher cost base in comparison with many other refineries in the Asian region (Singapore, Thailand, South Korea and Taiwan) which compete for the supply of petroleum products into Australia. For example, a refinery in Singapore that is owned and operated by Mobil's affiliated company ExxonMobil Asia Pacific Pte Ltd has the capacity to process around 600 KBD of crude oil (35 billion litres per annum), which is equivalent to around 80% of the total capacity of Australia's seven operating refineries. The Altona refinery has been upgraded to produce high quality fuels, which are typically traded at a premium price relative to fuels meeting the lower standards which apply in many other Asian countries. However, this local product price premium may diminish over time as product specifications tighten generally around the region and more of the production from regional refineries meets Australian standards. The ability to compete with product sourced from ExxonMobil Asia Pacific P/L's Singapore refinery was clearly established as the benchmark for Altona when Mobil made the decision in 2004 to restructure the refinery and proceed with the Clean Fuels Project.

The tightening of Commonwealth and State fuel standards in recent years has led to significant investment in cleaner fuels by Australian refiners. AIP data indicates that some $2 billion has been spent by the Australian industry over the last decade in order to meet increasingly stringent product quality requirements up to and including those applying from 1 January 2009.

As indicated above, the fact that product specifications generally in Asian countries are not as stringent as those in Australia has meant that not all refineries around the region can currently supply product meeting Australian standards. However, there are large refineries in Singapore, South Korea, Taiwan and Japan which are capable of supplying fuel to Australian standards and the Australian Petroleum Statistics (APS) published every month by DITR show regular imports from these countries.

The Australian Petroleum Statistics also show how Australia's fuel demand has exceeded local production capacity since 2001/2, resulting in a growth in imports (and reduction in exports). There was a step increase in the level of imports in 2003/4, following the closure of Mobil's Port Stanvac refinery. However, since that time imports of petrol in particular have slowly declined, notwithstanding the changes made at Altona refinery as well as broader industry supply issues in the lead up to the introduction of new fuel standards on 1 January 2006, which suggests that Australian refiners have managed to largely keep pace with the growth in petrol demand.

Mobil is currently the largest importer of petroleum fuel into Australia, sourcing products from ExxonMobil Asia Pacific P/L's refinery in Singapore. These imports primarily supply markets in South Australia and Western Australia but some is supplied into Sydney and Melbourne. Mobil is a net supplier of fuel to the industry (both to other major oil companies and independents) and currently over half the fuel Mobil imports is supplied to other companies. Mobil plans its product imports on a long term basis and has not experienced difficulty sourcing product imports which meet the Australian quality standards.

Mobil pays market prices for these imports, which represent a substantial portion (over 40%) of the fuel (petrol, diesel and jet) it supplies into the Australian market. If Mobil was unable to recover those market prices from its wholesale customers in Australia then it would not be commercially viable for it to continue to supply that fuel.

Mobil buys petrol and other fuels from other refiners in Australia to maintain efficient supply to meet its market requirements around the country. For example, in Sydney and Brisbane Mobil currently purchases products from Caltex, BP and Shell. Similarly, Mobil sells products to other companies in Adelaide, Melbourne and Perth. Mobil's fuel purchase and sale arrangements with other companies are negotiated independently on commercial terms off a transparent "import parity pricing" (IPP) basis, i.e. broadly the cost involved in purchasing product on the Singapore spot market, plus a quality premium for local standards, freight, wharfage and other charges to deliver that product to Australia.

Mobil has not entered into product exchange arrangements with other Australian refiners for several years. Instead it has moved to greater use of fuel purchase and sale arrangements. Mobil usually negotiates such "buy/sell" agreements for either a 6 or 12 month term. The detailed arrangements and pricing at each location are determined based on the competitive options that each party has and take into consideration a range of factors, such as the buyer's terminal infrastructure and possible alternative supply arrangements, port constraints, particular product quality requirements, etc.

Mobil operates jointly owned fuel distribution terminals at Yarraville in Melbourne, Silverwater in Sydney and Birkenhead in Adelaide. Mobil also lifts fuel products under joint ownership or long term throughput arrangements (separately negotiated by location) from the following distribution terminals operated by other companies - Whinstanes in Brisbane (operated by BP); Botany in Sydney (operated by Vopak); Darwin (operated by Vopak); Kwinana in Perth (operated by Coogee Chemicals); Newcastle (operated by Shell); Cairns, Townsville and Mackay (operated by BP); Gladstone (operated by Caltex); Port Lincoln (operated by Shell); Burnie and Hobart (operated by BP); Bell Bay (operated by Marstel). The products supplied by Mobil via terminals which are operated by others are either purchased from other refiners or imported by Mobil.

Mobil has sufficient terminalling capacity, both through the facilities it operates as well as through those operated by others, to meet its Australian product demand. Mobil has directionally increased terminal storage capacity for the major product grades over recent years to provide a better match with import parcel sizes, allow for continuing improvement in shipping efficiency and ensure sufficient stock is maintained at each terminal to meet its customers' needs. Mobil is proud of its reputation for reliable supply of high quality products to the market at competitive prices. We take our responsibilities to our customers very seriously and continually review our supply arrangements to maintain a high level of service to them.

In Mobil's view there is a high level of competition for product supply at the refinery/terminal level in Australia. There are two refineries in each of the three largest states (NSW, Victoria and Queensland) as well as a multiplicity of product terminals able to receive product imports in all states, including many which are not operated by any of the four major oil companies. Independent fuel suppliers can and do import fuel into Australia as well as purchase product from local refiners.

Mobil competes actively with Shell (Geelong) and with imports to supply fuel ex Altona refinery into the Victorian market. In each of NSW and Queensland Mobil has a choice of two local suppliers, as well as the ability to import, and negotiates its fuel supply arrangements on a competitive basis. The South Australian market is wholly supplied by imports from overseas (Mobil) or interstate (BP and Shell). Currently Mobil is a major supplier to Caltex in South Australia and also supplies some product to Shell. In Western Australia Mobil imports product from Singapore in competition with supply from local refiner, BP, while in Darwin all fuel is supplied via imports by Shell through the Vopak terminal. Mobil's product requirements in Tasmania are currently supplied by Shell under buy/sell ex the Geelong refinery through terminals operated by BP and Marstel.

The Structure of the Wholesale and Retail Market for Petrol in Australia

Appendix 1 provides a simple diagrammatic representation of the structure of Mobil's fuel marketing arrangements within Australia. Currently Mobil markets petrol at the wholesale level throughout Australia via the following principal channels:

- A single multi-site franchisee (SEP; 50% Mobil equity) which operates a network of approximately 310 owned or leased service stations, principally in the major metropolitan markets of Adelaide, Melbourne, Sydney and Brisbane
- A large number of independent Mobil-branded distributors covering regional areas of Australia (not including Tasmania) who in aggregate supply an independently owned and operated network of over 500 Mobil-branded and unbranded service stations, as well as selling fuel directly to farmers and other small rural and regional businesses
- Large independent resellers, such as United, Liberty, APCO, etc, who supply non Mobil-branded service stations in both metropolitan and rural/regional areas of Australia
- Large commercial and industrial customers throughout Australia

Sales through the latter three channels are all made on a contractual basis with varying terms as negotiated with each customer. Mobil rarely, if ever, makes spot marketing sales of petrol, as the majority of its customers prefer to contract with Mobil for their fuel needs for a set period of time to provide greater security of their supply.

Competition at the wholesale and retail level continues to be vigorous. In addition to the entry of the two major supermarket chains (Coles and Woolworths/Safeway), the last decade or so has seen the growth of a significant number of large, independent resellers across most parts of the Australian market, which are not linked to any of the major oil companies. This includes companies such as United, Liberty, Neumanns, Freedom, Gull, 7/11, APCO, Australian Farmers' Fuel, Peak Petroleum, Gascorp/Budget, Ausfuel, Choice Petroleum, etc, who in aggregate provide a strong independent presence in the retail market in all states.

Sales to distributors, independent resellers and other commercial and industrial customers are fully contestable and renegotiated on contract expiry, hence there can be regular changes in fuel supplier for pricing or other reasons. Mobil's contracts with its branded distributors are generally longer term, because of the investment both parties have in the brand; such customers tend to choose not to change suppliers as frequently.

Competition in the retail petrol market is also intense and Australian motorists enjoy petrol prices which are among the lowest in the developed world (refer to OECD quarterly fuel price summary provided by DITR).

In this tough business environment, Mobil has completely restructured its retail operations, in consultation with its franchisees and dealers, to improve the viability of the Mobil-branded retail network. Some 250 service stations (over 40% of the network) have been closed during the last six years and the core Mobil retail network (operated by SEP) now comprises around 310 sites, primarily located in the four East Coast metropolitan markets. Data compiled by AIP indicates that many other oil company branded and independent service stations have also closed over recent years, presumably in response to similar market pressures.

Over the last five years Mobil has also divested its ownership interest in all but two of its branded distributors and has also sold most of the rural and regional service stations it owned, either to those (now) independent distributors or to other parties.

Mobil has exited the retail market in WA and Tasmania, while in the NT and in rural and regional areas of SA, Victoria, Queensland and NSW, the Mobil-branded retail network is supplied entirely via independent distributors.

Based on industry data reported by DITR, Mobil's share of the wholesale petrol market in Australia is currently around 15%, reduced from over 20% several years ago, while Mobil's branded share of the retail market (covering both the SEP-operated core retail network of 310 sites and distributor outlets) has reduced from 15% five years ago to approximately 10% today.

The nature of fuel retailing in Australia has changed significantly over recent years. The entry of the major supermarket chains (Coles and Woolworths) has fundamentally altered the competitive playing field and economics of fuel retailing. These new competitors are able to leverage much larger sales in supermarkets and associated mass-merchandise stores in their fuel discounting or "shopper dockets" approach. The level of fuel discounts offered at service stations allied to particular supermarket chains is substantial. Mobil has also observed instances where certain fuel discount promotions offered by Coles and Woolworths have actually exceeded what Mobil would view as the available fuel marketing margin for most retailers.

Given the competitive pressure on fuel margins, retailers have had to focus on developing sites which are capable of delivering very high fuel throughput, as well as additional margin from non-fuel offerings such as convenience stores, car washes and repair facilities. While competitive fuel pricing is always critical to the viability of individual service stations, there is also non-fuel price competition through factors like brand and product differentiation, site facilities, customer service and site condition and appearance.

One factor which Mobil expects should benefit the retail fuel market is the implementation of the Commonwealth Government's retail market reform package which came into effect on 1 March this year. The reform package has removed outdated legislation which unreasonably restricted the ability of Mobil and other refiner/marketer companies to compete effectively in the retail fuel market. The removal of the Sites Act, in particular, will enable Mobil to further optimise its retail operations to enable it to compete with large, low cost resellers, including the supermarkets. The overall effect of this reform (which is still in its early days) should be to create a more level playing field for all fuel retailers in Australia.

In Mobil's view, the various State Government regulations on fuel pricing appear to have had little or no impact on the retail fuels market. The Victorian Government TGP regulations do not affect the retail market. The Queensland Government subsidy to fuel retailers has resulted in lower fuel prices to motorists relative to other states, with this differential matching the amount of the subsidy (slightly more than 8 cpl) over the long term. The Western Australian TGP legislation and 24 hour rule for changes in retail prices have imposed a significant administrative load on fuel wholesalers and retailers, with no demonstrable benefit to consumers.

Wholesale and Retail Fuel Prices in Australia

The AIP submission to the Senate Committee Inquiry provided a detailed explanation of how fuel prices are set in Australia.

Petroleum fuels are readily traded on the open regional and global market. This competitive market determines the price which local suppliers, whether domestic refiners or importers, can get for their products and effectively establishes the Australian wholesale price. At the retail level many other factors come into play, including a different group of competitors such as supermarket alliances and independent resellers, who have different business models and cost structures. Fuel retailers and distributors therefore have to compete in an open and very challenging retail market. Over the years, this has resulted in Australian motorists paying amongst the lowest prices for their fuel in the developed world.

At the wholesale or terminal gate level, petrol prices in Australia are largely a function of the international market prices for these products. The Australian market for crude oil and the products made from it operates as an integral part of the global and regional market for petroleum. In a free market framework, Australia cannot isolate itself from this global market. However, as long as Australian fuel suppliers and consumers continue to pay international market prices they will continue to have access to the crude oil and petroleum products they need.

This position applies whether the Australian market is supplied by local refineries or by imports. The price of petroleum products in Australia is dependent on the regional (Singapore) market for those products and what it would cost to supply them to Australia. This is generally known as "import parity pricing" (IPP). If an attempt were made to set some other (lower than market) price for fuels in Australia then local refiners would have an incentive to export their products to markets where they could obtain a higher realisation, while those purchasing fuel offshore for import to Australia might stop doing so if they were unable to recover their acquisition costs in the local market.

The benchmark price for petrol in the Asia Pacific region is the Singapore spot market price for 95 RON unleaded mogas (petrol), which is commonly known as "MOPS 95R" ("MOPS" standing for "Mean of Platts Singapore"). Platts is an independent international reporting service which collects a wide range of market information from various sectors of the global oil industry and uses this to develop its daily pricing assessments for Singapore and other key market centres around the world. Mobil's view is that MOPS 95R is an appropriate "liquid" (i.e. it is based on a significant number of daily trades) price marker for regular unleaded petrol which meets the Australian standard.

From Mobil's experience, Australian fuel suppliers generally appear to use MOPS 95R and the resultant import parity price (IPP) for petrol in Australian ports as an appropriate marker to reflect international market prices, as well as the cost of freight, insurance, wharfage, product quality differentials and other transport and delivery costs. Product quality premia are market based and are regularly tested by negotiation between local and offshore buyers and sellers. Freight rates for product shipping to Australia have increased significantly in recent years, as has the cost of wharfage and other port charges, while the cost of insurance and shipping losses has increased in line with the base product price.

Mobil's Australian terminal gate prices (TGPs) reflect all the above market components, excise and other taxes (including GST), local terminal costs and a wholesale marketing margin, to the extent such a margin is achievable competitively. TGP data therefore provides a good guide as to how changes in international crude oil and product prices flow through to wholesale petrol prices in Australia.

Mobil supplies fuel to its retail franchisee, SEP, at a wholesale price, which moves in line with changes in TGP. Mobil closely monitors competitive retail pricing in its four key metropolitan markets through subscription to an independent price monitoring service as well as direct observations by SEP retailers. Similar commercial price monitoring services are publicly available to consumers. Based on observed local market conditions, Mobil may provide SEP with a wholesale price discount, where required, to enable them to respond as appropriate to their competitors' prices. As direct owner or lessor of most of the sites operated by SEP, Mobil has a substantial financial stake in the performance of the core Mobil-branded retail service station network in the major metropolitan markets. Pump prices are highly visible, with large price boards on most service stations. Experience has shown that many consumers respond promptly to changes in petrol prices and fuel discount offers and a particular service station can lose significant volume quickly if its pricing is above the local competition.

Historically, retail prices in the major Australian metropolitan markets have demonstrated regular (often weekly) price cycles. Several years ago the ACCC conducted a study into the variability of retail prices and concluded that this was symptomatic of strong competition and was generally beneficial to consumers. The ACCC, motoring organisations, and other parties provide regular advice to motorists about when is the optimum time to buy fuel. During these cycles prices have tended to drop steadily for a period, whilst some retailers strive to attract additional volume based on aggressive pricing while others respond promptly to avoid losing volume, followed by a generally sharp upwards price movement when one or more retailers or their fuel suppliers presumably can no longer sustain the low (possibly negative) margin they have been achieving. Mobil believes motorists are generally well aware of these pricing cycles and, to the extent possible, adjust their fuel buying patterns accordingly.

Mobil is aware of price cycles occurring in other retail fuel markets around the world. In general, however, while retail fuel prices in all unregulated markets do change in response to global/regional trends and local competitive factors, such changes tend to be more gradual. Mobil considers that the volatility of retail prices in Australia reflects the highly competitive nature of the local retail fuel market and the on-going struggle for volume between active competitors in a low margin business. From Mobil's observations the cycles are not uniform across Australia and the differences that occur between the different retail markets presumably reflect different local competitive conditions. Mobil exited the WA retail market some years ago and is not in a position to comment on any differences in that market.

Over the longer term (i.e. months or years), Mobil petrol TGPs and observed retail petrol prices at Mobil-branded service stations have both closely tracked Singapore market prices (MOPS 95R). Over short time periods (days up to several weeks) variances from that long term historical trend, particularly at the retail level, can occur due to local competitive factors. The ACCC's focus on an apparent widening of the gap between retail prices and MOPS 95R during early January and late May/early June this year is highly selective. It is important to note that the chart provided in the Issues Paper also shows periods (e.g. late January/early February, and mid March this year) when this same gap was significantly compressed and consumers presumably benefited from lower prices than expected. In Mobil's view, it is unreasonable, in the Australian context, to seek to draw conclusions about what is happening in the market from an analysis of such a limited period or periods of time.

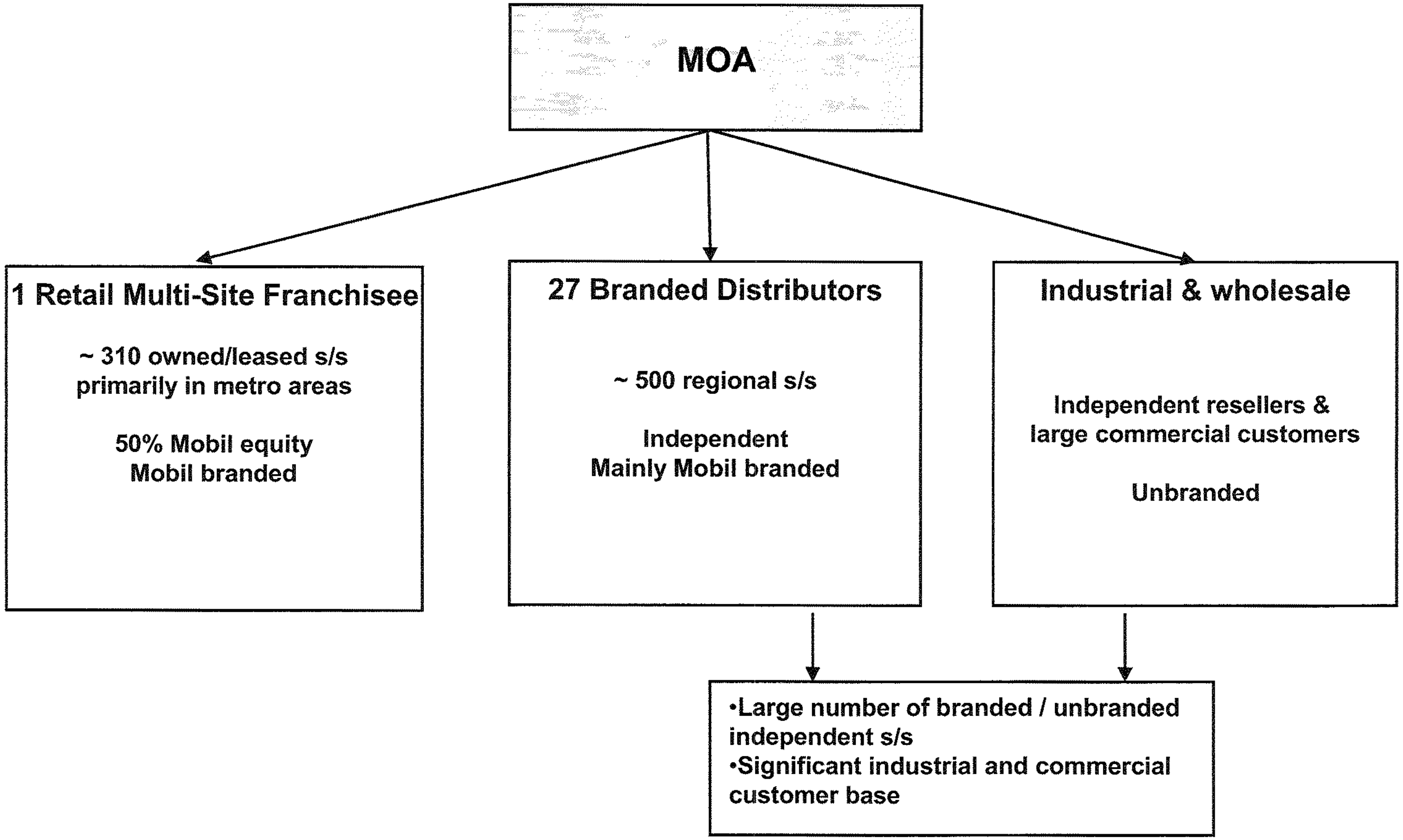
Australian motorists have grown accustomed to very competitive and aggressive pricing of the fuels they buy, with a wide range of fuel discount offers and other loyalty programs providing additional opportunities to save money on fuel. The proliferation of the supermarket "shopper docket" offers has made the retail fuels market even more competitive in recent years. In 2005 Mobil developed its own fuel discount program which is offered throughout the Mobil-branded franchised retail network as well as by some branded distributors. This program offers a 4 cpl discount for a minimum $5 worth of purchases in the service station shop. The offer is fully transparent and easy for consumers to understand and take advantage of and it has proven very popular with Mobil dealers and their customers.

Conclusion

In conclusion Mobil would like to make the following points:

- Crude oil and refined petroleum products are freely traded in a global market and Australia cannot insulate itself from that market.
- There is a very close relationship between international market prices and the wholesale price of petrol in Australia.
- The Australian fuel market is highly competitive at all levels and, as a result, Australian motorists pay among the lowest prices in the developed world for their petrol.
- There are a large number of participants in the wholesale and retail fuel market in Australia
- New entrants such as the major supermarkets have gained a significant share of the retail fuel market in recent years, which reflects the relatively low barriers to market entry in Australia
- The relatively limited number of fuel suppliers (refiners/importers) is not an impediment to effective competition given the small scale and large geographic spread of the Australian market
- Mobil supplies fuel to a wide range of participants in the petroleum market - less than half of Mobil's petrol sales are made through its core branded retail service station network.
- While the Australian wholesale and retail fuel markets are (largely) unregulated, historical prices at both the retail and wholesale level do closely track the Singapore benchmark price (MOPS 95R) over the long term.
- Australian retail petrol prices are not regulated, hence they are subject to short term local competitive market forces which can cause them to deviate from this long term trend for a period - such deviations can lead to lower as well as higher differentials versus the Singapore benchmark
- Petrol prices are highly visible and transparent to the consumer, demonstrating the truly competitive nature of the market

Appendix 1 - Mobil Oil Australia (MOA) Fuels Marketing Structure



ExxonMobil